EEI POLICY PAPERS

Competition

Economic Approach to Article 82

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Essays edited by Marcus Stober

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The publication in December 2005 of DG Competition's Discussion Paper on the application of Art. 82 focused attention on accelerating the introduction of a more modern and economic-based approach when assessing the abuse of dominance by companies. In his article *An Economic Perspective on Art. 82 EU,* Federico Etro, economist at U.C.S.C. in Milan and founder of Etro Consulting Group provides insights into the economic arguments underpinning this debate and an analysis of how the Discussion Paper reflects these theoretical underpinnings. Etro criticises the paper for – amongst other problems – associating dominance to too great an extent with market shares and efficiency defences.

Executive Summary

The published DG Competition Discussion Paper on Art. 82 is a welcome contribution to the debate on how to introduce a more economic approach in assessing the abuse of dominant positions in the market place. However, its purpose is still in question. David Hull, a partner in the Brussels office of Covington & Burlington, raises some questions in his article concerning the Commission's true intention in publishing the Discussion Paper. He also expresses some concerns about some of the legal underpinnings of the arguments put forward by the Commission.

Executive Summary

Four years since the now-famous court setbacks for DG Competition, the European Commission and the media that report on it can still do much more to avoid such mistakes in the future. Greater transparency by the Commission and more effective scrutiny by the press could go some way to reversing a culture where too often secrecy is confused with confidentiality. In his article on transparency Robert McLeod, editor-in-chief of MLex markets & law, explains some of the challenges facing reporters who cover competition law in Brussels.

Executive Summary

The increased focus on economic arguments in applying Art. 82 – as displayed by the Commission Discussion Paper – has presented opportunities for new thinking in contrast to the traditional approach on excessive prices. Considering an economically sound approach to regulating excessive prices challenges EU regulators to strike the balance between providing efficient regulation practice while enhancing consumer welfare. In his article *Exploitative Practices in Article 82*, Yannis Katsoulacos provides a framework for a way forward in the reform of Art. 82 as applied to excessive prices.

Executive Summary

The European Commission, including DG Competition, has to operate against a political backdrop of ongoing battles over the ideology and economic direction of the EU. It would be easy to believe that EU competition policy is apart from all this political maneuvering, but in reality politics matters, say Hans Kribbe and Tim Price at GPlus Europe in their article *Political Commission*. In their conclusion the authors argue that companies under Commission review need a strong, well-argued legal case above all, but that this alone is not enough as the influence of politics grows.

Executive Summary

Securing a strong intellectual property regime is often mistaken as being in opposition to ensuring a competitive market. In reality, the very basis for having a competitive market is the adherence to strong IP rules. Mr. André Heitz, Director of the World Intellectual Property Organisation, provides an overview of some of the historic thinking linking IP rights with a modern competition policy. In his article *Intellectual Property and Competition,* Heitz makes the case against disassociating IP rights from competition regulation. (The article is his personal contribution to the debate.)

Introduction

Following a longer period of buzz in the policy community on what direction the European Commission would go with its reforms of Article 82, in December 2005 it published a Discussion Paper taking aim at exclusionary abuses under art 82 EC. This Discussion Paper is not only interesting as an academic exercise but, more importantly, as an indication of how the Commission approaches dominant companies that are facing accusations of unlawfully pushing out competitors in other markets. Particularly in the ICT industries, regulators face the challenge of establishing a framework promoting long-term innovation and consumer welfare.

Whether the Commission has taken the correct approach in its Discussion Paper is still a matter for debate, but the paper has exposed the wide interest in that debate. The European Commission's consultation on the Discussion Paper was met with a wide array of different contributions from many parts of society. Although views diverge, the debate has shown that the way the European Commission is thinking about introducing and interpreting economic concepts in its applications of Art. 82 will be heavily discussed.

The idea to publish this EEI Policy Paper on this topic came from this discussion. As time has gone by and the discourse developed we realized that the issue had become larger than just an exercise about the economic reasoning in the Commissions paper. What the publication of the EC Discussion Paper really disclosed is a pressing need for the Commission to motivate its decisions to the wider policy audience. Driven by several high-profiles Art. 82 cases before the Courts in Luxembourg, the Commission is sensitive to critic and has shown with the publication of this Discussion Paper that it needs to motivate its actions to the wider policy community, outside the courts. The Commission has thereof ceased to be just an enforcer and has become an actor susceptible to politics. Some might argue that it has always been so, but in the wake of increased EU scepticism and nationalistic tendencies this has become more apparent.

We have therefore chosen to publish in this EEI Policy Paper a wide array of articles on EU's competition policy. We have not only included some very important contributions on competition policy application, but we have also examined the wider context in which the EU's Competition DG operates. We hope, therefore, that you will find this EEI Policy Paper interesting reading.

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Should you have some comments on this paper or ideas for future projects, the EEI would be happy to hear from you; they will be published on our webside www.european-enterprise.org, alongside with the papers itself.

European Enterprise Institute
Brussels, October 2006

Market Dominance: An Economic Perspective on Art. 82 EU

By Federico Etro U.C.S.C., Department of Economics, Etro Consulting Group and Intertic

In line with the recent evolution of U.S. antitrust, the European Commission is trying to implement an important reform for the EU approach to abuse of dominance with foreclosure of competitors, moving from a formal approach to antitrust to a more modern welfare-based approach focused on the protection of consumers and of competition (not of the competitors). While this attempt is positive, there are some concerns that these efforts will not be fully carried through into the proposal of the Commission, the DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses. For instance, still in line with outdated economic views, dominance is associated too closely with large market shares. The efficiency defence – the chance for the dominant firm to prove that its aggressive strategy enhances consumer welfare or improves the allocation of resources – is virtually excluded when companies have very large market shares. This article will approach the debate on this reform by focusing in particular on the issue of market dominance. The analysis will be largely based on an economic point of view, hence, it will start with a description of the basic insights economic theory provides on this issue.

The theory of market leaders and antitrust

Recent developments in the economic research on market structure suggest the need for a new approach to competition policy. The new theory of market leadership[1], inspired by the classic analysis of pioneers such as Stackelberg, Schumpeter and Modigliani, tries to integrate the Chicago approach of the 60's and 70's, which has emphasized the importance of competition in constraining market leaders, with the post-Chicago approach of the 80's and 90's, which has emphasized the strategic interaction between market leaders and competitors[2]. While the former approach has ignored strategic interactions and the asymmetric role of market leaders, the latter has ignored the role of endogenous entry,

1 See Etro, F., "Aggressive Leaders", *The Rand Journal of Economics*, 37, Spring (2006a), 1-10; "Competition Policy: Toward a New Approach", *European Competition Journal*, 2, 1, March (2006b), 21-47.

2 See Williamson, O. E., *The Economic Institutions of Capitalism* (New York, Free Press, 1985) for an early evaluation of this approach. Broadly speaking, U.S. antitrust authorities have been highly influenced by the Chicago and post-Chicago approaches over time, while in Europe it has taken longer for new developments in economic theory to affect competition policy. Pre-Chicago school considerations still play a role in Europe, even if often dressed up in post-Chicago clothing.

focusing only on the relationship between an incumbent and a competitor: the theory of market leaders tries to fill these gaps. The results, however, are conflicting: under price competition, while the post-Chicago approach associates any aggressive pricing with predatory purpose, the new theory of market leaders shows that aggressive pricing can have a pro-competitive and welfare enhancing role without exclusionary purposes.

The general theory of market leaders clarifies their role by studying the incentives they have to undertake preliminary investments and other market strategies to gain advantage over their competitors. Traditionally, the post-Chicago approach taught us that when competition in quantities takes place between two firms, one of them would usually gain by over-investing to reduce costs, which allows it to be aggressive in the market (expanding production and inducing its rivals to produce less), but under competition in prices, the same firm would prefer to under-invest in cost reductions so as to be accommodating (increasing its price so as to induce its rivals to raise price). The theory of market leadership, however, shows that things change when entry is endogenous, that is when firms endogenously decide whether or not to enter the market based on their opportunities to make profits. In this case, the pressure of entry induces a firm to undertake always investments to be aggressive in the market; that is, to expand production under competition in quantities and decrease prices under competition in prices. For instance, a leader will always find it optimal to over-invest in cost reductions to be able to produce more and to reduce its price below the price of its competitors. This outcome emerges in many other contexts: in any market where entry is endogenous, the leader always over-invests to gain a strategic advantage and conquer a larger market share. However, this results in a reduction in prices with a net gain for consumers!

Such a phenomena happens under any form of competition (including in prices and in production levels) as long as entry for competitors is endogenous. As long as this condition applies, the competitors' fear induces the leader to be aggressive: its best strategy requires reducing costs, improving product quality, engaging in a lot of advertising, producing complementary products and so on. This allows the leader to lower its price, gain market share and gain from a reduction in the average costs of production, but it also disciplines competitors and keeps prices at a low level, with unambiguous benefits for society.

It is also easy to derive simpler and even more radical results in a more basic context where the leader does not undertake a preliminary strategic investment but directly decides its own strategy before the other firms. In general, a leader in a market where fixed or sunk costs constrain entry will produce more and will set lower prices than its competitors. Actually, in a market of homogeneous products where production requires a fixed sunk cost and a constant marginal cost of production and firms choose their production levels (a simple structure typical of energy and telecommunication industries and some high-tech sectors), the competitive equilibrium implies that only the leaders produce in the market. Paradoxically, such apparently monopolistic markets completely dominated by a single firm are perfectly competitive and extremely efficient since they save in costs of entry, making the productive process much cheaper, and consequently keep prices at a low level. With this kind of market leadership, society gains from greater cost efficiency and lower prices. Hence, a proper competition policy in this situation should not obstruct the market leader and should limit its intervention to promote entry.

Now, to extend the analysis to other contexts, imagine that goods are not homogeneous but that they differ in quality. This happens when consumer needs or tastes are quite differentiated, as is the case in many sectors where the design and the inner quality of products play an important role. Under these circumstances, firms often compete in prices by choosing different mark-ups for different products. When quality differs, it is important to have a number of firms producing different varieties of goods. A competitive market typically satisfies this requirement, but it tends to induce excessive proliferation of products. The presence of market leaders is again beneficial: they will not conquer the entire market as before, but they will expand production and consequently reduce their prices below the prices of their competitors, some of which will be driven out of the market. Consumers will then face a lower variety of alternative products but pay less for some of them. Again, market leadership with endogenous entry creates a net gain for society. An analogous situation appears when we relax the other assumption adopted in the basic example, that of constant marginal costs. When the average cost function has a standard U-shape due to increasing marginal costs (at least beyond a certain production level), the leader again produces more than each competitor. In such a case, the price of the market leader is also equal to its marginal cost. Hence, the theory of market leaders confirms that, in this situation, the theoretical price above which there cannot be predatory purposes corresponds to the marginal cost, which, according to the traditional *Areeda-Turner test*, approximates the average variable cost. The adoption of other standard price levels above which predation should not be an issue in general is therefore inconsistent with our results.

This discussion implies two main conclusions. First, a leading market position associated with aggressive strategic investments can be the consequence of a competitive market environment and not the result of market power. Second, whenever firms engage in price competition, the post-Chicago approach associates aggressive pricing or other aggressive strategies (including bundling) with a predatory purpose, while the theory of market leaders provides arguments for which an aggressive strategy is generally pro-competitive and without exclusionary purposes. This creates doubts about the traditional approach to predatory pricing and other exclusionary conducts that characterises EU competition policy.

Moreover, the new theory of market leaders provides insights into what constitutes a dominant position in a market and what an abuse of that position consists of. First of all, it would be better to differentiate market leaders from dominant firms: market leaders have some strategic competitive advantage over their competitors, but only when they can use it to prevent effective competition and harm consumers should they be considered to be dominant and their behaviour potentially abusive. The point is to understand when market leaders can prevent effective competition and when they cannot.

As previously noticed, the behaviour of market leaders tends to be pro-competitive whenever entry of competitors in their markets is constrained by entry barriers or fixed costs of entry. Second, there should be no presumption that a certain market share amounts necessarily to dominance. As a matter of fact, the theory of market leaders shows that, paradoxically, the correlation between market share and effective market power can be negative. Consider a market where a leader and its rivals compete on price. According to the post-Chicago approach, the leader could try to deter entry with a predatory strategy, or just be accommodating, sharing the market with competitors, in which case its market share may be even smaller than that of its competitors. However, when entry into the market is endogenous and constrained just by technological conditions, the leader has to adopt a strategy of aggressive pricing, and, by undercutting its competitors, it acquires a larger share of the market. In this case, the market share of the leader is increasing when product differentiation is weaker, when fixed costs of production are higher and when variable costs do not increase too much as production level goes up. Actually, as we have seen before, the theory of market leaders describes the conditions under which endogenous entry induces the leader to be so aggressive as to conquer the whole market. But this implies that the same possibility of entry and hence lack of effective market power is associated with the largest market share for the leader.

In conclusion, to find dominance based solely on a large market share is potentially highly misleading.

Competition for the market and competition policy

Competition in the high-tech markets is dynamic – in the Schumpeterian sense – in that it takes place as competition *for* the market in a so called *winner-takes-all-race*, and such an element requires an even deeper rethinking of industrial policy than suggested in the analysis of the previous sections, which was mostly focused on a static concept of competition *in* the market.

Even if most economists are used to thinking about market leaders as firms with weaker incentives to invest in R&D, recent theoretical and empirical research has also noticed that market leaders play a crucial role in the innovation sector for competitive markets.

Evidence shows that dominant firms invest a lot in R&D and obtain relatively more innovations. An important economist in the field, Segerstrom talks about *Intel Economics,* referring to a primary example of a technological leader in the chips market, which in 2000 invested 11.5% of its total sales in R&D. High investments can also be found in many other major firms in the high-tech sector. Also in 2000, the R&D/Sales ratio was 15% for Pfizer and 5.8% for Merck, two leaders in the pharmaceutical sector; 16.4% for Microsoft, the leading firm in operating systems; 5.8% for IBM, and 5.4% for Hewlett Packard, two leaders in computer technologies and services; 11.8% for Motorola and 8.5% for Nokia, leaders in wireless, broadband and automotive communications technologies; 10% for Johnson & Johnson, the world's most comprehensive manufacturer of health care products and services; 6.6% for 3M and 6.3% for Du Pont, which are leaders in multiple fields; and 5.6% for Xerox (mostly focused on the legendary Palo Alto Research Center) and for Kodak, leaders in the markets for printers and photographs. The fact that these companies remain at the technological forefront in their respective industries may not be the sign of a monopolistic position in the traditional sense, but rather show the results of their investments and of the competitive threat deriving from other firms and potential entrants.

The recent theories of market leadership[3] have clarified the mechanics of these results. Dominant firms have more incentives to invest in innovation than do outsiders when the market for innovation, or what sometimes is called the patent race, is characterized by endogenous entry (as long as the dominant firms have a leadership, which in economic jargon means just that they can commit to an investment choice before the other firms). The crucial thing here is that market leaders often remain on top thanks to their investments, but this should not be seen as evidence of inefficiency or of dominance, but rather as a proof of the opposite: the competitive environment spurs investment by leaders and consequently provides a chance for their leadership to persist.

Clearly, this has strong implications for competition policy. What the above theory suggests in this case is that market leaders in high-tech sectors investing a lot in innovation may create an efficient situation. Thus, antitrust authorities should be especially careful when trying to stamp out monopoly power in markets that are marked by technical innovation.

Reforming EU Competition Law

In December 2005 the European Commission published a Discussion Paper on exclusionary abuses under Article 82. This paper is the subject of an open debate and gives an important indication as to how the Commission may approach exclusionary abuses in the future. The Discussion Paper states that the purpose of Article 82 is "the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources" (#4). This implies that antitrust should protect competition and not competitors and be based on an economic approach aiming to maximize consumer welfare and allocative efficiency, rather than be based on a legalistic approach. In the current proposal there are some positive aspects, mainly in the important area of enhancing consumer welfare and protecting competition and not competitors. The overall design of these guidelines, however do not give enough support to such a welfare-based approach.

According to the European Competition Law, while dominance in a market or its creation cannot be punished, its abuse by dominant firms is subject to antitrust screening. Hence, the preliminary phase of any antitrust case applying Article 82 must define the relevant market and verify the existence of a dominant position. The Discussion Paper briefly refers to the definition of a proper market, which can be complex in Article 82 cases because the market price could be above its competitive level (#11-19). This creates problems with the usual methods of market definition. For instance, the *SSNIP-test*, which defines the relevant separate market as the smallest market where a Small but Significant Non-transitory

[3] See Etro, F., "Innovation by Leaders", *The Economic Journal*, April, 101, 495 (2004), pp. 281-303.

Increase in (competitive) Prices (say of 5-10%) increases the profits of a hypothetical monopolist, is biased when the market is characterized by higher than competitive prices (which is more likely in cases of abuse of dominance). Such a bias usually leads to a too-wide market definition, which in turn may lead to a finding of no dominance, the so-called "*cellophane fallacy*" (from the Du Pont case). However, it should be noted that the cellophane fallacy only applies in the presence of a single monopolist in the market and when entry is impossible, while the SSNIP-test at the prevailing prices remains a valid test whenever the market leader is constrained by effective competition and/or potential entry.

Following a traditional definition, the Discussion Paper associates dominance with "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers" (#20). Such a definition requires "a leading position on that market" compared to the rivals (#22) and the lack of "effective competitive constraints" (#23) in the process, in which "the undertaking and the other players act and inter-act on the market"(#23). Given the positive stress put on an economic-based approach to competition policy, it is important to notice that this definition of dominance is clearly associated with two situations: the pure monopoly, as an extreme case of dominance, and the market leadership where the dominant firm faces some competitors, which is the subject of the theory of market leaders previously studied. It should be emphasized that, according to this theory, a market leader can really act independently of its rivals (so as to satisfy the above condition for dominance)[4] <u>only when the number of competitors is exogenously set and further entry is impossible</u>, while a market leadership constrained by effective competition and potential entry cannot be associated with dominance. In such a case, modern economic theory tells us that leaders tend to be aggressive (pro-competitive) in their pricing and investment strategies, conquering larger market shares in a way that has nothing to do with dominance as defined above, and which is also beneficial to consumers.

As a consequence of the approach of the Discussion Paper, a certain ambiguity emerges in the statement at #27 stating that "the fact that an undertaking is compelled by the pressure of its competitors' price reductions to lower its own prices is in general incompatible with […] the existence of substantial market power" and hence with dominance. In particular this should be always true and not just "in general", since in this case the market leader is constrained by effective competition and cannot act independently from it. The definition of dominance would require evidence of such constraint, and such evidence could be in any other form of aggressive competition than competition in prices, such as competition in quantities or in alternative forms of strategic investments. Hence, the fact that an undertaking is compelled by the pressure of its competitors' aggressive strategies to adopt aggressive (pricing and investment) strategies should be always considered incompatible with dominance.

The stress on market shares in the evaluation of dominance (#29-33) appears in clear contrast with the conclusions of the theory of market leadership, because market leaders have larger market shares exactly when they are constrained by effective and potential

4 And potentially it can implement anticompetitive strategies, that is engage in abusive conduct.

competition. In such cases, they adopt more aggressive (pricing and investment) strategies that expand their market shares. In other words there is not necessarily a positive correlation between the presence of larger market shares and a dominant position and, especially in highly dynamic markets, there is not unambiguous theoretical support for a statement saying that "[m]arket share is only a proxy for market power" (#32). The structural indicators that traditionally serve as proxies for 'dominance' are accurate indicators in some traditional markets, but not in others, such as high-tech and New Economy industries (for example, computer hardware and software, online businesses, mobile telephony and biotechnology).

Finally, and maybe even more importantly, the part of the Discussion Paper on dominance clearly refers to competition *in* the market, while it is hardly useful to evaluate cases where competition *for* the market takes place. In these cases, typical of the New Economy, competition is dynamic and innovators conquer large parts of a market, so any static analysis of market shares cannot say anything about dominance. In other words, a single firm can dominate a market at a given moment, but if many other firms that are not even active in that market at that time are investing in R&D to enter it, as happens in many high-tech sectors, this market is substantially competitive in a dynamic sense. Nevertheless, any leader in such a competitive winner-takes-all market always would be characterized as dominant by the static and market-share-based approach of the Discussion Paper.

Moreover, as explained above, the theory of market leaders tells us that in these dynamic sectors market leaders, as long as they are constrained by effective competition in the market for innovations, invest more than their competitors and hence are more likely to remain leaders. In this sense, suppositions such as "high market shares, which have been held for some time, indicate a dominant position" can be true in some sectors, but not in high-tech sectors with competition *for* the market. In conclusion, the general impression is that there is an excessive stress on the importance of market shares to evaluate dominance, and that this can be highly misleading, especially for dynamic markets.

Finally, the part of the Discussion Paper on barriers to expansion and entry (#34-40) concerns a concept that is far from unambiguous in economic theory. The definition of these barriers as "factors that make entry impossible or unprofitable while permitting established undertakings to charge prices above the competitive level" (#38) applies well to legal barriers but not to other factors that are sometimes seen as barriers. For instance, high fixed costs of production and R&D or investments needed to develop network externalities or learning by doing advantages, do not make entry impossible. In these cases, the correct definition would be that these factors endogenously limit entry or endogenously determine how many and which firms profitably enter the market. The difference is not just in the definition but also in the economic consequence. As modern economic theory has shown, when entry is impossible market leaders may behave in an anti-competitive way, but when entry is constrained by technology or demand conditions they (always) behave in a pro-competitive way even if the cited factors limit entry and the market leaders obtain high market shares.

The Article 82 Guidelines: Threading the Needle Between Precedent and Reform

David W. Hull, Partner, Covington & Burling, Brussels

Introduction

After testing the water with the publication of its Discussion Paper on the application of Article 82 to exclusionary abuses in December 2005, the European Commission is now considering whether or not it will move forward with the promulgation of some form of guidelines. Such guidelines could be a welcome development. The point at which otherwise standard business practices such as discounting and tying become abusive practices prohibited by Article 82 is often unclear because it depends on a number of factors, such as whether the company is dominant and whether its behaviour is likely to result in substantial market foreclosure.

While guidelines would not eliminate the difficulties inherent in making these kinds of determinations, they could increase legal certainty for companies by setting forth a clearer, more coherent analytic framework.

The Commission appears to have approached the Article 82 project with some trepidation. It gave its initial effort the non-committal title of "Discussion Paper", avoiding reference to "guidelines" or even "draft guidelines", presumably to emphasize that it was merely putting forward ideas for discussion and that it had not yet decided whether to move forward with guidelines. While the Commission now appears prepared to issue a revised paper that will take into account the public debate on the Discussion Paper, perhaps as early as the end of 2006, it remains non-committal about the precise form that any eventual guidance might take and, indeed, whether or not it will wind up giving any guidance at all. For a number of reasons, the Commission's cautious approach to its task is understandable:

- It is difficult to provide meaningful guidance on the various factors that must be considered in an Article 82 case, much less the kind of bright-line rules that many consider useful in guidelines. Questions such as whether or not a company is dominant or how much market foreclosure is too much are among the most challenging in the field of competition law. The difficulty of these questions is reflected in the lack of consensus within the antitrust community on how to answer them. As of this writing, the Commission has received over 120 sets of comments on the Discussion Paper, which bears stark testimony to the difficulty of finding common ground on at least some of the issues.
- In promulgating guidelines on the application of Article 82, the Commission is entering territory that is largely uncharted in terms of articulating a coherent set of guiding

principles. In contrast, when it issued the various sets of guidelines dealing with restrictive agreements covered by Article 81 – vertical agreements[5], horizontal agreements between competitors[6], and technology licensing agreements[7] – the Commission had the benefit of having had corresponding block exemption regulations in place for a number of years. For example, by the time that it issued guidelines on technology licenses in 2004, different iterations of a block exemption regulation on technology licensing had been in place for nearly two decades. While the revision of the regulation and the promulgation of guidelines gave rise to a vigorous debate on certain principles, many of the core principles had been in place for many years. Thus, the Commission not only had experience as to how these principles worked in practice, the business community was accustomed to them.

- The Article 82 case law does not form a coherent whole that easily lends itself to guidelines. Some of the cases are outdated and do not reflect the current thinking in the antitrust community. There are significant gaps in the case law in some areas. The meaning of some cases is unclear. In addition, certain key principles remain unsettled due to the pending appeals of two landmark cases, *Microsoft* (refusals to deal and tying)[8] and *British Airways* (discounts)[9].

This paper will focus on this last issue of how the Commission might deal with the existing case law in its effort to develop a coherent analytic framework for Article 82 cases. It will first discuss why it is important to strike the right balance between existing case law and reform when developing guidelines on Article 82. It will then suggest some guiding principles for dealing with existing case law in competition guidelines and the extent to which the Discussion Paper follows these principles.

The Delicate Balance Between Precedent and Reform

Guidelines in the competition field are not static documents that merely codify existing case law. Guidelines are used as a vehicle to move the law forward, and the Article 82 guidelines are likely to follow this pattern. If the Discussion Paper provides any indication, they will likely prescribe an important shift in the general analytic framework used in Article 82 cases by focusing more on economic effects. But while such a broad shift in the analytic paradigm will not necessarily contradict existing case law, specific principles

5 Guidelines on Vertical Restraints, OJ (2000) C291/1.

6 Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ (2001) C3/2.

7 Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, OJ (2004) C101/2.

8 Case T-201/04, *Microsoft Corporation v. Commission*.

9 Case C 95/04, *British Airways v. Commission*.

articulated as part of this shift might. Thus, in drafting guidelines, the Commission will need to grapple with the issue of how to reconcile a new analytic framework with case law that has been developed over the course of several decades.

How the Commission resolves the inevitable tension between existing case law and reform in developing specific principles will have important ramifications for the success of the guidelines. If the Commission hews too closely to precedent, it risks falling short of its objective of developing a comprehensive and coherent analytic framework for Article 82 that is solidly grounded in economics. Moreover, unless the Commission regards precedent with a critical eye, it risks simply carrying over into the guidelines the shortcomings of the existing case law.

To develop an economics-based approach to Article 82 cases, the Commission will need to be particularly careful about accepting a principle uncritically simply because it has been repeated frequently in the case law. As Robert Bork cautioned in his seminal work, *The Antitrust Paradox*, antitrust, like other areas of the law, tends to suffer from a "falsely imagined past" in which there is a tendency to accept first principles uncritically on the often mistaken assumption that they were established theoretically and confirmed empirically by legislators and judges long ago.

There are numerous examples of this tendency at work in the area of Article 82 as the law has tended to evolve in a formalistic manner, which is precisely why the Commission has undertaken a review of its policy. One example is in the area of refusals to supply existing customers. The received wisdom, which can be traced back to the 1974 judgment in *Commercial Solvents*[10], is that the termination of an existing supply relationship should be treated more strictly than a refusal to supply a new customer. Applying an approach that focuses on economic effects, it is arguable that there is no reason to treat the refusal to supply an existing customer differently from a new customer, as the impact on the market will be the same. In both cases, the key issue is whether or not the customer has access to alternative sources of supply.

While adhering too closely to existing precedent can impede needed reform, if the Commission strays too far from precedent, it risks undermining the overall effectiveness of the guidelines. The legal effect of guidelines in the competition field and the relationship between guidelines and existing case law raise a number of intriguing questions, particularly in today's world of a decentralized enforcement regime that places the main enforcement burden on national competition authorities and national courts: To what extent is the Commission bound by guidelines? Do guidelines create legitimate expectations on the part of companies that must be respected by the Commission and, ultimately, the European Court of First Instance ("CFI") and the European Court of Justice ("ECJ") (together, the "European Courts")? To what extent are national competition authorities and national courts bound by guidelines?

An examination of these questions is well beyond the scope of this paper, but it is probably safe to say that guidelines are more than just guidelines in that they are likely to at least constrain the Commission and may well be hard for courts to ignore if companies rely upon them to their detriment. That said, it is clear that guidelines are not legally binding

[10] *Commercial Solvents v. Commission*, [1974] ECR 223.

on the courts.[11] Undoubtedly, the final version of the guidelines will include the usual disclaimers that their application will depend on the circumstances of each case and that they are without prejudice to the interpretation of the European Courts.[12]

Since guidelines are non-binding documents, their effectiveness depends on the extent to which they articulate principles that are likely to be accepted. The relationship of the guidelines to existing case law has an influence on the degree of acceptance in the sense that, the further the guidelines deviate from existing case law, the stronger the policy rationale will need to be. National competition authorities and national courts may be reluctant to follow the guidelines if they are at odds with existing case law. Companies and their advisors may also decline to follow the guidelines in these situations, preferring to take their chances before the courts in the event of a challenge.

If the Commission departs too far from existing case law, this may not only sow confusion and undermine widespread acceptance of the guidelines, but it would raise broader institutional questions as well. As a matter of sound public administration and in deference to the role of the courts in the institutional structure of the European Union, it would seem preferable for the Commission to err on the side of caution in deciding to what extent it should depart from precedent in promulgating guidelines.

Some Guidelines for the Guidelines

In threading the needle between precedent and reform, the following considerations may be useful:

- How well-developed is the case law?

If a number of cases have been decided on a given issue, the European Courts would normally have had an opportunity to develop a coherent set of principles in a variety of factual situations, it would seem appropriate to exercise caution in departing from these principles. As discussed below, a good example of such case law is in the area of refusals to license intellectual property rights.

In contrast, if the case law is sparse and very fact-specific, the principles developed by the European Courts may be sketchy and narrow. In these circumstances, it may be more appropriate to depart from the case law or at least to fill in the gaps in order to create a more useful and coherent analytic framework. An example of such case law is in the

11 *See* Case 74/69 *Hauptzollamt Bremen-Freihafen v. Waren-Import-Gesellschaft Krohn & Co.* [1970] ECR 451, ¶9 ("An unofficial interpretation of a regulation by an informal document of the Commission is not enough to confer on that interpretation an authentic community character. Such documents, which no doubt have their value for the purpose of applying certain regulations, have, however, no binding effect.… The uniform application of community law is only guaranteed if it is the subject of formal measures taken in the context of the Treaty").

12 *Commission Notice: Guidelines on Vertical Restraints,* OJ (2000) C291/01, ¶¶ 3-4.

area of tying. The two leading cases, *Hilti*[13] and *Tetra Pak*[14], both dealt with the tying of consumables – cartridges for Hilti's nail guns and cartons for Tetra Pak's packaging machines. As a result, the judgments do not articulate principles that are particularly useful in coping with other kinds of tying cases such as those involving technological tying where two products are physically integrated.

- Is the case law recent?

While any departure from the case law will need to be carefully considered, this would seem to be particularly true of more recent case law. If the European Courts have recently ruled on an issue, the Commission should only depart from this case law if it thinks that it is absolutely necessary to implement an important change in policy. This does not mean that the Commission should lightly ignore older case law, but only that it should be particularly cautious in departing from recent judgments.

- Is the case law in line with the prevailing consensus in the antitrust community?

Even if the case law on a given topic is well-developed and of recent vintage, the Commission may still decide to depart from this case law if it is not in line with the current thinking in the antitrust community. Indeed, it is precisely here that the Commission can use guidelines to improve on the existing case law and achieve its goal of developing an analytic framework that is firmly grounded in economics. Of course, any such departure from the case law should be undertaken with caution. In practice, such caution presumably would mean that the Commission would not depart from the existing case law absent a strong and widely-accepted policy rationale.

An area that would seem ripe for reform despite the existence of numerous cases, including some recent ones, is rebates and discounts. The current law on rebates and discounts is considered one of the most unsatisfactory areas of the Article 82 case law. The current law articulates an almost *per se* condemnation of practices that are among the most common in the business world. The case law is disconnected from the kinds of cost concepts that economists would use to analyze discounts and rebates with the exception of the dominant firm's defence of having a cost justification for the rebate. In addition to lacking a sound economic basis, the case law on rebates is very fact-specific, making it difficult for practitioners to discern any clear guiding principles.

The Discussion Paper suggests that the Commission has recognized this problem. The Discussion Paper moves away from the *per se* approach of the cases towards a more nuanced approach, although the underlying economic principles appear to still need some refinement. In addition, the Discussion Paper's treatment of rebates and discounts leaves much to be desired in terms of clear, practical guidance.

- How well-settled is the case law?

In the case of an issue that is the subject of a pending appeal before the European Courts, it would seem appropriate for the Commission to exercise particular caution in promulgating guidelines that go beyond the existing case law. In these situations, it would seem inappropriate as an institutional matter for the Commission to use guidelines to advance arguments that it is making before the European Courts. Moreover, there is the

[13] *Hilti v. Commission*, [1994] ECR I-667.

[14] *Tetra Pak International v. Commission*, [1996] ECR I-5951.

practical problem that, if the European Courts disagree with the Commission, entire sections of the guidelines could become obsolete overnight.

As discussed below, the section of the Discussion Paper on refusals to supply intellectual property rights relies heavily on principles drawn from the Commission's decision in *Microsoft*, which is currently on appeal before the CFI. Similarly, the CFI's judgment in *British Airways*, which deals with the controversial topic of discounts and rebates, is on appeal to the ECJ.

As a practical matter, it may not be realistic to avoid these topics altogether simply because they are the subject of a pending appeal. It would seem preferable, however, for the Commission to take a conservative approach in articulating guiding principles, staying as close as possible to the existing precedent.

An Example:
Refusals to License Intellectual Property Rights

While a thorough analysis of how the principles described above might apply in the context of the Discussion Paper is well beyond the scope of this paper, it is worth taking an example from the Discussion Paper to illustrate how the analysis might work. The following paragraphs discuss the application of these principles to the Discussion Paper's treatment of refusals to license intellectual property rights (IPRs), which has been criticized heavily in the public comments.

Refusals to license IPRs is an example of an area where the case law is well-developed and relatively recent. Over a series of cases – *Volvo Veng*[15], *Magill*[16] and *IMS*[17] – the European Courts have developed a set of principles governing the question of when a refusal to license an IPR may be abusive. These cases were heavily litigated and were the subject of extensive commentary in the antitrust community, so the European Courts were undoubtedly aware of the policy issues at stake, particularly the effect of its judgment on the delicate balance between the exclusive rights flowing from IPRs and the need to maintain competition on the market. In their judgments, the European Courts sought to strike the right balance by recognizing that firms, even dominant ones, should normally be able to enjoy the exclusivity conferred by the IPRs and that they should only be forced to license these IPRs in exceptional circumstances.

In its discussion of refusals to license IPRs, the Discussion Paper not only departs from this case law, but embraces an approach that is currently on an appeal to the CFI in *Microsoft*. The Discussion Paper acknowledges the well-established principle that a refusal to license an IPR is abusive only in "exceptional circumstances"[18], but proceeds to place a broad

15 *Volvo AB v. Erik Veng (UK) Ltd*, [1988] ECR 6211.

16 *RTE and ITP v. Commission*, [1995] ECR I-743.

17 *IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG*, [2004] ECR I-5039.

18 Discussion Paper, ¶239.

gloss on such circumstances that is at odds with existing case law. In discussing when a refusal to license an IPR may constitute an abuse, the Paper articulates essentially the same test proposed for refusals to supply generally, but then adds the condition that the refusal to supply "prevents the development of the market for which the licence is an indispensable input, to the detriment of consumers"[19]. The Discussion Paper elaborates that this condition is only met where the company requesting the licence "does not intend to limit itself essentially to duplicating the goods or services already offered on this market by the owner of the IPR, but intends to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand"[20]. This language is taken almost verbatim from the ECJ's judgment in *IMS*[21].

However, the Discussion Paper then proceeds to set forth circumstances in which a refusal to license may be abusive that go well beyond those so carefully articulated by the ECJ. The Discussion Paper states that a dominant firm's refusal to license its IPR may be abusive if the IPR-protected technology "is indispensable as a basis for follow-on innovation by competitors ... even if the license is not sought to directly incorporate the technology in clearly identifiable new goods and services"[22]. This statement is clearly inconsistent with *IMS*. It represents a substantial expansion of refusal-to-supply doctrine beyond the limits that the ECJ has carefully crafted in its case law because the circumstances in which an IPR might be "indispensable" to any conceivable form of "follow-on innovation" is likely to be far broader than indispensability to the creation of a new product or service. At a minimum, this new standard will expose dominant companies to significant legal uncertainty when exercising their IPRs.

The Discussion Paper offers no policy rationale for such an approach. Indeed, the principles set forth in the Discussion Paper would seem to be contrary to the widely-accepted principle that a dominant firm should only be required to grant a license in narrowly-defined circumstances. Nor is the Discussion Paper's treatment of IPRs in any sense broadly shared in the competition community. To the contrary, it stands out as a somewhat idiosyncratic rejection of rather recent and well-established case law.

Conclusion

In threading the needle between precedent and reform in promulgating guidelines on Article 82, the Commission must consider the quality of the case law – how well-developed is it? how recent is it? how settled is it? – and weigh this against the policy arguments for moving towards new principles. While the Commission must examine existing principles critically to avoid falling into the trap of assuming that well-established principles are necessarily correct, it must also exercise caution in departing from existing case law, both in the interest of legal certainty and as a matter of institutional balance.

[19] *Id.*

[20] *Id.*

[21] *IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG*, [2004] ECR I-5039 at ¶49.

[22] *Discussion Paper,* ¶240.

Reporting from Brussels is a Lonely Affair

By Robert McLeod, Editor-in-chief of MLex Markets & Law.

Four years since the now-famous court setbacks for DG Competition, the European Commission and the media that report on it can still do much more to avoid such mistakes in the future. Greater transparency by the Commission and more effective scrutiny by the press could go some way to reversing a culture where too often secrecy is confused with confidentiality.

Sometime towards the end of next year a group of five judges will walk out from a room behind a court bench in Luxembourg and announce whether Europe's citizens will need to fork out as much as 1 billion euros to pay for errors and failures formulated on their behalf by European Commission officials in Brussels.

The damages claim by Airtours for the European Commission's decision to block its 1999 takeover of rival tour operator First Choice, the first of two big claims related to a series of overturned merger vetoes by the Court of First Instance in 2002[23], raises questions of accountability, oversight and transparency that to this day have only been partly answered.

There is no doubt that the unprecedented actions of the Court shook the Commission out of its complacency and the effect of the vetoes was to trigger a sea change in the way the European Commission vetted mergers. Then-Competition Commissioner Mario Monti, effectively saddled with the decisions on procedures overseen by his predecessor Karel van Miert, launched, partly successfully, an overhaul of not just the practices, but the spirit of antitrust regulation in Europe. But the question, as valid now as it was then, is how did an administrative body in a modern democracy gain so much power with so little restraint? Where were the checks and balances? Why wasn't anyone shining a light onto the workings of Europe's civil service?

Reporting on antitrust in Brussels is a lonely affair

Europe's capital boasts the largest number of foreign correspondents of any place on earth. Every major and even the minor news agencies have a presence here. Local, regional, national and international press sit side-by-side, documenting every last detail of the Commission's thoughts on democracy in Asia and war in Africa. There is no one to remind the horde that the Commission, for all its bureaucracy, has neither the mandate nor the ability to affect these subjects. A holiday by a Commissioner or the nationality of

[23] Airtours v. Commission, June 2002; Schneider Electric v. Commission, October 2002; Tetra Laval v. Commission, October 2002.

a spokesman will account for pages of ink and hours of questioning. Yet where the Commission does hold power; where it can act independently of member states and impose its will on the world's most powerful corporations, the media is mostly silent.

The sight of Italian journalists desperately trying to tie current Competition Commissioner Neelie Kroes with Dutch bank ABN-Amro in an attempt to derail her attempt to stifle recent outright protectionism in Italy was a case in point. A lack of understanding or comprehension of competition law isn't the only issue when governments nudge journalists reporting for their national press to do the government's bidding.

So what does this mean? The Commission has gotten – and by and large still does get – a free ride. The bulk of the media, when it focuses on competition law at all, focuses on national irrelevancies. Most of the rest, and there are very few among the rest, depend on the good will of the Commission for an occasional exclusive. The thought that they could, and should, challenge the Commission is alien. The Airtours case isn't the only one where the Commission, or rather, the taxpayer, is facing damages claims. Whether or not the claims are successful is not the point so much as how the Commission got into the situation in the first place.

The National Competition Days are now a de rigueur event for national authorities trying to flaunt their consumer credentials, but they have very little relevance for consumers. They do, however, at least provide an opportunity to open up national regulators to a little outside scrutiny that in many, though not all, cases is all too rare. At the time of the merger review process for Schneider Electric's ill-fated attempt to buy Legrand SA, Competition Commissioner Mario Monti gave a press conference in conjunction with the Belgian government, at the time of the Belgian presidency of the European Union's National Competition Day. The questioning, however, got off to a bad start for the Commissioner, as it focussed on a slew of concessions semi-publicly offered by Schneider to overcome antitrust concerns. Monti impatiently outlined the legal regulatory timetable the decision faced, i.e., that the acquisition was notified to the Commission, which had opened an in-depth investigation, and had a legal deadline to rule on the merger. No attempt was made to offer any explanation of the types of problems being faced, the degree of opposition to the deal, or the issues being raised by the concessions proffered by the company.

The issues being raised, however, were of problems with the regulatory process and a legitimate request for at least some explanation of the Commission's position. The Commission, however, refuses all but the blandest of public pronouncements, and with few exceptions will make little attempt to explain actions, motivations or procedures in public or private. The result is, at best, imbalanced reporting and, at worst, poorly informed public debate and a Commission more detached from the consumers it is supposed to protect.

Without allowing the press the right to have questions answered, the Commission is in a position of not having to ask itself the questions. While it can't be argued that this is the sole or even main cause of the predicament the Commission is in, the Commission did, and still does, find itself in a position in which it doesn't feel it should be questioned. This casts doubt on its accountability, or at least the perception of its accountability.

The Commission, and the Commissioner, obviously need to be cautious and to protect the confidentiality of the process, particularly that of the merging parties and of the customers who might complain but are fearful of retaliation. (Although, this begs the question of whether if the customers are fearful of retaliation, there's already an antitrust problem.)

But, whether in merger reviews or antitrust probes, the level of secrecy stifles all debate. The Commission, probably because it feels it isn't or doesn't need to be accountable to the public, confuses secrecy with confidentiality. Its argument that a Statement of Objections, effectively the charge sheet a company must face, is simply its working document about a case and shouldn't be made public misses a few key realities.

First of all, the rule doesn't make a distinction between cartels and mergers. The Commission may require and demand more secrecy in a merger review, subject as it is to a tight time frame and intense lobbying from governments, competitors, customers and the companies themselves. But without any summary or explanation of the Commission's decision-making process, the press is subjected to the same lobbying.

Secondly, the Commission says the Statement of Objections can't be made public so as to protect the confidentiality of the process. Yet, SOs exists in confidential and non-confidential forms. It seems that once the non-confidential version is sent out, the Commission's rational for not publicizing the SO would become irrelevant.

A case in point

When I worked at an international news agency, we were the first to get hold of a non-confidential version of the SO in the General Electric-Honeywell merger review. Yet, I am sure that we obtained a copy at least 24 hours after a U.S. based hedge fund. The Commission's decision to withhold the publication of non-confidential versions of SOs leaves an imbalance of information in the market and has a negative impact on objective reporting and commentary. A non-confidential version of an SO has been redacted of business secrets. Anyone who could possibly have a direct business use for the information will be no doubt an interested third party and will already have a copy. But those who may have a legal or financial interest in the process are left without access to the SO.

If non-confidential versions of SOs were to be made public, investors (from hedge funds to pension funds to individuals) could be left to personally assess the merits of the Commission's thinking on the case, the possible responses of the merging parties, and the risks inherent in the transaction. If an investor reads an SO, makes an assumption about what it means, and takes a decision, then, well, it's a case of caveat emptor. Investors are familiar with the process. Or they should be. Or they should be paying someone to advise them. None of this would require any additional work by the Commission. The non-confidential versions already are produced. The Commission can refer all questions to the document. Pretending the SOs don't make their way into the public domain leads to a head-in-the-sand information imbalance of the Commission's own making.

The time constraints don't explain the need for secrecy usually claimed in the case of an antitrust probe; even after dawn raids have taken place. Indeed, one could imagine it would be conducive to the task of unearthing evidence to publicise the fact that an investigation was taking place.

The Commission says that even admitting a cartel investigation amounts to tarring the company or companies involved as guilty and could taint "the process". This is an absurd position and one that doesn't figure in other areas of criminal or civil law. While SOs in antitrust cases rarely become public, there seems little point in keeping them confidential, particularly in transatlantic cases, where the information is likely to be available through the courts in the U.S. in any case. There is a suspicion, in both merger cases and in antitrust cases, that the Commission is hiding behind the veil of confidentiality to protect its own interests.

The most recent example is in the hotly disputed Microsoft investigation relating to its compliance with a 2004 antitrust order. While few people doubt that Microsoft isn't complying with the order, or doubt the Redmond, Washington, giant is dragging its feet, the Commission is in danger of falling into a procedural irregularity trap. The facts, presented by Microsoft but not denied by the Commission, do raise a number of serious questions. (The Commission disputes the interpretation of some of the facts, but doesn't explain its own interpretation.)

The fact that Microsoft has selectively made documents public has, on balance, probably helped its case, at least with the press and relatively independent professional onlookers. This is partly because the facts the company has presented display the Commission and its process in the worst possible light, and partly because the Commission's occasional refusal to respond raises concerns that the Commission is hiding something.

This is not an abstract concern. The courts in Luxembourg have found the Commission both negligent and culpable when it comes to the treatment of evidence and the rights of the accused. The Commission's flat out refusal to allow the defendant to open up the hearings relating to whether it has complied with an original 2004 antitrust decision to release confidential data also raises concerns. The Commission claims it is adhering to the letter of the law, or at least the regulation. It fails the test if one asks who the rules are benefiting.

The rules are meant to protect the defendant, not the Commission. So if the defendant wishes to have the proceedings open to the public, it seems bizarre that the Commission would refuse. Claims that it doesn't want Microsoft to be able to play to the gallery ignore the fact that hearings in other courts are open. What is certain is that the Commission would have to work harder and put forward a more thorough case than it does at present, and that would indeed change both the nature of the hearing and the importance of the hearing officer in managing the process.

If the defendants obtain the right to have the hearings made public, it can be argued that all hearings will be made public, as insisting on secrecy would raise suspicions that the defendant had something to hide. What the Commission would find would be that, except in rare circumstances, there would hardly be any media attending the hearings.

There are no quick fixes here

The decision to open the hearings is an important and fundamental one. It would make the entire process more transparent, and place a greater onus on the Commission to prepare and present its case. It could also put an end to the practice, often criticised by defendants, of the Commission's representatives not taking an active part in the proceedings, leaving the feeling that the hearings are little more than a circus. The Commission's position and its practices in this case will eventually be made public at the Court of First Instance in Luxembourg. (They may even be made public beforehand in a U.S. courtroom, but that is another point.)

The positions, as presented by the parties, are open to debate. Without access to any source materials, however, the press and the public are left to interpret as best they can the information presented to them. Again, the problem arises that much reporting is subject to intense lobbying and partial fact selection. Too often, the response to each revelation is a short intake of breath and a "well they will have really upset the judges now". The debate and discussion is not about merits, it's about scoring points and how arguments might play in a courtroom.

In the courtroom, the situation is better, but not much. There is little or no access to documents relating to the case before the court and little access to the case files themselves. The media and other outsiders are left with a "Report for the Hearing" drafted to summarise the different positions and made available at the court on the morning of the hearing.

There are attempts to open up the process in Luxembourg and to provide more access to documentation. For all the complaints from the press and other media that the Commission processes are opaque and unnecessarily secretive, members of the media itself are doing little to force the issue.

Most media, including the agencies and the specialist press, are under intense pressure to produce "exclusives" that can, and do, sometimes lead to lapses in depth or precision. Agencies, and increasingly the Internet offshoots of the established press, are also under additional time pressure just to publish headlines. So much so that most reporters and editors probably send out too many headlines taken directly from press releases. Journalists do not use sufficient thought and judgement to assess what information to highlight when the pressure is on not to "be naked", that is, to not send out a headline that has been highlighted on a rival news service. It matters little whether the information is important or not, as the editors with ultimate responsibility for a news service have little or no understanding or knowledge of the topic and just compare time-offs with rivals.

When a reporter for an agency is writing for currency traders in London, gold traders in Johannesburg and pension fund managers in Boise, Idaho, there is pressure to flatten out the story – essentially stripping it down to its bare essentials – to make it understandable for the widest possible audience. For the informed observer, including regulators as well as lawyers and corporate representatives, even the experienced media can sometimes appear to have missed the point on a story or issue.

The dumping down of copy, and the rush to print, mean that reporters often fail to convey the very issues that they are attempting to report, often because they are written for the broadest possible audience in the shortest possible time. This leaves little time for research and reflection and can often result in hurried and poorly informed reporting. While generally this is a result of the editing process, it is also abetted by the lack of timely and factual information at the disposal of the journalist or the reporter.

The Commission itself could do more to explain its decision making process

The Commission, like any administration, will produce reams and reams of paper about subjects that cast it in a positive light, yet it neglects to adequately explain trickier subjects like decisions to drop investigations. The Commission, like any administration, does drop embarrassing decisions onto the press at the last minute to minimise reporting. One such case, a decision to drop an investigation into CD prices, was made late on a Friday afternoon during the middle of the August summer vacation during a week, already slow, that had been split in half by a public holiday. Difficult merger decisions, whether by accident or by chance, are delivered late in the day, precluding the chance for a public discussion of the case at a press conference. The news cycle, for all but the rare cases that draw great public interest, won’t last until the official briefing, which takes place the following afternoon.

What then, can be done to improve the quality of reporting of the European Commission, in particular with regard to competition and antitrust? And why should we care? Greater access to officials who can speak “on the record” and better and more accessible background briefings would be a start. More fully explained decisions for those that want them would also be beneficial.

The role of an independent press is to shine a light on the administrative processes in Brussels. It is supposed to hold the officials and the institutions accountable and, in doing so, contribute to an effective and efficient administration. To do this, the press needs to develop and maintain its own independence. It must become less reliant on informal sources and semi-official leaks. To reach that point and to still be able to provide accurate and informed reporting, the press and the Commission must work together to enact a sea change in the rules and practice that govern the transparency of the administrative process.

Such changes wouldn’t come easily, and would, or at least could, be incremental.

Exploitative Practices in Article 82

By Yannis Katsoulacos, Professor at Athens University of Economics and Business

Introduction[24]

One of the most disputed aspects of Article 82, which regulates abuses by firms with dominant position in the market, relates to the prohibition of so-called Exploitative Practices or, more specifically, to the prohibition of excessive prices[25]. In addition to intervening in cases of so-called Exclusionary (or Foreclosure) Practices, Competition Authorities in Europe can, under Art. 82, also condemn "excessive pricing" (that is, pricing excessively above costs). This is an area where EU Competition Law[26] differs from U.S. Law, which does not provide the competition agencies with the power to intervene in cases of "too high" prices[27].

The Commission's recent proposals for the revision of Art. 82 (contained in the DG Competition Discussion Paper) do not at present address the issue of exploitative practices[28]. It is, however, anticipated that such proposals will be made in due course. The purpose of this article is therefore to assess how the application of a more economics-based approach, which is at the forefront of the current reform proposals of Art. 82, might affect the treatment of exploitative practices. It is interesting that while for exclusionary practices an economics-based approach leads naturally to a rule-of-reason attitude[29] toward the assessment of potential offenses, in the case of exploitative practices an economics-based approach suggests that a *per se* legality norm may be the most appropriate norm to apply. Evans and Padilla have indeed recently proposed such a norm[30].

24 Useful comments by Victoria Merticopoulou, Legal Expert at the Hellenic Competition Commission, are gratefully acknowledged. All errors and/or ambiguities are of course my responsibility only.

25 Too high "discriminatory" prices can be dealt with as an "exclusionary abuse", if the discrimination aims to foreclose, or as "exploitative". We do not deal with discriminatory prices here.

26 See below for examples of EU cases.

27 This aspect of Art. 82 may have influenced or inspired recent changes in Competition Law in some countries in which Competition Authorities have their powers extended to deal with excessive prices as if they were sector regulators: by preventively or *ex ante* intervening in markets in which they judge that market competition as such is "ineffective" they can try to secure improved competitive conditions and lower prices (the latter can be achieved even by enforcing the obligation of cost-oriented pricing to the firms).

28 See DG COMP Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses (Dec. 2005), page 4, §3, and page 17, §53.

29 An attitude, that is, that there can be no presumption that a certain practice is *per se* unlawful and that, before making a judgement, the tools of economic analysis should be applied in each specific case in an effort to identify adverse effects on the welfare of consumers.

30 "Excessive Prices: Using Economics to Define Administrable Rules" by David S. Evans and A. Jorge Padilla, CEMFI Working Paper No. 0416, Sept. 2004.

To reach such a conclusion, however, we believe that certain modifications, specifically in relation to the "as-efficient" competitor test, have to be made in the proposed reforms to the application of Art. 82[31].

The paradox of condemning excessive prices under an economics-based approach to Art. 82

In U.S. competition law, the fact that "monopolization-as-such" (or the very existence of monopoly power) is not condemned implies that excessive prices are not viewed as a potential offence. In the EU, where the concept of dominance (rather than that of monopolization) is used, it is also the case that "dominance-as-such" (or the very existence of a dominant position) is not condemned; Art. 82 purports to condemn only abusive practices by dominant firms. However, if from now on, as the Discussion Paper suggests, we associate the EU Competition Law concept of "dominance" with economists' concept of "significant market (or monopoly) power", than given that the latter is defined as the ability to charge prices significantly higher than costs, it would be a paradox not to condemn "dominance-as-such" but to condemn excessive prices. In other words, if Art. 82 does in the future, as the DP suggests, treat "dominance" as "substantial market power", it can then continue to treat excessive prices as potentially abusive conduct only if it also explicitly condemns "dominance-as-such".

The challenges of regulating substantial market power (MP)

In order to better understand the potential treatment of excessive prices in Art. 82, we should remind ourselves that the regulation of MP can, in principle, be achieved in two ways.

The first is indeed the *ex ante* regulation of MP-as-such, that is the preventive regulation of the exploitation of MP as manifested in excessive prices. With *ex ante* regulation of MP the regulatory authority is responsible for setting the prices (or setting an allowable range of prices) that the regulated company can charge. Of course, MP is manifested in excessive prices as well as with distortions in product quality, variety, and innovation. However, the assessment of the potential distortions that MP creates on these is even more difficult than the assessment of its distortion on prices.

Ex ante regulation of prices is proposed by economic theory only in the cases of Natural Monopolies in which competition in the market (as opposed to competition for the market)

31 See below for an explanation of this test.

is not desirable for reasons of cost efficiency. In these cases the *ex ante* regulation of prices can be undertaken by specialized Sector Regulators[32]. This is the approach that has been followed in the EU in the last 20 years or so, after the privatization of the previously public monopolies and the liberalization of the relevant sectors[33].

The second way of regulating MP is the regulation of behaviour or practices by firms in oligopolistic industries, which aim to create, maintain or enhance MP, with significant negative effects on consumer welfare. Such practices are unilateral practices that aim to foreclose rivals – these include practices whose objective is to induce the exit of an existing rival, the deterrence of entry of a new rival, or the weakening of an existing rival – or cooperative practices and agreements (tacit or otherwise) that create cartels. Also, competition policy addresses *ex ante* (i.e. preventively) merger-induced changes in the concentration of markets by requiring firms, under certain conditions, to obtain approval for proposed mergers. Mergers potentially create conditions that lessen the competitive constraints facing firms to unilaterally raise prices and/or that enhance their collective market power (their ability to collude), again with potentially significant negative effects on consumer welfare.

We need to stress the proviso that the above practices should be prohibited only if they have significant negative effects on consumer welfare, taking into account that practices that create, maintain or enhance market power often have simultaneously significant beneficial effects, e.g. on the efficiency of the firms, that tend to lower prices and thus raise consumer welfare[34]. So it is the *net effect* on welfare, taking into account both the effect on market power *and* that on efficiency, that must be considered before reaching a judgment on whether a practice is unlawful or not. This approach to competition policy, which has been used for many years in the U.S. and Canada, is in the process of being adopted in EU as well.

Should competition policy really strive to condemn excessive prices?

The reasons why economic theory does not consider desirable the prohibition by competition law of significant market power-as-such (or "monopolization-as-such", to use the U.S. terminology), is that, in contrast to the case where one is evaluating the potential effects on welfare of the practices described above, it is much more difficult to assess the welfare implications of monopolisation-as-such, taking into account the

[32] Alternatively, as is well known, franchise bidding, or competition for the market can be used.

[33] This approach was adopted in the U.S. very early on, as there, in contrast to in the course of events in Europe, the potential solution of establishing public firms in (the "public utility") sectors that were Natural Monopolies, after the Second World War, was not favoured.

[34] Thus even though a practice raises MP, and therefore price-cost margins, it may lower prices (and increase consumer welfare) if it leads to substantial efficiency gains (cost reductions).

potentially adverse effects of an active anti-monopolisation-as-such policy on the behaviour of firms[35].

A number of serious problems arise when attempting to assess the welfare implications of MP-as-such:

- The first problem concerns the difficulty of measuring the exact *magnitude* of MP at a given point in time – this must be "substantial" compared to the cost of regulatory intervention. Moreover, measuring the *sustainability* of the MP over time is another challenge.
- The second problem arises from the need to identify the *source* of the MP.

The above problems are particularly acute in the case of markets of the New Economy or, more generally, markets with high innovative activity.

A first observation here is that the assessment of the "intensity of competition"[36] is a thorny issue that has bedeviled both theoretical and empirical work for many years. The reason for this is, of course, that when economists talk of competition in this context they have in mind three distinct concepts: actual competition, referring to structural market characteristics as reflected in shares and concentration indices; potential competition, the intensity of which is determined by entry barriers; and competitive behaviour or the mode of interaction between oligopolistic firms. The latter may be less or more aggressive. Though it is related to, it is not easily determined by, structural market characteristics and entry barriers.

In practice, because it is not possible to directly identify market power at a given point in time on the basis of price-cost margins or other performance indicators, competitive behaviour is assessed indirectly through imperfect market structure indices such as shares and degree of concentration. This can lead to very misleading results especially in dynamic sectors characterized by economies of scale and/or scope and high investments in R&D and innovation[37]. Attempts to identify market power through performance indicators such as profits are likely to be very misleading too, as accounting profit seldom reflects economic profit with any accuracy, while the benchmarking of prices or rates of return as methods of assessment conceal many dangers.

Even if it could be established that the market power of a firm is significant at a given point in time, and that this is not the result of its efficiency-enhancing investments, it still needs to be investigated to what extent that market power can be sustained for a long period of time. If there are legal entry barriers, which can be relatively easily identified, then the problem should be sought in an investigation of the rationale and possibly the removal of the state intervention that has created the barriers (see also below). If there are no legal barriers however, then the sustainability of market power will depend on

[35] See also, for an eloquent defense of what they call the "anti-dirigiste approach to competition policy" the recent report by the EAGCP economists on "An economic approach to article 82", P.Rey et.al. (July 2005).

[36] "Intensity of competition" is inversely related to the "magnitude of MP".

[37] See also the article by F. Etro in this volume.

entry barriers related to the nature of the technology and products/demand and may also be the result of the exclusionary actions of the firm. In the latter case, market power should indeed be condemned. However, note that it is these actions (or abusive practices) that should be controlled, not high prices.

Furthermore, market power will often have its source in factors that do not reduce long-run welfare, but on the contrary, may well increase it. Thus high prices and profit will often be justified when they are the reward for engaging in high-risk investments. Without the prospect of high prices and profit firms will not have incentives to undertake these investments. In other words, the high prices and profit could be the result of investment in R&D, innovation, advertising, or, generally, building up superior efficiency. The market power of a firm could not be considered illegal in any of these cases.

Thus, the manifestation of market power in high prices will often reflect the firm's just reward for its past investments. In these circumstances, the prospect of acquiring market power is necessary for the firm to have the incentives to invest and plays the role of signaling to other firms that the activity is profitable (which is necessary for potential competitors to enter and invest in this market).

Many of the difficulties above are largely avoided or diminished when the objective of the regulatory authorities is the control of practices that aim to create, maintain, or enhance MP. This is because it is generally more difficult to find out whether a price is "too high" (in relation to costs), whether the price is "right" (in that it gives the firm the opportunity to recoup substantial efficiency-enhancing investments), and whether it is sustainable, than it is to assess whether a given business practice is likely to allow a firm to significantly raise and maintain its price at a high level. In the latter case we avoid having to judge what the competitive level of prices is and we do not have to face the "source of MP" issue. Rather than having to assess what the "appropriate" price is and how it should evolve over time we face the easier task of assessing the extent to which the current price is likely to be raised by the practice under investigation[38].

The experience of excessive pricing cases in Europe

The European Commission has only used its specific rules on excessive prices a few times. As Whish (2001)[39] has noted, "it is not surprising that competition authorities prefer to deploy their resources by proceeding against anti-competitive abuses that exclude competitors from the market rather than establishing themselves as price regulators". However, there are signs showing that there has been a growing use of the rule against excessive prices in recent years at least in some countries (e.g., the UK).

38 Of course there is still the difficulty of assessing the relative importance of potential efficiency gains from the practice.

39 R. Whish *Competition Law* (4th edn, Butterworths, London 2001).

Out of the following examples of cases pursued on grounds of excessive pricing, there is only one clear case in which the decision to condemn the firm under investigation was also upheld by the courts (the list excludes several recent cases brought by the Commission against dominant firms in utility sectors that should have, in our opinion, be investigated by specialized regulatory authorities)[40]:

- Commission/United Brands (1975) – condemnation that was rejected by the European Court of Justice (hereafter, "ECJ") (although the ECJ did specify several conditions for assessing excessive pricing, in an *obiter dictum*).
- Commission/General Motors/British Leyland (1975) – condemnation. Though the decision was revoked by the ECJ, the latter did confirm the principle that too high prices could be in violation of Art. 82. (The case could have been examined as a case of price discrimination with intent to exclude.)
- UK/Napp (2001) – condemnation that was upheld by the Competition Commission Appeals Tribunal.
- UK/SSL International plc – after a three-year investigation (2002-2005), the OFT closed the case, deciding that it was impossible to reach a final decision.
- UK/BSkyB – case closed in 2004 with acquittal (even though the OFT found evidence for the existence of very high switching costs, it decided that on their own they did not provide sufficient evidence of excessive prices).
- Greece/Company for the Protection of the Intellectual Property of Composers (AEPI) (2003) – condemnation that was rejected by the Court of Appeals.
- Ireland (2005) – the Groceries Order and excessive prices in the Irish food sector (see below).

What should be the appropriate norm for "excessive prices" under an economics-based approach?

The above examples suggest, as also noted by Evans and Padilla (2004), that the probability of mistaken condemnations in excessive price cases (Type I errors) is indeed very high. In addition to this, the real cost of these errors is likely to be very high when measured in terms of the reduced incentives for investments (such as investments on innovation) that these errors induce, as such investments usually increase market power even though they could simultaneously increase consumer welfare. These considerations lead the authors to propose that the European norm for excessive prices should be one of *per se* legality – which they prefer to the alternative of "structured rule-of-reason". As they suggest, the

[40] Katsoulacos Y. and E. Metsiou (2005) "Excessive Prices in EU Competition Policy", mimeo, contains an account of the various cases.

costs of Type II errors – mistaken acquittal under a rule of *per se* legality – is likely to be much smaller than the cost of using a rule-of-reason for high prices plus the cost of errors of Type I (mistaken condemnation).

Circumstances that might justify retaining an "excessive prices" clause in Art. 82

If a *per se* legality norm were advocated, there would be no need for a distinct excessive prices clause in Art. 82. Three types of circumstances could potentially justify retaining such a clause.

1. The first set of circumstances concerns cases in non-R&D intensive sectors with Natural Monopoly characteristics and substantial entry barriers. Even though there may be none of what are usually considered "essential facilities" owned by the firm, such firms do possess substantial economies of scale, sunk costs in obtaining market from long experience, and 100% market shares. A good example of such a situation is provided by the recent case examined between 2001 and 2003 by the Hellenic Competition Authority regarding the company that administers the returns from the intellectual property rights of composers and songwriters. The decision that the monopoly company (AEPI) had charged an excessive commission, based on benchmarking, was overruled by the Court. The Court argued that there should have been a proper identification of the firm's costs and their relation to the commission charged. Such monopolies should be, however, controlled by government specialised regulatory bodies that are likely to have more and better information than Competition Authorities and that are in a much better position to monitor compliance. In other cases, in which the firms' exclusionary tactics create insurmountable entry barriers, competition authorities have the option of using structural remedies. Such remedies include disallowing joint ventures that block entry into a downstream market.
2. The second set of circumstances concerns cases in which a firm, usually a retailer, exploits a temporal or location-specific monopoly position over its customers by charging prices that are *obviously* excessive. This would be clear in the sense that it would be very easy to identify that they are multiples of the prices charged for exactly the same product under different circumstances – and where the difference in circumstances has no, or no substantial, influence on costs. An example is the case of selling bottles of mineral water in a passenger ship at prices three or four times the price that the same bottle is sold for in a kiosk outside the ship. Ad hoc administrative rules that prohibit these practices seem to be the best solution in such cases.
3. A final justification for potentially retaining an excessive prices clause would emerge if the "as-efficient" competitor test contained in the current Commission proposals for reform is retained in the final product. According to this test, the exclusion practices that lead to the exit of less efficient rivals are not abusive. The fundamental justification for such a test is that normal competitive behaviour, without any exclusionary intent, could also lead to the exit of less efficient rivals. Nevertheless, less efficient rivals do constrain the market power of dominant firms and their presence may well be beneficial

to consumer welfare. More specifically, consider the case in which a firm, following the exit of its rivals, raises its price not to the level of costs of the exiting firms but to the (much higher) monopoly level, anticipating no re-entry due to the presence of sunk re-entry costs. In this case, a potential prohibition of too high (excessive) prices following the exit of a rival (in the spirit of Baumol's predation test) may constrain the firm from acting in the manner described above. Indeed, in this case, we would favour that the excessive prices clause is retained under a structured rule-of-reason approach. We think however that this is not the ideal situation. In our view, it would be more appropriate to:

- Abandon the "as-efficient" competitor test when assessing exclusionary abuses and investigate under the proposed rule-of-reason of the Discussion Paper *the implications for consumer welfare of the exclusion of even less efficient rivals,* thus treating such exclusion also as potentially abusive, and
- Adopt a *per se* legality norm for excessive prices.

Such an approach would have the additional advantage of consistency. It would avoid the paradox that we mentioned at the beginning of this article, and would also avoid having to obtain additional reliable information to assess the efficiency of the firm under investigation. Such a task, *if* it were relatively easy to complete, would make it difficult to justify the (economists' usual) claim that it is difficult to judge what the "appropriate" prices (in an excessive prices case) are in the first place.

Excessive prices as a result of state intervention

Article 82 could be reformed so that it can also be used in cases where problems for effective competition, that are likely to result in excessive prices, are the result of state interventions (other than those cases addressed by State Aid rules). These state interventions do not aim to alleviate market failures but to increase or maintain political support. The removal of these interventions will reduce the regulatory burden and are likely to reduce prices and to increase welfare (e.g., in the case of removing regulations that create the so-called "closed professions").

Recent amendments in the competition law of some countries, such as Denmark, Russia and the newly acceded EU countries, provide examples of such situations. In these countries, the competition authorities are authorized to examine actions / practices by the state or state organizations that create problems for competition and potentially reduce welfare as the state were a private firm. Another example comes from Ireland, in which the Competition Authority investigated in 2004 whether there were excessive prices in the Irish food sector. It found that excessive prices were a problem, the root cause of which is the "Groceries Order" – a state ordinance for the protection of companies in the food sector – which costs Irish consumers 600 million euros each year, according to the Authority. The Authority has requested that the government retract the ordinance[41].

[41] See "Submission to the Minister for Enterprise, Trade and Employment on the Groceries Order" by the Authority – July 2005 (www.tca.ie)

Political Commission

By Tim Price and Hans Kribbe, GPlus Europe

Since the historic reunification of the European continent, public confidence in the European "project" is at an all-time low. Still reeling from the impact of the no-votes in France and The Netherlands against Europe's proposed constitution, the European Commission is in search of direction.

The Commission's free-market President José Manuel Durão Barroso has put competitiveness at the heart of his mandate. The Eurozone economy is slipping further behind the United States and in the first major tests of his resolve – liberalizing Europe's services industries – Barroso has been forced to stage a tactical retreat by a coalition of governments led by Jacques Chirac, the European Parliament, and special interests fearing the onset of unfettered capitalism.

The European Commission, including DG Competition, has to operate against a demanding political backdrop. The ideology and economic direction of the EU are still battlegrounds. Its central institutions, above all the Commission, have to steer a delicate course through this political maelstrom, buffeted by the competing pressures and priorities of the Member States, particularly the big ones. This can affect the way cases are handled internally by the Commission and should inform the way outside stakeholders approach the EU's competition authorities.

It is easy to assume that EU competition policy is cocooned from all this political manoeuvring. The rules are clear, case law abounds, the Commission's treaty powers are unassailable, and its formal obligation to consult and strike deals with EU member states – the point where its independence is most threatened – is minimal. It is, after all, a quasi-judicial system. Companies under the loop of the regulatory arm of the Commission need, above all, a strong, well-argued legal case, but this alone is not enough. Dealing with DG Competition requires a deep understanding of the broader context in which it acts. EU antitrust officials are adept at keeping the politics at bay, but the politics are there nonetheless.

Current Commissioner for Competition Neelie Kroes, a Dutch liberal, has compared her role to that of a football referee. But while a referee polices the match more or less on his own, the Competition Commissioner must listen to many different constituencies. This is as true inside the Commission as outside, and pressure upon the Commission does not always appear in the most transparent form. The very structure of the Commission contributes to this. It is a mixture of permanent and temporary officials, the latter either brought in for specific policy expertise or seconded from EU governments. Higher up the ladder, EU governments vie to place their preferred officials – often presumed loyal to their national positions – in key jobs. Though fixed national quotas for the top posts have been abolished, the Commission still has to balance out the interests of Berlin, Paris, London and other capitals when making key appointments.

Informal networks of national influence build up throughout Commission departments. DG Competition – though more resistant than most – is not immune to this tendency. For example, member states use their Permanent Representations – *de facto* embassies to the EU – to stay in close touch with their nationals working for the Commission. Despite their pretensions to the contrary, these "Perm Reps" seek to exert influence over DG Competition in the most politically sensitive cases. They are present for a formal part of the EU's decision-making process, so their access tends to be good.

DG Competition is also subject to regular pressure from other policy departments. Sometimes the motive is pure turf rivalry. As the number of Commissioners grows there are fewer real jobs to go round, and many are reluctant to cede ground to DG Competition, already one of the biggest beasts in the jungle. Charlie McCreevy, the Irish Internal Market Commissioner, now has a more or less formalized role as the EU's "shadow" Competition Commissioner in cases where Kroes needs to withdraw herself due to conflict of interest because of her past business affiliations.

Lobbying the Commission

Political influence is at its most visible and intense when policies and cases reach the Competition Commissioner for a final decision. Indeed, case-handlers tend to harden up their recommendations on the assumption their superiors will dilute them as their dossiers come under political scrutiny. By and large, support for Ms Kroes is strong and her 24 Commissioner colleagues tend to rally round her. Most competition decisions in this Commission are settled in advance by officials and then rubber-stamped as "A-points" by the full body of Commissioners, not least to present a unified face to the outside world.

But large, politically sensitive cases that cut to the core of a nation's industrial policy can provoke stormy debates and frantic down-to-the-wire lobbying, with Commissioners often reflecting national positions despite their official oath of independence. This is usually the case with state aid, but with diverging views across Europe of whether industrial champions should enjoy state protection, the current Commission also faces an upsurge of political in-fighting over mergers and acquisitions. There is another fundamental reason for other departments to take a close interest in the affairs of DG Competition. The latter increasingly uses its powers to *make* new policy rather than merely punishing corporate misbehaviour, curbing state subsidies, or vetting mega-mergers. This is the case in particular with unfinished parts of the EU's single market, where the removal of barriers through legislation has not always worked. The sector inquiry into energy, a bastion of state protection in many member countries, is a case in point. To stretch the football analogy, DG Competition and Neelie Kroes, rather than just refereeing the match from the middle, also are setting the rules of the game.

So there are many more forces at play than the classical hierarchy of case-handler, head of unit, director, cabinet (Commissioner's private office) and Commissioner. Legal and economic considerations come first, but even the lowliest official keeps one eye on the political repercussions of his or her work. Given the political forces weighing upon DG Competition, both within the Commission and without, it is a miracle that its policy is as independent as it is.

Much of the political pressure placed on DG Competition stems from its own success. As a result of its strong record and gladiatorial reputation, EU competition policy is treated like the crown jewels within the Commission, a body whose overall stature has been in decline since the mass resignation of Jacques Santer's team of Commissioners. At a time when the Commission is perceived to be losing power to the Council and to Parliament, it is only natural that it should play up its strengths.

This matters to companies and governments because it helps explain possible motives behind some of DG Competition's current initiatives. Going after cartels, for example, while wholly justified, is arguably an easy win: it is politically popular, makes good headlines and avoids the risk of one or other large member state feeling victimized and so riding to the defense of its national company. Likewise, consumer-friendly initiatives such as investigating excessive bank charges or launching a sector inquiry into payment card systems can help to "bring the EU closer to the citizen", another of this Commission's favourite mantras.

But recent efforts by governments to shield their national champions against foreign takeovers have put DG Competition under greater strain than ever before. In the energy market, a bid by Italy's Enel for France's Suez was warded off by state-run Gaz de France, which assumed the role of white knight. Spain has been trying to thwart a bid from Germany's E.on for its national champion Endesa.

In other markets, defensive strategies and rhetoric are also on the rise. Mittal Steel's bid for EU steel giant Arcelor triggered a spate of high-level political interventions from the French, Spanish and, in particular, the Luxemburg governments. The Polish Finance Ministry, in its turn, tried blocking Italian bank Unicredito from increasing its presence in Poland, whilst not so long ago the Governor of the Italian central bank, Antonio Fazio, stepped down over allegations of having used improper means to keep Banco Antonveneta in Italian hands. Last year, in a thinly veiled attack on the internal market, Franz Müntefering, now a senior Cabinet Minister in German Chancellor Angela Merkel's government, described hedge funds as "locusts", invoking images of foreign investors raiding healthy, German companies and leaving a scorched earth behind.

What is striking is the public way in which the Member States are challenging the foundations of the internal market and competition law. Having drawn up a list of *secteurs exclus*, the French government is openly touting its intention to protect its industrial champions against foreign threats. It is the frankness with which walls are raised around national markets that will be seen as a provocation in DG Competition and the Commission at large.

It must be a source of frustration for the DGs for Competition and the Internal Market that they are not always able to act forcefully against these provocations. While all protectionist measures contravene the spirit of the internal market, whether or not they actually break EU laws is invariably more mooted. There are no EU laws against enlisting national pension funds in the service of "economic patriotism", as France seems intent on doing. There are no EU laws against state-owned companies such as Gaz de France wooing Suez shareholders with a better bid. When Fazio stepped down, the Commission breathed a sigh of relief. For the reality was that, in the short term, it could have done little to bring the Italian central bank into line. To avoid such political embarrassment in the future, the EU is now reviewing the Banking directive.

This renaissance of economic nationalism partly finds its roots in the unfortunate history of the directive on takeover bids. When, after years of negotiation, the EU finally adopted this directive, it was decided – much against the Commission's wishes – that if Member States so chose, their companies should be allowed to use a wide range of defensive measures, such as poison pills and minority rights, without shareholder consent. The chickens have come home to roost. There is a mood that the internal market is in danger of moving backwards. But when companies, liberal governments and likeminded observers urge the Commission to clamp down on national obstructions, often it can do little more than "name and shame" and warn of the consequences.

Neelie Kroes did just that when she warned earlier this year of the risks of „taking Europe into a 1930s-style downward spiral of tit-for-tat protectionism." Charlie McCreevy has equally come out fighting. Stopping a slide into protectionism has become a decisive test of the Commission's strength. When the Commission feels weak, showing off its potency is the logical response. Outwardly, at least, the Commission must be seen to act. If it cannot always act as forcefully as it would like to against protectionism in one market, it will naturally tend to flex its muscle elsewhere. Businesses or sectors under investigation by DG Competition and other parts of the Commission must be aware that they risk becoming the victim of such compensation.

Reforms on the horizon?

The question is where and how the Commission will seek to reinforce its standing as Guardian of the Treaty. The Barroso Commission has seen a sharp drop in proposed internal market legislation. Coupled with a deregulation drive ordered by Barroso himself, the Commission is now tending towards a more active approach to policing the internal market and the competition rules that are already in place. Litigation is rapidly becoming as important a tool as legislation. While this pattern has been evolving for some years, it will intensify and mature under Kroes, who believes competition policy should also serve the EU's broader economic reform agenda.

Apart from standard individual investigations, one instrument she picked early to achieve this goal is "sector inquiries". Though in existence for over 30 years, it was dusted down and has been applied to some of the sternest pockets of resistance against the internal market: energy and the financial services.

Of all the measures targeted in Jacques Delors' 1992 Internal Market White Paper, energy has proved among the most resistant to change. Attempts to liberalize energy have succeeded in some countries but failed in others. Energy policy has developed into a key EU battleground and is rapidly moving into the realm of "high politics". With increased concern over EU dependency on Russian gas supplies, Kroes and her colleague at DG Energy Andris Piebalgs will need all their political guile to push liberalization further.

For sector inquiries into financial services, the stakes are equally high. With Charlie McCreevy's frequent and well-publicized calls for banking sector reform, freeing up financial services looks like something this Commission wants to be remembered for. Removing obstacles to cross-border consolidation in the financial services market has been a long-held political aim. DGs Competition and Internal Market (which handles financial services regulation) look set to work together in order to remove these barriers, with insurance and payment cards also singled out for special scrutiny.

Above all, these sectors were chosen because removing market barriers through legislation alone was less effective than originally hoped. Following the adoption of the Financial Services Action Plan (FSAP), which contains over 40 legislative proposals, the Commission has acknowledged that the financial services industry suffers from regulatory exhaustion. However, after the no-votes against the Constitution, the Commission is also keen to generate visible EU benefits to the citizen. Cards and banks are also high on the Commission's agenda for that reason. Promising lower prices for payment cards is an easy sell. The inquiry further connects with legislative plans for the creation of an internal market for payments (SEPA), allowing consumers to use cards abroad as if they were at home.

The results of the sector inquiries will become clearer in the course of this year. The greatest threat the Commission faces may be one of exaggerated expectations. The inquiries were widely publicized in advance of their commencement, and expectations are running high. Many assume, egged on by the media, that underlying cartels and corporate skulduggery will be unearthed. DG Competition and Kroes herself must feel under pressure to produce tangible results – rather than just progress reports – within her mandate. This will be hard, given the breadth of the brief and the lack of resources allocated to the inquiries.

Finally, while litigation is becoming an increasingly important policy instrument, playing to the hands of citizens is a tactic that may again whet the Commission's appetite for more *ex ante* legislation. One example of this is international roaming. The Commission's proposal to force the telecom industry to bring charges for international roaming in line with those for national roaming show that when the pressure to produce concrete results is high enough, the Commission has no apparent difficulty in brushing aside hesitations about employing the more heavy-handed instruments it has at its disposal.

Filling out a Form CO, replying to requests for information, or staring down the barrel of a Statement of Objections may seem disconnected from the sectoral actions described above, but in this new world of cooperation, in which DG Competition works closely with other departments and supports the EU's broader strategy of competitiveness, every contact with the Commission could potentially have a bearing on the next deal or investigation. Such contact is best made early, and in peacetime.

The Commission has a long and effective institutional memory, officials are in regular touch with each other and word can travel quickly. With all Commissioners and their staff housed back in a single building, there is more scope for a company's reputation, good or bad, to spread across the whole institution. This can affect attitudes towards parties in individual competition cases.

Yet many companies, particularly those of U.S. origin, wrongly assume that DG Competition is quick to sharpen its knives. In reality, DG Competition is more defensive than ever before. It has suffered a string of defeats in the European Court of Justice and is anxious to make its decisions now safe from appeals. This explains why DG Comp can seem slow, cautious, and pedantic, as well as a stickler for procedures, much to the distress of businesses that crave quick decisions.

DG Competition seeks more than ever before to engage with the private sector so that decisions can be reached amicably if possible, and if not, then with minimum interference in the market or fuss in the media. It strives, of course, to maintain tactical advantage throughout a negotiation, not least with the protracted threat of a Statement of Objections. And, yes, it does leak to the press for tactical purposes, but leaks are more often the result of a case-handler's vanity, a squabble between Commissioners, or some deft footwork by Brussels' diligent pack of competition journalists. With a few isolated exceptions, DG Competition is not out to get individual companies.

This has important consequences for how businesses communicate in Brussels, either alone, in a trade association or in loose coalition with others. And if a company finds that its EU "narrative", to use the jargon of public affairs, is different during a competition case to how it is during everyday relations with the Brussels regulators, then the company will find itself exposed.

DG Competition is more cautious, less headstrong, less reckless even, than in the late 1980s and 1990s. It is also less isolated and more mainstream. But its task is more arduous given just how much European integration – and the Commission's role as driver of that process – has fallen out of fashion in even the EU's founding member states. If an applicant thinks DG Competition has misunderstood its market and is threatening its bottom line, that company should fight it tooth and nail. But it should do so behind closed doors and without questioning it's the authority's right to regulate the business. Above all, adopt a manner and language that shows appreciation of the difficulties faced by DG Comp and support for its central aim of making Europe more competitive. Love the EU's trustbusters or hate them, the goal of doing business in an open European market would be a lot less achievable without them.

Intellectual Property and Competition

By André Heitz, Director, World Intellectual Property Organization (WIPO)

In December 2005, the European Commission's Competition Directorate-General launched a public consultation on the application of Article 82 of the Treaty to exclusionary abuses. The Discussion Paper defines exclusionary abuses as "behaviours by dominant firms which are likely to have a foreclosure effect on the market, i.e. which are likely to completely or partially deny profitable expansion in or access to a market to actual or potential competitors and which ultimately harm consumers". It makes a number of references to intellectual property and includes a section (9.2.2.6) devoted to the refusal to license intellectual property rights.

One month later, the Directorate-General for Internal Market and Services launched a public consultation on future patent policy in Europe. Views were sought "on the patent system in Europe, and what changes if any are needed to improve innovation and competitiveness, growth and employment in the knowledge-based economy". Stakeholders have also been invited to comment on the first evaluation report of Directive 96/9/EC on the legal protection of databases. Furthermore, the recasting of copyright has been slated as one of the policy priorities for 2006, a consultation that took place in the second half of 2004 having shown that copyright was at a crossroad.

Other Directorate-Generals also have a stake in these issues. Thus, DG Information Society has just completed a consultation on the "i2010 Digital Libraries Initiative", with copyright issues ending up high on the to-do list. The latest consultation is by DG Research on Europe's scientific publication system; again, copyright is likely to be at centre stage.

This wealth of initiatives, which does nothing other than reflect the increasing role played by intellectual property in society, makes a description of the true nature and effects of intellectual property quite timely.

The Monopoly Myth

Conventional wisdom says that "intellectual property right equal's monopoly" and, of course, "monopoly equals evil". The carefully crafted DG Competition Working Paper has to some extent succumbed to that theory, as it notes, in paragraph 245, that: "Often patents or know-how will allow the supplier of the primary product to have a monopolistic position on the aftermarket." This, at worst, is a *lapsus calami*.

Even renowned economists take this equation as a springboard for doctrine. A recent occurrence (summer of 2005) is, for instance, the article by Joseph Stiglitz, widely published in South-East Asia, on "Intellectual-Property Rights and Wrongs": "…an intellectual property regime rewards innovators by creating a temporary monopoly power, allowing them to charge far higher prices than they could if there were competition. In the process, ideas are disseminated and used less than they would be otherwise". We can easily kill the argument of "far higher prices": first, in the case of patents, it does not work at all where the invention concerns a process. In the case of product patents, it only works in very special circumstances, particularly when there is no alternative to the product.

The Lessons of History

Whether we can truly learn from history is a subject that would warrant a debate on its own: today's information and knowledge society can hardly be compared with the pre-industrial or even the industrial societies. It is nevertheless noteworthy that both the copyright and the patent systems have a utilitarian origin. The Statute of Anne, deemed to be the first copyright law (1710), was an "Act for the Encouragement of Learning...". It produced a monopoly, the monopoly granted to the Worshipful Company of Stationers and Newspaper Makers, in effect a printers' guild, in 1556 during the reign of Mary I, which was renewed several times. Obviously, the renewal had a price tag attached to it, so the Statute of Anne was also an important contribution to freedom of speech.

The 1474 Decree of the Republic of Venice, the ancestor of patent laws if we disregard a forerunner from the ancient Greek colony Sybaris, clearly was an instrument to attract foreign innovators – today, we would say it was an instrument to promote the transfer of technology. By requiring that inventive devices, once put into practice, had to be communicated to the Republic in order to obtain legal protection against potential infringers, the Statute also sought to break the monopoly maintained by the guilds on technical knowledge. Back in England, the 1623 Statute of Monopolies – a patent law, despite what its name suggests – was enacted to explicitly limit the power of the Crown to grant monopolies. Parliament decided that the King could only issue letters patents to the inventors or introducers of original inventions for 14 years. Interestingly, this remaining power was again restricted: "...provided that: ...they be not contrary to the law nor mischievous to the state by raising prices of commodities at home, or hurt of trade, or generally inconvenient".

Patents Promote Competition

It should be a matter of great concern to policy-makers that mainstream economic theory and a large segment of public opinion shapers view intellectual property with suspicion, to say the least. Yet, empirical evidence shows that intellectual property is a power tool for social, cultural and economic development. We have not been effective in communication, and this is a major challenge. Intellectual property is also a power tool for competition in many ways. We shall illustrate this on the basis of the patent.

Legal theory postulates that the patent is a social contract: the inventor receives an exclusive right – in fact, a right to exclude – in exchange for the public disclosure of the invention. This dry statement has become the following on a Libertarian website: "The point of patents is not to protect the patent-holders; it is to allow the rest of us to read the patents, adding to our collective knowledge base. The protection provided is a carrot. Nothing more....". What is the effect? First, patent information will always be much more detailed than commercial flyers or scientific publications (and better accessible, intellectually speaking, than the latter). Second, patents are classified and indexed. You want to know about horseshoes? Go and look for IPC Class A01L5/00 ("shoeing of animals") on Espacenet, the European Patent Office's database! Third, patents not only disclose the invention ("in a manner sufficiently clear and complete for it to be carried out by a person skilled in the art", article 83 of the European Patent Convention), but also identify the originators and holders of the relevant knowledge and know-how. Fourth, patent applications are frequently published at a time when the invention has not yet been translated into a commercial product or process. You want to know what your competitor is up to, what development is in the pipeline (particularly in a fast-developing area such as biotechnology or the ICTs), what opportunity to buy into an emerging market there is. Look it up in the patents database! On top of this, with the Internet, patents are now physically accessible with a few mouse clicks.

Critics of the patent system frequently refer to Sir Isaac Newton, "If I have seen further, it is by standing on the shoulders of giants", suggesting that patents would prevent this or slow it down. The suggestion is far from true: patents are a record that there is or was a giant, and they tell you on which giants' shoulders to climb. Patents are thus the vehicle for a culture of open access to, and open exchange of, knowledge that fosters innovation, and consequently competition, by scrapping the price of inventing anew and other costs.

The patent provides a technical teaching (the famous *Lehre zum technischen Handeln* of German case law), experts say. It tells us how to do something and, more importantly, invites inventive minds and competitors to look for a way to do it better. Competition law basically endeavors to prevent exclusionary abuses and, if need be, sanction them (possibly at a cost to consumers); patent law, in contrast, endeavors to stimulate competition through innovation. One is rather static, the other dynamic. Ironically, the pro-competitive power of intellectual property is by far superior to that of the law that has "competition" in its title. In an economic environment in which the challenge is not "competition", but "competitiveness", this is an essential finding.

The DG Competition Discussion Paper, and rightly so, makes ample use of the potential new entrant as an indicator of the existence or non-existence of an exclusionary abuse. Opponents of intellectual property would argue that patents stand in the way of new entrants because of their very nature as a monopoly; critics might refer to such things as "patent thickets" or the "tragedy of the anti-commons". Though there is no denial that there are abuses, the empirical evidence is that patents allow the emergence of new entrants. What does an innovative start-up have except its intellectual property? How would it attract capital? Some of the giant companies that are today the subject of an investigation by the competition authorities started as garage ventures and grew through the strategic use of their own and others' intellectual property.

The other side of the coin is that those who have been sitting on their intellectual capital have withered and in some cases died. We should not leave this subject at just two examples from the patent field. The DG Competition Discussion Paper notes that: "Products are differentiated when they differ in the eyes of consumers for instance due to brand image, product features, product quality, level of service or the location of the seller". What is the single most effective identifier (or "differentiator")? The trade mark. "Effective competition" – the Discussion Paper also says – "brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation". Effective intellectual property measures can bring the same benefits.

Intellectual Property Law Includes Competition Policy Provisions

Effective intellectual property does even more in the field of competition. First, there is a frequently overlooked provision in the Paris Convention for the Protection of Industrial Property (169 Member States), namely Article 10bis: "The countries of the Union are bound to assure to nationals of such countries effective protection against unfair competition". This has given rise to an extensive body of case law. The case law on intellectual property rights also provides guidance on competition. For instance, Case C-228/03 (The Gillette Company, Gillette Group Finland Oy v. LA-Laboratories Ltd Oy) is indexed under Approximation of Laws, with Trade Marks as the leading keyword. Yet, an essential part of the ruling is that: "The condition of 'honest use' within the meaning of Article 6(1)(c) of Directive 89/104, constitutes in substance the expression of a duty to act fairly in relation to the legitimate interests of the trade mark owner". This is followed by some examples of use of the trade mark that would not be in accordance with honest practices in industrial and commercial matters. This, in effect, is defining fair competition and, in the final analysis, promoting competition.

Second, all branches of intellectual property include exceptions and limitations. For instance, the exception from patent protection for "acts done for experimental purposes relating to the subject-matter of the patented invention" (proposed Regulation on the Community Patent, which reproduces existing rules) creates a *de facto* prohibition on contractual clauses that would seek to forbid or restrict research. Absent a patent, there is no legal basis for such a prohibition. Exhaustion – the principle that, once a product is put on the market, the owner of the right that attaches to it cannot assert that right to oppose certain acts of exploitation (such as the resale of a copyrighted work) – may also act as a strong promoter of competition when it is international or regional. A related buzzword in the European Union is "parallel imports".

Third, all branches of intellectual property include remedies for cases in which the unfettered exercise of the right would defeat the social and economic purpose of the law, and also provide sanctions in cases of abuse. The compulsory license is no doubt the most important remedy and sanction. Article 21.1 of the above-mentioned proposed Regulation, for instance, is very sharp: "The Community Patent Court may grant a compulsory license for lack or insufficiency of exploitation of a Community patent... if the patent proprietor has not exploited the patent in the Community on reasonable terms or has not made effective and serious preparations to do so, unless he provides legitimate reasons to justify his inaction".

Intellectual Property and Competition Law Are Complementary

According to conventional wisdom, competition law seeks to maximize social welfare by condemning monopolies and intellectual property law by condoning (time-limited) monopolies. We have seen above that this view is defective as regards the second part of the proposition. Granted, intellectual property rights sometimes enable, on their own or more frequently as one element of a toolkit, their owner to acquire an abusive dominant position. Competition law provides a remedy. There is, however, a significant drawback: antitrust proceedings are the heavy gun, which can only be put to action if a market analysis shows *prima facie* that some corrective measures are warranted. Defining the market and the nature and extent of the damage arising from the alleged dominant position is a key issue in this regard.

Intellectual property also provides remedies of a different nature, such as the compulsory license, mentioned above. Furthermore, certain jurisdictions apply the misuse doctrine and will not allow an infringement complaint by a rights holder unless the misuse has been "purged". Certain practices of rights holders may be held sufficiently anticompetitive to constitute misuse, even though the practices would not result in antitrust liability. To put this into a practical perspective, intellectual property law can – the word "can" is important – be applied to regulate, or police, or guide an emerging "innovation market", already at an early stage. That market is probably beyond reach for competition law.

The Bigger Stake: "Honest Practices in Industrial and Commercial Matters"

It all boils down to "honest practices in industrial and commercial matters" to use the language of the Gillette decision. The estimates of international trade in counterfeit and pirated goods lie between 5 and 10%, with 7 being articulated most frequently. No matter which figure is correct, those numbers are too high. There is no great need to set out the devastating consequences of this shadow economy on public health and security, on the very fabric of our societies, etc.

The events of September 11, 2001 changed the face of the world. According to the 9/11 Commission Report, more than 2,600 people died at the World Trade Center. A fake meningitis vaccine distributed in Niger in 1995 is estimated by the World Health Organization to have claimed 2,500 lives. These incidents are just the tip of one iceberg. Fake drugs alone cause several silent 9/11 a day. Fake, under-dosed drugs are also an efficient tool, so to speak, to select an infectious agent that is resistant to them. Thus, the problem threatens all of us.

Enforcing "honest practices in industrial and commercial matters" has become a crucial objective. Such practices can only be based on effective intellectual property rights. What does "effective" mean? It means the kind of rights that are necessary to fulfill the social role assigned to them. Nothing more, nothing less. The enforcement of intellectual property rights is frequently seen as a favour to the small class of intellectual property owners, the "fat cats". The true picture is that those owners are – and must be much more – harnessed in support of an endeavor of public policy and public interest. Ironically, the owners of those rights may have been called upon to shoulder the full cost of acquisition and maintenance of the rights.

The Challenges from the Information and Knowledge Economy

Both the competition and the intellectual property laws in Europe are, to a large extent, based on the circumstances of the Common Market under construction. The European Patent Convention is an illustration: it was adopted in 1973. They have evolved through amending legislation, case law and practice to accommodate new technological and economic circumstances. It is fair to say that, in this age when we seek "champions", be they large companies or small or medium-size enterprises with a leading edge in their domain, the limits have been pushed back both in terms of admissible dominant position and of acquisition and exercise of intellectual property rights. There is no fatality in this. The proposed spare parts Directive illustrates the capacity of policy-makers to wind some systems back; many consider that the rejection of the proposed Directive on the patentability of computer-implemented inventions has put a halt to an ever-increasing expansion of intellectual property at the expense of other rights and interests. Through the facilitation of the Internet, the patent and copyright systems have come under the spotlight, more precisely the real or perceived shortcomings and failures. Communication probably is the greatest challenge. Horror stories always sell better! And for some critics of the system, there is nothing objectionable in reporting one day that giants are strangling ordinary people and the next day that "patent trolls" are tying down Gullivers.

The challenge is compounded by the fact that intellectual property, as a constraint, has become a subject of direct relevance to citizens and consumers, whilst, in the past, it only affected them marginally. Technically and economically, vinyl taping and file transfer are two worlds apart. The solutions found to accommodate the former in copyright terms are no longer relevant. The debates in the French *Assemblée Nationale* on the draft law transposing the Directive on the harmonization of certain aspects of copyright and related rights in the information society (2001/29/EC) cast doubts as to the – at least political – relevance of the latter.

Concluding Remark: the European Union's Law-making Process

Law-making is a matter of delicate balance in terms of timing: should it arrive too early, a regulatory text might miss important elements of the emerging situation to be regulated, or influence the evolution in an undesired way; if it arrives too late, it might have been overtaken by uncontrolled and unforeseen developments. There is no doubt that the system of European Directives followed by national transposition is cumbersome, slow and somewhat unreliable, as shown by the recent events in France (or the unfinished work on the Directive on the Legal Protection of Biotechnological Inventions). The problem is particularly pressing in the case of copyright and the information society: the protection enjoyed by creators – and by users as a result of the promotion of creativity – will only be as strong as the weakest national link.

The problem must also be considered from two other angles. First, intellectual property, once a subject left to specialists, has entered the boardroom; once a tool in support of social, cultural and economic development, it is also becoming a good on its own. Second, the demand-driven economy is progressively giving way to an intellectual property-driven economy. The foundation of the "one-issue" Piratpartiet in Sweden and the recent events in France should be taken as a signal: intellectual property will soon govern choices at the polls. Intellectual property and competition are friends. Intellectual property and competitiveness are great friends. Competitiveness is growth and jobs. The greatest challenge is to make it known and accepted that stealing from a creator is stealing from oneself; that honoring the contribution of today's creator is building one's own future.

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