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DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses

Public consultation

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This document is a DG Competition discussion paper and has no enforcement status.

[NB: This document has been annotated by Val Korah, with additional headings centered and in italics. Some phrases within a paragraph are in italics to help readers find what they are seeking. I am indebted to my friend, David Michnal, for skilled help in preparing the annotations. He is not responsible for remaining errors.]

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DG COMPETITION DISCUSSION PAPER ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO EXCLUSIONARY ABUSES

1. INTRODUCTION

Possible principles for Commission's application of Article 82 to exclusionary abuse

1. This discussion paper sets out *possible principles for the Commission's application of Article 82 of the Treaty to exclusionary abuses. By exclusionary abuses are meant 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.* Foreclosure may discourage entry or expansion of rivals or encourage their exit. The paper is structured in the following way:

- Section 2 (paragraphs 8 to 10) describes the relationship between Article 82 of the Treaty with other provisions;
- Section 3 (paragraphs 11 to 19) addresses market definition issues;
- Section 4 (paragraphs 20 to 50) describes the principles used for finding a dominant position;
- Section 5 (paragraphs 51 to 92) describes the general framework for the analysis of exclusionary abuses;
- Sections 6 to 9 (paragraphs 93 to 242) describe the application of this general framework to a number of exclusionary abuses;
- Section 10 (paragraphs 243 to 265) describes the approach to the analysis of aftermarkets.

Possible analytical approach of Commission Factual context

2. While this paper *presents the analytical approach that could be used by the Commission*, it cannot provide details of all possible applications of this approach. The approach described in this paper, if applied by the Commission, would have to be *applied taking into account the particular facts and circumstances of each case*.

Wide variety of abuses – DP not exhaustive

3. *A wide variety of practices may be abusive if carried out by an undertaking in a dominant position*. The discussion paper is not exhaustive in the sense that *not all possible abusive practices are described*. The most important categories of *practices not covered at this stage are exploitative and discriminatory practices*.

Objective of Article 82: Protection of consumer welfare, efficient allocation of resources

4. With regard to exclusionary abuses the objective 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*. *Effective competition brings benefits to consumers*, such as low prices, high quality products, a wide selection of goods and services, and innovation. *Competition and market integration serve these ends* since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumers. In applying Article 82, the Commission will adopt *an approach which is based on the likely effects on the market*.¹

Commission's evolving case law on Article 82 and judgments of ECJ and CFI

5. This paper draws and elaborates on the Commission's evolving experience with the application of Article 82 as well as on the case-law of the Court of Justice and the Court of First Instance of the European Communities.

Without prejudice to Commission notices, past or future

¹ See section 5 below.

6. The approach to Article 82 discussed in the present paper is without prejudice to the approach which the Commission has described or will describe in notices on how to apply the Community competition rules to specific sectors.²

DP does not create legitimate interest

7. Being a discussion paper this paper cannot create any legitimate interest *nor can it be relied upon to provide guidance to current Commission enforcement policy*. While the discussion paper sets out possible principles for the Commission's application of Article 82 of the Treaty to exclusionary abuses, it is in good parts drafted in the style of guidelines in order to avoid too much conditional phrasing and enhance its readability. Lastly, any possible Commission's interpretation of Article 82 is without prejudice to the interpretation that may be given by the Court of Justice or the Court of First Instance of the European Communities.

2. RELATIONSHIP OF ARTICLE 82 WITH OTHER PROVISIONS³

Aim of Articles 81 & 82 is to maintain effective competition on the market - They can be applied simultaneously, but efficiency may save Domco

8. *Articles 81 and 82 of the Treaty both pursue, with regard to exclusionary practices, the aim of maintaining effective competition on the market and, according to settled case law, can be applied simultaneously.*⁴ Consistency requires that *Article 81(3) be interpreted as precluding any application of this provision to restrictive agreements that constitute an abuse of a dominant position*. However, *a company holding a dominant position may also benefit from an exemption under Article 81(3) of the EC Treaty when its conditions are fulfilled.*⁵ Therefore, *if the conduct*

² See, for instance, Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services, OJ C 39, 06.02.1998, pp. 2-18, and Notice on the application of competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles (“Access Notice”) OJ C 265, 22.08.1998, pp. 2-28.

³ See also Commission Notice Guidelines on the application of Article 81(3) of the Treaty, OJ C 101, 27.04.2004, pp. 97-118, paragraph 106.

⁴ See Joined cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports SA, Compagnie maritime belge SA and Dafra-Lines A/S v Commission* [2000] ECR I-1365, paragraph 33.

⁵ See Commission Notice Guidelines on the application of Article 81(3) of the Treaty, cited in footnote 3, paragraph 106. See in this respect also Case 27/76 *United Brands Company and United Brands Continentaal BV v Commission* [1978] ECR 207, paragraph 113; Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] ECR 461, paragraphs 39 and 90; Case T-51/89 *Tetra Pak Rausing SA v Commission (Tetra Pak I)*, [1990] ECR

*of a dominant company generates efficiencies and provided that all the other conditions of Article 81(3) are satisfied (see below section 5.3.3), such conduct should not be classified as an abuse under Article 82 of the EC Treaty.*⁶

Article 82 in combination with Article 86

9. Article 82 may be infringed by conduct of public undertakings or undertakings to which Member States have granted special or exclusive rights.⁷ Article 82 in combination with Article 86 may also be infringed *where a Member State adopts or maintains in force measures, which create a situation in which such undertakings are led to, or cannot avoid, abusing their dominant position.*⁸ The conditions of applying Article 82 to such abuses and the conditions for their justifications are laid down in Article 86 EC. Due to the specificity of Article 86 and its conditions, the application of Article 82 in conjunction with Article 86 *remains outside the scope of the present discussion paper.*

MS to take all appropriate measures to ensure that Treat obligations fulfilled

10. Article 10 of the Treaty obliges Member States to take all appropriate measures to ensure fulfilment of the obligations arising out of the Treaty. This article, which imposes on the Member States a duty to cooperate, read in conjunction with Articles 81 EC and 82 EC, *requires the Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings.*⁹ *These specific situations will not be addressed in the present discussion paper, either.*

II-309, in particular paragraph 28, and Joined Cases T- 191/98, T-212/98 to T-214/98, *Atlantic Container Line AB and Others v Commission* [2003] ECR II- 3275, paragraph 1456.

⁶ See Case T-193/02, *Laurent Piau v Commission* (26 January 2005), not yet reported, paragraph 119.

⁷ See for example Case 127/73 *Belgische Radio en Televisie v SV SABAM and NV Fonior (BRT II)* [1974] ECR 313; Case 41/83 *Italian Republic v Commission of the* [1985] ECR 873; Case C-393/92 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij* [1994] ECR I-1477.

⁸ Case C-18/88 *Régie des télégraphes et des téléphones v GB-Inno-BM SA* [1991] ECR I-5941, paragraph 20; Case C-41/90, *Klaus Höfner and Fritz Elser v Macrotron GmbH* [1991] ECR I-1979, paragraphs 26-29, Case C-242/95 *GT-Link A/S v De Danske Statsbaner* [1997] ECR I-4449, paragraph 33; Case C-203/96 *Chemische Afvalstoffen Dusseldorp BV and Others v Minister van Volkshuisvesting, Ruimtelijke Ordening en Milieubeheer* [1998] ECR I-4075, paragraph 61; Case C-340/99, *TNT Traco SpA v Poste Italiane SpA and Others* [2001] ECR I-4109 paragraph 44.

⁹ See Case C-18/88 *GB-Inno-BM*, cited in footnote 8, paragraph 31; Case 267/86 *Pascal Van Eycke v ASPA NV* [1988] ECR 4769, paragraph 16; Case C-185/91 *Bundesanstalt für den Güterfernverkehr v Gebrüder Reiff GmbH & Co. KG* [1993] ECR I-5801, paragraph 14; Case C-153/93 *Bundesrepublik Deutschland v Delta*

3. MARKET DEFINITION IN ARTICLE 82 CASES

Market Definition

11. The concept of dominance contained in Article 82 of the Treaty relates to a *position of economic strength on a market*. In the application of Article 82 it is therefore *necessary to define a relevant market*. The relevant market provides a framework for analysing whether the undertaking concerned holds a dominant position and, therefore, whether its conduct may be abusive within the meaning of Article 82.¹⁰

Main purpose of market definition

12. The main purpose of market definition is to identify in a systematic way the immediate competitive constraints faced by an undertaking. The objective of defining a market in *both its product and geographic dimension is to identify all actual competitors of the undertaking concerned that are capable of constraining its behaviour*. Guidance on this issue can be found in the *Commission Notice on the definition of the relevant market for the purposes of Community competition law*.¹¹ That Notice will not be further explained in this paper and should serve as the basis for market definition issues also for the application of Article 82.

Cellophane Fallacy

13. This paper does, however, provide additional guidance with respect to one specific market definition issue that may arise in the context of Article 82 cases¹²: the price charged by the allegedly dominant undertaking – if it is indeed dominant – will almost inevitably have been raised above the competitive level. Unless appropriately accounted for, this can lead to markets

Schiffahrts- und Speditionsgesellschaft mbH [1994] ECR I-2509, paragraph 14; Case C-96/94 Centro Servizi Spediporto Srl v Spedizioni Marittima del Golfo Srl [1995] ECR I-2883, paragraph 20; Case C-35/99 Arduino [2002] ECR I-1529, paragraph 34; and Case C- 198/01 Consorzio Industrie Fiammiferi (CIF) v Autorità Garante della Concorrenza e del Mercato [2003] ECR I-8055, paragraph 45.

¹⁰ See Case T-62/98 Volkswagen AG v Commission [2000] ECR II-2707, paragraph 230.

¹¹ OJ C 372, 09.12.1997, p. 5.

Aftermarket cases

¹² Issues relating to market definition in aftermarket cases are discussed in section 10.

Elasticity of demand

being defined too widely.¹³ *This problem relates to the so-called SSNIP test and the “cellophane fallacy”¹⁴, which are both described in more detail below. The existence of the cellophane fallacy implies that market definition in Article 82 cases needs to be particularly carefully considered and that any single method of market definition, including in particular the SSNIP-test, is likely to be inadequate. It is necessary to rely on a variety of methods for checking the robustness of possible alternative market definitions.¹⁵*

Small but Significant Non-transitory Increase in Price

14. Under the SSNIP-test, which in particular in merger cases constitutes a central part of the Commission’s approach to market definition, it is asked *whether the customers of the undertaking(s) concerned would switch to readily available substitutes or to suppliers located elsewhere to such an extent that it would be unprofitable to implement a small but significant (normally in the range 5%-10%), non-transitory increase in relative prices for the products and the areas being considered.* If answered in the affirmative, additional substitutes and areas are added to the relevant market until such a price increase would be profitable. At that point, a hypothetical single seller of the now included products and within the now included areas would be able to profitably raise prices by 5%-10%, signifying that the products and areas in question constitute a market that is worth monopolising. As a consequence thereof it constitutes an appropriate framework for competition analysis.

SSNIP test based on prevailing prices not competitive price

15. It is essential to take account of the fact that the SSNIP-test normally is based on the assumption that prevailing prices constitute the appropriate benchmark for the analysis. This assumption often does not hold in Article 82 cases. The very notion of dominance involves an assessment of whether or not the undertaking in question is subject to effective competitive constraints. The appropriate benchmark for this assessment is the competitive price, which may not be the prevailing price. Indeed, the prevailing price may already have been substantially

¹³ It is assumed that undertakings seek to maximise their profits. As long as the demand facing the undertaking is relatively inelastic, it has an incentive to increase prices.

Cellophane Case

¹⁴ This problem has received its name from a United States case involving a producer of cellophane, United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 76 S.Ct 994 (1956).

¹⁵ See paragraph 25 of the Commission Notice on the definition of the relevant market cited in footnote 11.

increased, a fact which must be taken into account.¹⁶ Otherwise, the market could be defined too widely, as it might include products or geographic areas, which only impose a competitive constraint due to the fact that prices have already been elevated above competitive levels. The failure to take account of this reality is normally referred to as the cellophane fallacy.

SSNIP test useful but not exhaustive

16. The SSNIP-test at prevailing prices remains useful in the sense that it is indicative of substitution patterns at such prices. Products and areas that can be excluded from the relevant market at prevailing prices would also be excluded at any lower competitive price. However, additional tools are required to *check whether the market has been defined too widely so as to include false substitutes*. One method of checking for false substitution patterns would involve reconstructing the competitive price, i.e. to estimate the competitive price and use that price for the purposes of applying the SSNIP-test. However, in most cases it is not possible to reconstruct the competitive price with the requisite degree of accuracy. *As a correct application of the SSNIP-test also involves some knowledge of the demand curve at the competitive price, this method is rather difficult to apply in practice.*

SSNIP test useful in markets with no Domco

17. Article 82 cases may also involve markets in which there is no dominant company. For instance, the problem being investigated could be claims that an allegedly dominant company “leverages” its market power from one market into another market. In this second market, the SSNIP test may be more readily applicable, as there may be no reason to suspect that the prices in that market are already above competitive levels.

“Characteristics and intended use of product concerned”

18. Another approach is to examine the *characteristics and intended use of the products*¹⁷ concerned and to assess whether they are capable of satisfying an inelastic consumer need.¹⁸ It is thus examined whether the characteristics of the products and their intended use are such that

¹⁶ See paragraph 19 of the Commission Notice on the definition of the relevant market cited in footnote 11.

¹⁷ The term “product” as used in this paper encompasses both goods and services.

¹⁸ See Case 6/72, Europemballage Corporation and Continental Can Company Inc. v Commission [1973] ECR 215, paragraph 32, and Case T-30/89 Hilti AG v Commission [1991] ECR II-1439, paragraph 64.

they differentiate the products in question from other products to such an extent that they are only to a small degree interchangeable with such other products and therefore not effectively constrained by them at competitive prices.¹⁹ In making this assessment regard must in particular be had to the needs of marginal consumers. In most cases it is not decisive that a certain group of consumers does not consider the products in question to be good substitutes. What matters is that *a sufficiently large number of consumers do consider that a product is a good substitute for the product supplied by the undertaking concerned*. If so, the two products form part of the same market, unless a single supplier of the product in question would be able to sell to consumers with less elastic demand at a higher price and prevent consumers with more elastic demand from reselling to the former group of consumers. In that case the group of consumers with less elastic demand may be in a market of their own.²⁰

Geographic Market

19. It may also be relevant to compare prices across various regions. This may in the first place be helpful to determine the geographic market, but may also be useful in determining the product market. If an undertaking supplies a product in several regions and charges higher prices in regions where it has a higher share of sales of that type of product, it is an indication that the main competitive constraint comes from other suppliers of that type of product and not from suppliers of other types of products. Even if the undertaking in question does not itself supply its product in different regions, a similar analysis may be possible if the same type of product is sold in other regions by other undertakings. *Price comparisons across regions* should, however, take into account whether there *are other factors differing between the regions* than the intensity of competition.

4. DOMINANCE

4.1 INTRODUCTION

¹⁹ See in this respect Case T-86/95, *Compagnie générale maritime and Others v Commission* [2002] ECR-1011, paragraph 48, and Case 27/76 *United Brands*, cited in footnote 5, paragraph 12, Case 66/86, *Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V* [1989] ECR 803, paragraphs 39 and 40.

²⁰ See paragraph 43 of the Commission Notice on the definition of the relevant market cited in footnote 11.

Definition of Dominance

20. According to settled case law, dominance is 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*.²¹ Dominance can exist on the part of one undertaking (*single dominance*) or two or more undertakings (*collective dominance*).²² In the case of collective dominance the undertakings concerned must, *from an economic point of view, present themselves or act together on a particular market as a collective entity*.²³

Three Elements

21. This definition of dominance consists of three elements, two of which are closely linked: (a) *there must be a position of economic strength on a market which* (b) *enables the undertaking(s) in question to prevent effective competition being maintained on that market by* (c) *affording it the power to behave independently to an appreciable extent*.

1. Dominance must relate to a market

22. The first element implies that *dominance exists in relation to a market. It cannot exist in the abstract*.²⁴ It also implies that an undertaking either on its own or together with other undertakings *must hold a leading position on that market* compared to its rivals.

2. Ability to exclude and 3. Independence from other players – market power

23. The second and third elements concern the link between the position of economic strength held by the undertaking concerned and the competitive process, i.e. the way in which the undertaking and other players act and inter-act on the market. *Dominance is the ability to prevent effective competition being maintained on the market and to act to an appreciable extent independently of other players*. The notion of independence, which is the special feature of dominance²⁵, is related to the level of competitive constraint facing the undertaking(s) in

²¹ See Case 27/76 United Brands, cited in footnote 5, paragraph 65, and Case 85/76, Hoffmann-La Roche, cited in footnote 4, paragraph 38.

²² See Joined Cases C-395/96 P and C-396/96 P Compagnie maritime belge transports, cited in footnote 4, paragraph 36.

²³ Idem.

²⁴ See paragraph 11 above.

²⁵ See Case 85/76 Hoffmann-La Roche cited in footnote 5, paragraphs 42-48.

question. For dominance to exist the undertaking(s) concerned *must not be subject to effective competitive constraints*. In other words, it thus must have substantial market power.

Market Power

24. Market power is the power to influence market prices, output, innovation, the variety or quality of goods and services, or other parameters of competition on the *market for a significant period of time*. In this paper, the expression “*increase prices*” is often used as shorthand for the various ways these parameters of competition can be influenced to the harm of consumers. An undertaking that is capable of substantially increasing prices above the competitive level for a significant period of time holds substantial market power and possesses the requisite ability to act to an appreciable extent independently of competitors, customers and consumers. Unlike undertakings in a market characterised by effective competition, a dominant undertaking not subject to effective competitive constraints is able to price above the competitive level. It can do so by reducing its own output or by causing rivals to reduce their output. The foreclosure of competitors may therefore allow the dominant company to further raise price or keep prices high.

Seller and Buyer market power

25. Both suppliers and buyers can have market power. However, for clarity, market power will usually refer here to a supplier’s market power. Where a buyer’s market power is the issue, the term ‘buyer power’ is employed.

Lack of Competitive Constraints

26. Higher than normal profits may be an indication of a lack of competitive constraints on an undertaking. More in general, the way in which a firm acts in a market may in itself be indicative of substantial market power, for instance where an undertaking increases its price while benefiting from falling costs. However, an undertaking’s economic strength cannot be measured by its profitability at any specific point in time; even short-run losses are not incompatible with a dominant position.²⁶

Not required that Domco has eliminated all opportunity for competition on the market

²⁶ See Case 27/76 United Brands, cited in footnote 5, paragraph 126, and Case 322/81, NV Nederlandsche Banden Industrie Michelin v Commission (Michelin I) [1983] ECR 3461, paragraph 59.

27. It is also not required for a finding of dominance that the undertaking in question has eliminated all opportunity for competition on the market.²⁷ For Article 82 to apply it is not a condition that competition has been eliminated.²⁸ On the other hand, 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 independent conduct which is the hallmark of a dominant position. In that case the undertaking concerned is likely to be subject to effective competitive constraints, which is incompatible with the existence of substantial market power.

4.2. SINGLE DOMINANCE

“Power to behave to an appreciable extent

independently of its competitors, its customers and ultimately of the consumers”

28. When the relevant market has been defined, it can be analysed whether on that market the allegedly dominant undertaking “has the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers”, that is, whether it holds *substantial market power*. In conducting this analysis it is relevant to consider in particular the market position of the allegedly dominant undertaking, the market position of competitors, barriers to expansion and entry, and the market position of buyers. The existence of a *dominant position may derive from several factors* which, taken separately, are not necessarily determinative.²⁹

4.2.1 MARKET POSITION OF ALLEGEDLY DOMINANT UNDERTAKING AND ITS RIVALS

Market shares are first indication of dominance

29. The analysis of the market position of the allegedly dominant undertaking and its rivals provides insight into the degree of actual competition on the market. The starting point for this analysis is the market shares of the various players. Market shares provide useful first indications of the market structure and of the competitive importance of various undertakings active on the market. If the undertaking concerned has a high market share compared to other players on the market, it is an indication of dominance, provided that this market share has been held for some

²⁷ See Case 27/76 United Brands, cited in footnote 5, paragraph 113, and Case T-395/94 Atlantic Container Line AB and Others v Commission [2002] ECR II-875, paragraph 330.

²⁸ See paragraphs 91-92.

²⁹ Case 85/76 Hoffmann-La Roche, cited in footnote 5, paragraph 39.

time.³⁰ If market shares have fluctuated significantly over time, it is an indication of effective competition. However, this is only true where fluctuations are caused by rivalry between undertakings on the market. Fluctuations caused, for instance, by mergers are not in themselves indicative of such rivalry.

Market shares, current or historic

30. Normally, *the Commission uses current market shares in its competitive analysis.*³¹ However, *historic market shares* may be used *if market shares have been volatile*, for instance when the market is characterised by large, lumpy orders. *Changes in historic market shares* may also provide useful information about the competitive process and the likely future importance of the ³²various competitors, for instance, by indicating whether firms have been gaining or losing market shares. In any event, the Commission interprets market shares in the light of likely market conditions, for instance, whether the market is highly dynamic in character and whether the market structure is unstable due to innovation or growth.

Likely that very high market shares, which have been held for some time, indicate a dominant position – fairly save harbour if market share not above 25%

31. It is *very likely that very high markets shares, which have been held for some time, indicate a dominant position.*³³ This would be the case where an undertaking holds 50 % or more of the market, provided that rivals hold a much smaller share of the market.³⁴ In the case of lower market shares, dominance is more likely to be found in the market share range of 40 % to 50 % than below 40 %, although also undertakings with market shares below 40 % could be

³⁰ See Case 27/76 United Brands, cited in footnote 5, paragraph 111 and Case 85/76 Hoffmann-La Roche cited in footnote 5, paragraph 41.

³¹ As to the calculation of market shares, see also Commission Notice on the definition of the relevant market, cited in footnote 11, paragraphs 54-55.

³² See Case 85/76 Hoffmann-La Roche, cited in footnote 5, paragraph 41.

³³ See Case 85/76 Hoffmann-La Roche cited in footnote 5, paragraph 41; Case C-62/86 AKZO Chemie BV v Commission [1991] ECR I-3359, paragraph 60, and Case T-395/94 Atlantic Container Line, cited in note 27, paragraph 328.

³⁴ See Case 27/76 United Brands, cited in footnote 5, paragraphs 108-109 where the undertaking concerned was found to be dominant with a market share between 40 % and 45 %. See also Case C-250/92, Gøttrup-Klim e.a. Grovwareforeninger v Dansk Landbrugs Grovvareselskab AmbA [1994] ECR I-5641, paragraph 48, where the undertaking concerned held market shares of 36 % and 32 %, and the ECJ stated that an undertaking holding market shares of that size may, depending on the strength and number of its competitors, be considered to be in a dominant position.

considered to be in a dominant position.³⁵ However, undertakings with *market shares of no more than 25 % are not likely to enjoy a (single) dominant position on the market concerned.*³⁶

Strength of indication depends on facts & market power

32. The strength of any indication based on market share depends on the facts of each individual case. *Market share is only a proxy for market power*, which is the decisive factor. It is therefore necessary to extend the dominance analysis beyond market shares, especially when taking into account the difficulty of defining relevant markets in Article 82 cases, cf. section 3 above.

Product Differentiation

33. The importance of market shares may be qualified by an analysis of the degree of product differentiation in the market. 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. *The level of advertising in a market may be an indicator of the firms' efforts to differentiate their products.* When products are differentiated the competitive constraint that they impose on each other is likely to differ even where they form part of the same relevant market. *Substitutability is a question of degree.* In assessing the competitive constraint imposed by rivals, it must therefore be taken into account what is the degree of substitutability of their products with those offered by the allegedly dominant undertaking. It may be that a rival with 10% market share imposes a greater competitive constraint on an undertaking with 50% market share than another rival supplying 20% of the market. This may for instance be the case where the undertaking with the lower market share and the allegedly dominant undertaking both sell premium branded products whereas the rival with the larger market share sells a bargain brand.

4.2.2 BARRIERS TO EXPANSION AND ENTRY

³⁵ The calculation of market shares depends critically on market definition. It must be emphasised that the Commission does not necessarily accept the market definitions proposed by the allegedly dominant undertaking or by third parties.

³⁶ Recital 32 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) , OJ L 24, 29.01.2004, pp. 1-22.

If barriers to expansion and entry low, market share is poor indicator

34. If the barriers to expansion faced by rivals and to entry faced by potential rivals are low, the fact that one undertaking has a high market share may not be indicative of dominance. Any attempt by an undertaking to increase prices above the competitive level would attract expansion or new entry by rivals thereby undermining the price increase.

Speed or likely entry or expansion

35. In assessing whether expansion or entry has been, would have been or is likely to be timely, the Commission will look at whether any such expansion or entry has been or would have been or will be sufficiently immediate and persistent to prevent the exercise of substantial market power. *The appropriate time period depends on the characteristics and dynamics of the market.* The period of time needed for undertakings already on the market to adjust their capacity can be used as a yardstick to determine this period. Expansion or entry which is not of sufficient scope and magnitude is not likely to constitute an effective constraint on the undertaking concerned. *Small-scale entry, for instance into some market 'niche', may not be considered sufficient.*

History of Industry

36. The Commission will look carefully at the *history of the industry* when assessing barriers to expansion or entry. It is *not likely* that the Commission will find barriers to expansion and entry in an industry that has experienced *frequent and successful examples of entry*. On the other hand if previous attempts to expand in or enter into the market have been *unsuccessful, perhaps due to deterring behaviour by incumbents*, then expansion and entry would seem less likely to have constituted an effective constraint.

Entry likely if others have production facilities needed

37. Entry may be particularly likely if suppliers in other markets already possess production facilities that could be used to enter the market in question, thus reducing the sunk costs of entry.

Expansion or entry profitable if...

38. *Barriers to expansion and entry are factors that make entry impossible or unprofitable* while permitting established undertakings to charge prices above the competitive level. Undertakings expand output and enter markets to earn profits. *Whether expansion or entry is profitable* depends in particular on the cost of (efficient) expansion or entry and the likely prices post expansion or entry. The higher the cost of expansion or entry and the lower the likely post expansion or entry prices, the greater the risk that expansion or entry will be unprofitable and therefore not attempted.

Prices after expansion or entry

39. The prices post expansion or entry *depend firstly on the impact on prices of the additional output put on the market by the expansion or by the new entrant, but also on the reaction of incumbents, in particular the allegedly dominant undertaking.* Likely strategic responses from the incumbents are therefore taken into account. An *aggressive competitive response from incumbents would be particularly likely if they have committed to large excess capacity.* The allegedly dominant undertakings may also have built a reputation of responding aggressively to expansion or entry. When assessing whether or not expansion or entry would be profitable, the *likely evolution of the market should also be taken into account.* Expansion or entry is more likely to be profitable in a *market that is expected to experience high growth* in the future relative to a market that is expected to decline or stagnate.

Identification of possible barriers to expansion and entry

40. When identifying possible barriers to expansion and entry it is important to focus on *whether rivals can reasonably replicate circumstances that give advantages to the allegedly dominant undertaking.* Barriers to expansion and entry can have a number of origins relating to the legal or economic environment that pertains on the relevant market:

- *Legal Barriers:* The legislative framework covering the relevant market can be an important barrier. Such legislation may limit the number of market participants, for example by granting special or exclusive rights in the shape of concessions, licenses or intellectual property rights. Legislative measures that grant a single undertaking the exclusive right to perform a certain activity excludes rivals and may lead to such an

undertaking having a legal monopoly in a relevant market. Planning laws and licensing laws that impose limits on the number of retail outlets limits expansion possibilities of existing and entry possibilities for new retailers, which in turn may make it more difficult for suppliers to gain access to efficient distribution. Intellectual property rights may also prevent expansion and entry or make it more difficult. However, intellectual property rights do not as such confer dominance on the holder. The impact of intellectual property rights on expansion and entry depends on the nature and actual strength of the intellectual property right held by the allegedly dominant undertaking. Finally, also tariff and non-tariff barriers can give advantages to incumbent firms.

- *Capacity Constraints*: Competitors may have to commit large sunk investments in order to expand capacity. An investment or cost is sunk when it cannot be recovered if the undertaking exits the market. Moreover, even existing excess capacity may be so expensive to employ that these costs constitute a barrier to expansion; for instance, the costs of introducing another shift in a factory may constitute a barrier to expansion.
- *Economies of scale and scope*: Large-scale production or distribution may give the allegedly dominant undertaking an advantage over smaller competitors. Scale and scope economies result from the spreading of fixed costs over larger output or a broader set of products, leading to a reduction of average costs. When economies of scale or scope are important and require a substantial production capacity compared to the size of the market, efficient expansion or entry is more costly and risky. Large fixed costs have to be committed and the output produced will constitute a significant increase in output, which is likely in itself to have a significant impact on price post expansion or entry. If expansion or entry occurs at an inefficient scale, the competitive constraint imposed on the incumbents will be less effective. In assessing barriers to expansion and entry it is therefore useful to consider the minimum efficient scale in the market concerned. The *minimum efficient scale* is the level of output required to minimise average cost, exhausting economies of scale.³⁷

³⁷ Scale economies are normally exhausted at a certain point. Thereafter average costs will stabilise and eventually rise due to, for example, capacity constraints and bottlenecks.

- *Absolute cost advantages*: These include preferential access to essential facilities, natural resources, innovation and R&D, intellectual property rights and capital conferring a competitive advantage on the allegedly dominant undertaking, which makes it difficult for other undertakings to compete effectively. In the large majority of cases financial strength is unlikely to be an issue. However, in some cases it may be one of the factors that contribute to a finding of a dominant position, in particular in those cases where (i) finance is relevant to the competitive process in the industry under review; (ii) there are significant asymmetries between competitors in terms of their internal financing capabilities; and (iii) particular features of the industry make it difficult for firms to attract external funds.
 - *Privileged access to supply*: The allegedly dominant undertaking may be vertically integrated or may have established sufficient control or influence over the supply of inputs that expansion or entry by smaller rival firms may be difficult or costly.
 - *A highly developed distribution and sales network*: The allegedly dominant undertaking may have its own dense outlet network, established distribution logistics or wide geographical coverage that would be difficult for rivals to replicate.
 - *The established position of the incumbent firms on the market*: It may be difficult to enter an industry where experience or reputation is necessary to compete effectively, both of which may be difficult to obtain as an entrant. Factors such as consumer loyalty to a particular brand, the closeness of relationships between suppliers and customers, the importance of promotion or advertising, or other reputation advantages will be taken into account. Advertising and other investments in reputation are often sunk costs which cannot be recovered in the case of exit and which therefore make entry more risky.
 - *Other strategic barriers to expansion or entry*: These encompass situations where it is costly for customers to switch to a new supplier. This may for example be the case where
-

personnel have been trained to use the product of the allegedly dominant undertaking or where due to network effects the value of rivals' products are lower because they do not have a large installed base of customers. For instance the value of a piece of software may not only depend on the intrinsic qualities of the product but also on how many people use it and thus with whom the new buyers can exchange files. Finally, the incumbent firms may through the use of long-term contracts with customers have made it difficult for rivals at a particular point in time to find a sufficient number of customers able to switch supplier that expansion or entry would be profitable.

4.2.3 MARKET POSITION OF BUYERS

Market position of buyers indicates strength of constraint they exercise

41. The market position of buyers provides an indication of the extent to which they are likely to constrain the allegedly dominant undertaking. However, given the fact that *dominance is assessed in relation to a market, it is not sufficient that certain strong buyers may be able to extract more favourable conditions from the allegedly dominant undertaking than their weaker competitors*. The presence of strong buyers can only serve to counter a finding of dominance if it is likely that in response to prices being increased above the competitive level, the buyers in question will pave the way for effective new entry or lead existing suppliers in the market to significantly expand their output so as to defeat the price increase.³⁸ In other words, the *strong buyers should not only protect themselves, but effectively protect the market*.

Possibility of separate markets for weak and strong buyers

42. On the other hand, if one or more strong buyers are able to extract more favourable conditions from the allegedly dominant undertaking than their weaker competitors, it may be appropriate to define separate relevant markets for, respectively, strong and weak buyers.³⁹

4.3 COLLECTIVE DOMINANCE

³⁸ See in this respect Case T-228/97, Irish Sugar plc v Commission [1999] ECR II-2969, paragraph 101.

³⁹ Commission Notice on the definition of the relevant market cited in footnote 11, paragraph 43.

43. Article 82 prohibits any abuse by one or more undertakings of a dominant position. It follows that the application of Article 82 is not confined to cases where a single undertaking holds a dominant position; it is also applicable where two or more undertakings together hold a dominant position.

Concept of Collective Dominance

44. For collective dominance to exist under Article 82, two or more undertakings must *from an economic point of view present themselves or act together on a particular market as a collective entity*.⁴⁰ It is not required that the undertakings concerned adopt identical conduct on the market in every respect.⁴¹ What matters is that they are *able to adopt a common policy on the market and act to a considerable extent independently of their competitors, their customers, and also of consumers*.⁴²

Connecting Factors

45. *In order to establish the existence of such a collective entity on the market, it is necessary to examine the factors that give rise to a connection between the undertakings concerned*.⁴³ Such factors may flow from the nature and terms of an agreement between the undertakings in question or from the way in which it is implemented⁴⁴, provided that the agreement leads the undertakings in question to *present themselves or act together as a collective entity*. This may, for instance, be the case if undertakings have concluded cooperation agreements that lead them to coordinate their conduct on the market. It may also be the case if ownership interests and other links in law lead the undertakings concerned to co-ordinate.

Legal links not indispensable

46. However, the existence of an agreement or of other links in law is not indispensable to a finding of a collective dominant position. *Such a finding may be based on other connecting factors and depends on an economic assessment and, in particular, on an assessment of the*

⁴⁰ See Joined cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports*, cited in footnote 4, paragraph 36.

⁴¹ See in this respect Case T-228/97 *Irish Sugar* cited in footnote 38, paragraph 66.

⁴² See Joined Cases C-68/94 and C-30/95, *French Republic and Société commerciale des potasses et de l'azote (SCPA) and Entreprise minière et chimique (EMC) v Commission* [1998] ECR I-1375, paragraph 221.

⁴³ *Idem*.

⁴⁴ Case C-393/92 *Almelo*, cited in footnote 7, paragraphs 41 to 43.

structure of the market in question.⁴⁵ It follows that the structure of the market and the way in which undertakings interact on the market may give rise to a finding of collective dominance.⁴⁶

Oligopolistic Coordination

47. *Undertakings in oligopolistic markets may sometimes be able to raise prices substantially above the competitive level without having recourse to any explicit agreement or concerted practice.* Coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. *The simpler and more stable the economic environment, the easier it is for undertakings to reach a common understanding.* Indeed, they may be able to coordinate their behaviour on the market by observing and reacting to each other's behaviour. In other words, they may be able to adopt a common strategy that allows them to present themselves or act together as a collective entity. *Coordination may take various forms.* In some markets, the most likely coordination may involve *directly coordinating on prices in order to keep them above the competitive level.* In other markets, coordination may aim at *limiting production or the amount of new capacity brought to the market.* Firms may also *coordinate by dividing the market, for instance by geographic area or other customer characteristics, or by allocating contracts in bidding markets.* The ability to arrive at and sustain such co-ordination depends on a number of factors, the presence of which must be carefully examined in each case.

Conditions for interdependence work – 1) Ability to monitor chiseling

48. *Firstly, each undertaking must be able to monitor whether or not the other undertakings are adhering to the common policy.* It is not sufficient for each undertaking to be aware that interdependent market conduct is profitable for all of them, because *each undertaking will be tempted to increase his share of the market by deviating from the common strategy.* There must, therefore, be sufficient market transparency for all undertakings concerned to be aware, sufficiently precisely and quickly, of the market conduct of the others.⁴⁷

⁴⁵ See Joined cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports*, cited in footnote 4, paragraph 36.

⁴⁶ See also the Commission's Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31, 05.02.2004, pp. 5-18, paragraphs 39-57.

⁴⁷ See Case T-342/99, *Airtours plc v Commission* [2002] ECR II-2585, paragraph 62, and Case T-193/02 *Piau*, cited in footnote 6, paragraph 111.

2) Policy sustainable –Deter from cheating

49. Secondly, the implementation of the common policy must be sustainable over time, which *presupposes the existence of sufficient deterrent mechanisms*, which are sufficiently severe to convince all the undertakings concerned that it is in their best interest to adhere to the common policy.⁴⁸

3) Insufficient constraints from third parties

50. Finally, it must be established that competitive constraints do not jeopardise the implementation of the common strategy.⁴⁹ As in the case of single dominance, it must *be analysed what is the market position and strength of rivals that do not form part of the collective entity*, what is the *market position and strength of buyers* and what is the *potential for new entry* as indicated by the height of entry barriers.

5. FRAMEWORK FOR ANALYSIS OF EXCLUSIONARY ABUSES

51. *This section describes in general terms the framework that could be used by the Commission in its analysis of exclusionary abuses.* More detailed descriptions of the analysis of individual abuses are given in the following sections.

DP deals only with most common exclusionary abuses

52. This discussion paper *only deals with exclusionary abuses* and in that category only with the *most common abuses*, that is, predatory pricing, single branding and rebates, tying and bundling, and refusal to supply.

DP excludes excessive pricing & discrimination unless foreclosing

53. The fact that this paper only deals with exclusionary abuses means that *some abuses are not analysed in this paper* (for instance excessive pricing) and that *others are only analysed to the extent that they may have exclusionary effects* (for instance discrimination).

⁴⁸ Idem.

⁴⁹ Idem.

5.1 THE CENTRAL CONCERN AND PROOF OF FORECLOSURE

*Protection of competition on the market as a means of enhancing consumer welfare
and of ensuring an efficient allocation of resources*

54. *The essential objective of Article 82 when analysing exclusionary conduct is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. The concern is to prevent exclusionary conduct of the dominant firm which is likely to limit the remaining competitive constraints on the dominant company, including entry of newcomers, so as to avoid that consumers are harmed. This means that it is competition, and not competitors as such, that is to be protected. Furthermore, the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance, but to ensure that these competitors are also able to expand in or enter the market and compete therein on the merits, without facing competition conditions which are distorted or impaired by the dominant firm.*

Duration – harm to intermediate buyers – long term harm

55. *Article 82 prohibits exclusionary conduct which produces actual or likely anticompetitive effects in the market and which can harm consumers in a direct or indirect way. The longer the conduct has already been going on, the more weight will in general be given to actual effects. Harm to intermediate buyers is generally presumed to create harm to final consumers. Furthermore, not only short term harm, but also medium and long term harm arising from foreclosure is taken into account.*

Foreclosure

56. *The central concern of Article 82 with regard to exclusionary abuses is thus foreclosure that hinders competition and thereby harms consumers. The general principles for assessment are already provided in the previous two paragraphs. In the remainder of this section and in the following sections concerning individual abuses, more detailed principles and tests, sometimes tailored to specific practices, are provided. Where in a particular case it proves not*

possible to apply the more detailed principles and tests, for instance because of insufficient access to relevant data, the *Commission will analyse the case using the general principles in view of the central concern described above.*

ECJ's definition of abuse in the context of exclusionary conduct

57. The above is in line with the definition of exclusionary abuses given by the European Court of Justice. *The Court has, in the context of exclusionary conduct, defined the term "abuse" in the following way:*

*"An objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition."*⁵⁰

Capability, market context, market distorting foreclosure effect

58. This definition implies that the conduct in question must in *the first place have the capability, by its nature, to foreclose competitors from the market.* To establish such capability it is *in general sufficient to investigate the form and nature of the conduct in question.* It secondly implies that, *in the specific market context, a likely market distorting foreclosure effect must be established.* By foreclosure is meant that *actual or potential competitors are completely or partially denied profitable access to a market.* Foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market: *it is sufficient that the rivals are disadvantaged and consequently led to compete less aggressively.* Rivals may be disadvantaged where the dominant company is able to *directly raise rivals' costs or reduce demand for the rivals' products.* Foreclosure is said to be *market distorting* if it likely hinders the maintenance of the degree of competition still existing in

⁵⁰ Case 85/76 Hoffmann-La Roche, cited in footnote 5.

the market or the growth of that competition and thus have as a likely effect that prices will increase or remain at a supra-competitive level.

Market distorting foreclosure effect

59. To establish such a market distorting foreclosure effect it is in general necessary not only to consider *the nature or form of the conduct*, but also *its incidence*, i.e. the extent to which the dominant company is applying it in the market, including the *market coverage of the conduct or the selective foreclosure of customers to newcomers or residual competitors*. Other market characteristics including the existence of *network effects and economies of scale and scope* may also be relevant to establish a foreclosure effect. In addition the *degree of dominance* will be a relevant factor. In general, the higher the capability of conduct to foreclose the wider its application, and the stronger the dominant position, the higher the likelihood that an anticompetitive foreclosure effect results.⁵¹ In view of these sliding scales, where in the following sections various factors are used to indicate circumstances under which a likely foreclosure effect is considered to occur with high(er) or low(er) likelihood, it needs to be kept in mind that *these descriptions can not be applied mechanically*.

If clearly no efficiencies, exclusion rebuttably presumed to be abusive

60. *Where a certain exclusionary conduct is clearly not competition on the merits, in particular conduct which clearly creates no efficiencies and which only raises obstacles to residual competition, such conduct is presumed to be an abuse.*⁵² However, the dominant company will have the *possibility to rebut that presumption*. Such rebuttal can be brought by *providing convincing evidence that the conduct does not and will not have the alleged likely exclusionary effect, or that the conduct is objectively justified* (see in particular paragraph 80 below).

5.2 PRICE VERSUS NON-PRICE BASED EXCLUSIONARY CONDUCT

⁵¹ As to the importance of the degree of dominance for finding abuse, see Joined Cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports*, cited in footnote 4, paragraph 119; Case T-228/97 *Irish Sugar*, cited in footnote 38, paragraph 186.

⁵² See for instance the recent Commission decision *AstraZeneca* of 15.06.2005.

Non-price based exclusion

61. Exclusionary abuses may be both price based and non-price based. Examples of *non-price based abuses* are *contractual tying, single branding contracts and “naked” refusals to supply*. In these situations it is clear that some “foreclosure” takes place; *the question is whether this foreclosure may be characterized as anticompetitive*.

Similar foreclosure effects through pricing

62. It is evident that similar foreclosure effects may be achieved through pricing. *High stand-alone prices in comparison to a bundled price for two products may “tie” these two products together as effectively as contractual tying. High rebates given on condition of single branding may have the same effect as contractual exclusive dealing. Asking a very high price for a product or combining a high upstream price with a low downstream price may amount to a “constructive” refusal to supply. Furthermore, predatory pricing is, of course, also a price-based exclusionary abuse*.

Pricing behavior-foreclosing only hypothetical competitor less efficient than Domco

63. As regards pricing behaviour a certain *conduct may have different exclusionary effects depending on how efficient the rivals are*. A very efficient rival may be able to thrive in a market where the dominant company prices in a certain way, while a less efficient rival may be excluded from the market. The more detailed principles described in this paper for assessing alleged price based exclusionary conduct are *based on the premise that in general only conduct which would exclude a hypothetical “as efficient” competitor is abusive*. The “as efficient” competitor is a hypothetical competitor having the same costs as the dominant company. Foreclosure of an as efficient competitor can in general only result if the dominant company prices below its own costs.

Cost Benchmarks

64. In order to apply the hypothetical as efficient competitor test the following are often mentioned as possible cost benchmarks: marginal cost (MC), average variable cost (AVC), average avoidable cost (AAC), long-run average incremental cost (LAIC) and average total cost (ATC). *Marginal cost* is the cost of producing the last unit of output. *Average variable cost* is the

average of the costs that vary directly with the output of the company. Average avoidable cost is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case usually the amount allegedly subject to abusive conduct. *Long-run average incremental cost* is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. *Average total cost* is the average of all the variable and fixed costs.

Multi-product Companies

65. In case of multi-product companies it *may be difficult to calculate ATC* because of certain common costs, which are fixed costs that are necessary for the production of more than one product and where it is *difficult to allocate these costs to the different products*. Where necessary to apply a cost benchmark based on ATC, the *Commission will allocate common costs in proportion to the turnover achieved by the different products unless other cost allocation methods are for good reasons standard in the sector in question or in case the abuse biases the allocation based on turnover*. Whereas ATC takes account of all variable and fixed costs, LAIC takes account of only the product-specific variable and fixed costs. The LAIC will thus usually fall below ATC because it does not take into account (non-attributable) common costs. The LAIC will usually be above AAC because *LAIC takes into account all product specific fixed costs, including product-specific fixed costs made before the period of abusive pricing, whereas AAC only takes product specific fixed costs into account that are made in order to foreclose*. The AAC will be higher than AVC to the extent that the company does make product specific fixed costs to behave abusively, *otherwise AAC and AVC are the same* by taking into account the variable costs only. Finally, *MC, because it concerns the additional cost made to produce one extra unit of output and does not concern an average, can be lower or higher than all the other cost benchmarks, depending on the actual output and capacity constraints of the company in question*.

Principles for Price Based Abuses

66. For price-based alleged abuses, principles are provided to *evaluate whether a competitor, which is as efficient as the dominant company, can compete against the price schedule or rebate system of the dominant company*. The question is asked *whether the dominant*

company itself would be able to survive the exclusionary conduct in the event that it would be the target. The exact formulation of these principles varies from abuse to abuse, depending on, for instance, considerations about whether potentially abusive low prices or rebate schemes are offered to the

whole market or only a part of it and whether low prices apply to all of a customer's requirements or only a part of them. If examination of a dominant company's price schedule or rebate system according to these principles leads to the conclusion that an as efficient competitor can compete with the dominant company, the Commission will normally reach the conclusion that the dominant company's price schedule or rebate system is not abusive (safe harbour). If, however, an as efficient competitor cannot compete with the dominant company, the Commission will consider the conduct to have the capability to foreclose competitors and therefore examine the likely market impact of the price schedule or rebate system.

As Efficient Competitor Test

67. To apply the as efficient competitor test *the authority in principle needs to have reliable information on the pricing conduct and costs of the dominant company.* A number of remarks need to be made in this context. *Firstly, it may be necessary to look at revenues and costs of the dominant company in a wider context.* It may not be sufficient to only assess whether the price or revenue covers the costs for the product in question, but it may be necessary to look at *incremental revenues in case the dominant company's conduct negatively affects its revenues in other markets or of other products.* Similarly, in case of two sided markets it may be necessary to look at revenues and costs of both products at the same time. *Secondly, in case reliable information on the dominant company's costs is not available it may be necessary to apply the as efficient competitor test using cost data of apparently efficient competitors.* *Thirdly, where no reliable information on cost data is available but where the Commission has nonetheless been able to build on other arguments a credible case of abuse, the dominant company may show that it is not pricing below the appropriate cost benchmark.* *Fourthly, it may sometimes be necessary in the consumers' interest to also protect competitors that are not (yet) as efficient as the dominant company. Here too the assessment does not (only) compare cost and price of the dominant company but will apply the as efficient competitor test in its specific market context, for instance taking account of economies of scale and scope, learning curve*

effects or first mover advantages that later entrants can not be expected to match even if they were able to achieve the same production volumes as the dominant company.

Decision need not follow order of DP

68. Where in later sections the different steps of the assessment of certain conduct is described, these steps do not necessarily need to be followed in that order in a particular case. In particular in view of the difficulties that may arise in a case to establish cost levels, *the Commission may decide for reasons of administrative efficiency to address cost issues only at a late stage of its dealing with a case.*

5.3 HORIZONTAL VERSUS VERTICAL FORECLOSURE

*Distinguish whether foreclosure of competitors (horizontal) or down stream
(Different level of supply chain)*

69. When analysing exclusionary behaviour by a dominant company it is in addition useful to distinguish whether the dominant company is attempting to exclude an upstream or a downstream rival. The abuses analysed in the following sections can be divided in two groups. The first group consists of predatory pricing, single branding and rebates, and tying and bundling. The second group consists of refusal to supply.

Horizontal Foreclosure

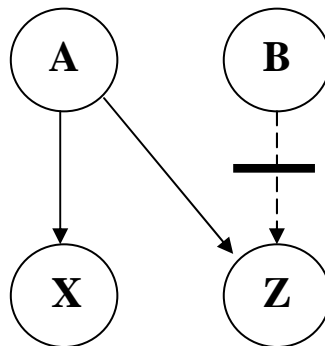
70. The abuses in the *first group* have in common that the *possible foreclosure effect arises from a dominant company attempting to exclude, discipline or marginalise a rival at its own level in the supply chain by foreclosing its access to customers* (horizontal foreclosure).⁵³ *The terms “upstream” and “downstream” market* are often used to distinguish between two different levels: the closer to the final consumer a market is, the further “downstream” it is.⁵⁴

⁵³ For ease of exposition the term “exclude” should in the following be understood also to cover “marginalise”. That is, “exclude” should not be understood in the literal sense of complete exclusion but also covers situations where a dominant company impairs the ability of a rival to compete in an effective way so that it becomes “marginalised”.

⁵⁴ The terminology “upstream” and “downstream” may not always be completely appropriate in that the two markets may in some ways be considered as equally “close” to the final consumer. However, in such a case, for a competitive concern to arise, it will be the case that one market (which is then called the “upstream” market) will provide an input to the other market (the “downstream” market).

This is illustrated in Figure 1, where A is dominant in the upstream market and tries to foreclose access of an actual or potential upstream rival B to customers such as X and Z in the downstream market.

FIGURE 1



Foreclosure of competitor by denying access to customers downstream

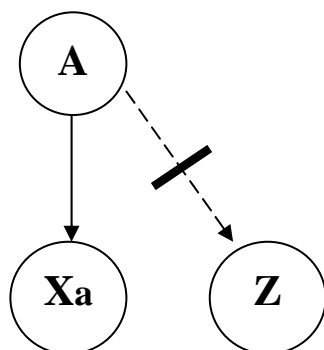
71. In some situations there is *more than one upstream market*. The dominant company A typically is or wants to be present on all of these markets while B may be present on only one or a few of these adjacent markets. The *concern may then be that A is trying to exclude B from one or more of these markets through foreclosing its access to the downstream customers X and Z*, for instance through tying the products from the various upstream markets. This, however, does not change the basic point that A is trying to exclude an upstream rival from one or more of the upstream markets.

Group 2, refusal to supply & margin squeeze

72. The second group of abuses consists of *refusal to supply*, which here includes *margin squeeze* cases. Whereas the *aim in the situations described above is to exclude B, a rival in the upstream market*, in the typical refusal to supply case the *aim is to exclude an already active or a potential participant in the downstream market*, for instance Z (*vertical foreclosure*). From a competition policy point of view, this is mostly only a worry if the dominant company A is itself

active downstream. This is illustrated in Figure 2, where Xa is now a downstream company owned by A. It is this type of refusal to supply that is analysed in section 9, “Refusal to supply”.⁵⁵

FIGURE 2



73. The above two-way characterisation of price versus non-price based conduct and exclusion of an upstream versus exclusion of a downstream rival may be visualised in the following table.

⁵⁵ Sometimes the form of a conduct might seem to be a refusal to supply but in reality the refusal to supply is best seen as an “instrument” to achieve, for instance, single branding or tying and should therefore be analysed according to the framework developed for these abuses in sections 7 and 8. That is, in some refusal to supply cases the concern is similar to the ones described for the first group of abuses. The aim of the refusal to supply is to foreclose an upstream rival from access to downstream customers with the purpose of excluding this rival from its upstream activities. This could, for instance, be the case where A refuses to supply Z if Z also buys from B (a form of single branding) or refuses to supply Z unless Z buys a whole range of products from A (a form of tying).

TABLE 1

	Horizontal foreclosure	Vertical foreclosure
Non-price Based exclusion	Single branding Tying	Refusal to supply Constructive refusal
Price based exclusion	Loyalty rebates Mixed bundling Predation	Margin squeeze Constructive refusal

5.4 ABUSE OF COLLECTIVE DOMINANCE

74. A finding of abuse of a collective dominant position is *typically based on showing that the collectively dominant undertakings have tacitly or expressly been following a common policy on the market, at least in regard to the abusive conduct*. For instance, the undertakings concerned may follow a common policy of denying potential rivals access to infrastructure or a policy to charge allegedly excessive prices to their customers. However, the *abuse does not necessarily*

have to be the action of all the undertakings in question. It only has to be capable of being identified as one of the manifestations of the collective dominant position.⁵⁶

E.g., If different tasks

75. This could, for instance, be the case *if it could be shown that the dominant undertakings had different tasks, for instance that each should “defend” a certain area or group of customers in case of entry, and that the allegedly abusive conduct had only been observed on the part of one of the dominant undertakings as entry had only occurred in the area or customer group that it was supposed to defend.*

76. The case law so far with respect to exclusionary abuse of a collective dominant position has dealt with situations where there were strong structural links between the undertakings holding the dominant position.⁵⁷

5.5 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Efficiencies that outweigh negative effect on competition

Domco bears burden of proof

77. Exclusionary conduct may escape the prohibition of Article 82 in case the *dominant undertaking can provide an objective justification for its behaviour or it can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition.*⁵⁸ *The burden of*

⁵⁶ See Case T-228/97 Irish Sugar, cited in footnote 38, paragraph 66; Joined Cases T-191/98, T-212/98 to T-214/98, Atlantic Container Line, cited in footnote 4, paragraph 633.

⁵⁷ Joined Cases C-395/96 P and C-396/96 P, Compagnie maritime belge, cited in footnote 4; Case T- 228/97, Irish Sugar, cited in footnote 38; Joined Cases T-191/98, T-212/98 to T-214/98, Atlantic Container Lined, cited in footnote 5; Case T-193/02, Piau, cited in footnote 6.

⁵⁸ See for instance Case 40/70 Sirena S.r.l. v Eda S.r.l. and others [1971] ECR 69, paragraph 17; Case 78/70 Deutsche Grammophon Gesellschaft mbH v Metro-SB-Großmärkte GmbH & Co. KG [1971] ECR 487, paragraph 19; Case 27/76 United Brands, cited in footnote 5, paragraphs 182-184; Case 77/77 Benzine en Petroleum Handelsmaatschappij BV and others v Commission [1978] ECR 1513, paragraphs 32-34; Case 395/87 Ministère public v Jean-Louis Tournier [1989] ECR 2521, paragraph 46; Case 311/84 Centre belge d'études de marché - Télémarketing (CBEM) v SA Compagnie luxembourgeoise de télédiffusion (CLT) and Information publicité Benelux (IPB) [1986] ECR 3261, paragraph 27; Joined cases C-241/91 P and C-242/91 P Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission (Magill) [1995] ECR 743 paragraph 55; Case T- 30/89 Hilti, cited in footnote 18, paragraphs 102-119; Case T-83/91 Tetra Pak International SA v Commission (Tetra Pak II), paragraphs 115, 136 and 207; Case T-228/97 Irish Sugar, cited in footnote 38, paragraphs 167, 188-189 and 218; Case C-163/99 Portuguese Republic I v Commission [2001] ECR 2613, paragraph 53.

*proof for such an objective justification or efficiency defence will be on the dominant company.*⁵⁹ It should be for the company invoking the benefit of a defence against a finding of an infringement to demonstrate to the required legal standard of proof that the conditions for applying such defence are satisfied.⁶⁰

78. In general there are two types of possible objective justifications. The first type of objective justification is where the dominant company is able to show that the *otherwise abusive conduct is actually necessary conduct on the basis of objective factors external to the parties involved* and in particular external to the dominant company (*'objective necessity defence'*). The second type of objective justification is where the dominant company is able to show that the otherwise abusive conduct is actually a loss minimising reaction to competition from others (*'meeting competition defence'*).

Efficiency defense – outweigh negative effects on competition

79. In relation to the efficiency defence the *dominant company must be able to show that the efficiencies brought about by the conduct concerned outweigh the likely negative effects on competition resulting from the conduct and therewith the likely harm to consumers that the conduct might otherwise have.*

5.5.1 OBJECTIVE NECESSITY DEFENCE

Objective necessity defined narrowly

80. *The dominant company may be able to show that the conduct concerned is objectively necessary, for instance because of reasons of safety or health related to the dangerous nature of the product in question. Such necessity must be based on objective factors that apply in general for all undertakings in the market. On the basis of these factors the dominant company must be able to show that without the conduct the products concerned can not or will not be produced or distributed in that market. In these situations the Community Courts apply strictly the condition of indispensability. It is considered not the task of a dominant company to take steps on its own*

⁵⁹ See Case T-203/01 Manufacture française des pneumatiques Michelin v Commission (Michelin II) [2003] ECR II-4071, paragraphs 107-109.

⁶⁰ See Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1, 04.01.2003, recital 5 and article 2.

*initiative to eliminate products which it regards, rightly or wrongly, as dangerous or inferior to its own product.*⁶¹

5.5.2 MEETING COMPETITION DEFENCE

81. The meeting competition defence is *only applicable in relation to behaviour which otherwise would constitute a pricing abuse*. It can in addition *only apply to individual and not to collective behaviour to meet competition*. For this second type of objective justification it is necessary to apply a *proportionality test*. The Community Courts have considered that *defending its own commercial and economic interests in the face of action taken by certain competitors may be a legitimate aim*.⁶² In other words, to minimise the short run losses resulting directly from competitors' actions can be a legitimate aim. This automatically implies that an objective justification is not possible if the dominant company is not able to show that its conduct is only a response to low pricing by others or if the Commission, for instance through documents seized at the company, has been able to demonstrate that the objective aim of the conduct is to directly foreclose competitors.

Proportional – burden on Domco

82. In order to fulfil the proportionality test the dominant company must in the first place show that *the chosen conduct is a suitable way to achieve the legitimate aim*. An objective justification is not possible if upon examination it is, for instance, established that the conduct also involves extra investments in capacity and is therewith not minimising losses directly resulting from the action taken by certain competitors. In case it is shown that the chosen conduct is a suitable way to achieve *the legitimate aim*, the dominant company *must in the second place* show that the conduct is *indispensable*, i.e. that the legitimate aim cannot be achieved to a similar extent by less anticompetitive alternatives and that the conduct is limited in time to the absolute minimum. It is *for the dominant company to provide all the relevant*

⁶¹ Case T-30/89 Hilti, cited in footnote 18, paragraph, 118; Case T-83/91 Tetra Pak II, cited in footnote 58, paragraphs 83-84 and 138.

⁶² Case 27/76 United Brands cited in footnote 5, paragraphs 189-191; Case T-65/89 BPB Industries Plc and British Gypsum Ltd v Commission [1993] ECR II-39, paragraph 69; T-228/97 Irish Sugar, cited in footnote 38, paragraphs 112. **[Original seems to be lacking the end of this footnote Val checked from DG Comp's website, error is in that too]**

information necessary to demonstrate that there are no other economically practicable and less anticompetitive alternatives which limit its short run losses, taking into account the market conditions and business realities facing the dominant company. As to the third condition of the proportionality test, it must be shown that meeting competition is a proportionate response in view of the aim of Article 82. This requires, with a view to protect the consumers' interest, a case by case weighing of the interest of the dominant company to minimise its losses and the interest of its competitors to enter or expand.

Meeting competition defence not available if price below ATC

83. In view of the above, in case the conduct concerns *pricing below AAC the meeting competition defence can normally not be applied*. Pricing below average avoidable cost is *in general neither suitable nor indispensable to minimise the dominant company's losses. In case the abuse concerns pricing above average avoidable cost the meeting competition defence can be applied only if all the conditions of the proportionality test described in the previous paragraph are fulfilled*, which in general is considered unlikely to be the case.

5.5.3 EFFICIENCY DEFENCE

Conditions

84. For this defence the dominant company must demonstrate that the following conditions are fulfilled:

- i) That efficiencies are *realised or likely to be realised as a result of the conduct* concerned;
- ii) That the *conduct concerned is indispensable* to realise these efficiencies;
- iii) That the *efficiencies benefit consumers*;
- iv) That *competition in respect of a substantial part of the products concerned is not eliminated*.

Where all four conditions are fulfilled the net effect of such conduct is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals.

Domco must show: (1)

85. The *dominant company must thus in the first place be able to show that the conduct is undertaken to contribute to improving the production or distribution of products or to promote technical or economic progress*, for instance by improving the quality of its product or by obtaining specific cost reductions or other efficiencies. The *Commission considers any substantiated efficiency claim in the overall assessment of the conduct*, possibly along other defences put forward by the dominant company. Such claim may for instance concern the protection of client-specific investments made by the dominant company.

(2) Indispensable – burden of proof

86. The dominant company must in the second place show that the conduct is *indispensable to achieve the alleged efficiencies*. It is for the dominant company to demonstrate that there are no other economically practicable and less anticompetitive alternatives to achieve the claimed efficiencies, taking into account the market conditions and business realities facing the dominant company. *The dominant company is not required to consider hypothetical or theoretical alternatives. The Commission will only contest the claim where it is reasonably clear that there are realistic and attainable alternatives. The dominant company must explain and demonstrate why seemingly realistic and less restrictive alternatives would be significantly less efficient.*

(3) Efficiencies outweigh negative effects on competition & consumers

87. In order to fulfill the third condition the dominant company needs to show that efficiencies brought about by the conduct concerned *outweigh the likely negative effects on competition and therewith the likely harm to consumers* that the conduct might otherwise have. This will be the case when the Commission on the basis of *sufficient evidence is in a position to*

conclude that the efficiencies generated by the conduct are likely to enhance the ability and incentive of the dominant company to act pro-competitively for the benefit of consumers.⁶³

Protect competition, consumer welfare and efficient allocation of resources

88. The *Community competition rules protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources*. This requires that the *pass-on of benefits must at least compensate consumers for any actual or likely negative impact caused to them by the conduct concerned*. If consumers in an affected relevant market are worse off following the exclusionary conduct, that conduct can not be justified on efficiency grounds.

Time value of consumer gain

89. In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. In general, the later the efficiencies are expected to materialise in the future, the less weight the Commission can assign to them. This implies that, in order to be considered as a counteracting factor, the efficiencies must be timely.

Incentives to pass on related to pressure of competition

90. The incentive on the part of the dominant company *to pass cost efficiencies on to consumers is often related to the existence of competitive pressure from the remaining firms in the market and from potential entry*. The greater the actual or likely negative effects on competition, the more the Commission has to be sure that the claimed efficiencies are substantial, likely to be realised, and to be passed on, to a sufficient degree, to consumers. It is therefore, when assessing the pass-on requirement, highly unlikely that the exclusionary conduct of a dominant company with a market position approaching that of a monopoly, or with a similar level of market power, can be justified on the ground that efficiency gains would be sufficient to outweigh its actual or likely anti-competitive effects and would benefit consumers. Similarly, in a market where demand is very inelastic it is highly unlikely that abusive conduct of a dominant company which

⁶³ See Case T-228/97 Irish Sugar, cited in footnote 38, paragraph 189.

strengthens its dominant position can be justified on the ground that efficiency gains would be sufficient to counteract the actual or likely anti-competitive effects and would benefit consumers.

(4) Elimination of Competition

91. The fourth condition is that *competition in respect of a substantial part of the products concerned is not and will not be eliminated*. When competition is eliminated the competitive process is brought to an end and short-term efficiency gains are outweighed by longer-term losses stemming *inter alia* from expenditures incurred by the dominant company to maintain its position (rent seeking), misallocation of resources, reduced innovation and higher prices. This is a *recognition of the fact that rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the shape of innovation*. Ultimately the *protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains*. This is also required for a consistent application of Articles 81 and 82. It is therefore, also when assessing the no-elimination-of competition requirement, *highly unlikely that abusive conduct of a dominant company with a market position approaching that of a monopoly, or with a similar level of market power, could be justified on the ground that efficiency gains would be sufficient to counteract its actual or likely anti-competitive effects*.

Domco's market position approaching monopoly

92. A dominant company is in general considered to have a market position approaching that of a monopoly *if its market share exceeds 75%* and there is almost no competition left from other actual competitors in the market, for instance because they are producing at considerably higher costs and/or are severely capacity constrained for a longer period of time, and entry barriers are so substantial that relevant entry can not be expected in the foreseeable future.⁶⁴

6. PREDATORY PRICING

6.1 INTRODUCTION

⁶⁴ See C 85/76 Hoffman-La Roche cited in footnote 5, paragraphs 38-39; Case T-228/97 Irish Sugar cited in footnote 38, paragraphs 186 and 233.

Definition of Predatory Pricing

93. For the purposes of Article 82 predatory pricing can be defined as the practice where a *dominant company lowers its price and thereby deliberately incurs losses or foregoes profits in the short run so as to enable it to eliminate or discipline one or more rivals or to prevent entry by one or more potential rivals thereby hindering the maintenance or the degree of competition still existing in the market or the growth of that competition.*

Hard to distinguish normal price competition

94. Predatory pricing is in practice often difficult to distinguish from normal price competition. The *lowering of prices*, the directly visible part of predation, is *also an essential element of competition*. By lowering its price and/or improving the quality of its products a company competes on the market. This is competition that benefits consumers and that a competition authority wants to defend and protect. Pricing is not predatory merely because a company is lowering its price.

Incurring losses or forgoing profits in short term may not be predatory

95. *Pricing is also not predatory just because the lower price means incurring losses or forgoing profits in the short run.* An investment in temporarily lower prices may for instance be required to enter a market or to make more customers familiar with the product.

Recoupment

96. The predatory nature of charging lower prices to all or certain customers is found in the predator making a sacrifice by *deliberately incurring short run losses with the intention to eliminate or discipline rivals or prevent their entry*. The company will make this sacrifice when it considers that it is likely to be able to recoup the losses or lost profits at a later stage after its actions have had the foreclosure effect.⁶⁵ *The exclusion should thus allow the predator to return to, maintain or obtain high prices afterwards.* Although consumers may have benefited from the lower predatory prices in the short term, in the longer term they will be worse off due to weakened competition resulting in higher prices, reduced quality and less choice.

⁶⁵ Throughout this section exclusionary or foreclosure effect is used as the short form for the effect of eliminating or disciplining rivals or preventing their entry.

Recoupment requires substantial market power

97. Such exclusionary *strategy can normally only be effective and profitable if a company has already substantial market power on the market in question. In order for predation to be abusive under Article 82 the exclusion should be instrumental in protecting or strengthening the predator's dominant position and thereby allow the predator to return to or obtain high prices afterwards.* In a competitive market with many competitors the exclusion of some of them will in general not lead to a sufficient weakening of competition so as to allow the predator to recoup the 'investment'. Also in a market with only a few but strong competitors such an exclusionary strategy is unlikely to succeed. *Predatory pricing is a risky strategy because the self-inflicted losses may not be regained if the predator makes a mistake about market conditions, for instance, if the prey is more resilient than expected, if mainly competitors benefit from the exclusion or if entry or re-entry occurs at a later stage. In other words, predation can be said to be to a certain extent self-detering. However, predation is certainly not impossible, for instance, in case of multiple markets where reputation effects are important and in case the dominant company is less dependent on external financing than (potential) entrants.*

Collectively dominant companies unlikely to be able to predate

98. Companies that are collectively dominant are less likely to be able to predate *because it may be difficult for the dominant companies to distinguish predation against an outside competitor from price competition between the collective dominant companies and because they usually lack a (legal) mechanism to share the financial burden of the predatory action.*

Predation may discipline competitors without eliminating them

99. *Predation of actual competitors may work not only through elimination of these competitors from the market but also through disciplining these competitors. One of the risks for the dominant company of eliminating a competitor is that its assets may be sold at a low price and stay in the market, creating a new low cost entrant. Even though the dominant company may be best placed to acquire the assets, it may prefer disciplining the competitor without eliminating it, that is making the competitor stop competing vigorously and to have the latter follow the*

pricing of the dominant company. This strategy may also be less costly to the dominant company.

6.2 ASSESSMENT

Link between Domco and the market – cost concepts

100. The remainder of this section first deals with the necessary *link between the dominant position and the market on which the predatory pricing takes place*. Subsequently separate sections deal with *pricing below average avoidable cost*, *pricing above average avoidable cost but below average total cost*, *pricing below long-run average incremental cost* and *pricing above average total cost*. The section concludes with a subsection on *objective justifications*.

Predatory pricing in market in which dominant or in another

101. *In general predatory pricing will only be dealt with as an abuse under Article 82 if the dominant company applies it to protect or strengthen its dominant position*. Usually it will do so by applying predatory pricing in the market where it has a dominant position. *It may also do so by applying predatory pricing in another, for instance adjacent market, if it has the effect of protecting or strengthening its dominance in the dominated market.*⁶⁶ For the latter to happen, there is usually a certain degree of economic interdependence between the two markets, for instance because the products are complements or because demand on the separate antitrust markets is or is expected to become interrelated. *A company dominant on the market for a particular product may want to strengthen its market power in a complementary product market to make entry in the dominated market more difficult*. Likewise, a company dominant in an older market may want to protect its dominant position by strengthening its market power in a new separate relevant market because demand on the old and new market is or will in the future become interrelated, possibly to the extent of becoming one market. *The exception to the rule that predatory pricing is only dealt with as an abuse under Article 82 if it is used to protect or strengthen the dominant position, is the Commission's policy in sectors where activities are protected by legal monopoly. In these cases the dominant position is based on exclusive or*

⁶⁶ Such was for instance the situation in the AKZO case, where AKZO was considered to predate in the flour additives market in order to protect its dominance in the organic peroxides market (Case 62/86, AKZO, cited in footnote 33).

special rights granted to the dominant company and while it does not need predation to protect its dominant position the concern is here the prevention of cross subsidisation (see below paragraph 125). Predatory pricing by a dominant company in an unrelated market where it is not dominant and where the predation will only have effects in this unrelated market will normally not be an abuse under Article 82.⁶⁷

Domco can usually price above total cost

102. *Under most market conditions a dominant company is unlikely to have to price below average total cost and make a loss.* Its market share, the importance of its product on the market, the entry barriers, competitive constraints being absent or weak and its resulting power over the price usually enable the dominant company to price well above average total cost and thus to avoid making losses. *If therefore a dominant company reacts to entry or to competition from a smaller company in the market by lowering its price and making a loss, in general or on certain specific sales, there may be good reasons for the Commission to look into such behaviour.*

Cost Benchmarks

103. In its assessment the Commission may use certain cost benchmarks, below which there is more reason to assume predation may take place and/or below which no additional proof may need to be brought by the authority because predation can be presumed. These cost benchmarks are *normally applied using cost data of the dominant company*. Where however reliable information on the dominant company's costs is not available, the Commission *may instead use cost data of apparently efficient competitors*. In addition, where in general no reliable information on cost data is available to the Commission, it may nonetheless be able to build on other arguments a credible case of predatory abuse. Where the case is argued on the basis of cost data of competitors, the *dominant company may rebut by showing that it is or was actually not pricing below the appropriate cost benchmark* (see also paragraph 67).

⁶⁷ The Court followed the Commission to prohibit predatory pricing that took place and had its effect only in a non-dominated market in Case T-83/91 Tetra Pak II, cited in footnote 58. The case can however be considered exceptional because the markets of aseptic and non-aseptic cartons were strongly linked and the Court and Commission considered that due to the quasi monopolistic position of Tetra Pak on the aseptic markets and its leading position on the closely associated non-aseptic markets it enjoyed a quasi dominant position also on the latter markets.

Period over which to measure the costs

104. *To use a cost benchmark one needs to decide on the relevant time period over which to measure the costs. This is important because what is a fixed cost in the short run may become a variable cost in the longer run. In the long run all factors of production become variable as the production process, the plant and machines will be replaced. What are fixed and variable costs can only be determined in the actual situation of the case.*

Period over which to measure costs

105. *The relevant period over which to measure the costs will in principle be the time period in which the alleged predatory pricing has taken place or, if still continuing, is expected to take place. However, in certain cases a different period of time may be appropriate. For instance, in particular liberalised sectors the Commission has used LAIC, which by definition looks at costs in the long run.*

6.2.1 PRICING BELOW AVERAGE AVOIDABLE COST

If price below appropriate bench mark, presumption that predatory

106. *In general the appropriate cost benchmark is the one that most accurately justifies the presumption that pricing below that benchmark can be expected to be predatory. The relevant question in that context is whether the dominant company, by charging a lower price for all or a particular part of its output over the relevant time period, incurred or incurs losses that could have been avoided by not producing that (particular part of its) output. If such avoidable losses are incurred, the pricing can be presumed to be predatory. At the same time the benchmark must be practical enough to be implemented.*

Below Marginal Cost

107. *In theory, the MC benchmark does answer the question for each individual unit of output separately; a price below MC means that the production and sale of that unit led to an immediate loss that could have been avoided by not producing that unit. However, not only is the per unit approach cumbersome, in most cases there will be no data available to calculate MC.*

AAC Benchmark

108. The *AAC benchmark* is the appropriate and practical answer to the question about avoidable losses. If a dominant company charges a price below AAC this means that the price it is charging for (that particular part of) its output is not covering the costs that could have been avoided by not producing that (particular part of its) output. *Often the AAC benchmark will be the same as the AVC benchmark* as in many cases only variable costs can be avoided. However, *if the dominant company, for instance, had to expand capacity in order to be able to predate*, then also the fixed or sunk investments made for this extra capacity will have to be taken into account and will filter into the AAC benchmark. In the latter case AAC will, for good reasons, exceed AVC.

If price below AAC

109. If the price charged by the dominant company is below AAC this means that the *dominant company incurred a loss that it could have avoided*. It is, *at least in the short run, not minimising its losses*. This is sufficient to *presume* that the dominant company *made this sacrifice in order to exclude the targeted competitor*. This is however a *rebuttable presumption*; there may be exceptional circumstances under which a price below AAC is justified (see below under possible defences: objective justifications and efficiencies). *This presumption is reflected in the case law*. In AKZO the ECJ held: “A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its price by taking advantage of its monopolistic position, since each sale generates a loss...”⁶⁸

Presumption avoids need to prove that intent or effect, but may be justified

110. *The presumption that below AAC the pricing of a dominant company can be assessed as predatory implies that once the Commission has established that the price charged was below AAC it does not need to further justify its decision with elements concerning the actual or likely exclusion of the prey, the predatory intent of the dominant company, its*

⁶⁸ Case 62/86 AKZO cited in footnote 33, paragraph 71. In this case the Court actually referred to the AVC benchmark, stating that prices below AVC must be regarded abusive. However, as explained above, in most cases the AVC benchmark will coincide with the AAC benchmark.

possibility to recoup the losses in the future through (a return to) high prices and other elements that could be used to strengthen its case. In such a case, the dominant company may wish to take up these elements and other circumstances of the case to show that it can justify its pricing (see below paragraph

130 seq.). The dominant company may also wish to show that, although the price is below the relevant cost benchmark, for clear-cut reasons the dominant company's pricing behaviour should not be considered predatory pricing because there is no possibility that it could have an exclusionary effect on rivals. This may for instance be the case where the low price is part of a one-off temporary promotion campaign to introduce a new product and where the duration and extent of the campaign are such that exclusionary effects are excluded.

6.2.2 PRICING ABOVE AVERAGE AVOIDABLE COST BUT BELOW AVERAGE TOTAL COST⁶⁹

No presumption if price above AAC but below ATC

111. Where in general a dominant company may have no reason to price below average avoidable cost as it does not maximise profits in the short term, *it may have some more reason to price above average avoidable cost but below average total cost. For instance in case of a serious fall in demand the short run profit maximising price may temporarily fall below average total cost. Pricing below average total cost will not entail losses by the mere production of that (particular part of its) output. While the sales do not cover total costs, they still allow coverage of all variable costs and a part of the fixed costs. It is for this reason that above average avoidable cost predation can not be presumed.* Extra elements of proof are required to substantiate a prohibition decision. This has also been expressed by the ECJ in the AKZO case: “Moreover, prices below average total costs ... but above average variable costs, must be regarded as *abusive if they are determined as part of a plan for eliminating a competitor.* Such prices can derive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them”.⁷⁰

Must show predatory intent or strategy

⁶⁹ The assessment described below will also be followed in case cost levels can not be ascertained.

⁷⁰ Case 62/86 AKZO cited in footnote 33, paragraph 72.

112. It will *need to be shown on the basis of objective factors that the pricing of the dominant company has a predatory intent, that it objectively speaking is part of a strategy or plan to predate*. This can be shown with the help of various elements, which individually or together may prove such a strategy. The following elements may in particular be important in this respect: direct evidence of intent, evidence that the pricing only makes commercial sense as part of a predatory strategy, the actual or likely exclusion of the prey, whether certain customers are selectively targeted, whether the dominant company actually incurred specific costs in order for instance to expand capacity, the scale, duration and continuity of the low pricing, the concurrent application of other exclusionary practices, the possibility of the dominant company to off-set its losses with profits earned on other sales and its possibility to recoup the losses in the future through (a return to) high prices. Such a strategy or plan, by showing objective intent, is also an indication of likely effect.

6.2.2.1 DIRECT EVIDENCE OF A PREDATORY STRATEGY

E.g. Domco's documents

113. Direct evidence of a predatory strategy can consist of documents from the dominant company, such as a *detailed plan demonstrating the use of predatory prices to exclude a rival*, to prevent entry or to pre-empt the emergence of a market, or evidence of concrete threats of predatory action. Such evidence needs to be clear cut about the predatory strategy and for instance indicate the specific steps the dominant company is taking and not just concern company internal general talk that the dominant company “will crush the competition”.⁷¹

If direct evidence, no need to prove other elements

114. In case of such direct evidence it does not need to be shown that also other elements point towards predation. It may be *assumed that* the dominant company, as it has devised a clear strategy to predate, also *has the means to predate and that its pricing behaviour does or will*

⁷¹ For instance in the AKZO case, the Court agreed with the Commission that there was clear evidence of AKZO threatening ECS in two meetings with below cost pricing if it did not withdraw from the organic peroxides market. In addition there was a detailed plan, with figures, describing the measures that AKZO would put into effect if ECS would not withdraw from the market.

eliminate or discipline the rival in question and thereby have a negative effect on (the growth of) competition in the market.

6.2.2.2 INDIRECT EVIDENCE OF A PREDATORY STRATEGY

Examples of Indirect Evidence

115. In case there is no direct evidence of a predatory strategy a case will have to be built on *indirect evidence of such a strategy to predate*. In arguing such a case the following elements will in particular be of relevance to show a plausible scheme of predation: *does the pricing behaviour only make commercial sense as part of a predatory strategy or are there also other reasonable explanations*, is there an actual or likely exclusionary effect, the scale, duration and continuity of the low pricing, does the dominant company actually incur specific costs in order for instance to expand capacity which enables it to react to entry, are certain customers selectively targeted, is there concurrent application of other exclusionary practices, does the dominant company have the possibility to off-set its losses with profits earned on other sales, does it have the possibility to recoup the losses in the foreseeable future through (a return to) high prices, can predation on one market have a reputation effect on other markets, is the prey particularly dependent on external financing and does the prey have counter strategies. The relevance of the different elements for individual cases may not always be the same and it is not possible to define in the abstract and in advance what is exactly required in an individual case to show a predatory strategy with such indirect evidence. However the following can be said on the importance of the various elements.

If makes commercial sense only if part of predatory strategy

116. If the pricing behaviour only *makes commercial sense as part of a predatory strategy and there are no other reasonable explanations*, such will normally suffice to show a *strategy to predate*, certainly if also other exclusionary practices are applied by the dominant company. In such a case it will *not be necessary to show that a foreclosure effect is likely*.

In other cases

117. In all other cases it is *at least necessary to show that a foreclosure effect is likely in view of the scale, duration and continuity of the low pricing before predatory pricing can be found to exist. In general it will not suffice to show only the likely foreclosure effect.* The investigation of more elements is usually necessary before a strategy to predate can be convincingly shown.

If Domco targets specific customers

118. If the dominant company with its low prices selectively *targets specific customers and in particular when these customers are the actual customers of one or more particular rivals in the market*, this may be an important part of the evidence of a predatory strategy. Such prices can be designed to damage a competitor's viability and to foreclose the market *while limiting the losses incurred by the dominant company to those arising from the targeted sales.*⁷² The same holds in case the low prices are *selectively targeted at those customers that might switch to a potential entrant in case entry is imminent.* Such evidence may be considered *stronger if also other exclusionary practices can be shown.* On the other hand, *a general price decrease applied to all the output of the dominant company is in general less likely to be part of a predatory strategy. With a general price decrease the dominant company will not have the possibility to off-set its losses with profits earned on other sales* and the losses will usually be higher, making recoupment less likely. The latter point about a market wide price decrease may have less force of argument *if the market is more prone to pre-emption* due to characteristics such as *network effects* or if the dominant company is active on a number of adjacent markets where predation in one market *may help to build up a reputation of being an aggressive competitor for all markets.*

Multiple markets or periods

119. To show a plausible scheme of predation it *may be necessary to investigate whether the predation and its effects are limited to one market or one period of potential entry or whether the effects may also be felt on other markets or in future periods of possible successive entry. In the latter case of multiple markets or multiple periods it may be rational for the dominant company to 'invest' in a reputation of being a 'rough' competitor and it may want to sacrifice more profits than what would seem rational if only one market or period is taken into account*

⁷² Case 62/86 AKZO, cited in footnote 33, paragraphs 81, 114 and 115.

(see also below on recoupment). This argumentation requires evidence not only that multiple markets or periods exist, but also that the dominant company pursues such a reputation effect strategy and that the (successive) potential entrants can observe the adverse conditions imposed on or the exit of the current prey.

Necessary to investigate

120. To show a plausible scheme of predation it may be necessary to investigate *whether the prey is dependent on external financing* and whether the lowering of prices by the dominant company has *such an adverse effect on the prey's initial performance that it seriously undermines its supply of further financing*. This argumentation requires showing not only of the negative effects on the prey's financial situation, but also that the dominant company is less dependent on external financing than the prey and that the dominant company has or can reasonably be expected to have knowledge of this difference in dependency.

Ability to finance losses incurred while predating not proof of predation, but

121. *The fact that the dominant company can off-set its losses with profits earned on other sales can generally not be proof on its own of predatory pricing*. It can show that the dominant company is actually capable of financing the losses with the profits made on other sales in the same period and may therefore be *less dependent on external financing*. In specific circumstances such as a multi-market situation or selective price cutting it *may also be an indication that recoupment already takes place while the predatory pricing occurs*. Similarly, if the dominant company can not off-set its losses with profits earned in the same period on other sales, this is not sufficient to disprove predation. While *ability to directly finance the losses incurred may be relevant, it is more important to investigate the incentive to predate and investigate whether the losses can be recouped*.

Reasonable to presume recoupment

122. The issue of recoupment concerns the question *whether the negative effect on (the growth of) competition in the market makes the sacrifice of the temporarily incurred losses a good 'investment' from the dominant company's perspective*. Is it reasonable to assume that the predation and its exclusionary effect will allow the dominant company to have higher prices in

the future than it otherwise would have had and can it thus recoup its losses? This does not require that the dominant company will be able to increase its prices above the level persisting in the market before the predation. *For recoupment it is sufficient that the predation avoids or delays a decline in prices that would otherwise occur as a result of the increased competition that would have come from the companies that are now eliminated, disciplined or whose entry is prevented.* It may often be impossible to exactly quantify the likely price and profit effects.⁷³ It will in general be sufficient to show the likelihood of recoupment by investigating the entry barriers to the market, the (strengthened) position of the company and foreseeable changes to the future structure of the market. As dominance is already established this normally means that entry barriers are sufficiently high to presume the possibility to recoup. The Commission does therefore *not consider it is necessary to provide further separate proof of recoupment in order to find an abuse.*⁷⁴ *In case it is observed that the dominant company's price that was lowered upon entry is again increased after exit or disciplining of the entrant, this may be an indication that recoupment is likely and can help to convincingly show the existence of a predatory strategy.* In case of disciplining it should then be observed that also the entrant is raising its price after the dominant company's lowering of price.

Presumption Refutable

123. Where the Commission argues a case of predatory abuse, the *dominant company may rebut it by establishing that its conduct is wrongly assessed as predatory, for instance by showing that it has not and will not have the alleged exclusionary effect or that recoupment will never be possible and consumers are not and will not be harmed.*

6.2.3 PRICING BELOW LONG-RUN AVERAGE INCREMENTAL COSTS

⁷³ One particular problem with quantifying recoupment is that predation may be applied by the dominant company not just to exclude an identified rival but also in order to build up an aggressive reputation with effect further into the future and on other markets.

⁷⁴ This was confirmed in Case T- 83/91 Tetra Pak II, upheld on appeal to the ECJ in Case C-333/94 P Tetra Pak International SA v Commission [1996] ECR I-5951, where the Court stated that proof of actual recoupment is not required. More in general, as predation may be more difficult than expected, the total costs to the dominant company of predating could outweigh its later profits and thus make recoupment impossible while it may still be rational to decide to continue with the predatory strategy that it started some time ago. See also COMP/38.233 (Wanadoo Interactive) Commission Decision of 16 July 2003.

124. *In certain sectors the decisional practice of the Commission has deviated from the cost benchmark based on AAC and has chosen to use LAIC as the benchmark. In these cases the LAIC benchmark is used as the benchmark below which predation is presumed. Pricing above LAIC but below ATC in these sectors is assessed like pricing above AAC but below ATC in all other sectors (see section 6.2.2).*

Presume predatory if protected by legal monopoly

125. Firstly, it is *presumed that pricing below LAIC is predatory in cases concerning activities protected by a legal monopoly*. In such cases it is considered that a company dominant in the protected market should not be allowed to use the profits made in that market to establish itself or defend its position in another, often related, market which is open to competition. In order to *prevent such cross-subsidisation* the decisional practice requires the dominant company to cover with its pricing in the free market at least all the variable and fixed costs it makes in order to be active on that market, in other words to price above LAIC.⁷⁵ In these cases *pricing below LAIC is presumed to be an abuse under Article 82, not only if the dominant company is in addition dominant in the free market but also if it is not dominant in that market and the predation will only have effects in that market (see paragraph 101 above).*

Presume predatory if market recently liberalised

126. Secondly, it is *presumed that pricing below LAIC is predatory in cases concerning sectors which recently have been liberalised or which are undergoing liberalisation*, such as the telecom sector.⁷⁶ It is considered important that the liberalisation efforts in these sectors are not undermined by predatory behaviour by the incumbent dominant companies, which may try to protect and maintain their monopoly positions that resulted from their previous legal monopoly or access to state funds. *These sectors concern network industries, with very high fixed costs and very low variable costs*, where it is considered that the use of an AVC or AAC benchmark would not reflect the specific economic realities of these industries. The Commission in its policy

⁷⁵ See Case COMP/35.141-Deutsche Post AG (Commission Decision 2001/354/EC of 20.03.2001, OJ L125, 05.5.2001, p. 27). See also Notice from the Commission on the application of the competition rules to the postal sector, cited in footnote 2, in particular paragraphs 3.1-3.4.

⁷⁶ See Access Notice, cited in footnote 2, in particular paragraphs 110-115.

towards the telecommunications sector stated that “[i]n order to trade a service or group of services profitably, an operator must adopt a pricing strategy whereby its total additional costs in providing that service or group of services are covered by the additional revenues earned as a result of the provision of that service or group of services. Where a dominant operator sets a price for a particular product or service which is below its average total costs of providing that service, the operator should justify this price in commercial terms: a dominant operator which would benefit from such a pricing policy only if one or more of its competitors was weakened would be committing an abuse.”⁷⁷

6.2.4 PRICING ABOVE AVERAGE TOTAL COST

Seldom Predatory – excludes only less efficient competitors

127. Price cuts where the resulting price remains above average total costs are in general not considered to be predatory because such pricing can usually only exclude less efficient competitors.⁷⁸ Companies that are equally or more efficient will, if challenged by the dominant company, be able to follow such price cuts and the ensuing price competition would normally be characterised as competition on the merits. Where it thus can be established that the price, also after the price cuts, remains above average total cost the pricing will not be assessed as predatory, unless exceptional circumstances indicate that such price cuts have led or will lead to substantial harm to consumers.

Collective Domco’s strategy to exclude or discipline

128. An example of such an exceptional situation is where companies in a collective dominant situation apply a clear strategy to collectively exclude or discipline a competitor by selectively undercutting the competitor and thereby putting pressure on its margins, while collectively sharing the loss of revenues.⁷⁹ In the case *Compagnie Maritime Belge* the Court prohibited such a ‘collective exclusion or marginalisation’ where a liner conference in a dominant position selectively cut its prices in order deliberately to match those of a competitor,

⁷⁷ Access Notice, cited in footnote 2, paragraph 112.

⁷⁸ This assessment may be different in case the price cuts are combined with other exclusionary practices.

⁷⁹ Such a case can in general be looked at both under Article 81 and 82.

thereby eliminating the principal, and possibly only, competitor facing the liner conference.⁸⁰ The collectively dominant companies in the liner conference used "fighting ships", that are vessels used by the maritime conference to sail in competition with the non-conference carrier. The "fighting ships" called at the same ports as the non-conference competitor, and they charged the same or lower rates as the outsider while such rates were well below the conference tariff.⁸¹ Financial losses or losses of revenue of the "fighting vessels" were distributed over the several members of the conference, each of whom were suffering proportionately much less than the non-conference carrier while at the same time having the advantage of obtaining higher rates on their other sailings. If in such an exceptional case it can be shown that there is a clear strategy to exclude or discipline including a mechanism to share the sacrifice in lost revenues between the collectively dominant companies and that there are negative effects on competition in the market or that there is a high likelihood that such effects will materialise, then also selective price cuts above average total costs will be assessed as predatory.

Where entry possible only below minimum scale

129. *Another example of such an exceptional situation where price cuts above average total costs could be deemed predatory is where a single dominant company operates in a market where it has certain non-replicable advantages or where economies of scale are very important and entrants necessarily will have to operate for an initial period at a significant cost disadvantage because entry can practically only take place below the minimum efficient scale. In such a situation the dominant company could prevent entry or eliminate entrants by pricing temporarily below the average total cost of the entrant while staying above its own average total cost. For such price cut to be assessed as predatory it has to be shown that the incumbent dominant company has a clear strategy to exclude, that the entrant will only be less efficient because of these non-replicable or scale advantages and that entry is being prevented because of the disincentive to enter resulting from specific price cuts.*

6.2.5 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

⁸⁰ Joined cases C-395/96P and C-396/96P *Compagnie maritime belge transports*, cited in footnote 4.

⁸¹ Instead or in addition to lowering its price on the route where the rival is operating the conference could also predate by adding capacity to that route.

Defences even if below relevant cost benchmark

130. *In a case where a presumption of predatory pricing is established, the dominant company may rebut that finding by justifying its pricing behaviour even if the price is below the relevant cost benchmark.*

If Domco minimizing its losses in short run

131. A first justification could be that although the price is below the relevant cost benchmark and although there is a likely exclusionary effect, the dominant company *is actually minimising its losses in the short run*. Such *justification* is, for the reasons explained above, *unlikely for pricing below the AAC benchmark*, although in exceptional cases there may even be a reason which could justify temporary prices below AAC. This could for instance be the case *where there is an issue of re-start up costs or strong learning effects*.⁸² *Above the AAC benchmark* the company may show that its low price is actually a short run loss minimising response to changed conditions in the market, such as resulting from *a dramatic fall in demand* leading to excess capacity. This could also be the case *where there is a need to sell off perishable inventory or phased out or obsolete products or where the costs of storage have become prohibitive*.⁸³

New Entry

132. *A change in market conditions could also be provoked by entry by a rival*. In case the rival is asking a price lower than the dominant company, the dominant company may invoke *the meeting competition defence*, to the extent that this is the response that minimises its short run losses. *A dominant company can not use the meeting competition argument to justify responding to entry with a predatory price where it incurs deliberate losses to prevent, frustrate or slow down entry by a rival*. Therefore, in case the pricing abuse concerns pricing below AAC

⁸² More accurately, in case of learning effects the price may be below AAC if calculated using historical cost data of the period during which the learning effects are achieved, but could be above AAC if the calculation is based on a longer period including the period after the learning effects have had their cost reducing effect.

⁸³ Sometimes a certain pricing behaviour may be justified for more than one reason. For instance, the need to sell off perishable inventory or phased out or obsolete products at a loss making price may just as well indicate that there will be no (lasting) exclusionary effect on rivals. In such cases it may also have to be taken into account that certain costs that would under normal circumstances be considered variable costs may have become fixed costs at the time of sale.

the meeting competition defence can normally not be applied. *Pricing below AAC is in general neither suitable nor indispensable to minimise the dominant company's losses.* In case the pricing abuse concerns pricing above AAC the meeting competition defence will only apply if it is shown that the response is suitable, indispensable and proportionate. This requires that there are no other less anti-competitive means to minimise the losses and that the conduct is limited in time to the absolute minimum and does not significantly delay or hamper entry or expansion by competitors.

In general, no efficiency defence to predatory pricing

133. *An efficiency defence can in general not be applied to predatory pricing. It is highly unlikely that clear efficiencies from predation can be shown and even when they exist that predation is the least restrictive way to achieve them.* In addition it is similarly unlikely that, in the case that such benefits arise, that in the longer run *some of these benefits are passed on to the customers and that these benefits outweigh the loss of competition brought about by the predation.*

7. SINGLE BRANDING AND REBATES

7.1 INTRODUCTION

134. A supplier, whether manufacturer or distributor, has various ways in which it can oblige or induce its buyers to purchase all or at least a significant proportion of their requirements from it⁸⁴. Most straightforwardly, its product, in terms of price/quality ratio, may simply be more attractive than competing products. *A superior price/quality ratio for individual orders of customers is unobjectionable under Article 82 because it is competition solely based on the merits,* apart from what is said on predation in section 6. *The supplier may however also use single branding obligations and rebate systems to attract more of customers' demand.*

Single Branding

⁸⁴ The reverse may also be the case, i.e. a buyer, whether manufacturer or distributor, can oblige or induce its suppliers to sell all or at least a significant proportion of their output to it. Such possibly abusive practices are not dealt with here.

135. Single branding obligations are obligations which require the buyer on a particular market to concentrate its purchases to a large extent with one supplier. A so-called '*English clause*', requiring the buyer to report any better offer and allowing it only to accept such an offer when the supplier does not match it, can be expected to have the same effect as a single branding obligation of concentrating the purchases with one supplier, especially when the buyer has to reveal who makes the better offer.

Many kinds of rebate systems

136. Rebate systems can be formulated and modulated in many ways and it is therefore *not possible to provide an exhaustive list*. The supplier may simply offer a rebate, in general from a list price, *on an individual order* of the buyer. Rebate systems can also be *more complex* where the supplier for instance offers *a rebate on an aggregated number of orders of the buyer*.

Conditional and unconditional rebates

137. A basic distinction for rebates is between unconditional rebates and conditional rebates. *Unconditional rebates*, while granted to certain customers and not to others, are *granted for every purchase of these particular customers, independently of their purchasing behaviour*.⁸⁵ For instance, a rebate that is offered only to customers that might more easily switch to foreign suppliers because they are located in the border region. *Unconditional rebates differentiate the purchase price between customer groups. Conditional rebates are granted to customers to reward a certain (purchasing) behaviour of these customers*. The latter type of rebates may depend on a number of aspects of the customer's behaviour, such as *the amount purchased in a preceding period from the same supplier or the percentage of total requirements purchased in a preceding period from the same supplier or the supply of a certain service by the customer*. These *conditional rebates differentiate the purchase price for each customer depending on its behaviour*. Although not necessarily so, this may also lead to a differentiation in purchase price between buyers.

⁸⁵ Such rebates are termed unconditional because they are granted independently of the purchasing behaviour of the customer in question. However, an unconditional rebate is not available to all customers as it would otherwise be a general price decrease, but is only made available to certain customers depending on characteristics other than their purchasing behaviour.

Efficiency enhancing, anticompetitive or both

138. A supplier may use single branding obligations and rebate systems for efficiency enhancing reasons and for anti-competitive reasons and they may have efficiency enhancing effects and anti-competitive effects. An efficiency may for instance be obtained *in case the supplier*, in order to supply a particular customer, makes a *relationship specific investment*. In order to be able to earn back the investment, the *supplier may require that the buyer purchases a certain minimum amount of the product*, which may be ensured by a single branding obligation or a rebate system.

The *possible positive effects of single branding obligations and rebate systems are dealt with mainly in the section on possible defences*. Before that the possible negative effects will be dealt with. *Both the positive and negative effects depend on the form of the single branding obligation and/or rebate system, on the extent such obligations or rebate systems are used by the supplier and on the circumstances on the market where they are applied*.

Main possible negative effects are horizontal foreclosure of competitors

139. The main possible negative effect of single branding obligations and rebate systems is foreclosure of the market to competing suppliers and potential suppliers, which maintains or strengthens the dominant position by hindering the maintenance or growth of residual or potential competition (*horizontal foreclosure*). In case such obligations or systems are *used by several, collectively dominant, suppliers, this may have a cumulative foreclosure effect and may in addition further facilitate collusion*. In case the buyers are retailers selling to final consumers the foreclosure may *also lead to a loss of in-store inter-brand competition*.

Price discrimination between buyers considered only if forecloses Domco's competitors

140. Another possible negative effect of rebate systems is *price discrimination between the different buyers*. In a number of cases the *Commission and European Courts have stressed not only the intent and/or effect to foreclose, but also the discrimination* which resulted from the applied rebate system, *in particular discrimination between competitors on a downstream market*.⁸⁶ This section deals with the use of rebate systems to foreclose competing suppliers and

⁸⁶ See Case – 85/76 Hoffmann-La Roche cited in footnote 5, paragraph 106; Case T-228/97 Irish Sugar, cited in footnote 38, in particular paragraphs 140-141; Case T-203/01 Michelin II cited in footnote 59, paragraph 158;

potential suppliers on the upstream market. It is considered that in most cases a *negative effect on competition between the customers on the downstream market is unlikely unless competitors are foreclosed from the upstream market.*

Discrimination to exploit customers

141. To the extent that the discrimination has the *intention and/or effect to directly exploit (certain of) the customers, this is not dealt with.* Such direct exploitation may in particular be the case where unconditional rebates are used.⁸⁷ The direct exploitation takes place by discriminating between customers and making customers with a higher willingness to pay and less switching possibilities pay a higher price than others.⁸⁸ The exclusionary rebates dealt with in this section do not result in higher prices for those customers that can not and do not switch, but higher prices for the customers that are less loyal to the supplier, i.e. the customers that do switch. Exclusionary rebates are in general conditional rebates which may differentiate the price for each customer, depending on its purchasing behaviour, in order to obtain more purchases from these customers, thus leading to infra-personal but not necessarily inter-personal price discrimination. To the extent that this may also lead to discrimination between customers, this may have the effect of distorting competition between the buyers on the down-stream market as described in the previous paragraph.

7.2 ASSESSMENT

This section deals with negative effects in the market where Domco is dominant

142. The single branding obligations and rebate systems that are dealt with in this section are applied by the dominant company *for a particular product* and have their possible negative effects in the market where it is dominant. *Single branding obligations and rebate systems that*

Case T-219/99 British Airways plc v Commission (17 December 2003) not yet reported, paragraphs 233-240. It should be noted that a discriminatory effect may be an indication for an abuse but absence of such an effect does not place a rebates system out of the reach of Article 82. See Case 322/81 Michelin I, cited in footnote 26, where the Court of justice found breach of Article 82 although it did not uphold the Commission's complaint that the rebates were discriminatory, see also Case T- 219/99 British Airways, paragraphs 248-249.

⁸⁷ As indicated by the example in paragraph 138 of a rebate that is offered only to customers that might more easily switch to foreign suppliers because they are located in the border region, unconditional rebates can also be used for exclusionary purposes.

⁸⁸ The lower price for other customers may at the same time induce extra customers to purchase from the supplier.

have effects in other markets are dealt with in the section on tying and bundling. Rebate systems that lead to mixed bundling of different products in the same market are also dealt with in the section on tying and bundling.

Domco likely to supply most of customer's requirement anyway

143. The dominant position of the supplier will make that on average the buyers, also without loyalty enhancing measures, will buy a large part or even most of their purchases from the dominant supplier. *The dominant position usually implies that for a good part of demand on the market there are no proper substitutes to the dominant supplier's product*, because for instance its brand is a 'must stock item' preferred by many final consumers or because the *capacity constraints on the other suppliers* are such that a good part of demand can only be provided for by the dominant supplier. *For distributors* it may be necessary to trade in the dominant supplier's products in order to be able to satisfy an important part of their customers' demand and in order to reach a viable scale of business.⁸⁹

Consider likely and actual foreclosure effects

144. Article 82 *addresses single branding obligations and rebate systems to the extent that these are methods different from those which condition normal competition and which have as effect to hinder the maintenance of the degree of competition still existing in the market or the growth of that competition.*⁹⁰ The Commission will make its assessment of the obligation or system *in the light of the likely and actual foreclosure effects*. In that context *it will also consider the possibilities of the existing and possible future competitors to curb and counter the fidelity enhancing potential of the dominant company's conduct.*

Relevance of size of Domco's tied share

145. The incidence, i.e. the extent that the dominant company is applying the single branding obligation or rebate system in the market, is the same as its tied market share, i.e. that part of its market share sold under the single branding obligation or rebate system. The *potential*

⁸⁹ See section 4 on dominance. See also Case T-219/99 British Airways, cited in footnote 86, paragraphs 276-278, and Case T-65/98 Van den Bergh Foods Ltd v Commission [2003] ECR II-4653, paragraph 154.

⁹⁰ Case – 85/76 Hoffmann-La Roche, cited in footnote 5, paragraph 91.

negative effects will in general depend on the size of the tied market share. In case the dominant company does not apply the single branding obligation or rebate system to a good part of its buyers but only selectively to some and not to others, the Commission will investigate *whether or not these selected buyers are of particular importance for the possibilities of entry or expansion of competitors.* It will for instance investigate *whether the tied customers are the ones that are most likely to be responsive to offers from alternative suppliers.* These customers may form a particular way of distributing the product that would be suitable for a new entrant. Or they may be customers situated in a geographic area well suited to new entry, for example because of proximity to suppliers in other geographical areas. The Commission will also take into account *whether there are economies of scale and scope, network effects or learning curve effects.*⁹¹ The Commission will also investigate *whether the single branding obligation or rebate system is targeted at the customers of specific competitors.* In such cases the Commission may find that a market distorting foreclosure effect results even though the tied market share is very modest.

Where these are good substitutes, rebate system unlikely to foreclose

146. In markets where for all or most part of demand there are proper substitutes, for instance where the *product is homogeneous* and the *competitors* to the allegedly dominant company are *not capacity constrained*, *rebate systems will generally not have a market distorting foreclosure effect.* If competitors are competing on equal terms for all the customers and for each individual customer's entire demand, then a rebate system is unlikely to have a foreclosure effect *unless the effective price under the rebate system*, calculated over all sales by the dominant company to its customer(s), is *found to be predatory* (see section 6 on predatory pricing).⁹² In case in a homogeneous product market the *competitors* of the allegedly dominant company are *capacity constrained*, a rebate system may have a foreclosure effect in case the average customer's

⁹¹ Network effects arise when consumers place greater value on larger networks than small ones. Examples include telephone networks where, in the absence of an obligation to interconnect, users directly derive value from being able to communicate with many other users, but also networks of users of computers where users indirectly derive value from more software being made available to large networks.

⁹² In general, if the market conditions are as described here, it is unlikely that a dominant position is found, even at high market shares.

demand exceeds the capacity of an individual competitor or entrant and it is costly for customers to have more suppliers.

Scheme of this section

147. The remainder of this section *will first deal with the way in which single branding obligations and rebate systems may have a market distorting foreclosure effect. This must not be seen as an effort to describe an exhaustive list of the various forms that these obligations and systems may take. The purpose is to describe the key elements of such obligations and systems that will in general influence and determine the capability and likelihood to foreclose. The text concludes with a section on possible defences.*

7.2.1 SINGLE BRANDING OBLIGATIONS AND ENGLISH CLAUSES

Capable of foreclosing, likely to foreclose

148. *Single branding obligations, because they require the buyer to purchase all or a significant part of its requirements from the dominant supplier, have by their nature the capability to foreclose. The obligation may for instance require the buyer to purchase a significant percentage of its total requirements or a minimum amount which constitutes a significant percentage of its total requirements from the dominant supplier. The higher the percentage the stronger the foreclosure potential. Such an obligation may lead to market distorting anti-competitive effects even if only a modest part of market demand is affected by the obligation. The dominant position already enables the dominant company to prevent effective competition to be maintained or to emerge in the market and it thus becomes particularly important to protect the limited degree of competition still existing in the market and the growth of that residual competition.*⁹³

Where Domco applies single branding to a good part of buyers

149. Where the *dominant company applies a single branding obligation to a good part of its buyers* and this obligation therefore affects, if not most, at least a substantial part of market

⁹³ As indicated above this is not an exhaustive list of single branding obligations. Obligations such as cooler exclusivity or stocking requirements may become single branding obligations to the extent that they effectively require the buyer to purchase all or a significant part of its requirements from the dominant supplier and possibly even lead to outlet exclusivity. See T-65/98 Van den Bergh Foods cited in footnote 89.

demand, the *Commission is likely to conclude that the obligation has a market distorting foreclosure effect and thus constitutes an abuse of the dominant position*. In its assessment the Commission will however *not only look at the capability of the obligation, the degree of dominance and the level of the tied market share*, but will also take into account *evidence why for particular reasons no market distorting foreclosure effect may result*. For instance, whereas *in general a short duration or a right to terminate the single branding obligation does not limit its likely foreclosure effect, under particular circumstances a short duration or right to terminate at short notice may make a market distorting foreclosure effect unlikely*.⁹⁴ Such may be the case where the product is a homogeneous good and competitors are not capacity constrained. In case the dominant company does not apply the single branding obligation to a good part of its buyers but only selectively to some and not to others, the *Commission will investigate whether or not these selected buyers are of particular importance for the possibilities of entry or expansion of competitors*.

‘English Clauses’

150. The Commission will apply the same approach to so-called *‘English clauses’*, *requiring the buyer to report any better offer and allowing it only to accept such an offer when the supplier does not match it*. They can be expected to have the same effect as a single branding obligation as the dominant company will only have to lower its price where there is a risk that customers switch. *The foreclosure effect may be especially strong when the buyer has to reveal who makes the better offer*, as this may discourage competitors to make competing offers to the dominant companies’ customers.⁹⁵

7.2.2 CONDITIONAL REBATE SYSTEMS

⁹⁴ In general the European Courts have not considered duration of single branding obligations to be of relevance for their assessment under Article 82. There are indeed good reasons to ignore duration as the dominant position implies that for a good part of demand on the market there are no proper substitutes to the dominant supplier’s product, because for instance its brand is a ‘must stock item’ preferred by many final consumers or because the capacity constraints on the other suppliers are such that a good part of demand can only be provided for by the dominant supplier. In such a case a short duration or the right to terminate the obligation are found to be illusory by the European Courts, see Case T-65/89 BPB Industries, cited in footnote 62, paragraph 73.

⁹⁵ See in the context of Article 81 BP Kemi (Commission Decision 79/934) OJ L 286, 14/11/1979 p. 32–52, paragraphs 64–65; In the context of Article 82, see IRI/ AC Nielsen Company, reported in the XXVIth Report on Competition Policy 1996, paragraph 64. See Case – 85/76 Hoffmann-La Roche, cited in footnote 5, paragraphs 104–108.

Retrospective Rebates

151. *Conditional rebates are granted to customers to reward a certain (purchasing) behaviour of these customers in a particular period of time. The usual form is that the customer is rewarded if its purchases exceed a certain threshold during a defined reference period. It makes an important difference for the assessment whether the rebate is granted on all purchases during that period or only on incremental purchases above the threshold. It will also be important for the assessment in what terms the threshold is formulated, for instance as a percentage of total requirements of the buyer, as an individualised volume target or as a standardised volume target. Also other characteristics may make a certain difference in the assessment, such as whether there is only one threshold and rebate or whether a grid of thresholds and rebates is established.*⁹⁶

7.2.2.1 CONDITIONAL REBATES ON ALL PURCHASES

Retrospective Rebates

152. Conditional rebates that are granted on all purchases in the reference period once a certain threshold is exceeded *can have a strong foreclosure effect.*⁹⁷ To induce such an effect it is necessary that the *dominant supplier sets the threshold above the level that the buyer would purchase from the dominant company in the absence of any loyalty enhancing obligation or rebate.* As explained in paragraph 143 above, the dominant position will in general ensure that most buyers will anyhow purchase most of their requirements from the dominant supplier, for instance because its brand is a ‘must stock item’ preferred by many final consumers *or because the capacity constraints on the other suppliers are such that a good part of demand can only be provided by the dominant supplier. If the threshold is only set at the level that would anyhow be purchased by the buyer from the dominant company, the rebate will not have a loyalty enhancing effect.* If the threshold is set above the amount that would otherwise be purchased, the rebate may induce the buyer to purchase more than it would otherwise do, in particular by diverting purchases from other suppliers to the dominant company, in order to be able to benefit from the rebate on all its purchases and thus effectively lower the price for all its purchases.

⁹⁶ If a company uses different conditional and/or unconditional rebate systems for the same product, the Commission will both assess their individual and their collective effects.

⁹⁷ Case 322/81 Michelin I, cited in footnote 26, paragraphs 70-73.

Suction Effect

153. The strength of the inducement to purchase more from the dominant supplier, i.e. the *loyalty enhancing effect*, will depend amongst other things *on the level of the rebate percentage and on the level of the threshold*. The higher the rebate percentage and the higher the amount that needs to be purchased before the rebate kicks in, the stronger the inducement just below the threshold.⁹⁸ *The fact that exceeding the threshold will not only reduce the price for all purchases above the threshold, but also for all previous purchases during the reference period, will create a so-called ‘suction’ effect*. The price of the units of the last transaction before the threshold is exceeded will effectively be seriously lower and is possibly even negative because this transaction triggers the rebate for all the purchases below the threshold in the reference period. The higher the amount that constitutes the threshold and the higher the rebate percentage, the stronger the suction effect will be near the threshold.⁹⁹ *The rebate enables the dominant supplier to use the inelastic or ‘non contestable’ portion of demand of each buyer, i.e. the amount that would anyhow be purchased by the buyer, as leverage to decrease the price for the elastic or ‘contestable’ portion of demand, i.e. the amount for which the buyer may prefer and be able to find substitutes.*¹⁰⁰

Suction effect stronger on final unit bought - ATC

154. *The suction effect in principle is strongest on the last purchased unit of the product before the threshold is exceeded*. However, what is relevant for an assessment of the loyalty enhancing effect is not competition to provide an individual unit, but the *foreclosing effect of the rebate system on commercially viable amounts supplied by (potential) competitors of the dominant supplier*. These competitors are smaller rivals already active in the market and potential entrants. *The rebate system should not hinder as efficient competitors to expand or enter. As these competitors can not compete for an individual customer’s entire demand (see §143 above) the question is whether the rebate system hinders them from supplying*

⁹⁸ In case the rebate is granted not in the form of a percentage but in the form of a lump sum payment once the threshold is exceeded, the inducement will be higher if the lump sum rebate increases. However, in such a case the inducement felt near the threshold will not be related to the level of the threshold.

⁹⁹ This has been recognised in the case law. Case 322/81 Michelin I, cited in footnote 26, paragraph 81; Case T-203/01 Michelin II, cited in footnote 59, paragraphs 87-88; Case T-219/99 British Airways, cited in footnote 86, paragraphs 272-273.

¹⁰⁰ See Case T-203/01 Michelin II, cited in footnote 59, paragraphs 162-163.

commercially viable amounts to individual customers. In other words, whether the rebate system hinders them to supply commercially viable shares of individual customers' requirements. To answer this question the *Commission will endeavor to calculate*, in view of the level of the rebate percentage, what is *the effective price for the buyer over such a commercially viable share in case this share would allow the buyer to benefit from the rebate on the purchases below the threshold.* The lower the calculated effective price is compared to the average price of the dominant supplier, the stronger the loyalty enhancing effect. In case this effective price is below the average total cost of the dominant company, it will be very difficult and possibly even impossible for as efficient competitors to compete with the dominant company for this part of demand. In case the effective price is above cost this may make it possible for efficient competitors (in the long run) to match the dominant company's offer, but it may exceptionally still work as a disincentive on expansion or entry by competitors. *The main reason to take ATC as the cost benchmark below which the rebate system is considered to lead to an exclusionary effective price is that the leveraging between the 'non-contestable' and the 'contestable' portion of demand allows the rebate system to operate without a profit sacrifice and thus to operate for a long time.* The customer may not derive a direct benefit from the rebate system as the rebate may only bring the average price down to the level existing without the rebate system. Below is a box giving an example of the calculation of the effective price.

Box A retro-active rebate and calculation of the effective price

Rebate of 2.5% on all sales once $St > 1,000,000$

St is the purchased amount in the reference period

Price per unit = 100 before rebate

Price per unit = 97.5 after rebate

Commercially viable amount = 5% or 50,000 units

With rebate: $1,000,000 \times 97.5 = 97,500,000$

Without rebate: $950,000 \times 100 = 95,000,000$

The difference of 2,500,000 is what is paid for the last 50,000 units over which the suction effect is calculated

P effective (P_e) over the last 5% = $2,500,000 / 50,000 = 50$

The question is thus whether or not $ATC > 50$

Required Share

155. As a first step the Commission will endeavour to calculate how big a share of customers' requirements on average the entrant at least should capture so that the effective price is at least as high as the average total cost of the dominant company (*"the required share"*).¹⁰¹ In a number of cases the *size of this share, when compared to the actual market shares of competitors and their shares of the customers' requirements*, may make it clear whether the rebate system is able to have a foreclosure effect. In case the shares of the customers' requirements purchased from actual rivals are smaller than the required share, the rebate scheme is likely to have a foreclosure effect where there is in addition no indication that these rivals are less efficient. In such a situation a rival would have to more than double its sales to these customers to overcome the foreclosure effect. *In case the market share of each competitor is much bigger than the required share, the rebate system is unlikely to have a foreclosure effect that hinders competition.*

Box: calculation of the required share in case of a uniform rebate

The required share (RQS) is calculated as follows:

$$\text{RQS} = R \times P / (P - \text{ATC})$$

Where R is the rebate percentage customers obtain once they have purchased more than the threshold, P is the (list) price without the rebate and ATC is the average total cost of producing the product of the dominant company.

For instance, where the rebate is 5%, P is 100 and ATC is 75:

$$\text{RQS} = 5\% \times 100 / (100 - 75) = 20\%$$

What to do if foreclosure not clear

¹⁰¹ In case the required share differs significantly between customers because of differing rebates, the Commission will not calculate the average share for all customers but an average share per group of customers with a similar rebate. It will evaluate the importance of these different groups of customers for entry and expansion.

156. Where it is *not clear from the required share itself whether or not the rebate system is likely to have a foreclosure effect*, the Commission will endeavour to assess the commercially viable share an efficient competitor or entrant can be expected to supply and to compare this with the required share. The required share is the share of customers' requirements an entrant should capture so that the effective price resulting from the rebate would equal the average total cost of the dominant company. The commercially viable share is the share of customers' requirements an efficient entrant can reasonably be expected to capture and determines over which part of the customers' demand the effect of the rebate needs to be assessed. Where the required share exceeds the commercially viable share the rebate system is likely to have a foreclosure effect which reduces competition as the effective price that results from the rebate system over this commercially viable share will be below the average total cost of the dominant company.¹⁰²

Box: comparing commercially viable share and required share

If $CVS = RQS$ and thus $CVS = R \times P / (P - ATC)$, then $Pe = ATC$

If $CVS < RQS$ and thus $CVS < R \times P / (P - ATC)$, then $Pe < ATC$

If $CVS > RQS$ and thus $CVS > R \times P / (P - ATC)$, then $Pe > ATC$

To assess commercially viable share in context of specific market and sector

157. The *commercially viable share that is appropriate in a particular case will have to be assessed in its specific market and sector context*. In its assessment the Commission will in particular be attentive that the rebate system does not foreclose potential competitors. As to the latter, the Commission will in general first assess what is the effect of the rebate system on a company that wants to enter at minimum efficient scale. The Commission will establish the effect on an entrant that would enter at minimum efficient scale and which would sell the same percentage to each customer in the market. If this first estimate of the commercially viable share

¹⁰² In case rebate percentages differ between customers the required share may exceed the commercially viable share for certain customers but not for others. In such a case the Commission will take the ratio and importance of these two groups of customers into account in the assessment. The same holds if, in case of a grid of rebates, the required share is above the commercially viable amount for some rebates but not for others.

is smaller than the required share, the Commission will continue to investigate whether this estimate of the commercially viable share is not too low. It may be too low, for instance, because entry is likely to occur at a larger scale than the minimum efficient scale, because other incumbent competitors are likely to expand at a larger scale or because entrants are likely to concentrate sales on a limited number of customers to whom they can sell more per customer. Such reasons may necessitate revising the estimate upward and establish whether the revised commercial viable share is still smaller than the required share.

Terms in which the threshold is formulated

158. It is also important for the assessment in what terms the threshold is formulated. An *important distinction* can be made between on the one hand a formulation in terms of a *percentage of total requirements of the buyer or an individualised volume target* and on the other hand a *standardised volume threshold*. *The first two allow the dominant supplier to set the threshold at which the rebate kicks in at such a level as to create a maximum loyalty enhancing effect*. Setting the threshold in terms of a percentage of total requirements of the buyer is most straightforward in order to enhance loyalty.¹⁰³ Individualised volume targets allow the dominant supplier to create the same loyalty enhancing effect.¹⁰⁴ Such requirement percentage targets and individualised volume targets are normally set in view of the purchases made by the same buyer in the previous period and may also take the form of growth targets. *The loyalty enhancing effect may increase in case the threshold is adjusted to the individual demand of the customer in successive periods*. In case there is some uncertainty about the optimal target to be set, for instance because of changing loyalties or because of overall demand changes, *the targets are sometimes formulated in the form of a grid of targets with different rebates*. In case the threshold(s) is (are) formulated in terms of a percentage of total requirements of the buyer or an individualised volume target, the *Commission will normally presume that it (they) is (are) set at*

¹⁰³ See Case 85/76 Hoffmann-La Roche, cited in footnote 5, paragraphs 89-90; Case T-65/89 BPB Industries, cited in footnote 62, paragraphs 68 and 120; Soda-ash-Solvay (Commission Decision 91/299) OJ 152, pp. 21-39, paragraphs 16-17.

¹⁰⁴ See Case 85/76 Hoffmann-La Roche, cited in footnote 5, paragraph 97; Case 322/81 Michelin I, cited in footnote 26, paragraphs 72-73 and 81-82; Case T-288/97 Irish Sugar, cited in footnote 38, paragraph 213; Case T-203/01 Michelin II, cited in footnote 59, paragraphs 75, 81 and 207-208; Case T-219/99 British Airways, cited in footnote 86, paragraphs 7-11 and 270-273.

such level(s) as to hinder customers to switch to and purchase substantial additional amounts from other suppliers and thus enhance loyalty.

Standardised Volume Target

159. *In case the threshold set is a standardised volume threshold, it is less likely that the rebate system will have a loyalty enhancing effect.* Because the volume threshold at which the rebate kicks in is set at the same level for all buyers, the threshold may be too high for smaller buyers and/or too low for large buyers to have a loyalty enhancing effect. The smaller buyers may never reach the threshold, while the larger buyers may purchase considerably more than the threshold. In such a case the rebate system is unlikely to have a foreclosure effect as switching to an alternative supplier for part of its demand currently purchased from the dominant company will not make the buyer lose the rebate. In general a rebate system with standardised volume thresholds is therefore less likely to be found abusive. *If, however, it is established that the standard volume threshold(s) is (are) well targeted,* for instance because most of the buyers are purchasing more or less the same amount close to the threshold or can be classified in a limited number of size groups while combined with a linked grid of thresholds, the Commission will presume that it (they) is (are) set at such level(s) as to hinder customers to switch to and purchase substantial additional amounts from other suppliers and thus enhance loyalty.

Did customers know their target & level of rebate?

160. For the assessment whether the loyalty enhancing effect and foreclosure effect of a rebate scheme are market distorting it may also make a difference whether the customers are left in uncertainty as to the level of the target threshold and/or the level of the rebate. Such uncertainty may, where the customers want to minimise the risk of not obtaining the rebate, induce further loyalty.¹⁰⁵ Similarly, uncertainty on the part of the customers whether they will be able during the reference period to reach the target threshold may, especially in case of a longer reference period, induce further loyalty. *Evidence of this could be obtained from customers of the dominant company.* This type of effect will in particular play a role in case the rebate is so high

¹⁰⁵ See Case 85/76 Hoffmann-La Roche, cited in footnote 5, paragraphs 98-100; Case 322/81 Michelin I, cited in footnote 26, paragraphs 83-84; Case T-203/01 Michelin II, cited in footnote 59, paragraphs 111 and 141.

that without the rebate the customer can not make a profit when using or reselling the product concerned.¹⁰⁶

Conditions when rebate or single branding likely to be abusive

161. The case law of the Community Courts gives some relevance to the length of the reference period and as stated in the previous paragraph this factor may have an impact on the degree of uncertainty felt by the customer. However, in most cases the length of the reference period has no bearing on the loyalty enhancing effect. The exception is where the dominant company is no longer an unavoidable trading partner. This could be the case where the reference period is very short and therefore the customer's requirements in that period so low that the different competitors can compete for all requirements of the customer in that period, in which case the rebate system will normally not have a loyalty enhancing effect (see also paragraphs 143 and 146). This could also be the case where the product is homogeneous, in which case a long reference period and a high threshold may work as a disincentive to switch supplier after having started to purchase from the dominant supplier.¹⁰⁷

Conditions when rebate or single branding likely to be abusive

162. In view of the above, where it is established that:

- (a) The dominant company applies a conditional rebate system where the rebates are granted on all purchases in a particular period once a certain threshold is exceeded, and
- (b) There is no indication that this threshold is set so low that for a good part of the dominant company's buyers it can not hinder them to switch to and purchase substantial additional amounts from other suppliers without losing the rebate, and
- (c) The required share exceeds the commercially viable amount per customer, and

¹⁰⁶ This is for instance clearly the case if the list price, i.e. the price without the rebate, is above the resale price on the downstream (distribution) market.

¹⁰⁷ There is a similarity here with the conclusion that in general the duration of single branding obligations is not relevant for their assessment under Article 82 (see footnote 94).

(d) The dominant company applies the rebate system to a good part of its buyers and this system therefore affects, if not most, at least a substantial part of market demand, and

(e) There are no clear indications of a lack of foreclosure effect such as aggressive and significant entry and/or expansion by competitors and/or switching of customers,

The Commission is likely to conclude that the rebate system creates a market distorting foreclosure effect and thus constitutes an abuse of the dominant position. In case the dominant company does not apply the rebate system to a good part of its buyers but only selectively to some and not to others, the Commission will in addition investigate whether or not these selected buyers are of particular importance for the possibilities of entry and expansion of competitors. The Commission's preliminary conclusion will be strengthened where there are also clear indications of an actual foreclosure effect such as exit or declining market shares of competitors or de-listing of their products.

Domco may rebut presumption of foreclosure

163. *In case such a presumption of abuse is established, the dominant company may rebut the Commission's preliminary conclusion by showing that the rebate system nonetheless does not and will not have a foreclosure effect, for instance because the individualised or standard volume targets are set particularly low compared to the buyers' total purchases from the dominant company. The dominant company may thus be able to show that the rebate system does not and will not create a foreclosure effect because most or all buyers can switch to and purchase substantial additional amounts from other suppliers without losing the rebate. Another way to rebut the Commission's preliminary conclusion may be to show that entry or expansion of competitors is in effect not limited to the amount assessed by the Commission as the commercially viable share. In case the dominant company can show that entry or expansion can take place without extra difficulties at a larger scale, then the Commission will reassess the effective price in the light of this higher amount.*

Where required or commercially viable share uncertain

164. *Where it is not possible to establish accurately the required share because reliable information on the dominant company's costs is not available, the Commission may use cost data of apparently efficient competitors. Where it is in general not possible to accurately establish the required share or the commercially viable share, the Commission will overall assess to what extent the rebate system hinders expansion or entry by competitors. It will do so by investigating the market performance of the dominant company and its competitors, preferably by comparing the situation before and after the rebate system was introduced. It will amongst others estimate the importance of the rebate by comparing its size to the full price per unit of product and will assess the indications of an actual foreclosure effect such as exit or declining market shares of competitors or de-listing of their products.*

165. *In case it is clearly established that the effective price is above ATC, it is unlikely that the Commission will conclude that a market distorting foreclosure effect results. However, exceptionally this may be concluded, for instance if it is established that the dominant company operates in a market where it has certain non-replicable advantages and that the rebate system is likely to exclude entrants that would help the competitive situation on the market to improve. In such a situation the dominant company could prevent entry or eliminate entrants by using rebates while the effective price stays above its own ATC. For such rebates to be assessed as abusive additional elements will have to be shown, in this case that the entrant will only be less efficient because of these non-replicable advantages.*

7.2.2.2 CONDITIONAL REBATES ON INCREMENTAL PURCHASES ABOVE THE THRESHOLD

Important whether rebate retrospective or incremental

166. *Whether the conditional rebate is available to all purchases below and above the threshold once the latter is exceeded or only to incremental purchases above the threshold makes an important difference to the way possible loyalty enhancing effects are induced and how they are assessed.¹⁰⁸ In case the rebate is only available to incremental purchases, the dominant supplier, in order to create in a cost efficient way a loyalty enhancing effect, will try to set the threshold at*

¹⁰⁸ This applies to percentage rebates. A rebate in the form of a lump sum once the threshold is exceeded is by definition available for all purchases.

the level that the buyer would purchase in the absence of any loyalty enhancing obligation or rebate. If the threshold is set at the amount that would anyhow be purchased, the rebate may induce the buyer to purchase extra units in order to be able to benefit from the rebate on these incremental purchases.

Loyalty Enhancement depends on:

167. *The strength of the inducement to purchase more from the dominant supplier, i.e. the loyalty enhancing effect, will depend in the first place on the level of the rebate percentage: the higher this percentage, the lower the price for these additional purchases. It will not be important for the assessment whether the threshold is set in terms of a percentage of total requirements of the buyer or an individualised volume target, as both are ways to set the threshold at what would anyhow be purchased.* Here too a grid may be used by the dominant supplier in case of uncertainty about the optimal threshold to be set, for instance because of changing loyalties or because of overall demand changes.

Conditional rebate on incremental purchases

168. In view of the above, once it is established that the *dominant company grants conditional rebates only on incremental purchases* and where the *threshold is set in terms of a percentage of total requirements of the buyer or an individualised volume target*, the Commission will conclude that the rebate system constitutes *an abuse only if the resulting price for these incremental purchases is a predatory price*. The Commission will apply to such a system the *guidance as developed in the section on predatory pricing*. In that context, as the *leveraging between the ‘non-contestable’ and the ‘contestable’ portion of demand allows the rebate system to operate without a profit sacrifice and thus to operate for a long time, an abuse is considered likely if the resulting price does not cover average total cost and the part of demand to which the rebate is applied is important enough to create a foreclosure effect*.

If rebate incremental and target standardised

169. Also in case it is established that the dominant company grants conditional rebates *on incremental purchases* but that the threshold is set in terms of a *standardized volume target*, will the Commission *apply the guidance as developed in section 6 on predatory pricing*. In such

a case it is unlikely that the rebate system will have a loyalty enhancing effect. Because the volume target at which the rebate kicks in, is set at the same level for all buyers, *the target may be too high for smaller buyers and/or too low for large buyers to have a loyalty inducing effect.* The smaller buyers may never reach the threshold, while for the larger buyers the threshold may be easily reached. *Where however it is established that most of the buyers are purchasing more or less the same amount and that the standard volume target happens to work as an individualised volume target for these buyers or where it is established that the standard volume rebate happens to target selectively buyers that are of particular importance for the possibilities of entry and expansion of competitors, the system may have loyalty enhancing effects* and the Commission will apply the *same rebuttable presumption* of predation in case the price for the additional units is below average total cost.

7.2.3 REBATES IN RETURN FOR THE SUPPLY OF A SERVICE BY THE BUYER

170. *Conditional rebates where the condition that triggers the rebate is the supply of a service by the customer, such as a rebate for payment in cash or payment upon delivery, will normally not be abusive.* However, this does not mean that conditional rebate systems as described in the previous paragraphs *can be justified* by claiming that the buyers are encouraged but not obliged to use the rebates obtained if they exceed a certain percentage of total requirements or an individualised volume target, for promotion or other activities.¹⁰⁹

7.2.4 UNCONDITIONAL REBATES

Selective unconditional rebates (see predatory pricing)

171. Unconditional rebates, while *granted to certain customers and not to others*, are granted for every purchase of these particular customers, independently of their purchasing behaviour. Unconditional rebates differentiate the purchase price between customers and *may have exploitative effects* (see paragraph 141 above). However, *unconditional rebates may also have exclusionary effects*, for instance if a rebate is offered only to customers that might more easily switch to foreign suppliers because they are located in a border region. *To assess possible*

¹⁰⁹ See Case 322/81 Michelin I, cited in footnote 26, paragraph 73; Case T-65/89 BPB Industries, cited in footnote 62, paragraph 71; Case T- 203/01 Michelin II, cited in footnote 57, paragraph 137.

exclusionary effects the Commission will apply to these unconditional rebates and the resulting lower prices for certain customers the guidance as developed in the section on predatory pricing. In its assessment the Commission will take into account that the exclusionary effect may not only inhibit entry and competition for these customers that may more easily switch, but may also delay entry and competition that would benefit the other customers of the dominant company. In such a case *recoupment may take place not just after but also during the time that the predation takes place* (see section 6, paragraph 121). Here too the selectivity will be taken as an important part of the evidence to show that there is intent to predate and the Commission will apply the *same rebuttable presumption of predation in case the price for the additional units is below average total cost.*

7.2.5 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Four Conditions

172. In case a single branding obligation or a rebate system is likely to have an appreciable foreclosure effect, *the dominant company may argue* that it can justify its obligation or rebate system because of efficiency considerations. *In order for the efficiency defence to apply to the obligation or rebate system, it must be shown that the four conditions described in section 5.3.3., paragraph 84, are fulfilled.*

1) Indispensable to obtain cost savings passed on to consumers

173. A first example could be that the *rebate system is indispensable to obtain cost advantages and pass them on to the customers.* These cost advantages *may be related to the size of the individual transaction or delivery and to the size of total purchases by a customer in a particular period.* Such cost savings *need to be substantiated.* General remarks about transaction cost savings or general claims of better production planning are not enough.¹¹⁰ Such cost savings *may require a rebate system using a (grid of) standardised volume target(s) but are unlikely to require and are unlikely to be efficiently achieved with a rebate system where the threshold is set in terms of a percentage of total requirements of the buyer or an individualised volume target.*

¹¹⁰ Case 322/81 Michelin I, cited in footnote 26, paragraph 85; Case C-163/99 Portugal v Commission, cited in footnote 57, paragraphs 55-56; Case T-203/01 Michelin II, cited in footnote 59, paragraphs 107-108.

2) *Induce higher sales and avoid double marginalisation*

174. A second example could be that the rebate system is *indispensable to incite the customers to purchase and resell a higher volume and avoid double marginalisation*. Here it needs to be shown in the first place that the *customer has considerable market power and that without the rebate system the resulting resale price applied by the customer would be higher than the price a vertically integrated monopolist would ask* and that thus without the rebate system total output would be lower. Such efficiency *may require a rebate system with conditional rebates on incremental purchases above a certain threshold* but is unlikely to require and is *unlikely to be efficiently achieved with a rebate system with conditional rebates on all purchases*.

3) *Incentive to supplier to make relationship-specific investments that are sunk*

175. A *third example could be that the rebate system or the single branding obligation is indispensable to provide the incentive for the dominant supplier to make certain relationship-specific investments in order to be able to supply a particular customer*. An investment is considered relationship-specific if, after termination of the supply contract with that particular customer, the investment cannot be used by the supplier to supply other customers and can only be sold at a loss. General or market-specific investments in (extra) capacity are normally not relationship-specific investments. In case of relationship-specific investments the dominant supplier may not want to commit these investments before particular supply arrangements are fixed. Before such can be considered necessary it must be shown that the *relationship-specific investment is a significant long-term investment that is not recouped in the short term and that the investment is asymmetric*, i.e. that the supplier invests more than the buyer. Under such circumstances it may be indispensable to require that the customer purchases at least a certain minimum amount over a period and to an extent necessary to allow depreciation of the relationship-specific investment and thus *solve the holdup problem*. In case future demand is uncertain it may not be possible to require absolute minimum amounts to be purchased, in which case an alternative more adequate measure may be to impose a rebate system or a single branding obligation until the investment is depreciated.

Meeting Competition

176. *Meeting competition can in general not be used as a justification for single branding obligations.*¹¹¹ This holds both for those obligations already in place before a competitive action took place as for obligations introduced upon a competitive action in the market.

8. TYING AND BUNDLING

8.1 INTRODUCTION

Definitions of Tying and Bundling

177. *Tying occurs when the supplier makes the sale of one product (the tying product) conditional upon the purchase of another distinct product (the tied product) from the supplier or someone designated by the latter. Only the tied product can be bought separately. Bundling refers to situations where a package of two or more goods is offered. Cases where only the bundle is available and not the components are referred to as pure bundling. Cases where both the bundle and the components are available on the market are referred to as mixed bundling if the bundle is sold at a discount to the sum of the prices of the components.*¹¹² Tying and bundling may have similar effects on competition.

Tying and bundling are common practices, often harmless and efficient

178. *Tying and bundling are common practices that often have no anticompetitive consequences. Both companies with and without market power engage in tying and bundling in order to provide their customers with better products or offerings in cost effective ways. At the most basic level, bundling or integrating two or more components into one product is a fundamental part of many economic activities. Such bundling can lead to significant savings in production, distribution and transaction costs and to improved quality. Companies may also engage in tying for reasons related to the quality, reputation and good usage of their machines.*

¹¹¹ Case T-228/97 Irish Sugar, cited in footnote 38, paragraphs 186-187 and 189.

¹¹² The distinction between mixed bundling and pure bundling is not necessarily clear-cut. Mixed bundling may come close to pure bundling when the prices charged for the individual offerings are high.

Tying and bundling can have anti-competitive effects – foreclosure, price discrimination & higher prices

179. *However, tying and bundling can lead to the following possible anticompetitive effects: foreclosure, price discrimination and higher prices. The present section deals only with the foreclosure effects of tying and bundling.*

Horizontal Foreclosure

180. *A company that is dominant in the tying market can through tying or bundling foreclose the tied market and can indirectly also foreclose the tying market (horizontal foreclosure). By tying the dominant company reduces the number of potential customers that is available for its competitors in the tied market. This may cause existing competitors to be marginalised or exit from the tied market and create a barrier for new entrants. Economies of scale, network effects and high entry barriers in the tied market all make such a strategy more likely and more successful.*

Domco may foreclose in tied market and indirectly in tying market

181. *The foreclosure of the tied market may allow the dominant company to achieve larger profits in the tied market, for example through catching more of the customers in that market. Moreover, tying may allow the dominant company to protect or strengthen its dominant position in the tying market. If the tied good is important for buyers of the tying good a reduction of alternative suppliers of the tied good can make entry in the tying market more difficult, since it may in the end make it necessary to enter both the tying and the tied market in order to compete effectively. Furthermore, the dominant firm may through tying force the exit from the tied market of a product which is or may become itself a threat to the dominant product in the tying market.¹¹³*

8.2 ASSESSMENT

¹¹³ Pure and mixed bundling can have similar foreclosure effects to those described above for tying. However, the terminology used for tying may not be appropriate, since in a sense both markets become tied in the case of pure bundling, while none of them are “tied” in the traditional sense in the case of mixed bundling.

Article 82(d)

182. Tying is mentioned by Article 82(d) as a possible abuse. According to this article it is abusive to make “*the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts*”. However, it may be abusive for a dominant company to tie sales of products *even when this is in accordance with commercial usage in the market*.¹¹⁴ Typically tying involves the dominant undertaking by contract depriving its customers of the choice to obtain the tying product without the tied product (*contractual tying*). However, the dominant company may also as a matter of fact deprive its customers of this choice, if the dominant undertaking refuses to sell the tying good individually (tying) or any of the two products individually (*pure bundling*). *Technical tying* occurs when the tied product is physically integrated in the tying product. *Customers may also be deprived of the choice in less direct ways*. The dominant company may, for example, *refuse to acknowledge guarantees* unless customers use its components, consumables or services. Mixed bundling (*commercial tying*) is an indirect measure to achieve the same result as through contractual tying by inducing customers to purchase the tied product through granting bonuses, rebates, discounts or any other commercial advantage. Also *mixed bundling* can be an abuse under Article 82(d).¹¹⁵ Therefore, *the possible abuse is the practice by which a dominant company either imposes on customers the acquisition of one product or service conditional upon the purchase of another (tying) or forces or economically induces customers to only buy a bundle consisting of the two products (pure or mixed bundling)*.

Conditions of Abuse

183. For such practices to be prohibited under Article 82, the presence of the following elements is usually required: (i) *the company concerned is dominant in the tying market*¹¹⁶; (ii) *the tying and tied goods are two distinct products*; (iii) *the tying practice is likely to have a*

¹¹⁴ C-333/94 P Tetra Pak II, cited in footnote 74, paragraph 37.

¹¹⁵ Case 85/76 Hoffman-La Roche, cited in footnote 5, paragraph 111.

¹¹⁶ The analysis differs in the special case of tying in aftermarkets, which is described in section 10.

market distorting foreclosure effect; (iv) the tying practice is not justified objectively or by efficiencies.

8.2.1 DOMINANCE IN THE TYING MARKET

Dominant in tying market

184. For tying to be abusive the company concerned needs to *be dominant in the tying market*.¹¹⁷ It is not necessary *that the company also is dominant in the tied market. However, dominance also in the tied market renders the finding of an abuse more likely.* In order to assess this properly it is *normally necessary to define the relevant market(s) on which both the tying and the tied product are sold.*

8.2.2 DISTINCT PRODUCTS

Depends on customers' demand

185. What can be considered as distinct products is *determined by the demand of the customers.* Two products are *distinct if, in the absence of tying or bundling, from the customers' perspective, the products are or would be purchased separately.* It is, however, *not necessary that the two products belong to two separate product markets.* In a market with *differentiated products,* two products may be sufficiently differentiated that a company can be said to tie or bundle two distinct products.¹¹⁸

Direct or indirect evidence that markets are distinct

186. Evidence that two products are distinct *can include direct evidence* that, when given a choice, customers purchase the products separately. *Or indirect evidence* that *companies with little market power, particularly in competitive markets, tend not to tie the two products,* presumably because this best serves the demand of the customers. Another example of indirect evidence is the situation where *there are already on the market independent companies who are*

¹¹⁷ In case of bundling dominance in one of the markets concerned is necessary.

¹¹⁸ In such a case it is necessary that the company concerned can be considered dominant by virtue of selling one of the two products (the tying product) on its own, since the sales of the tied product allegedly result from the tying or bundling practice. Practices involving two or more units of the same product, such as imposing minimum purchasing requirements and giving loyalty rebates, may also be abusive; such practices are analysed in section 7 on single branding and rebates.

*specialised in the manufacture and sale of the tied product without the tying product. Such indirect evidence may come from other geographical markets with more competitive conditions. Commercial usage may also indicate that two products are not distinct, and that the tying may be done for non-exclusionary purposes.*¹¹⁹ *Often combinations have become accepted practice because the nature of the product makes it technically difficult supplying one product without also supplying another product.*¹²⁰ Such combinations are more likely to be found not to be tying practices than is contractual tying or bundling.

187. A particular problem arises in determining whether a new product development integrating two products that previously were distinct would mean that the combination in the future should be considered to be one product. Deciding this entails *evaluating whether consumer demand has shifted as a consequence of the product integration so that there is no more independent demand for the tied product*. Such a scenario could be envisaged in cases of technological integration rather than in cases of contractual tying or bundling.

8.2.3 MARKET DISTORTING FORECLOSURE EFFECT

Possible foreclosure – 2 aspects

188. The main direct anticompetitive effect of tying and bundling is possible foreclosure on the market of the tied product.¹²¹ In principle, the assessment of the foreclosure effect on the tied market *can be considered to consist of two parts*. First, to establish *which customers are “tied”* in the sense that competitors to the dominant company cannot compete for their business. *Second, to establish whether these customers “add up” to a sufficient part of the market being tied*. However, *an overall assessment of the likely foreclosure effect of the tying or bundling practice will be made*, which will combine an analysis of the practice, its application in the market, and the strength of the dominant position. The elements described below therefore *cannot be applied in a mechanical way*. Where the Commission on the basis of the elements

¹¹⁹ However, as mentioned in paragraph 182, commercial usage does not automatically bring a certain practice outside the scope of Article 82.

¹²⁰ Similar evidence may come from the behaviour of a dominant company before it achieved dominance.

¹²¹ For expositional ease the section on the foreclosure effect uses the terms “tying market” and “tied market”. In the cases of pure and mixed bundling, these terms may not be immediately applicable and the analysis should be appropriately adapted.

described below finds that *the dominant company ties a sufficient part of the market*, the Commission is likely to reach *the rebuttable conclusion* that the tying practice has a market distorting foreclosure effect and thus constitutes an abuse of dominant position.

Tying & pure bundling forecloses, mixed bundling may do so

189. In the case of *tying and pure bundling*, the individual customers in question clearly are foreclosed to the competitors - at least until the expiry of contracts in the case of contractual tying. In the case of *mixed bundling* this is less clear. Both products are available but may be priced in such a way that it would not be rational for customers to buy individual products from the bundle to match them with complementary products produced by a competitor. *Competitors are foreclosed if the discount is so large that efficient competitors offering only some but not all of the components, cannot compete against the discounted bundle.*

LRIC if including tied product

190. The *incremental price that customers pay for each of the dominant company's products in the bundle should therefore cover the long run incremental costs of the dominant company of including this product in the bundle.*¹²² This would allow an equally efficient competitor with only one product to compete profitably against the bundle. Long run incremental cost is used as the cost concept, since this captures the extra costs of the dominant company's activities in the market(s) in which it is not dominant. If a price charged by the dominant company covers its incremental costs, such a price cannot normally be considered exclusionary. The same must hold for the incremental prices described in this section. However, it *may exceptionally be concluded that although the price exceeds the long run incremental costs the mixed bundling nonetheless is considered exclusionary* (see paragraphs 67 and 129).

If Domco's incremental cost hard to calculate:

191. In certain cases it *may be difficult to calculate the incremental costs of the dominant company. In such situations a case can be based on information about a rival if there are no good reasons to believe that the rival is less efficient than the dominant company. First, if cost*

¹²² In principle, it would be more correct to use incremental revenue rather than incremental price. However, the complications of calculating incremental revenue mean that in most situations using incremental price is more practical

data are available for such a rival, the incremental price for the dominant company can be compared with the costs of the rival. Second, if no such cost data are available, it may be possible to show that the rival was actually excluded or marginalised following the bundling by the dominant company. If such methods are used, the dominant company has the possibility to rebut the findings by using its own incremental costs.

Incremental price of one item in bundle

192. A bundle may be discounted in various ways. In the simplest case, *a bundle AB consisting of two products A and B has a separate price that is lower than the sum of the stand-alone prices of A and B.* In that case the incremental price of product B is measured as the price of the bundle AB less the stand-alone price of product A. Similarly, the incremental price of a product C sold in a discounted bundle ABC is the price of ABC less the sum of the stand-alone prices of A and B (or the price of AB if such an option exists).

Multi-product Rebates

193. *The calculation of the incremental price may be more complicated if the discount is given in the form of a multi-product rebate.* The fact that a rebate is multi-product is not in itself problematic. A simple rebate giving a percentage discount on every purchase of a supplier's products does not in itself tie the products together. However, *competition problems may arise if the granting or the size of such a rebate is, for instance, conditional on buying several products from the dominant company or on reaching sales targets either for several products individually or added together.* In such a situation the granting or the size of a rebate for one product is dependent on the customer's purchases of one or more other products, and the products are therefore tied in the eyes of the customer. To calculate the effect of the rebate, the *incremental price should therefore incorporate the loss of rebate that the customer would incur if it stopped purchasing one but continued to purchase the other products from the dominant company.* Stopping purchasing a product may mean losing the entire rebate if, for instance, the rebate was given conditional on reaching a certain target purchase of the product that the customer considers to stop purchasing. Or it may mean that the rebates granted on the remaining purchases are lower, because a certain overall target purchase level is no longer reached.

Incremental price that varies as between customers

194. As the amounts acquired of the various products that are part of the bundle may differ from customer to customer, the *incremental price may also differ from customer to customer*. In order to understand the foreclosure effect of a given multiproduct rebate scheme, an *assessment of the effect of the rebate on the incremental price paid by the various customers may therefore be necessary*. If there are few customers in a market, this may be relatively straightforward. *If there are many customers it may be necessary to look at various customer groups with similar purchasing behaviour and assess the incremental price for each of these groups*. It may be a useful starting point to look at the market as a whole and calculate whether the “*incremental market price*” for the product covers the long run incremental costs for this product. However, as mentioned below, any analysis of the market-wide foreclosure effect also will need to pay attention to whether the multi-product rebate ties customers that are particularly important for the entry or expansion of rivals or whether the multi-product rebate is targeting the customers of specific competitors.

If Domco and competitors sell similar bundles

195. *If the competitors to the dominant company sell similar bundles* it may be less relevant to consider whether the incremental revenue covers the incremental costs for each product in the bundle. Such a situation is *better seen as bundle competing against bundle* and the *relevant question is then whether the price of the bundle as a whole is predatory* using the methodologies described in section 6.

Aspect 2 of tying and bundling – is whole market foreclosed?

196. The *second part of the assessment* is to establish *whether the market as a whole can be considered to be foreclosed*. The analysis of the foreclosure effect will take into account *several factors*. In general, the *higher the tied percentage of total sales on the tied market, the larger is normally the foreclosure effect*. However, the overall strength of the dominant company on both the tying and the tied markets should also be taken into account. Another important factor is the *identity of the tied customers*. For example, some customers may be important from an entry-detering point of view in that they would be most likely to be responsive to offers from

alternative suppliers. These customers may form a particular way of distributing the tied product that would be suitable for a new entrant. They may also be customers situated in a geographic area well suited to new entry, for example because of proximity to suppliers in other geographical areas. Or they could be the customers of specific, targeted competitors. *A growing share of a market with network effects* may also be problematic even if the share is still fairly low.¹²³

Other companies may also tie

197. The fact that other companies also tie *may add to the foreclosure effect, since this can contribute to making entry more difficult.*

Number of customers who buy both products

198. Another factor that may be important in assessing whether there is an appreciable foreclosure effect is *the number of customers that buy both products*. For instance, if only a third of the customers in the tied market buy both products, tying may pose less of a risk, since the tying practice may remain contained to at most a third of the market. However, *the tying could still in this case have an appreciable foreclosure effect, for example if some or all of the tied customers are particularly important* from an entry-deterring point of view.

Foreclosure stronger if entry barriers in tied market

199. The foreclosure effect is likely to be *stronger if there are significant scale economies, learning curve or network effects or entry barriers in the tied market*. Scale economies and learning curve effects may mean that rivals in the tied market are not able to stay in the market if the dominant company forecloses part of the tied market through tying or bundling. Similarly, network effects may allow the dominant company to “tip” the market as the tying can deprive its rivals of the chance to derive network effects through the tied customers.¹²⁴ The stronger the network effects, the higher the likelihood of foreclosure. When the customer’s value of a product or a bundle of product increases with the number of other customers using that product, it is more difficult for competitors to compete with the tying company since they have to discount their products to compensate customers for the lack of a network. Finally, entry

¹²³ Network effects arise when consumers place greater value on larger networks than small ones. See footnote 91.

¹²⁴ Commission decision in Case No COMP/37.792 Microsoft of 24.3.2004.

barriers in the tied market make it easier for the dominant company to protect itself from potential rivals in the tied market.

Product Differentiation in Tied Market

200. *Product differentiation in the tied market may reduce the foreclosure effect* as competitors are more likely to be able to survive in the market. Customers with strong preferences for the products of competitors in the tied market may, for instance, prefer to switch to a rival product in the tying market rather than forego their preferred product in the tied market.

Market performance of Domco and its competitors

201. *The market performance of the dominant company and its competitors may provide evidence about the foreclosure effect.* The market share of the dominant company in the tied market may rise after the company starts or intensifies the tying practice and some or all of its competitors may be marginalised or exit. *Also entry attempts* can provide evidence about possible foreclosure effects.

Possible Counter-strategies

202. *Rivals may have effective counter-strategies at their disposal that would allow them to protect themselves against the strategies of the dominant company.* Such counter-strategies could, for instance, consist in buying from a producer in the other market in order to create a bundle that can compete with the combined offering of the dominant company.

Counter-strategies of important customers

203. *Also important customers may have effective counter-strategies.* This may, in particular, be the case for customers in the tied market, especially if the tying company is not also dominant in this market. If such buyers are not themselves tied they may be able to prevent the marginalisation of the rivals to the dominant company or sponsor new entry into the tied market.

8.2.4 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Objective justification (see 5.3.1 above)

204. The dominant company may argue that it is an *objective necessity to tie products for reasons of quality or good usage of the products necessary to protect the health or safety of the customers. The general framework for analysis of such arguments is given in section 5.3.1.* It is, however, worth recalling that it is *not the task of a dominant company to take steps on its own initiative to eliminate products which it regards, rightly or wrongly, as dangerous or inferior to its own products.*

Efficiency Defence

205. The dominant company may *also invoke an efficiency defence. Tying and bundling may help to produce savings in production, distribution or transaction costs. Combining two independent products into a new, single product may be an innovative way to market the product(s).* Such combinations are more likely to be found to fulfil the conditions for an efficiency defence than is contractual tying or bundling.¹²⁵

Conditions for Efficiency Defence in section 5.3.3

206. *For tying not to be abusive, it must be shown that all of the conditions described in section 5.3.3 are fulfilled.* For instance, tying would be considered abusive when a retailer is able to obtain, on a regular basis, supplies of the same or equivalent products on the same or better conditions than those offered by the supplier which applies the tying practice, as *evidently the pass on is not realised.* In many cases *contractual tying* may not be indispensable to achieve the efficiencies and the price incentive contained in mixed bundling normally needs only to reflect the effective cost efficiency that is realised. Similarly, for a claimed efficiency effect of tying *helping to ensure a certain uniformity and quality standardisation,* it needs to be demonstrated that the positive effects cannot be realised equally efficiently by requiring the buyer to use or resell products satisfying minimum quality standards, without requiring the buyer to purchase these from the supplier or someone designated by the latter.

9. REFUSAL TO SUPPLY

¹²⁵ A persuasive argument that it is so efficient to combine the two products into one that the whole industry in the future will offer the integrated product instead of two separate products may lead to the conclusion that the two products are no longer distinct (see paragraph 187).

9.1 INTRODUCTION

Even Domcos are entitled to chose whom to supply

207. *Undertakings are generally entitled to determine whom to supply and to decide not to continue to supply certain trading partners. This is also true for dominant companies.*

Horizontal refusal to supply or threats may be anticompetitive

208. *Refusals to supply or threats of refusals to supply by dominant companies may, however, be anticompetitive. Examples include halting supplies to punish buyers for dealing with competitors¹²⁶ and refusing to supply buyers that do not agree to exclusive dealing or tying arrangements. In such circumstances the refusal to supply is best viewed as an instrument to achieve another purpose, such as exclusive dealing or tying, and should therefore be analysed as part of a single branding or tying practice.¹²⁷ Such practices are normally not aimed at excluding the buyer but rather a competitor of the dominant company.*

Vertical Foreclosure

209. *This section focuses instead on situations where a dominant company denies a buyer access to an input in order to exclude that buyer from participating in an economic activity (vertical foreclosure). Although the excluded buyer could be only a customer, typically competition problems arise when it also is a rival to the dominant company in the economic activity for which the input is needed. This type of exclusion may cover a broad range of practices, such the termination of an existing commercial relationship as,¹²⁸ the refusal to supply products, to provide information, to license intellectual property rights (IPR)¹²⁹ or to grant access to an essential facility or a network.¹³⁰ Practices such as delaying tactics in supplying, imposing*

¹²⁶ Case 27/76 United Brands, cited in footnote 5.

¹²⁷ See sections 7 and 8.

¹²⁸ Joined Cases 6/73 and 7/73, Istituto Chemioterapico S.p.A. and Commercial Solvents Corporation v Commission, [1974] ECR 223.

¹²⁹ Case 238/87, AB Volvo v Erik Veng (UK) Ltd, [1988] ECR 6211; Joined Cases C-241/91 P and C-242/P Magill, cited in footnote 58; and Case C-418/01, IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG, [2004] ECR I-5039.

¹³⁰ See Commission Decisions B&I Line plc v Sealink Harbours Ltd and Stena Sealink Ltd [1992] 5 CMLR 255; IV/34.689 Sea Containers v Stena Sealink – Interim Measures, (Commission Decision 94/19/EC of 21 December 1993, OJ 1994 L 15, 18.01.1994, pp. 8–19); Port of Rødby (Commission Decision of 21 December 1993, OJ 1994

unfair trading conditions and charging such prices that it is not economically viable for the buyer to continue its activity may also in reality amount to a refusal to supply.

May be exclusionary abuse

210. A refusal to supply *may be classified as an exclusionary abuse*. The dominant company prevents the requesting or terminated party from getting access to an input. As a result, this undertaking is either driven out of the market, marginalised or prevented from entering the market. *For a refusal to supply to be abusive, it must, however, have a likely anticompetitive effect on the market which is detrimental to consumer welfare.*

Collective refusal to supply

211. A refusal to supply *by several companies that are in a collectively dominant position can also be an abuse*. This could take the form of *refusing access to an input that is collectively owned by a group of companies*. In addition, *several collectively dominant companies refusing access to their individually owned inputs also could be abusive*.

212. It is useful to distinguish between an “upstream” market for access to the input and a “downstream” market for which the input is needed in order to manufacture a product or provide a service.¹³¹ *The owner of the input may refuse to supply in order to achieve a larger share of the profits in the downstream market*. Moreover, the refusal to supply *may allow the input owner to protect its position in the upstream market*. If the downstream market is necessary as an outlet for a product or service from the upstream market, by eliminating competition in the downstream market the owner of the input may make it less attractive for potential rivals to challenge its position in the upstream market. Furthermore, eliminating competition in the downstream market can also eliminate the possible competition from a product in the downstream market which is or may become a threat to the input in the upstream market.

Purpose of requiring access

L 26.02.1994, pp 52/57; IV/33.544 British Midland v Aer Lingus, (Commission Decision 92/213/EEC of 26 February 1992, OJ 1992 L 9610/04/1992, pp. 34– 45.

¹³¹ The terminology “upstream” and “downstream” may not always be completely appropriate in that the input may be at the same level as or downstream from the market for which it is needed. This may, for instance, arise where one undertaking controls a “downstream” distribution level that is indispensable in order to access customers.

213. *The main purpose of forcing companies to supply is to improve the competitive situation in the downstream market. However, investment incentives may also be influenced, both negatively and positively. The knowledge that they may have a duty to supply against their will might lead companies not to invest in the first place or to invest less. Other companies may be tempted to free ride on the investment made by the dominant company instead of investing themselves. However, access to the input may also lead other firms to increase investment in, for instance, follow-on research and development that would otherwise not be possible or profitable. Enforcement policy towards refusals to supply has to take into account both the effect of having more short-run competition and the possible long-run effects on investment incentives.*

Close scrutiny of factual and economic context required

214. Given these considerations, *any obligation to supply pursuant to Article 82 can be established only after a very close scrutiny of the factual and economic context; the factors which go to demonstrate that an undertaking's conduct in refusing to supply is abusive are highly dependent on the specific economic and regulatory context in which the case arises.*

9.2 ASSESSMENT

Variety of practices and situations

215. The *concept refusal to supply covers a variety of practices and situations; it is not possible for this paper to cover all of them. The situations that are covered are the following: First, where one or more companies are terminating an existing supply relationship; second, where one or more companies are refusing to start supplying an input, including where this input is covered by intellectual property rights; third, where this input is information necessary for interoperability.*

For access to electronic communications networks see Access Notice

216. As far as *specific issues of access to networks in the electronic communications sector* are concerned, the principles laid down in the relevant notice on the application of the competition rules should be applied.¹³²

¹³² Access Notice, cited in footnote 2, in particular paragraphs 83-130.

9.2.1 TERMINATION OF AN EXISTING SUPPLY RELATIONSHIP

Domco must have found supply efficient & customers have sunk cost

217. That the dominant company in the past has found it in its interest to supply an input to one or more customers *shows that the dominant company at a certain point in time considered it efficient to engage in such supply relationships*. This and the fact that its *customers are likely to have made investments connected to these supply relationships create a rebuttable presumption that continuing these relationships is pro-competitive*.

4 Conditions for Abuse

218. The following four conditions normally have to be fulfilled in order to find the termination of a supply relationship abusive: *(i) the behaviour can be properly characterised as termination; (ii) the refusing undertaking is dominant; (iii) the refusal is likely to have a negative effect on competition; (iv) the refusal is not justified objectively or by efficiencies*.

9.2.1.1 BEHAVIOUR PROPERLY CHARACTERIZED AS TERMINATION

What counts as refusal?

219. In many cases it is evident that an undertaking is terminating a supply relationship. *In other situations it will have to be established that a certain type of behaviour in reality amounts to a termination*. This can involve evaluating practices such as, for instance, *delaying tactics in supplying, imposing unfair trading conditions, or charging excessive prices for the input*.¹³³

Margin or price squeeze

220. *A particular behaviour, which can amount to a termination, is a “margin” or “price squeeze”*. This may occur *when the upstream input owner is integrated downstream and thus competing with actual or potential buyers of the input, and the margin between the price for the upstream input charged to competitors on the downstream market and the downstream price charged by the input owner is insufficient to allow a reasonably efficient competitor to obtain a normal profit*. The typical benchmark for a reasonably efficient competitor is the integrated

¹³³ Such practices are sometimes called “constructive” refusals to supply.

input owner. A margin squeeze could therefore be demonstrated by showing that the input owner's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by its upstream operating arm.¹³⁴

9.2.1.2 DOMINANCE

Competition problems only if dominant

221. A termination of a supply relationship can only raise *competition problems if the undertaking refusing to supply has a dominant position on a defined market*. This will often be an “upstream” input market, but it may also be a distinct market where access is needed to link this market with another market, for example to interface information.

9.2.1.3 LIKELY MARKET DISTORTING FORECLOSURE EFFECT

Abuse only if termination distorts market downstream

222. The termination of one individual customer from the downstream market does not in itself constitute an abuse. *An abuse may only arise when the termination is likely to have a negative effect on competition in the downstream market*. This should however *not* be understood to mean the *complete elimination of all competition*. The extent to which the termination of one customer has an impact on the level of competition depends on the pre-existing competition on the downstream market. In some cases, the termination of one customer may have a detrimental effect on the level of competition; in other cases the impact may be small to insignificant. For instance, if there are several competitors in the downstream market and the supplier of the input is not itself active in that market, the impact on competition of the termination may be small unless the exclusion is likely to lead to collusion. However, if the input owner is itself active in the downstream market and terminates supplies to one of its few competitors, it will normally be presumed that there is a negative effect on competition on the downstream market.

Identity of excluded competitor important

223. *The identity of the excluded competitor may be important for the assessment of the effect on the level of competition of the exclusion*. The exclusion of a particular competitor may

¹³⁴ See also Access Notice, cited in footnote 2, paragraphs 117-119.

have a special effect on competition, for instance if *it follows a different business model* than the established competitors on the market, while the exclusion of a competitor similar to the established competitors may not have the same negative effect on competition.

9.2.1.4 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Examples of Objective Justification

224. It may be an *objective justification for a termination of a supply relationship that an undertaking being terminated is not able to provide the appropriate commercial assurances that it will fulfil its obligations*. The dominant company may also argue that it is terminating the supply relationship because *it wants to integrate downstream and itself perform the downstream activities*. In such a situation it *falls upon the dominant company to show that consumers are better off with the supply relationship terminated*. This situation should be compared with both the existing situation continuing and with the situation where the vertically integrated dominant company competes downstream with its input customers.

9.2.2 REFUSAL TO START SUPPLYING AN INPUT

Five conditions normally have to be fulfilled in order for a refusal to start supplying to be abusive: (i) the behaviour can be properly characterized as a *refusal to supply*; (ii) the *refusing undertaking is dominant*; (iii) the *input is indispensable*; (iv) the refusal is *likely to have a negative effect on competition*; (v) the refusal is *not objectively justified*.

9.2.2.1 BEHAVIOUR PROPERLY CHARACTERIZED AS REFUSAL TO SUPPLY

Refusal to supply new customers delaying tactics, etc.

225. In many cases it is evident that an undertaking is refusing to supply new buyers. *In other situations it will have to be established that a certain type of behaviour in reality amounts to a refusal to supply*. This can involve evaluating practices such as, for instance, *delaying tactics in supplying, imposing unfair trading conditions, or charging excessive prices for the input*.

9.2.2.2 DOMINANCE

Article 81 infringed only if refusal by dominant company

226. A refusal to start supplying can only raise competition problems if the undertaking refusing to supply has a dominant position on a defined market. This will often be an “upstream” input market, but it may also be a distinct market where access is needed to link this market with another market, for example to interface information.¹³⁵

Hypothetical or potential market

227. In some circumstances, there may not be an existing market for the input in question as it is used only by the owner in a captive market. For example, an IPR may be nothing more than an input that is not marketed separately from the goods and services to which the IPR relates. However, it is sufficient that a captive market, that is, a potential market, or even a hypothetical market, can be identified. Such is the case where there is actual demand for the input on the part of undertakings seeking to carry out the activity for which the input is indispensable.¹³⁶

9.2.2.3 INDISPENSABILITY

228. To be an abuse the refusal to start supplying must concern an input, which is indispensable to carry on normal economic activity in the downstream market. Without this input companies cannot manufacture their products or provide their usual service levels. Therefore, when real or potential substitutes exist in the market, the input of the dominant company is not indispensable. The same holds if it would be legally and economically possible for other companies to produce the input in question themselves.

Indispensable narrowly defined

229. A facility is an indispensable input only when duplication of the existing facility is impossible or extremely difficult, either because it is physically or legally impossible to duplicate, or because a second facility is not economically viable in the sense that it would not

¹³⁵ COMP/C-3/37.792 (Microsoft) Commission Decision of 24.03.2004.

¹³⁶ Case C-418/01 IMS Health, cited in footnote 129, paragraph 44.

generate enough revenues to cover its costs.¹³⁷ One element that may be relevant for reaching such a conclusion is the switching costs that customers would have to incur in order to use an alternative structure.¹³⁸

Access to IPR may be indispensable

230. *In the case of IPRs it must not be possible for competitors to turn to any workable alternative technology or to “invent around” the IPR. Such a requirement would likely be met where the technology has become the standard or where interoperability with the rightholder’s IPR protected product is necessary for a company to enter or remain on the product market.*

9.2.2.4 LIKELY MARKET DISTORTING FORECLOSURE EFFECT

231. *The fourth criterion is the likely negative effect on competition. The likely exclusion of one individual competitor from the downstream market does not in itself constitute an abuse. An abuse only may arise when the exclusion of competitors is likely to have a negative effect on competition in the downstream market. This should however not be understood to mean the complete elimination of all competition. The extent to which the exclusion of one competitor has an impact on the level of competition depends on the pre-existing competition on the downstream market. In some cases, the exclusion of one competitor may have a detrimental effect on the level of competition; in other cases the impact may be small to insignificant. For instance, if there are several competitors in the downstream market and the owner of the indispensable input is not itself active in that market, the impact on competition of the exclusion may be small unless the exclusion is likely to lead to collusion. It is more likely that there is a negative effect on competition on the downstream market if, for instance, the input owner is itself active in the downstream market and excludes one of its few competitors.*

Identity of excluded firm may be important

232. *The identity of the excluded actual or potential competitor may be important for the assessment of the effect on the level of competition of the exclusion. The exclusion of a particular*

¹³⁷ Case 7/97 Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. K, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG [1998] ECR I-7791, paragraphs 43-46.

¹³⁸ See Case C-418/01 IMS Health, cited in footnote 129, paragraph 29.

competitor may have a special effect on competition, for instance *if it follows a different business model than the established competitors on the market*, while the exclusion of a competitor similar to the established competitors may not have the same negative effect on competition.

Impact on new market

233. The *exclusion may also have a negative impact on competition in a new and not yet existing downstream market*, if the owner of the indispensable input *refuses access to a buyer that would use the input to manufacture a new product or provide a new service in such a not yet existing market*.

9.2.2.5 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Examples of Objective Justifications

234. It *may be an objective justification for a refusal to start supplying that an undertaking seeking access is not able to provide the appropriate commercial assurances that it will fulfil its obligations*. In the case of an essential facility, *access may be denied if the facility is capacity constrained or if granting access would lead to a substantial increase in cost that would jeopardize the economic viability of the facility holder*. Access may also be denied if the *undertaking seeking access is not technically able to use the facility in a proper manner*.

Incentives to invest in sunk costs may justify exclusion for a time

235. In the assessment of a refusal to supply it must also be kept in mind that the *indispensable input*, be it a raw material, an essential facility or an intellectual property right, *often is the result of substantial investments entailing significant risks*. In order to *maintain incentives to invest and innovate*, the dominant firm must not be unduly restricted in the exploitation of valuable results of the investment. For these reasons the *dominant firm should normally be free to seek compensation for successful projects that is sufficient to maintain investment incentives, taking the risk of failed projects into account*. To achieve such compensation, it may be necessary for the dominant firm to exclude others from access to the input for a certain period of time. *The risks facing the parties and the sunk investment that must be committed may thus mean that an dominant firm should be allowed to exclude others for a*

certain period of time in order to ensure an adequate return on such investment,¹³⁹ even when this entails eliminating effective competition during this period.

More likely to be abusive if investments would have been made anyhow – e.g.

236. *The circumstances in which a refusal to supply by a dominant company may be abusive are therefore more likely to be present when it is likely that the investments that have led to the existence of the indispensable input would have been made even if the investor had known that it would have a duty to supply. This could be the case if the input is indispensable only because the owner enjoys or has enjoyed until recently special or exclusive rights within the meaning of Article 86(1) EC. Another example could be that the original investment primarily was made for reasons not related to the market in which the company asking access to the input intends to use*

the input. The original investment in a facility may also have been made by a public authority using investment criteria that likely would have led to the investment being made even if there would have been a duty to supply. And the investments behind innovations leading to intellectual property rights may not have been particularly significant, in which case it may be likely that the investment would have been made even knowing that a duty to supply would be imposed. In making such assessments the Commission will take account of the respective values that are at stake, including the possible positive effects on incentives to follow-on investment from allowing access.

9.2.2.6 REFUSAL TO LICENCE INTELLECTUAL PROPERTY RIGHTS

An extra condition for access to IPRs

237. In the case of a refusal to license an IPR an additional condition may have to be met, as described in this section.

¹³⁹ See also Commission Notice Guidelines on the application of Article 81(3) of the Treaty, cited in footnote 3, paragraphs 44 and 81, and Joined Cases T-374/94, T-375/94, T-384/94 and T-388/94 European Night Services Ltd (ENS), Eurostar (UK) Ltd, formerly European Passenger Services Ltd (EPS), Union internationale des chemins de fer (UIC), NV Nederlandse Spoorwegen (NS) and Société nationale des chemins de fer français (SNCF) v Commission [1998] ECR II-3141, paragraph 230.

No general obligation to license an IPR

238. *There is no general obligation for the IPR holder to license the IPR, not even where the holder acquires a dominant position in the technology or product market. The very aim of the exclusive right is to prevent third parties from applying the IPR to produce and distribute products without the consent of the holder of the rights. This protection would be eroded if the holder of a successful IPR would be required to grant a licence to competitors from the moment the IPR or the product incorporating the IPR becomes dominant in the market. Imposing on the holder of the rights the obligation to grant to third parties a licence for the supply of products incorporating the IPR, even in return for a reasonable royalty, would lead to the holder being deprived of the substance of the exclusive right.*¹⁴⁰

Obligation to license only in exceptional circumstances

239. *The refusal to license an intellectual property therefore does not in itself constitute an abuse.*¹⁴¹ *Only under exceptional circumstances can the refusal to license an IPR be considered an abuse.*¹⁴² *For example, the refusal by a dominant company to license access to the IPR could be considered abusive when the five conditions described above are all fulfilled and, furthermore, the refusal to grant a licence prevents the development of the market for which the licence is an indispensable input, to the detriment of consumers. This may only be the case if the undertaking which requests 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.*¹⁴³

License may be indispensable as basis for follow on innovation

240. *A refusal to licence an IPR protected technology which is indispensable as a basis for follow-on innovation by competitors may be abusive even if the licence is not sought to directly incorporate the technology in clearly identifiable new goods and services. The refusal of*

¹⁴⁰ Case 238/87 Volvo, cited in footnote 129, paragraph 8.

¹⁴¹ On the other hand, the mere fact that the refused input is a licence to a valid IPR protected by law is not in itself an objective justification.

¹⁴² Case 238/87 Volvo, cited in footnote 129, paragraphs 8-9; Joined Cases C-241/91 P and C-242/P Magill, cited in footnote 58, paragraph 49; and Case C-418/01 IMS Health, cited in footnote 129, paragraph 34.

¹⁴³ Case C-418/01 IMS Health, cited in footnote 129, paragraph 49.

licensing an IPR protected technology should not impair consumers' ability to benefit from innovation brought about by the dominant undertaking's competitors.

9.2.3 REFUSAL TO SUPPLY INFORMATION NEEDED FOR INTEROPERABILITY

Special case when enables Domco to leverage dominance from one market to another

241. *A special case arises when an undertaking refuses to supply information in a way that allows it to extend its dominance from one market to another.* This is the case for information necessary for interoperability between one market and another. Although there is no general obligation even for dominant companies to ensure interoperability, leveraging market power from one market to another by refusing interoperability information may be an abuse of a dominant position.

Even if information is a trade secret

242. *Even if such information may be considered a trade secret it may not be appropriate to apply to such refusals to supply information the same high standards for intervention as those described in the previous subsection.*

10. AFTERMARKETS

10.1 INTRODUCTION

Secondary markets - examples

243. *Aftermarkets* are also sometimes called “secondary markets”. Such markets comprise complementary products (or “secondary products”) that are purchased after the purchase of another product (the “primary product”) to which it relates. Standard examples include after sales services and spare parts for durable goods, as well as consumables such as ink cartridges and toner for printers and photocopiers. However, also *upgrades of computer software may be considered aftermarkets.*

Supplier of primary product may try to reserve secondary market for itself

244. *Aftermarkets typically appear in competition cases when they are “proprietary”, that is, when they are brand-specific in that secondary products that can be used with one brand of primary product cannot be used with another brand of primary product, although the primary products themselves are substitutes. The contentious issue is often that the supplier of a primary product attempts to reserve the secondary market for itself.*

Market definitions may be too narrow

245. The application of traditional market definition tools such as the *SSNIP-test* to *aftermarkets often leads to the definition of markets comprising only the products of the supplier of the primary product.* Often patents or know-how will allow the supplier of the primary product to have a monopolistic position on the aftermarket.

Extent to which competition in primary market controls supplier of secondary products

246. *The strong position of the supplier on such product markets may, however, not be indicative of the actual degree of market power of the supplier, since it may be constrained by competition in the primary market.* If the primary market is competitive, competition in the primary market may make price increases in the aftermarket unprofitable due to its impact on sales in the primary market, unless prices in the primary market are lowered to offset the higher aftermarket price. *Competition in the primary market may thus ensure that the overall price of the bundle of goods and services comprising the primary product and the secondary product(s) is competitive.* In such a situation the supplier of the primary product cannot be said to be dominant on the aftermarket.

10.2 ASSESSMENT

10.2.1 MARKET DEFINITION¹⁴⁴

Affects on primary market should be considered

247. At the market definition stage the Commission applies the normal approach described above in Section 3 on market definition.¹⁴⁵ This means asking whether the secondary products in a

¹⁴⁴ See also paragraph 56 of the Commission Notice on the definition of the relevant market, cited in footnote 11.

given aftermarket can be considered to form a relevant product market without taking into account effects on sales of the primary product giving rise to this particular aftermarket. In other words, *the focus of the market definition exercise is on the aftermarket sales to customers who have already acquired the primary product and not on potential new future buyers of the primary product.* The full effects of “bundle” or “systems” competition will thus be taken into account in the dominance analysis.

Primary market may not constraint producer in secondary products

248. An aftermarket consisting of the secondary products of one brand of primary product may not be a relevant product market in two situations. *First, if it is possible to switch to the secondary products of other producers.* Even though a customer has bought one brand of primary product the customer may not be “locked in” in the aftermarket and would switch to the secondary products of other producers if prices in the aftermarket were to increase. In such a situation questions of dominance and abuse should be analysed on the common “aftermarket” including the secondary products of other producers.

Switch to another primary market

249. Secondly, *it may be possible to switch to another primary product* and thus avoid the higher prices in the aftermarket. This would require that switching costs are not so high as to make such an option too expensive. Switching costs can basically be of two types. First, it may not be possible to sell the used primary product at a sufficiently attractive price that a switch would be economical. This is more likely to be important if the price of the primary product is high compared to the costs of the secondary product. It should be kept in mind that prices in the market for secondhand primary products may be influenced by the same actions that lead customers to consider switching. For instance, higher prices for spare parts will often lead to lower prices for second-hand primary products. Secondly, there may be significant investments other than the price involved in switching to another primary product. Examples of such investments are training, changing routines, installations, software etc. Such investment costs may restrain a customer from switching even where there is a well-functioning market for second-hand primary goods. If the conclusion is reached that there is no separate aftermarket, the

¹⁴⁵ See Case T-30/89 Hilti, cited in footnote 18, paragraph 66.

analysis must be conducted on the overall “systems” market. Dominance would then have to be established on this market and not on a separate aftermarket.

Scope of this section

250. *The remainder of this section analyses the case where a separate aftermarket consisting of the secondary products of one brand of primary product has been identified.*

10.2.2 DOMINANCE

When secondary product market separate

251. If an aftermarket consisting of the secondary products of one brand of primary product has been found to constitute a relevant product market, a dominant position on such a market can only be *established after analysis of the competition on both the aftermarket and the primary market.*

Consider possibilities and incentives for supplier of other brands of secondary products

252. *In the analysis of entry barriers to the aftermarket, attention should be given to the possibilities and incentives for suppliers of other brands of secondary products to adapt their products to allow entry into the aftermarket under investigation. In many aftermarkets the supplier of the primary product has proprietary rights - such as patents - or private information making entry difficult. Furthermore, suppliers of other primary products may be wary of entering the secondary market of a rival supplier for fear of retaliatory entry into their own secondary market.*

253. *The supplier of the primary product often has a very strong position on the aftermarket. If entry barriers are high it is therefore often easy to reach the conclusion that competition on the aftermarket on its own is not sufficient to restrain the supplier of the primary product. In such cases the link between primary market competition and the aftermarket determines whether a dominant position is found.*

Distinguish effect on customers who have bought primary product

from future customers of primary product

254. It is useful to *distinguish the effect* of a dominant position *on the aftermarket* on customers who may buy the primary product in the future and customers who have already bought the primary product.¹⁴⁶ As described in detail below, competition in the primary market may allow future customers to avoid negative effects of high aftermarket prices.¹⁴⁷ However, *competition in the primary market does not protect customers who have already bought the primary product* from being harmed *if the supplier changes policy* and raises prices or lowers quality after the customer bought the primary product.

Future customers may be protected by the primary product

255. *Future customers may be protected from harm by competition in the primary product market.* A supplier of a primary product will consider the effects on sales in the primary market of the price and quality of products and services in the aftermarket. There are two reasons for which the supplier may want to keep aftermarket prices low or compensate high aftermarket prices by lowering prices in the primary market so as to keep the overall price the customer pays for the “bundle” of primary and secondary products attractive.

Consumers of primary product may be concerned about cost of replacement parts

256. First, *consumers may base their purchasing decision not only on the price of the primary product but also on the aftermarket prices.* Secondly, even if consumers are not basing their choice on accurate life cycle calculations, the *competitors of the supplier in the primary market* are supposedly able to make such calculations and *may compete hard on primary market prices while enjoying profits on the subsequent aftermarket sales.* As a result, the supplier may not be enjoying high overall (“bundle” or “systems”) profits even though aftermarket prices are high.

The information available to consumers is important

¹⁴⁶ Although some of those who have already bought the primary product probably are potential future customers as well; for instance, when they need to replace their existing equipment. However, as noted below, even with respect to future purchases their situation may be different from other customers who have not yet bought the primary product.

¹⁴⁷ In the following, the expression “higher prices” in the aftermarket should be understood to also cover the possibility of lower quality.

257. The amount of information available to consumers is an important factor for assessing the extent to which the customers, when buying the primary product, make a calculation of the overall cost of the bundle. The information available must enable customers to make accurate calculations. This is more likely to be so when the secondary product is a consumable used with the primary product in fixed proportions, than in the case of spare parts and services.

Life Cycle costs

258. Moreover, for this competitive constraint from the primary market to function effectively, a sufficient number of customers must engage in life cycle cost calculations, and the supplier concerned must not be able to discriminate between customers that make such calculations and those that do not. For instance, a primary product may be purchased by both private and professional buyers. If only professional buyers make (accurate) life cycle calculations, the supplier may still have substantial market power in the aftermarket vis-à-vis private customers.

Strong competition in primary market may constrain primary supplier in secondary market

259. Strong competition in the primary market may restrain the primary product supplier in the aftermarket also if customers are not basing their choice on accurate life cycle calculations. This may be the case even if aftermarket prices are high, since lower primary market prices may compensate for this. The result would be that the margin earned on the sale of a system is competitive. This could be investigated by various methods, including the following: *first*, the system margin could be compared to margins in other markets or for other products, where there is no proprietary aftermarket. *Second*, the price of a system could be compared to the price of systems in either the same or other markets sold by other companies without a proprietary product market. *Third*, it could be analysed whether the system margin allows it a return on capital in the relevant market that is unusually high for the industry sector in question.

If company weak in primary market, unlikely that supplier dominant in secondary market

260. *Generally speaking, the stronger the competition on the primary market, and the weaker the position of the supplier in question on this market, the less likely it is that the supplier in question can be considered dominant on the aftermarket because of the link between the primary market and the aftermarket described above. This link is in particular likely to protect future customers in the primary market.*

Supplier may change its policy

261. *A supplier may, however, at a certain point decide to change policy and raise prices in the aftermarket or restrict the possibilities of other suppliers in the aftermarket. This means that the supplier is no longer restrained in the aftermarket by the link with the primary market. The supplier may therefore be found to have a dominant position.*

Installed base opportunism

262. *Such a policy change is sometimes called “installed-base opportunism”. Installed-base opportunism is more likely to take place when the future prospects for the supplier in the market are poor, for instance because the market is declining or the supplier has decided to exit or is losing market share. On the other hand, even a supplier in these conditions may hesitate to engage in installed-base opportunism if such behaviour can hurt its reputation in other markets.*

Counter-strategies to installed base opportunism

263. *Some customers may be protected against installed-base opportunism by contractual provisions such as long-term service contracts, non-discrimination clauses or the possibility to switch to other suppliers of primary or aftermarket products. If many customers are protected in this way, the overall damage to customers from the change in policy may be relatively limited.*

10.2.3 ABUSE OF DOMINANT POSITION

If dominant in aftermarket, presumption that abusive to exclude from aftermarket

264. *If a dominant position on an aftermarket has been established following the methodology described above, the Commission presumes that it is abusive for the dominant company to reserve the aftermarket for itself by excluding competitors from that market. Such exclusion is*

mostly done through either tying or a refusal to deal. The tying can come about in the various ways described in the section on tying. The refusal to deal may, for instance, involve a refusal to supply information needed to provide products or services in the aftermarket; a refusal to license intellectual property rights; or a refusal to supply spare parts needed in order to provide aftermarket services.

10.2.4 POSSIBLE DEFENCES: OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES

Objective justification and efficiency defence as for tying

265. The dominant company may bring forward as *possible objective justifications arguments similar to those described in the tying section*; that is, arguments related to, for instance, the *guarantee of the quality and good usage of the products*. The dominant company may also invoke an efficiency defence. For instance, *reserving the aftermarket to itself may help the dominant company to achieve savings in production, distribution or transaction costs*. The comments made on such arguments in the tying section apply equally here.

Notes and Questions on DG Competition discussion paper on the application of Article 82 of the Treaty to Exclusionary Abuses (DP)

1. What is the purpose of “public consultation” discussion papers versus the “guidance” that the Commission publishes from time to time? Why do you think DG Comp did not issue guidelines?
2. Paragraph 4 of the DP stresses that the Commission’s approach to Art. 82 enforcement will be based on the “likely effects” of the conduct in question on the market. What other approach has/might the Commission take(n).
3. In 1998 the European Commission issued its “Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings.” In it the Commission emphasized an “effects-based” approach. In paragraph 5, it elaborated that the Commissioner “will focus on those types of conduct that are most harmful to consumers.” However in paragraph 6, it added that it will emphasize “safeguarding the competitive process in the internal market and ensuring that undertakings which hold a dominant position do not exclude their rivals by other means than competing on the merits...”. Does it appear that any

conflicts in approach to exclusionary practices, as suggested in note 4 below, were resolved during the three year consultation period?

4. Paragraphs 1 and 9 of the Guidance paper suggest that dominant firms have a “special responsibility” to ensure that their conduct does not impair effective competition on the common market, yet this responsibility was neglected in the DP a few years earlier. Might its inclusion reflect the development of case law or political compromise or both?

5. In paragraph 91, regarding “the efficiency defense” the Discussion Paper emphasizes that the “protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains.” Does this reflect the lasting influence of the Ordo-liberal school on European competition law or can it be explained otherwise? Does this paragraph conflict with the requirement in paragraph 87 that the dominant firm need only to demonstrate that the efficiencies resulting from the conduct outweigh any negative effects on competition and consumers or paragraph 54 which emphasizes the Commission’s concern with protecting competition not competitors?

6. In paragraph 97, the Discussion Paper acknowledges that successful predatory pricing is “a risky strategy” while noting that it “is not impossible.” The U.S. Supreme Court similarly acknowledged in *Matsushita Electric Industrial Co. v. Zenith Radio* 475 U.S. 590 (1986) that “*predatory pricing schemes are rarely tried, and even more rarely successful.*” However, the Discussion Paper goes on for 36 additional paragraphs discussing how properly to assess pricing that may be predatory. Why go to such great lengths to address conduct that is so rarely attempted or successful?

7. In paragraph 17, the DP asserts that the SSNIP test may be an appropriate measure of market power in a “leveraged” market whereas it may not be an appropriate measure of a dominant firm’s market power in the market in which it is dominant. What accounts for this difference?

8. In paragraph 18, the DP asserts that when examining interchangeability of products, it is not important to consider whether merely some of the consumers do not find the product interchangeable so long as a significant portion does. Why does the Commission seem to disregard those consumers that might not have a viable alternative?

9. In paragraph 25, the DP distinguishes between market power of a supplier from that of a buyer (“buyer power”). What is the likely effect on prices and supply in a market featuring a dominant buyer? Can such a result be characterized as competitive harm? Why or why not?

10. In paragraph 31, the DP discusses market share threshold percentages and the likelihood of each category being considered dominant. Do these thresholds seem artificial? How could a firm with less than 40% market share be characterized as “dominant”?

11. In paragraph 33, the discussion paper distinguishes between “differentiated products” within a market. How do “differentiated products” differ from products in separate product markets?

12. Paragraph 44 et seq. discuss the conception of “collective dominance.” When are two or more firms collectively dominant but yet fall outside of Art. 81’s prohibition against cartels?

13. In paragraph 66, the DP indicates that it will evaluate a dominant firm’s conduct based on whether it would tend to exclude a competitor “as efficient” as Domco. If as described earlier, a competitor “as efficient” has similar or lower costs than the dominant firm then what does that imply regarding the prohibited conduct by a dominant firm relative to its own costs? Why would we be concerned that a presumably rational dominant firm might act this way?

14. In paragraph 110, the DP asserts that where pricing is below AAC, the Commission need not establish other elements of predation such as the likelihood of recouping losses sustained by the alleged predatory conduct. Later, in paragraph 122, the DP curiously poses the question whether it is reasonable to assume that the exclusionary effect of the alleged predatory conduct will allow Domco to recoup its losses. The DP then asserts that recoupment is presumed to be possible by the very definition of a “dominant undertaking” and that it is sufficient that the Commission demonstrate the likelihood of recoupment by showing, for example, that factors such as high barriers to entry are present. Why does pricing below AAC establish a presumption that the conduct is predatory, whereas pricing above AAC but below ATC require a sufficient demonstration despite the fact that it is presumably more difficult to recoup one’s losses for pricing below AAC than above it?

15. In paragraph 121, the DP asserts that profits derived from other markets or customers may indicate that Domco is already recouping losses attributable to predatory pricing. Wouldn’t a profit-maximizing firm set prices in other markets at a profit-maximizing level regardless of its losses in the alleged predatory market? In other words, how can profit derived in other markets be deemed recoupment if, as presumed, they are the result of prices set at the rational profit-maximizing level in the first place? Is this really recoupment (which is typically described as profits derived from

supra-competitive prices that result from a decrease in competition) or the case of a diversified company financing its losses through its efficiency and/or profit-maximizing behavior in other markets?

16. Does the assertion in paragraph 123 that Domco can “rebut” the Commission’s case of predatory conduct by showing that recoupment will never be possible indicate that the Commission is relieved of the burden to show a likelihood of recoupment or is it merely a presumption the Commission may establish that can be then rebutted by Domco. If the latter, how can the Commission establish this presumption?

17. Should the Commission be allowed to operate by imposing presumptions?

18. Does it make sense to conclude that profit realizing pricing is predatory when it is below the ATC of a competitor? Does this imply a duty exists on Domco to assist its competitor to establish the necessary scale, for example, needed to compete with Domco when Domco’s scale advantages presumptively came at great cost to it?

19. In markets where brand loyalty is an important feature is it “predatory” to meet the price of a new entrant even where that pricing is below AAC?

20. Might “English Clauses” be evaluated as facilitating practices in furtherance of tacit collusion under Art. 81?

21. What’s the difference between tying and bundling?

22. In what way might conditional rebates on all purchases be potentially more harmful to competition than conditional rebates on incremental purchases above the threshold?

23. If two products are evaluated as distinct from one another under a tying or bundling analysis, how can they also be considered part of the same product market?

24. Is treatment of margin squeeze in the DP point 220 and Guidance Paper point 79 similar? If not, what is the difference, which view do you prefer and why? Why did the Commission change its mind after dealing with several cases involving firms with exclusive rights granted by national governments? Should the treatment of margin squeeze be stricter when Domco is privileged by law?

25. In paragraph 223 (and similarly in para.232), the DP notes that a refusal to supply a down-stream purchaser may have a “special effect” on competition if that competitor

follows "a different business model." What is an example of such a business model and what might be that "special effect?"

26. Does the DP reflect the high water mark of the efficiency view of the objective of article 82, and has it retreated with Guidance Paper?