Abuse of Dominant Position: New Interpretation, New Enforcement Mechanisms?

European competition law is currently undergoing major changes as since the mid-1990s, the European Commission subscribes to a *more economic approach* to the interpretation and application of Articles 81 and 82 EC. Following the wholesale reform of the block exemptions under Article 81 EC, the Commission has now turned to reconsidering its practice on Article 82 EC. In December 2005, the Commission published a Discussion Paper on the application of Article 82 EC. In this, the Commission lays out a general framework for analysing abusive exclusionary conduct by a dominant undertaking. Almost simultaneously, the Commission launched a public consultation on enhancing private enforcement of EC competition law. In its Green Paper of 2005 and in its recently published White Paper, the Commission proposes policy choices and specific measures to ensure that victims of infringements of EC competition law are fully compensated for the harm they have suffered. Although the proposed reforms have attracted a good measure of attention from competition law scholars and practitioners, little thought has been given to the interaction between these two policy areas.

In October 2006, the Max-Planck Institute for Intellectual Property, Competition and Tax Law in Munich hosted a conference to highlight and discuss the major changes proposed by the Commission, and their combined effects. The conference brought together academics from all over Europe. *Ulf Böge*, then President of the German Cartel Office (Bundeskartellamt), opened the conference as keynote speaker. He stressed the importance of considering the possible repercussions on private enforcement of an effects-based approach in the application of Article 82 EC. Against the backdrop of the analysis presented by *Ulf Böge*, academics from several countries presented papers on the proposed reform of Article 82 EC in the light of a *more economic approach* as well as the distinct features of private enforcement of Article 82 EC. These papers are published here. The developments until May 2008, in particular the publication of the White Paper by the Commission, have been heeded in the articles.

In the first article, *Wolfgang Wurmnest* offers a critical appraisal of the Commission's Discussion Paper on exclusionary abuses. The author reproaches the Commission for obscuring departures from existing case-law with confusing language. He also criticises that the Commission gives little guidance on which economic tools and insights should be applied when assessing alleged abuses. On the more fundamental question of the goals of EC competition law in general and of Article 82 EC in particular, *Wurmnest* argues that in the light of recent decision practice of the European Court of Justice, the Commission is not entitled to declare "consumer welfare" ought not to be the only goal of competition law. Instead, he advocates an approach which places welfare considerations on an equal footing with other goals, such as the protection of economic freedom, market integration, and the promotion of innovation.

The articles by *Emanuela Arezzo* and *Pranvera Këllezi* examine different aspects of the concept of dominance. *Arezzo* asks whether there is a role for market definition and dominance in an effects-based approach. She compares a formalistic approach with the effects-based, more economic approach as envisaged in the Commission's Discussion Paper and in the report by the Economic Advisory Group for Competition Policy (EAGCP). Having examined the interrelationship between the concepts of market power, consumer welfare and anti-competitive harm, she warns against a departure from well established concepts, like, in particular, the notion of dominance and, in general from the adoption of a metadology which risks undermining the very political rational of Article 82 EC.

Këllezi then turns to the issue of the abuse of economic dependence. The author reflects on the concept of economic dependence as developed in the case law of national competition laws. She considers whether this concept is consistent with the definition in European competition law of a dominant position, as well as with the concept of market power.

Dimitris Riziotis analyses the arguments in favour of and against an efficiency defence in the context of Article 82 EC. The introduction of an efficiency defence represents a trade-off between economic efficiency and freedom of market participants. It would thus mean a shift of EC competition policy objectives in favour of market performance. Whereas such a shift may benefit consumers, focussing solely on market performance may prove to be detrimental for consumer welfare in the long run. The Commission would thus be well-advised to make the maintenance of a competitive market structure (i.e. the openness of markets) the main condition for the consideration of any efficiency gains.

Ariel Ezrachi maps the developments which have shaped private enforcement of European competition law to date. He considers the value of private action in general and its significance to competition enforcement, and goes on to illustrate the main challenges for an effective private enforcement in Europe. In this context, he evaluates the consequences of an effects-based approach in the application of Article 82 EC for the volume and quality of Article 82 EC damage claims as well as for actions for injuctive relief and out-of-court settlements.

Hedvig Schmidt identifies a lack of guidance from the Commission on how to establish a causal link between the abuse and the harm caused to the claimant in a private action. Under the present case-law, it is sufficient for the Commission to prove a likelihood of harm to competition. This standard of proof gives private claimants not enough to found their own case in a follow-on action. The move to a more rigorous economic analysis, *Schmidt* argues, would benefit these claimants but would, at the same time, raise the benchmark for those bringing an independent action in national courts.

Mark-Oliver Mackenrodt argues that effective enforcement requires that exactly those cases should be selected for decision which cause the type of negative welfare effects that Article 82 EC seeks to prevent. He finds that public enforcers seek to repress business strategies causing harm to competition as protected by Article 82 EC. Private plaintiffs, by contrast, are motivated by the prospect of gaining damage awards. *Mackenrodt* distinguishes several groups of private plaintiffs. For each, he

asks whether there is a correlation between individual harm and harm to competition. As it turns out, there is a divergence in the incentives of public enforcers as compared to certain potential private enforcers. *Mackenrodt* concludes by discussing the consequences for reaching the optimum level of enforcement and the influence of a more economic understanding of Article 82 EC.

Fernando García Cachafeiro focuses on the role of consumer associations in the enforcement of Article 82 EC. As one of the measures to improve private enforcement of the EC competition rules, the Commission suggests that consumer associations be enabled to bring damages claims against dominant companies on behalf of their members. Taking the US experience on mechanisms of collective redress into account, the author analyses those factors that contribute to effective representative claims and contemplates what happens to individual claims if an association brings a claim, which association should have standing to sue and who should be the beneficiary of any compensation paid.

A number of people deserve special thanks for their contributions to the success of the conference and to the publication of this volume. In addition to the authors, who demonstrated great commitment throughout the course of the project, Professor *Josef Drexl* gave advice and encouragement, *Delia Zirilli* helped in the organisation of the conference, *Allison Felmy* and *Christine Herrick* revised the papers in English, and *Sebastian Kestler* and *Lorenz Marx* assisted in the editing of the papers. Finally, the editors' would like to thank *Dimitris Riziotis* for taking notes of the presentations and of the lively discussion throughout the conference.

Munich, June 2008

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Is there a Role for Market Definition and Dominance in an effects-based Approach?

*Emanuela Arezzo**

1 Introduction

As the old millennium was coming to an end, European Competition law began a massive reform project aimed at modernizing each and every of its constituent parts. As well known, this ambitious project started with the introduction of Regulation n. 2790/1999 on vertical restraints, and its accompanying Guidelines, it followed with the Guidelines on horizontal cooperation agreements, and made all its way up till the review of the Merger Regulation.

The underlying *leitmotif* of these reforms has been to introduce a more *economics-oriented* approach to the assessment of competition cases. In practice, these reforms have resulted in a progressive erosion of *per se rules* in favour of the more

* I would like to thank Prof. Josef Drexl, Mark-Oliver Mackenrodt, Beatriz Conde Gallego, Stefan Enchelmaier and all participants of The Max Planck Forum on Competition Law (October 2006, Munich) for the lively discussions and inputs provided during the conference. I also wish to thank Prof. Steven Anderman and Prof. Gustavo Ghidini for precious comments on previous drafts of this contribution.

flexible *rule of reason* which leaves the floor open to case by case considerations and seems better suited to take into account the appropriate circumstances (especially of economic nature) of the controversy at issue.

The turn has come now for abuse of a dominant position to go under review to determine the extent it should conform to the new mainstream trend which calls for a more substantive recourse to economics insights into the assessment of unilateral practices.

As we are about to see, European Commission's (and European competition authorities' in general) treatment of abuse cases has attracted a good deal of criticism for being rather formalistic and rigid and hence inapt to sufficiently take into consideration the economic circumstances of the cases, in particular to weigh the anticompetitive effects apparently caused by the conduct against the likely positive pro-competitive (or, more precisely, pro-consumer) efficiencies which, in the end, could tilt the balance and reverse an initial finding of abuse.

In order to do justice to these points of criticism, the European Commission has drafted a Discussion Paper on the application of Article 82 to exclusionary abuses and has called for open discussion on it. Unfortunately, the document, mainly because of its guideline style, is rather confusing and obscure. A coherent suggestion for a new approach, however, may be inferred by reference to the report presented by the Economic Advisory Group for Competition Policy (hereinafter EAGCP) which the Commission has surely considered in the course of preparing its Discussion Paper.

The *effects-based* approach (so called to differentiate itself from the current *formalistic* one) apparently carries a strong economic imprint and seems aimed at correcting the early methodology adopted by European agencies and courts by introducing two substantive changes. On the one hand, the competition authorities would be asked to prove, with strong economics-based analysis and studies, the anticompetitive harm produced by the presumably abusive conduct. This with specific regard to the ultimate effect that the practice will assert on consumer welfare. On the other hand, because it is extremely complex to discern the pro- from the anticompetitive aspects within the same conduct and, as economists strongly assert, pro-competitive effects can also arise from a unilateral conduct adopted by a dominant firm, the new approach would grant defendants the faculty to plead an *efficiency defense* against a finding of abuse.

This change would appear, at least at a first glance, in line with the assessment of agreements in restraint of competition under Article 81 EC and would make the overall assessment of competition law cases uniform. Nonetheless, as I will try to demonstrate, such alignment with current assessment of (horizontal or vertical) agreements between firms is nor welcome or desirable.

This contribution is divided in the following way. The first part of this study (paras 1-2) is focussed on the criticism raised against the practice of the European Commission regarding exclusionary practices and the way the new *effects-based approach* intends to correct these alleged flaws. It then focuses on the renewed importance consumer welfare has in the new approach and analyzes the practical implication of choosing consumer welfare as a tool to measure the anticompetitive

harm of the conduct. In particular, the Neoclassical economic theory teaches us that consumer welfare is directly measured *via* market power and this indeed explains economists' interest in discarding the old definition of dominance and adopting the concept of *substantial market power* (para. 3).

In what follows, I will explain the conceptual difference between dominance and SMP but I will also point out that the two concepts entail an entirely different methodology in the assessment of unilateral practices (para. 4). I will discuss the likely economic, legal and political consequences arising from the adoption of a SMP test (together with the broader effects-based approach) to see whether it fits the needs of European economic scenario (para. 5). Some final thoughts are referred to consumer welfare and its aptness to serve as benchmark to assess the anticompetitive character of exclusionary practices (para. 6).

2 Criticism of the current assessment of unilateral exclusionary practices under Article 82 of the EC Treaty

The European doctrine of abuse of dominance has often attracted criticism. The doctrine has occasionally been criticised for its inconsistency and its contradictory nature, for its improper implementation for the benefit of competitors rather than competition, and in general for its excessive use as a direct tool to regulate markets.[1]

The criticisms levied today against the application of Article 82 EC are even more structured and profound.[2] While other substantive branches of competition law have been reformed in the light of a more economics-based methodology,[3] commentators argue that the doctrine of abuse of dominance is now the only one

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[1] In this sense, *see* PROSPERETTI/SIRAGUSA/BERETTA/MERINI, "Economia e Diritto Antitrust", 210 *et seq.* (2006); DETHMERS/DODOO, "The Abuse of Hoffmann-La Roche: The Meaning of Dominance under EC Competition Law", (2006) 27 E.C.L.R. 537.

[2] Among the most relevant economic studies *see*: EAGPC-REPORT, "An economic approach to Article 82 EC", (2005), available at http://www.ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf; AHLBORN/DENICOLÒ/GERADIN/PADILLA, "DG Comp's Discussion Paper on Article 82 EC: Implications of the Proposed Framework and Antitrust Rules for Dynamically Competitive Industries", (2006), available at http://www.ssrn.com/abstract=894466; ALBERS, "Der '*more* economic approach' bei Verdrängungsmissbräuchen: Zum Stand der Überlegungen der Europäischen Kommission", (2006), available at http://www.ec.europa.eu/comm/competition/antitrust/others/albers.pdf.

[3] Commentators refer to Regulations on agreements in restraint of trade (Commission Regulation (EC) No. 2790/1999 of 22 December 1999 on the application of Article 81(3) EC of the Treaty to categories of vertical agreements and concerted practices, [1999] OJ L 336/21; Commission Regulation (EC) No. 2658/2000 of 29 November 2000 on the application of Article 81(3) EC of the Treaty to categories of specialization agreements, [2000] OJ L 304/3; Commission Regulation (EC) No. 2659/2000 of 29 November 2000 on the application of Article 81(3) EC of the Treaty to categories of research and development agreements, [2000] OJ L 304/7) and to the Merger Regulations (Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings, [2004] OJ L 24/1), which have all been reformed in light of a more economic-based approach through a broader recourse to rule of reason and the introduction of countervailing factors based on efficiency rationales.

which has rested on a mechanical and rigid, *form-based* assessment of unilateral conduct. They criticize the whole legal framework of Article 82 EC, blaming it to be excessively formalistic and, for this reason, not suited to take into account and properly evaluate the specific economics-based factors that feature each unilateral conduct case.[4]

2.1 Rule of reason v. per se rule in the application of Article 82 EC

The first source of formalism stems from the fact that allegedly the Commission (and probably national competition authorities) would place undue weight on the list of presumptively abusive conduct contained in Article 82 EC rather than on the actual anticompetitive effects caused by the conduct. In fact, as well known, EC founders did not provide us with a definition of dominance nor of abuse. However, legislators have drafted a non-exhaustive list of conduct whose anticompetitive character is generally presumed.

According to mainstream criticism, over-reliance on the above list of anticompetitive conduct would reduce the overall abuse inquiry on unilateral practices to some sort of matching exercise, to see whether the circumstances of the case at issue correspond to one of the classified practices.[5] In their opinion, the framework envisioned in Article 82 EC does not require proof of a causal relationship between position of dominance and the committed abuse,[6] rather current methodology wrongly induces the Commission to focus on the form that the conduct has taken rather than the substance, i.e. the actual effect that the conduct has (or has not) caused.[7]

This point is extremely important because, as economists explain, any conduct – regardless of the degree of economic power the undertaking may hold – is capable of bringing about both positive and negative effects for competition and it is not an easy task to balance the two in order to eventually decide whether the conduct is or is not anticompetitive.[8] Clearly, this balancing task cannot be performed by recourse to presumption.

Moreover, because the Commission allegedly affords a different treatment – more or less favorable – to the behaviors banned by Article 82 EC[9] and because the same anticompetitive goal can be achieved through different behaviors, commenta-

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4 EAGPC-REPORT, note 2, 13.

5 *See* NIELS/JENKINS, "Reform of Article 82 EC: Where the Link between Dominance and Effects Breaks Down", (2005) 26 E.C.L.R. 605.

6 EILMANSBERGER, "Dominance-The Lost Child? How Effects-Based Rules Could and Should Change Dominance Analysis", (2006) 2 European Competition Journal 15, 19.

7 VICKERS, "Abuse of Market Power", (2005) 115 The Economic Journal 244; VICKERS, "The Reform of Article 82 EC: Recommendations on Key Policy Objectives", (2005) 1 European Competition Review 179; EAGPC-REPORT, note 2, 5 *et seq*.

8 EAGPC-REPORT, note 2, 6.

9 At this regard, Sinclair has explained that the case law under Article 82 EC has developed by considering various category of abuse distinctly, which led to the development of different and inconsistent tests based merely on the specific characteristics of the abuse-situation. SINCLAIR, "Abuse of Dominance at a Crossroads – Potential Effect, Object and Appreciability under Article 82 EC", (2004) 25 E.C.L.R. 491, 492.

tors argue that this may lead undertakings to engage in a sort of "conduct-shopping", where firms would choose the conduct which – they believe – is less likely to attract antitrust scrutiny.[10]

2.2 Formalistic assessment of dominance

In a formal framework like the one depicted above, where the assessment of the abusive conduct hinges strongly on a preliminary assessment of dominance, clearly the way such analysis is performed appears extremely important in that it practically becomes a "short-cut" to infer abuse.[11]

The definition of dominance, as elaborated by the case law of the European Courts, as 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",[12] has attracted several criticisms.[13]

The most obvious economic-based critique attacks the second prong of the above definition of dominance as power to behave independently. Because all undertakings, even near-monopolists, face a downward sloping demand curve and the pressure of competition from substitute products or services, economists claim that no firm will ever have the power to behave independently from any constraints; hence, independence is not a good proxy to infer dominance.[14] [Needless to say, economists often seem incapable of grasping the flexibility inherent the wording "to an appreciable extent".[15]] Other commentators have criticized this definition for assuming a causal correlation between the power to exclude or hinder (i.e. the power "to prevent effective competition") and the ability to exploit (implicit in the

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[10] EAGPC-REPORT, note 2, 5 *et seq*.

[11] NIELS/JENKINS, note 5, 606.

[12] Case 27/76 *United Brands v Commission* [1978] ECR 207, para. 65; Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, para. 38.

[13] On this subject see: GERADIN/HOFER/LOUIS/PETIT/WALKER, "The Concept of Dominance in EC Competition Law", (2005) Research Paper on the Modernization of Article 82 EC, Global Competition Law Center, College d'Europe; MONTI, "The Concept of Dominance in Article 82 EC", (2006) 2 European Competition Journal 31; EILMANSBERGER, note 6; OLIVER, "The Concept of 'Abuse' of a Dominant Position Under Article 82 EC: Recent Developments in Relation to Pricing", (2005) 26 European Competition Journal 315.

[14] PROSPERETTI/SIRAGUSA/BERETTA/MERINI, note 1, 210. Similarly, *see* GERADIN/HOFER/LOUIS/PETIT/WALKER, note 13. As we will see para 4.1.1, the concept of elasticity of demand (*i.e*. consumers' and customers' responsiveness toward a price increase of the dominant undertaking's product) and elasticity of supply (competitors' responsiveness – in terms of goods provision – to a price increase of the dominant undertaking's product) are the variables to be taken into account when measuring market power.

[15] In fact, the ECJ explains immediately after that finding of dominance does not imply total absence of competition in the market. Rather, dominance enables the undertaking "[…] if not to determine, to have an appreciable influence on the conditions under which competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment". Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, para. 39.

power to behave independently), improperly implying that the former results from the latter.[16]

On a similar footing, competition law & economics scholars have highly criticized the Commission for a rather mechanical calculation of dominance mainly based on market shares threshold (this even when such threshold did not reach the 50% of the relevant market) and for being insufficiently concerned with relevant countervailing factors which could disprove the initial finding of dominance inferred *via* market shares.[17]

The first criticism usually points to cases like AKZO where the ECJ found a position of dominance in the case of an undertaking holding 50% of the market and it seemed to move away from its balanced opinion formerly expressed in Hoffman La Roche[18] by asserting that when high degree of market share is found – for this purpose being sufficiently a threshold of 50% – very high shares, save in exceptional circumstances, are themselves evidence of dominance.[19] The second criticism stems from the famous GE-Honeywell case where apparently the Commission strongly relied on dominance as commercial rather than economic power and failed to take into account significant countervailing factors.[20]

While some commentators admit that sometimes (and indeed quite often, in my modest opinion) other market factors have also been taken into account, like barriers to entry and expansion, they argue that it is rather unclear how much weight each of them should be afforded and they fear that the dominance test risks resorting to kind of a mere check-list analysis.[21]

Eventually, on a lighter note, economists warn about the implementation of the so called SSNIP test in unilateral conduct cases as instrument to define relevant markets because of the so called *cellophane fallacy*,[22] which could lead to unduly broad market definition, hence altering the overall dominance outcome.[23]

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[16] This, indeed, according to Eilmansberger would be proper only of leveraging cases and not for the remaining exclusionary abuses. EILMANSBERGER, note 6, 16 *et seq*.

[17] MAJUMDAR, "Whither Dominance", (2006) 27 E.C.L.R. 161.

[18] In Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, the ECJ seemed to balance the finding of high market shares with other relevant economic factors such as the time dimension, the volume of production and the scale of supply, *et cet*. *See* Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, para. 41.

[19] Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, para. 60.

[20] More extensively on this *see* MONTI, note 13, 40 *et seq*.

[21] NIELS/JENKINS, note 5, 606.

[22] The Cellophane fallacy is named after the American case *United States v E.I. du Pont de Nemours & Co.* 351 U.S. 377 (1956) where the Supreme Court wrongly defined the relevant market measuring cross-elasticity of demand from the monopolistic price set by du Pont. Indeed, the Court did not realize that because du Pont was already exercising its market power, the price the Court took into account to measure cross-elasticity of demand was not the competitive price. Clearly, the higher the benchmark price, the greater will be the degree of cross-elasticity of demand: this, in turn, will lead to a broader market definition and, consequently, will lessen the chances that the firm will be found dominant.

[23] It is interesting to notice, however, that despite the dangers this concern warns us against, many commentators have often blamed the Commission to get to unduly narrow market definition which, conversely, would ease the likelihood that dominance is found. *See* UTTON, "Market Dominance and Antitrust Policy", 79 (2003); KORAH, "EC Competition Law & Practice", 99 *et seq*. (2004).

According to mainstream critics this formalism and presumed lack of considerations of significant economics factors in both the assessment of dominance and abusive conduct is responsible for an inappropriate abuse policy.

In their opinion, such a formalistic assessment, where presumptions substitute economics-based market analysis, makes it easier for competition authorities to draw a wrong conclusion from the case, leading to misconstrued outcomes.[24] In other words, commentators argue that the current formalistic approach strongly favors so called *false positives* – namely, the cases where conduct which do not cause any actual damage to the market is wrongly punished – which, according to mainstream thinking, affect competition adversely as they chill undertakings' incentives to compete and innovate fiercely.[25]

In this framework, commentators further notice that the situation is worsened by the fact that the allegedly dominant firm is not granted the right to disprove the finding of abuse by showing the pro-competitive effects that her conduct is also likely to create and pass on to consumers (as it is permitted in the case of mergers and agreements in restraint of competition under Article 81 EC).[26]

3 Towards the adoption of the new *effects-based* approach

To combat the evils of the current formalistic approach, the new effects-based approach proposes an inversion of route towards a method of analysis strongly supported by economic tools and specifically oriented at assessing the anticompetitive effects caused by the business behavior.

According to this new view, it is no longer sufficient to infer the anticompetitive character of the conduct simply by the fact that it matches one of the practices described at Article 82 EC. Presumption of anticompetitiveness – hence of abuse – must be substituted by the absolute certainty that the conduct is anticompetitive. Because, as mentioned earlier, economists of the EAGCP postulate that every conduct, no matter the undertaking's position on the market vis-à-vis her rivals, is capable of bringing about both pro- and anticompetitive effects, they explain that such evaluation necessarily calls for a balancing test. Therefore, Competition authorities should first identify an (***actual***) harm to competition and substantiate it with economics instruments; second, they should identify ***likely*** efficiency gains the conduct is capable of producing and then see whether the latter might offset the former. The practice would be punished only if it is found to bring about more negative than pos-

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[24] NIELS/JENKINS, note 5, 609; DETHMERS/DODOO, note 1, 548 *et seq*.

[25] It is generally argued that false negatives would be less dangerous for the market because new entry would mitigate the market power implemented by the dominant firm. In this sense *see* EASTERBROOK, "The Limits of Antitrust", (1984) 63 Tex. L. Rev. 1, 3. Similarly, MCGOWAN, "Between Logic and Experience: Error Costs and United States v Microsoft", (2005) 20 Berkeley Tech. L.J. 1185.

[26] The discussion on the efficiency defense and its role within the new *effects-based* approach is beyond the scope of this paper.

itive effects to competition,[27] regardless of the specific category of abuse under which the conduct of the case would fall.[28]

Within the new framework, effects on competition are to be assessed with regard to consumer welfare which stands out as the prominent goal of Article 82 EC.[29] This means that the assessment of what effect is pro- or anticompetitive would be dependent on whether consumers are better or worse off as result of the conduct. Accordingly, the overall unilateral practice will be deemed *anticompetitive* – hence abusive – only when its effects, on balance, will clearly harm consumers.[30]

As mentioned, this approach would guarantee a diminution in false positives and, by impeding undertakings to engage in "conduct-shopping", would ensure a more consistent treatment of practices, as only the truly anticompetitive conduct would be punished, despite its form. However, it is impossible not to notice a strong departure from notions and policies well settled in European competition law. For example, proof of actual and direct consumer harm has never been required to determine the anticompetitive character of an exclusionary practice. In addition to the fact that consumer welfare and not the restriction of competition would be the focus of the new approach, the burden of proving an abusive conduct would be sensibly worsened were the Commission compelled to prove *actual* – rather than simply *potential* – consumers' harm.[31] In contrast, following the economists suggested approach would make offsetting findings of abusive conduct particularly easier because the efficiency gains might well be *potential.*

This approach would be clearly in contrast to well settled and recent case law which has firmly ruled out the need to prove concrete effect on the market concerned and has expressly stated that "it is sufficient to show that the abusive conduct of the undertaking in a dominant position *tends to restrict competition* or, in other words, that the conduct *is capable of having such an effect*" (emphasis added)[32].

Moreover, as we are about to see in the following paragraphs, the new effects-based approach, in embracing consumer welfare as the paramount goal of competition policy, would completely overturn the current assessment of unilateral practices. In fact, the new approach in introducing the assessment of substantial market power which, regardless of the form of the conduct, simultaneously accounts for the pro- and anticompetitive effects caused by the practice, would practically cut off the very essence of Article 82 EC. Indeed, not simply current notion and assessment of dominance would be eliminated but also the whole conception of abuses as further

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[27] EAGPC-REPORT, note 2, 3.

[28] A second substantive part of the proposed reform regards the introduction of the so called *efficiency defense* which will not be specifically addressed in this study.

[29] EAGPC-REPORT, note 2, 2.

[30] From here it follows that, in the above framework, an exclusionary conduct which is likely to drive a competitor off the market will not be deemed anticompetitive unless the exclusion immediately causes a diminution of consumer welfare (for example through an immediate price increase as result of lessening of competition).

[31] *See infra* para. 5.2.

[32] *See* Case T-203/01 *Manufacture Francaise des Pneumatiques Michelin v Commission* [2003] ECR II-4071, paras 239 and 241; Case T-219/99 *British Airways v Commission* [2003] ECR II-5917, para. 293.

step beyond mere possession of dominance would be cancelled,[33] as well as the references to the list of presumptively abusive conduct which would be no longer taken into account.[34]

This substantive change has been expressly acknowledged by the economists of the EAGCP;[35] what has been less clearly recognized is that the proposed approach, advertised as the "more economic" approach, does not necessarily reflects a generalistic more economics-based methodology but rather it seems to fully embrace the tenets of a specific economic school of thought.[36]

4 Getting rid of dominance? The long path from dominance to substantial market power

The economists of the EAGCP explain that because, in the effects-based approach, all the focus of the inquiry goes directly toward the assessment of the effects and their impact on consumer welfare, "there is no need to establish a preliminary and separate assessment of dominance" nor to take into account the list of presumptively abusive conduct contained at Article 82 EC.[37]

This assumption stems from the belief that an anticompetitive harm from a unilateral conduct (thus, an abuse) is only possible if the firm holds a position of dominance; therefore once the conduct has been proved to be abusive there should be no need of a separate analysis of dominance.[38]

This alarming proposal is somewhat smoothed in the same report where commentators explain their intention not to completely eliminate the part of inquiry which is currently devoted to dominance but to integrate it into the broader verification of the anticompetitive effects produced by the practice at issue.[39] The implica-

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[33] In Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, para. 91, the ECJ explained that: "The concept of an abuse is an objective concept relating to the behavior 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 the basis of the transactions 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".

[34] As a side note, because the list of presumptively abusive conduct contained at Article 82 EC mirrors the one contained at Article 81 EC, it is not entirely clear why eliminating recourse to such list would make assessment of Article 82 EC more in line with the assessment of agreements in restraint of trade.

[35] EAGPC-REPORT, note 2, 6, where they expressly hold: "In proposing to reduce the role of separate assessments of dominance and to integrate the substantive assessment of dominance with the procedure for establishing competitive harm itself, we depart from the tradition of case law concerning Article 82 EC, but *not*, we believe, from the legal norm itself" (emphasis in the original).

[36] Indeed, as we are about to see, the idea of eliminating legal presumptions in antitrust cases and revert the overall analysis to a substantial evidence of consumer harm, even regardless of the distinction between unilateral practices and horizontal and vertical agreements in restriction of competition, comes directly from Richard Posner. *Cf.* POSNER, "Antitrust Law", 194 *et seq* (2001).

[37] EAGPC-REPORT, note 2, 14. This second proposition is not expressly written but it is implicit in the overall proposal.

tions of this statement, however, are not sufficiently clear at a first glance. The assessment of dominance, meaning the toolbox of instruments used to determine dominance (i. e. market shares considerations, entry barriers, capacity constraints faced by likely rivals, etc.) would be still in use but they would not serve the original purpose (checking whether there is dominance) as they would only be needed at a later stages of analysis to confirm or disprove the presence of anticompetitive harm. In other words, it seems that according to EAGCP, the so called "dominance toolbox" should only come into play within the assessment of this significant anticompetitive harm with the sole function of substantiating or disproving the finding of abuse.

Fortunately, the majority of commentators (both lawyers and economists) have refused the idea of eliminating a preliminary assessment of dominance and merging this moment with the verification of the likely anticompetitive harm caused by the conduct.[40] Conversely, they simply call for a reconceptualization of the concept of dominance in a more economic-oriented fashion and for a deeper implementation and *interpretation* of economics-based insights.[41]

As for the reconceptualization of the concept of dominance, these commentators all agree in configuring dominance as some sort of market power. As I mentioned at the very beginning of this paper, the definition of dominance as the power to behave independently from rivals, customers and consumers has never attracted sympathy from economists who have regarded it as unclear and vague. On the contrary, economists have liked more the part where the ECJ defines dominance as the power to impede effective competition being maintained in the relevant market. They claim that this part of the jurisprudential definition of dominance could be more in line with economics as the concept of maintenance of effective competition on the market could be equated with absence of market power, intended as the ability to raise price above the competitive level (i.e. above marginal costs) throughout a reduction in quantity.[42]

However because, as economists recognize, market power is not a zero-one matter and even non-dominant firm may hold some degree of market power, there is a widespread consensus that thinks appropriate to connect dominance with the concept of *substantial market power.*[43]

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[38] Note how this assumption clearly departs from our common understanding of the abuse doctrine in general whereby EU founders have specifically inserted the reference to dominance just to punish only the anticompetitive conduct put into practice by firms holding a special position of strength on the market. Moreover, it has been noted that anticompetitive harm might well result from the cumulative effect of similar practices pursued by the allegedly dominant firm and its competitors. In this sense *see* EILMANSBERGER, note 6, 25.

[39] EAGPC-REPORT, note 2, 14.

[40] VICKERS, "Market Power in Competition Cases", (2006) 2 European Competition Journal 3, 12.

[41] GERADIN/HOFER/LOUIS/PETIT/WALKER, note 13, *passim;* MONTI, note 13, *passim.*

[42] GERADIN/HOFER/LOUIS/PETIT/WALKER, note 13, 5 *et seq*.

[43] Whether substantial market power is easier to assess in practise is not shown by economists who, on the contrary, often explain how difficult can be to calculate the competitive price in a given market and then see whether the current price is indeed monopolistic.

Economists do not clearly explain when market power can be deemed substantial. However, as I will show later, the shift in the definition of dominance towards the economics-based test of market power seems surely in line with the new proposed approach which has proclaimed consumer welfare as the ultimate goal of antitrust law.

4.1 From dominance to substantial market power

As is well known, the traditional notion of dominance as the power to behave independently on a certain market involves a comprehensive evaluation that begins with the delineation of the relevant market(s) where all (existing and potential) competitors play and is specifically intended to measure whether one of such players holds a particularly strong position in that market.

The power to behave independently of rivals, customers and consumers, which is the special feature of dominance,[44] can stem from a variety of factors of different nature. Sources of strength can be well found in exclusive rights the firm has been vested with by the Government, or exclusive faculties the firm has contracted with a special supplier; or because the firm is itself the sole supplier of a raw material et cetera. Hence, while the sources of this power can be of economic nature, they can also come in form of legal and/or commercial privileges.

An inquiry in this sense tries to take into account all the likely factors of whatever nature that can reasonably put a certain firm on a pedestal and vest it with a far stronger power than her rivals'. At this regard, it is worth noting that rivals' market shares as well as rivals' competitive advantages are often taken into account at the dominance stage in order to simply assess whether the firm holds a position of dominance on a certain market vis-à-vis her competitors, if any. Having determined dominance the analysis proceeds to assess whether such a position of economic and commercial strength has been abused to further distort competition.

In the traditional analysis of dominance it can well happen that an undertaking holding 50% of a highly concentrated market will not be found dominant unless she is found to hold other significant competitive advantages. Clearly, once dominance has been found, it might be easy under the current regime, to prove the abuse, thanks to the formalistic approach discussed above and its over-reliance on the list of presumptively abusive conduct.[45] However, because at least in theory, as the ECJ has explained, the abusive conduct amounts to a separate moment from dominance, it could well happen that violation of Article 82 EC is not found even when dominance has been ascertained.

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[44] Case 85/67 *Hoffmann-La Roche & Co. v Commission* [1979] ECR 461, paras 42-48.

[45] Moreover, it must be said that Commission analysis does not end when the dominant company is found to have engaged into one of the practices listed by Article 82 EC. The Commission has developed, for almost any of such practices, doctrines aimed at further analyzing whether, in light of the peculiar circumstances of the case, the conduct amounts to an abuse. Take, for example, the *essential facility doctrine.*

4.1.1 Market power in economic terms

The economic concept of market power seems undoubtedly narrower, if compared to the notion of dominance.

There is widespread consensus in (neoclassical) economics that market power means the ability of a seller or a buyer to affect the price of a good.[46] As we have seen above, market power is directly related to a firm's ability to raise price above its marginal costs in a way to maximize its profits.

Although there is a lot of debate upon whether the concept of market power should be broadened in order to take into account other variables beyond price and quantity, in its simpler microeconomic formulation market power is usually measured by the so called Lerner index whereby:

$$L = (P - MC)/P = -1/E_d$$

The first part of the equation tells us that the Lerner Index, L, (which always results in a number between 1 and 0) is given by the difference between the price charged by the firm minus its marginal costs, divided again for the price. For a perfectly competitive firm the price equals marginal costs so in the end L = 0. Conversely, because a monopolist will try to set its price higher than its marginal cost in order to maximize its profit, the ratio will result in a number greater than 0. The larger is L the greater is monopoly power held by the firm.

The second part of the equation further explains that the markup (i.e. the markup over marginal cost as a percentage of price) should equal minus the inverse the elasticity of demand faced by the firm (E_d).[47] The elasticity of firm's demand tells the firm how consumers will react to a likely price increase. If consumers' preferences are highly elastic (hence, willing to switch to rivals' product) monopoly power cannot be strong so: the greater E_d, the smaller L.

According to current microeconomics thinking, firm's demand elasticity is determined by three factors: demand elasticity of the whole market, number of firms competing on the market, and interaction among firms. These are the factors to be directly taken into account to calculate a single firm's demand elasticity, hence market power.[48]

Because collecting the data outlined above has never amounted to an easy task, Posner and Landes in their seminal article on market power, have further defined the Lerner index as:

$$L = (P - MC)/P = s/\eta + (1 - s)\sigma$$

Where s is the market share of the dominant firm, η is the industry elasticity of demand and σ is the elasticity of supply of the competitive fringe.

This equation is somewhat more complex but also more comprehensive because it directly relates market shares held by the dominant firm with rivals' responsiveness to a likely price increase and it also takes into account consumers' elasticity of

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[46] PINDYCK/RUBINFELD, "Microeconomics", 328 *et seq*. (5th ed. 2001).
[47] PINDYCK/RUBINFELD, note 46, 334 *et seq*.
[48] PINDYCK/RUBINFELD, note 46, 345 *et seq*.

demand for the overall market. Clearly, absent any competitors, the Lerner index will only result in the ratio between monopolist's market shares and industry elasticity of demand; however, rivals' presence in the market will proportionally lessen the overall ratio, hence the degree of market power.[49]

In 1981 Landes and Posner suggested that Court would adopt their equation to concretely measure market power in antitrust cases, arguing that the adoption of their methodology would not cause a substantive departure from Courts' assessment of market power.

4.2 Substantial market power and the link with consumer welfare

It clearly emerges from the preceding paragraph that the economic concept of market power, mainly intended as power over prices, may result poorly suited to take into account the vast and diverse set of variables which can contribute in granting a position of dominance to a certain firm. Nonetheless, economists strongly assert the superiority of market power over dominance and urge the need to discard the latter and only adopt the test of SMP. Such urge can be easily explained: in fact, the shift from dominance towards the economics-based test of market power seems surely in line with the new proposed approach which has proclaimed consumer welfare as the sole and ultimate goal of antitrust law.

4.2.1 Antitrust as a "consumer welfare prescription"

The EAGCP begins its report by asserting that "an economic approach to Article 82 EC focuses on *improved consumer welfare* (emphasis added)" and it further explains, to eliminate any possible doubts, that "the ultimate yardstick of competition policy is the satisfaction of consumer needs".[50]

Such declaration of principle is extremely important because it does not simply affects competition law from a policy perspectives, as will be seen later, but it provides for a practical benchmark to determine when the firm has actually caused, with its conduct, substantial competitive harm. In other words, an exclusionary practice will be found abusive only when such practice, on balance, produces more negative than positive effects for consumer welfare.[51] Thus, at this point of the analysis the time has come to ask what is consumer welfare as well as what is the way to measure it.

Consumer welfare in general could be intended in various ways. Consumers might be benefited by the introduction of new products, by the availability of new services, by the availability of both at a convenient price and in quantities satisfying the overall demand. Equally, consumers are benefited when they have access to employment, which in turn gives them money to get products and services. Con-

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[49] LANDES/POSNER, "Market Power in Antitrust Cases", (1981) 94 Harv. L. Rev. 937.

[50] EAGPC-REPORT, note 2, 2.

[51] Note, indeed, that the "more economic approach" calls for increased attention on the actual effects produced by a certain conduct but such attention goes to the effects on consumers and not anymore on the competitive structure of the market, which is no longer focus of antitrust concern.

sumer welfare is all of this and even more, but we need a precise definition and especially an analytical framework to measure it in order to determine the magnitude of the relevant effects for antitrust purposes.

4.2.2 Consumer welfare in microeconomics

In economic terms consumer welfare is generally equated with the concept of consumer surplus. Neoclassical microeconomics teaches us an undertaking willing to maximize her profits will set a price right where her marginal revenue curve intersects her marginal costs curve. The theory shows that in perfect competition competitors' marginal revenue curve equals the overall demand curve yielding a price which is optimal for consumers.[52] Conversely, when a firm holds monopoly power, her marginal revenue curve is distinct from the market demand.[53] As a consequence, the price given by the intersection of marginal revenues' and costs' curve will be higher and the quantity offered lower.

This change in price and quantity graphically shows that consumers will be worse off: indeed, part of them will no longer be able to afford buying the item and others will have to bear a higher price for it. Accordingly, the theory shows a clear correlation between increase of monopoly power and decrease of consumer surplus.[54]

Although the EAGCP does not say it expressly, it is crystal clear that the kind of consumer welfare it refers to is the one borrowed from microeconomics. Indeed, in the neoclassical model just described, measurement of consumer welfare increase or decrease is directly given *via* market power assessment.

As it has been observed some years ago, an interpretation of antitrust as consumer welfare gatekeeper does not anyhow ease the overall analysis nor does it help formulating reasonable forecasts about a likely outcome of the case. From a practical point of view, bringing up consumer welfare as primary goal of Article 82 EC carries the only but significant consequence of bringing market power to centre stage. [55]

4.3 The position endorsed by the European Commission's Discussion Paper

While it is no mystery that the European Commission has largely relied on the economic suggestions contained in the EAGCP paper in the drafting of its Discussion

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[52] Obviously this is merely an assumption. Neoclassical economics assume that when firms set a price where their marginal revenues intersect their marginal costs such price will be optimal for consumers. Clearly, this depends on what class of consumers we are talking about.

[53] The more the market power detained by the firm, the more her marginal revenue curve will shift upright.

[54] Consumer surplus is defined as the difference between the maximum amount that a consumer is willing to pay for a good and the amount that the consumer actually pays. In this sense, *see* PINDYCK/RUBINFELD, note 46, 123 *et seq*.

[55] KRATTENMAKER/LANDE/SALOP, "Monopoly Power and Market Power in Antitrust Law", (1987) 76 Geo. L.J. 241, 246.

Paper (hereinafter "DP")[56], it is not clear the extent to which it has endorsed the innovative methodology contained in the effects-based approach.

At a first glance, the DP seems a comprehensive and systematic overview of the European case law of abuse of dominance. Constant reference is made to both old and recent decision of the Commission, Court of First Instance and European Court of Justice and the guideline style deliberately adopted by the Commission makes it hard to see where the changes have taken place and for what specific reason.

Generally speaking, the DP seems pervaded by a certain tension in the Commission between the intention to just confirming current approach to abuses of dominance and a desire to innovate and move towards more economic-based approach.[57] For example, with regard to the goal of Article 82 EC in exclusionary conduct cases, the Commission explains that the essential goal of antitrust law is "the protection of *competition on the market as a means* of *enhancing consumer welfare* and of ensuring an *efficient allocation of resources*" (italics added).[58] This is a very thoughtful and balanced definition because it confirms the principle that *competition on the market* and not consumers is the ultimate goal of Article 82 EC, but at the same time it explains that such goal has been elected in the belief that preserving a competitive and open market structure ultimately will safeguard consumers in terms of low prices, high quality products, wide selection of goods and services, and continuous innovation in general.[59]

Although one might point out that the preservation of *allocative efficiency* has rarely been pointed out so explicitly, from European bodies, as goal of competition policy, it should also be noted that the Commission places great emphasis on the protection of competition, instead of competitors. In doing this, the Commission explains that the purpose of Article 82 EC is not to protect competitors from dominant firm's genuine competition 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".[60]

Much in the same way, the Commission gives a cautious definition of exclusionary conduct intended as any behaviour that is able to cause an *actual* or *likely* anti-competitive effect in the market which *directly* or *indirectly* harms consumers.[61]

With regard to dominance, the Commission does not seem to accept EAGCP's suggestion of eliminating a preliminary and separate assessment of a dominant position. On the contrary, the DP seems to take a rather traditional approach. It firmly restates the principles set out in *Hoffmann-La Roche* about the role of market shares as significant indirect factor to assess dominance together with a profound inquiry on other market conditions such as rivals' market shares, rivals' ability to

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[56] EUROPEAN COMMISSION, "DG Competition discussion paper on the application of Article 82 EC of the Treaty to exclusionary abuses", (2005), available at http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf.

[57] MONTI, note 13, 31.

[58] EUROPEAN COMMISSION, note 56, para. 4 and paras 54, 17.

[59] EUROPEAN COMMISSION, note 56, para. 4 and paras 54, 17.

[60] EUROPEAN COMMISSION, note 56, para. 4 and paras 54, 17.

[61] EUROPEAN COMMISSION, note 56, paras 55, 18.

rapidly meet the demand etc.[62] It explains the importance of performing such an evaluation within the appropriate time-frame and, against to what economists suggest, it eventually concludes that, although highly unlikely, even a market share threshold of 25%, when coupled with the above market factors, might lead to a finding of dominance.[63]

However, while apparently preserving the status quo, the Commission silently introduces the concept of *substantial market power* as synonym for traditional concept of dominance.[64] The DP just presents the two concepts as equivalent, as if this were a consolidated point in the law.[65] However, the clear implications of such change are not clear. Some commentators argue that the Commission actually intends to move away from well settled case law and embracing the compelling economic concept of SMP.[66] While this could be true, it would contrast with the restatement of old principles and, especially, with the affirmation that even low market threshold may give rise to dominance.

5 Assessment of substantial market power in the new effects-based approach: How current assessment methodology may change

Both the supporters of the effects-based approach and the European Commission in the end seem to suggest the adoption of the more economic-oriented concept of substantial market power, mainly intended as economic power over prices. They further agree that such a definition should be broadened in such a way to comprehend the power to influence innovation pace and quality of products, and so on.[67] However, neither economists nor the Commission explain how these other variables should be taken into account in the measurement of market power (specifically, how would these variable fit with the economic assessment of market power quoted above)[68]. It is even more alarming to see that there is not consensus even with regard to what should be deemed *substantial* market power. In particular, it is not clear whether the term *substantial* refers to a time factor, as the Commission seems

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62 EUROPEAN COMMISSION, note 56, paras 29 and 30, 11.

63 EUROPEAN COMMISSION, note 56, paras 31, 11.

64 EUROPEAN COMMISSION, note 56, paras 23, 9 and 28, 10.

65 And indeed it has become really common - thanks to the increased recourse to economic analysis in antitrust law – to treat dominance and market power as synonyms.

66 MONTI, note 13, 32 *et seq*. Monti notices that the Commission has already introduced the economic concept of SMP in the field of electronic communications (*cf.* Directive 2002/21 of the European Parliament and of the Council of 7 March 2002 on a common framework for electronic communications networks and services, [2002] OJ L108/33, Article 14 (2).

67 EUROPEAN COMMISSION, note 56, para. 24, 9. But also in this sense GERADIN/HOFER/LOUIS/PETIT/WALKER, note 13, 5 *et seq.*

68 Recall from what explained *supra* para 4.1.1 that market power is a direct function of prices and costs. The other variable interconnected with market power are market shares and price elasticities of demand; other variables like product differentiation or innovation pace are not present. With regard to this latter point, *see infra* para. 7.1 and 7.2.

to suggest,[69] or rather is a matter of degree.[70] Probably it would be better to intend it as a mixture of both, although things are not very clear.

5.1 An inversion of route

Notwithstanding the uncertainties surrounding the concept of SMP, the latter is surely a crucial element for the successful implementation of the effects-based approach.

In the previous paragraphs, this study has focussed on the "conceptual" differences between dominance and market power. It has been shown that the notion of dominance has broader and more various contours than market power, who exhibits an exclusively economic connotation. Having said that, it must be further stressed that the choice between dominance and market power has significant implications also from a pure methodological point of view. In fact, the analysis of dominance, being conceptually separate from the abusive conduct, only concerns an exam of all the factors contributing to form a position of commercial and economic strength of the firm in a certain market; this regardless of what action the firm has taken. Conversely, measurement of market power stems directly from an evaluation of the price set by the company with regard to her marginal costs. In other words, measurement of market power directly comes from a direct evaluation of the *actual conduct* the firm has undertaken in the market.[71] Moreover, because measurement of market power gives direct account of consumer welfare diminution as result of the conduct, and because consumer welfare diminution represent the only meter to determine the anticompetitive character of the conduct, market power assessment directly responds the question of whether the conduct is or is not a violation of Article 82 EC.

At the end of the day, it seems that the adoption of the concept of substantial market power automatically calls for a reverse methodology in the assessment of abuse cases or simply a merger of the two steps into just one: proving the anticompetitive effect of the conduct.[72]

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[69] EUROPEAN COMMISSION, note 56, para. 24, where the Commission holds that "[…] 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".

[70] As it would be reasonable to think, given the fact that many commentators blame the Commission to find dominance even when companies hold very low market shares thresholds.

[71] EAGPC-REPORT, note 2, 14 where they expressly acknowledge that "[…] in proposing to reduce the role of separate assessments of dominance and to integrate the substantive assessment of dominance with procedure for establishing competitive harm itself, we depart from the tradition of case law concerning Article 82 EC of the Treaty, but *not*, we believe, from the legal norm itself."

[72] This appears particularly worrisome because even if the DP has not endorsed the methodology proposed by supporters of the effects-based approach, its adoption of SMP might be intended as pathway to implement the new "more-economic" approach.

5.2 Substantial market power and effective competitive constraint

This clear inversion in the assessment of exclusionary conduct under Article 82 EC is not the end of the story. The proponents of the new effects-based approach, suggest a two-steps assessment: first, competition authorities should measure the degree of market power held by the undertaking intended, in its purely economic definition, as power over prices; secondly, once market power has been found they have to inquire further to see whether such market power can be persistent in time or it is likely to be quickly eroded by actual or potential rivals' future behaviors.[73] If this is the case, competition authorities must infer that the conduct is incapable of hurting consumers because the presence of *effective competitive constraints* refrain the dominant firm from keeping her price above marginal costs for a significant period of time.[74] Eventually, in the remote circumstances a firm might be found to have violated Article 82 EC (note that it would be improper at this point to use the words "abused its dominant position"), she would still have the opportunity to rebut such a finding by showing that her conduct benefits consumers through efficiencies.

It is interesting to note that the role played by so called *effective competitive constraints* seems by far more important than it appeared in the Commission Notice on the relevant market where it was held that the systematic identification of the competitive constraints faced by the firms was the precise scope of market definition.[75] Indeed, at a closer look, the presence of *effective competitive constraints* asserted by rivals here has the effect of countervailing the market power likely held by the firm with the result that there is no market power in the first place, hence there is no chance of anticompetitive harm to consumers.

But what I think is more worrisome is that the extra-focus on the *effective competitive constraints* might practically result in an inquiry on the efficiency levels of rivals to see how they would practically respond to the dominant firm's behavior and whether their strategies might be able to offset its effects on the market. If this were to be the case, three major consequences would follow. First, competition authorities' attention would be distracted from the behavior of the dominant firm towards the efficiency level of its competitors, and such a thing seems no longer justified after market definition has been performed and a position of dominance has been ascertained. Second, this means that the very same anticompetitive character of the practice would be practically determined according to how rivals would respond to the conduct of the dominant firm. Third, competition authorities' analysis would be overstrained with the burden of testing the efficiency level of each firm competing in that specific market; whatever efficiency might be intended to mean.[76] For example, according to the

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[73] EAGPC-REPORT, note 2, *passim*.

[74] Note that the DP also describes SMP as absence of *effective competitive constraints*. *Cf* EUROPEAN COMMISSION, note 56, paras 24-27, 9-10.

[75] Commission Notice on the definition of the relevant market for the purposes of Community competition law, [1997] OJ C 372/5 expressly stated that: "[…] The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face", para. 2.

[76] This specific point will be analyzed more extensively, *infra* para. 6.2.

proposed framework if an undertaking is successful in restricting her output so that the resource she offers on the market becomes scarce and she can then raise the price for it, (supporters of the effects-based approach suggest that) competition authorities must look at how her rivals, if any, will respond and see whether they are *likely* to offset the effects of the (potential) anticompetitive manoeuvre. At this regard, economists explain that it is essential to look not just at barriers to entry but at barriers to expansion; in fact, if existing rivals face no barriers to expansion they can easily expand their output in response to the (dominant) undertaking restriction so that they will practically impede the latter to successfully raise its price.[77]

This clear shift of competition authorities' focus towards rivals' efficiencies rather than on the anticompetitive conduct adopted by the dominant firm is a central and radical change of the new effects-based approach, although it has not been publicized as it deserves. Indeed, while great emphasis has been put on the efficiency defense,[78] no one has really explained the role that efficiency should play already in Commission assessment of market power, consumer welfare and anticompetitive effects.

To give just an example of what I am referring to, I would like to quote some phrases of Commissioner Kroes at the Fordham Conference in 2005.

"certain forms of pricing conduct *may have different exclusionary effects depending on how efficient the rivals are*. It is clear to me that inefficient competitors should not be protected by competition policy from aggressive price-based actions of a dominant firm."[79]

These words perfectly reflect the policy rationale behind the reform of Article 82 EC. Clearly, Commissioner Kroes intends to get rid of the old criticism moved against European antitrust, protector of competitors rather than competition.[80] This sentiment is understandable and one can surely agree on the fact that a good set of antitrust laws must aim at promoting competition on the merits. However, one must be very careful because this assumption might lead us to practically favor bigger firms, who are easily found efficient, to the detriment of smaller ones, especially new comers who need time in order to stabilize on a certain market and become efficient.

Always with regard to exclusionary pricing conduct, Commissioner Kroes adds that:

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[77] Some economists argue that absence of barriers to expansion might even offset the presence of high barriers to entry and therefore even disprove an initial finding of market power. At this regard *see* GERADIN/HOFER/LOUIS/PETIT/WALKER, note 13, 16.

[78] At this regard, it is interesting noting that the DP has introduced a very narrow efficiency defense whereby the defendant has to prove that: a) the allegedly abusive conduct has realized or is likely to realize efficiencies; b) the conduct is *indispensable* to produce such efficiencies; c) the efficiencies benefit consumers; and that d) competition in a substantial part of the products concerned is not eliminated. EUROPEAN COMMISSION, note 56, paras 84-92.

[79] KROES, "Preliminary Thoughts on Policy Review of Article 82 EC", Speech at the Fordham Corporate Law Institute, New York, (2005), available at http://www.ec.europa.eu/comm/competition/antitrust/others/article_82_review.html.

[80] For the sake of preciseness, this criticism has not only been raised towards European antitrust. For a similar attack towards American competition law *see* BORK, "The Antitrust Paradox", 64-66 (1978).

> "[…] in my view, 'competition on the merits' takes place when an efficient competitor that does not have the benefits of a dominant position, is able to compete against the pricing conduct of the dominant company. […] One possible approach to pricing abuses could be based on the premise that only the exclusion of 'equally efficient' competitors is abusive."[81]

The theory of the "equally efficient competitor", of clear Posnerian derivation,[82] seems to call for a radical change in the philosophy of European antitrust treatment of abuses which finds its jus-political rationale in the German ordo-liberal school.[83]

6 Implications of the shift towards substantial market power

From what we have just seen it seems clear that the economic-based concept of substantial market power differs from the well known concept of dominance as intended and *assessed* in previous case law. The former is surely more in line with the mainstream economic thinking. In fact, the economic concept of market power is strictly linked to the concept of consumer welfare and therefore is better suited than the old concept of dominance to be part of an effects-based framework where the anticompetitive character of the conduct is directly inferred by recourse to consumer harm. Nonetheless, a likely implementation of the new concept of substantial market power-- as central part of the new effects-based approach – would bring a sensible departure from policy and economic rationales that underline European competition policy. Moreover, such a change of approach would carry significant procedural and practical drawbacks which risk to undermining the effectiveness of competition law enforcement system.

Please note that the considerations that follows in the subsequent paragraphs (5.1, 5.2, 5.3 and 5.4) directly relates to the situation which would be likely to arise were dominance discarded in favour of the substantial market power test. However, because, as emphasized several times, such a shift is an essential – if not the central – step of the so called effects-based approach, many of the following thoughts can be considered as if they were generally addressed to the effects-based approach directly.

6.1 Policy implications and economic shortcomings of the "welfarist" approach

The shift from traditional concept and assessment of dominance to SMP, as proposed by the new effects-based approach, signs a deep departure from traditional jus-political rationales and principles rooted into European competition law.

In order to better explain the magnitude of such departure, I would like to begin by quoting a sentence from AG Konott's opinion in the *British Airways v.*

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[81] KROES, note 79. In this sense *see* EAGPC-REPORT, note 2, 11, alleging that competition authorities ought to refrain from intervening against monopolistic pricing and instead should realize that such practice open up room for competition.

[82] POSNER, "Antitrust Law: An Economic Perspective", 194-195 (2nd ed. 2001).

[83] On this point see more extensively *infra* para. 6.1.

Commission case, which is representative of such values. According to AG Konott:

> "[…] Article 82 EC, like the other competition rules of the Treaty, is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the *structure of the market* and thus *competition as such (as an institution)*, which has already been weakened by the presence of the dominant undertaking on the market" (emphasis in the original).[84]

This short passage carries several hermeneutic keys to better understand the rationales of EU competition law.

First of all, the sentence underlines a persistent coherency between competition norms contained in the EC Treaty, as well as between the latter and the broad set of secondary legislations adopted by the EU.[85] Second, the sentence clarifies that the ultimate scope of Article 82 EC, and all competition law legislations in general, is not the protection of competitors' economic interests but neither of consumers'. Rather, the application of antitrust provisions should be intended as safeguarding the competitive structure of the market as value in itself. This basic proposition bears enormous importance for the understanding of competition law because it explains that although the protection of competition might be claimed to be an intermediate objective pursued in order to eventually obtain other goals (such as the protection of consumers, growth of industry, strengthening of the overall economy, achievement of market integration and so on), safeguarding a competitive structure of market remains the primary and direct aim of antitrust enforcement.[86]

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[84] Opinion of the AG Kokott in the Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331, para. 69.

[85] The words of AG Kokott express principles and ideas constituting the milestones of EC competition law. It is worth recalling the ECJ judgment in Continental Can where it clarified that Article 82 EC: "[…] is not only aimed at practices which may cause damage to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure, such as is mentioned in Article 3 (F) of the Treaty". Case 6-72 *Europemballage Corporation and Continental Can Company Inc. v Commission* [1973] ECR 215, para. 26.

[86] At this regard, *see* DENOZZA/TOFFOLETTO, "Contro l'utilizzazione dell' "approccio economico" nell'interpretazione del diritto antitrust", (2006) 3 Mercato, Concorrenza e Regole 563, 565 *et seq*. Denozza and Toffoletto emphasize the need to distinguish between the overall value(s) and goal(s) that a set of norms aims at protecting from the precise end a single provision (within that normative framework) aims at pursuing. They explain that the overall spirit and goal of the normative framework (let's assume, competition laws) should surely help the interpreter in the application of the precise legal provision (let's assume, Article 82 EC) but the interpreter always remains bound by the parameters (i.e. the legal instruments) set by the provision to ascertain the illicit conduct and is not free to elude them and simply pursue the overall goal of the normative framework (in this example, the protection of consumers instead of the protection of competition). Similarly, EILMANSBERGER, note 6, 18, explaining that the goal of competition norms in the Treaty is to promote a system of undistorted competition in the Common market and that such goal is ultimately pursued for the benefit of consumers, which surely account as one of the foremost rationale of abuse control. Nonetheless, "[consumer welfare] it should not be considered *a direct requirement* of the types of abuse of interest here (anticompetitive abuses)" (emphasis added).

Conversely, the new effects-based approach, by stating that Article 82 EC is exclusively focussed on "improved consumer welfare", shakes the political and economic foundations of the abuse doctrine as well as its coherency with the rest of competition norms.

The new methodology introduced by the effects-based approach by eliminating the distinction between dominance and abuse, as restated by AG Konott in the passage quoted above, as well as the list of presumptively abusive circumstances, would practically deprive Article 82 EC normative structure of its original meaning and would sign a profound departure from the ordoliberal school vision of competition law as guarantor of undertakings' freedom of action in a scenario of open market structures governed by complete competition.[87] To give just one example, it is not difficult to comprehend that in an effects-based approach where the anticompetitive character of the conduct depends on the degree of market power which, in turn, is directly measured per reference to rivals' efficiency level on the market, there would be no room for concept of dominance as "special responsibility".[88]

But it is worth pointing out that the "consumer welfare" approach represents a departure even from mainstream economic theories as traditionally applied to competition law. In fact, the microeconomic theory of perfect competition, which for long time has formed the economic blueprint of competition law, postulates a scenario where firms are price takers, consumers buy the entire amount they wish at the price they are willing to pay and where, as a consequence, consumer surplus equates producer surplus. In the shift from perfect competition to a situation of monopoly, micro-economists teach us that not simply consumer surplus is reduced. This is only one consequence of monopoly but monopoly power carries several other drawbacks: indeed, producer surplus grows as it absorbs good part of what was previously consumer surplus, but there is also a sensible reduction of the quantity the company would supply in a competitive setting, even though she probably has capacity and economies of scale which would encourage her to do so.[89]

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[87] *See generally*, GERBER, "Law and Competition in Twentieth Century Europe", chapter VII (2001), and EUCKEN, "The Competitive Order and Its Implementation", (1949), English translation reprinted in (2006) 2 Competition Policy International 219.

[88] In fact, the whole policy rationale underlying the European abuse of dominance (if not the entire European antitrust law) reverts to the understanding that certain conduct whose intrinsic character is difficult to assess may be particularly detrimental if put into practice by a stronger firm or by two or more undertakings jointly. The rationale for this is the acknowledgment that if a certain conduct is adopted by a firm who holds a position of substantial economic and commercial strength on the market, such conduct risks disrupting competition because the effect it is able to produce in the market is directly proportioned to the strength of the undertaking. With specific regard to Article 82 EC, these ideas have led EU courts to determine the "special responsibility" doctrine which hinges on firms having a dominant position on the market. Pursuant to the "special responsibility" doctrine, a dominant firm has the duty "[…] not to allow its conduct to impair genuine undistorted competition on the common market". *Cf.* Case 322/81 *NV Nederlandsche Banden Industrie Michelin v Commission* [1983] ECR 3461, para. 57. After that, the special responsibility principle was often confirmed: *see* Joint Cases C-395/96 and C-396/96 P *Compagnie Maritime Belge Transports SA and Dafra-Lines A/S v Commission* [2000] ECR I-1365, para. 37.

[89] PINDYCK/RUBINFELD, note 46, 347 *et seq*.

According to microeconomic theory, the triangle given by the sum of the area representing the diminution of consumer surplus (given by the percentage of consumers which will no longer be able to afford the good), plus the area representing the percentage of quantity no longer supplied by the monopolist, together constitute the so called *deadweighloss* associated with monopoly power.

Evidently, the concept of deadweighloss is much broader than consumer welfare as it gives account of aggregate loss for society as a whole.[90] And indeed in promoting the blueprint of perfect competition, economists used to refer to *total aggregate welfare* (rather than simply consumer welfare).

The proof that antitrust is not a consumer protection law can be easily found in the fact that antitrust enforcers proudly avoid punishing certain conduct which immediately cause a diminution of consumer welfare.[91]

In any case, even assuming that all economists would agree that consumer welfare represents a better standard than total welfare, and that therefore it should supplant the latter as economic goal in competition law, an approach which describes antitrust norms only in a "welfarist" perspective is highly misleading. At this regard, it has been pointed out (by other economists) that antitrust policy does not examines only the *consequences* of conduct (i.e. the change in consumer or total welfare), but also the *process* that generates such consequences (i.e. the nature of conduct). More specifically, they clarify that while antitrust may prohibit practices harming consumers or reducing efficiencies, it does so only insofar as companies achieve such result through actions that are deemed *anticompetitive*.[92] Merging these two elements together or simply redefining the meaning of the word "anticompetitive" in light of a welfarist perspective only adds confusion to the debate.[93]

6.2 Practical implications. The effects-based approach and burden of proof: When do efficiencies matter?

Beyond the changes in the political and economic rationales underlying the abuse doctrine, the introduction of the new methodology supported by the effects- based approach would carry several practical shortcomings.

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[90] The deadweighloss caused by the monopolist gives a broader picture of the economic loss in that it takes into account the loss in quantity that would be offered in a competitive setting, which implicitly considers also a diminution in terms of work and capital that are no longer used; and, conversely, does not take into account the loss of consumer welfare which becomes monopolistic surplus, in the assumption that such new welfare is also passed on workers.

[91] FARRELL/KATZ, "The Economics of Welfare Standards in Antitrust" (2006) 2 Competition Policy International 3, 6 *et seq*. The authors refers to conduct like monopoly pricing which not only is lawful under U.S. antitrust laws, but it has been recently proclaimed by the Supreme Court as "an important element of the free-market system" (*See Verizon Communications Inc. v Law Offices of Curtis V. Trinko*, LLP, 540 U.S. 398, 407 (2004)). European Competition law, in theory, punishes excessive pricing as a form of exploitative abuse under Article 82 (a) EC; however, in practice such conduct has hardly been caught by competition authorities.

[92] FARRELL/KATZ, note 91, 6 *et seq*.

[93] FARRELL/KATZ, note 91, 8.

A first set of practical inconveniences that directly affects the enforcement of Article 82 EC stems from the discard of dominance as a concept and as separate test of the assessment, distinguished from the abusive conduct.

First of all, the assumption that dominance is automatically inferred whenever an anticompetitive harm on consumer is proved cannot be shared. At this regard, it has been rightfully pointed out that the anticompetitive harm could also be consequence of a cumulative effect of similar practices employed by the firm under investigation and its competitors;[94] or even more simply, the effect could well be produced from concerted action of firms in the market whose aggregate market share is well below the threshold usually needed to infer dominance. Moreover, beyond its political rationale, dominance also represents an important safe harbour because European legislators have purposefully decided to left out of Article 82 EC all conduct aimed at achieving and building a position of dominance, even when based on competition different than competition on the merits.[95]

In this regard, therefore, a preliminary assessment of dominance has an important screening function whose importance has been recognized also by famous economists.[96] And indeed, contrary to what EAGCP surely want to achieve with this reform, the elimination of a preliminary finding of dominance could increase, rather than decrease, competition authorities' intervention because (at least in theory) any practices able to concretely produce a significant anticompetitive harm should be object of scrutiny. This, however, hinges strongly on what we understand with the term "significant anticompetitive harm"; clearly, if the bar is set too high no abuses are likely to be found.

Besides all the negative effects outlined above, there is another one which often remains in the shadow and has seldom attracted attention by commentators. I am referring to the subtle element of the burden of proof.

Under the current enforcement regime, as amended by recent modernization package, the Commission has the power to challenge firms' behavior on its own initiative or acting on a complaint, whenever it fears that competition is at stake. While in doing so, the Commission has a broad set of investigative powers, the Commission has the burden of proving that an actual *infringement* of either Article 81 EC or Article 82 EC has been committed.[97] There is a first phase where the Commission opens the investigation during which it collects all the relevant information and

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[94] EILMANSBERGER, note 13, 24.

[95] In this sense, Article 82 EC is somewhat more lenient than other antitrust laws, like the American Sherman Act, that punishes also conduct aimed at obtaining a position of dominance in the market On the differences between European treatment of unilateral exclusionary conduct vis-à-vis American attempt to monopolize, *see* AREZZO, "Intellectual Property Rights at the Crossroad between Monopolization and Abuse of Dominant Position: American and European Approaches Compared", (2006) 24 John Marshall Journal of Computer & Information Law 455.

[96] VICKERS, "Market Power in Competition Cases", (2006) 2 European Competition Journal, 12.

[97] Council Regulation 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, [2003] OJ L 1/1, Article 2.

forms an opinion regarding the character of the conduct (i.e. whether it is or not anticompetitive).

With regard to exclusionary conduct cases, the latter part (i.e. forming an opinion on whether the violation has occurred or not) is rather complex. Indeed, after the delineation of the relevant market and the assessment of the position the company holds therein, the Commission begins evaluating the conduct at issue. Here, contrary to what is argued by supporters of the effects-based approach, the verification *begins* from the form of the conduct to see whether it corresponds to one of the practices foreclosed by Article 82 EC and then it goes further to examine the peculiar circumstances of the case. Indeed, as it is well known, the mere correspondence of the company, for example, to a refusal to deal does not lead the Commission to declare straightforwardly that an abuse has been committed. On the contrary, the Commission will then turn to specific judicial doctrines which have been developed by European jurisprudence.[98] In the mentioned example, the Commission will further examine whether the dominant undertaking intends to reserve to itself an entire derivative market and through the refusal it aims at eliminating all competition coming from that rival.[99]

If the Commission eventually concludes that the conduct at issue has violated rules of competition, it issues a statement of objection which it must notify to the interested undertaking.[100] The latter then sends its written comments, usually alleging facts and circumstances aimed at disproving its violation of competition norms.[101] In these written submissions, undertakings may ask to be heard orally during the proceeding.[102]

It normally happens that notified companies ask to be heard before the Commission and strongly argue their case to convince the Commission to dismiss the proceeding. In an abuse case, accused companies usually claim that they do not hold a position of dominance in the relevant market or that the same relevant market has not been properly defined, and was indeed broader. In addition, they might claim that the conduct has not restricted competition or they could admit that the conduct was indeed anticompetitive but they might argue they had objective business justi-

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[98] It has been rigthly stressed that European courts have developed such doctrines along the years and they express the wisdom of a long judicial experience. Their codification is not result of accident, therefore the proponents of the effects-based approach cannot just suggest to simply thow them away. *See* DENOZZA/TOFFOLETTO, note 86, 568.

[99] Joint Cases 6 and 7/73 *Commercial Solvens v Commission* [1974] ECR 223, para. 25. Alternatively, if the case is examined under the *essential facility doctrine*, the Commission will verify whether competitors can duplicate the product, input or facility whose access has been denied; and it will further inquire on whether such product is essential to compete in the relevant market and so on. *Cf.* European Commission, Decision 94/19/EC *Sea Containers v Stena Sealink – Interim measure* [1994] OJ L 15/8, para. 66.

[100] Commission Regulation No. 773/2004 of 7 April 2004 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty, [2004] OJ L 123/18, Article 10(1).

[101] Regulation 773/2004, Article 10 (3).

[102] Regulation 773/2004, Articles 11 and 12.

fication for pursuing it. [103] In pleading their case before the Commission, defendants often recur to complex economic theories, models, econometric data and the like.

Were the effects-based approach to pass, things would radically change in the assessment of abuse cases. Under the current approach, evidence of consumer welfare diminution is not requested; rather, consumer harm is often presumed to follow from the restriction of competition, which is the direct concern of the Commission. Conversely, proponents of the effects-based approach want competition authorities to go one step further and prove that consumers have been harmed (i.e. their surplus has been actually eroded). This is not all. Proof of consumer harm must be corroborated by strong economic evidences.

In addition to this, economists explain that the economic toolbox shall be used not simply to demonstrate that the company has substantial market power and, consequently, actual consumer harm is produced, but also to prove that such effect is persistent: i.e. that such SMP is stable and not likely to be quickly eroded by countervailing factors. In such case, indeed, there would be no market power and, consequently, no consumer harm in the first place.

As explained above, economists want competition authorities to pursue such task by examining how actual or potential competitors might respond to the presumptively dominant company abusive strategy; this in the assumption that *efficient companies* will be able to constrain the anticompetitive potential of the exclusionary conduct.

From the procedural perspective, this new methodology seems to over-burden competition authorities with elements they were not supposed to prove under current regime. Providing evidence of actual consumer harm is indeed hard to accomplish, especially if such thesis must be corroborated with economic tools. Moreover, the inquiry competition agencies would be supposed to perform on the efficiency levels of competitors seems way too excessive. Indeed, it is worth remembering that under the current regime all these elements are usually brought up by the defendants to plead their case. Asking the Commission to start an investigation and then find by itself the economic justifications to dump it seem meaningless and against all procedural rules.

The proponents of the new approach have purposefully convoluted the attention towards the so called *efficiency defence*, however, the real innovation of the proposal regards the other type of efficiency discussed above: namely, the ones the Commission has to deal with.

This new procedural mechanism would probably succeed in reducing the numbers of false positives, because in the end it would make it extremely difficult for the Commission to prove the abuse; however, this does not necessarily means that the Commission would have less work to do. On the contrary, these changes would

[103] Under current regime, differently from what happens in the case of Article 81(3) EC, firms which have allegedly abused a dominant position are not required to justify their conduct in terms of efficiencies brought about by their conduct. Regulation 1/2003, Article 2, expressly shift the burden of proving the four conditions contained at Article 81(3) EC on the undertaking or association of undertaking claiming the benefits connected therein.

probably increase the amount of investigations to be pursued and the workload for each single case.

7 Substantial market power, consumer welfare and significant competitive harm: Some flaws in the new effects-based approach

It appears from what we have seen until now that the new *effects-based* approach evolves around three main concepts: *significant market power, consumer welfare* and *anticompetitive harm.*

It is interesting to notice how these concepts are interrelated one another: substantial market power is found when the firm is able to raise prices and diminish quantity, hence damaging consumers that will either stop buying the good or will have to bear a higher price. At the same time consumer welfare, as measured per market power inference, will be the benchmark to determine when a certain conduct (which is deemed anticompetitive because the firm has been found to have substantial market power) can be said to cause a significant anticompetitive harm. In practice, it seems that both substantial market power and significant anticompetitive harm – which indeed would be evaluated at the same time – are measured and assessed with regard to consumer welfare. Thus, the concept of consumer welfare bears significant implication as it becomes the sole key to determine the magnitude of the anticompetitive harm. Therefore, at this point of this study we should question whether consumer welfare (and, indirectly, market power) amount to the appropriate benchmark for antitrust analysis in exclusionary unilateral conduct.

In previous parts of this study, I have examined the likely shortcomings that would arise if consumer welfare would be adopted as sole and exclusive goal of competition law (so called "welfarist approach"). I have also shown that case law experience confirms that consumer welfare is not the *sole* and *direct* objective of European antitrust. In the following paragraphs, I will argue that from a practical point of view consumer welfare is not appropriate to serve as benchmark to assess anticompetitive character of unilateral exclusionary conduct.

7.1 Consumer welfare and dynamic efficiency

The reference to consumer welfare as benchmark to assess the ultimate anticompetitive nature of the conduct and the related market power assessment, as necessary instrument to measure consumer welfare, present some flaws which are worth and interesting discussing.

First of all, as we have observed above when discussing the model of monopoly power in microeconomics, consumer welfare and market power analysis belong to a framework where the monopolist decides her strategy only throughout two variables: namely, prices and quantity. In fact, as we have seen already, market power is widely perceived by economists throughout the world as power over prices. The (widely accepted economic) reason for this is that firms maximize their profits when they can set a price which exceeds firm's marginal cost. In a competitive scenario, competing undertakings are price-takers in the sense that they normally

undergo the price formed according to consumers' willingness to pay, as every competitor by herself is not strong enough to stand up and set a supra-competitive price. Conversely, the power to set prices above competitive levels shows that the firm has indeed market power.

The problem with this model (and the monopolistic model as well) is that it is not suited to take into account other forms of competition beyond competition on prices and quantities. It simply assumes that consumer welfare is maximized when consumers get a lower price and everyone can access the good that is affordable at the price she is willing to pay (hence, there is enough of the product to satisfy the entire market demand). However, this paradigm does not tell us anything about product differentiation, product innovation, quality and so on. How do we take them into account? How can we know if consumers are likely to prefer low prices to higher innovative products or vice-versa?

The difficulty inherent unilateral practices lies in that they often require a balancing of short-run effects directly produced by the conduct against long-run effects that the conduct, if not stopped, is *likely* to cause. The complexity of such evaluation is further increased by the fact that often the short-run effects are far from harmful for consumers who often, as a result of the conduct, get lower prices (think for example about predatory pricing, bundling and other forms of rebates) and sometimes even better products (think for example to the American and European Microsoft tying cases where consumers would get at the same price a much more complete product). Conversely, the negative implications of the conduct, like the lessening of competition on the market, are often potential and not already occurred. Obviously, this depends on the moment the Commission begins investigating the practice. If, for example, Commission analysis of a predation case begins after the predation period has ended, rivals have been driven off the market and the dominant firm is recouping her losses incurred in the first period, the overall balancing analysis is relatively easy. However, because usually rivals who risks exiting the market try to catch the Commission's attention before it is too late for them, it is very likely that unilateral conduct will be assessed in a moment where the negative effects - likely to stem from such behavior - have not yet occurred.[104]

Even though commentators would like to think that consumer welfare – in the meaning of consumer surplus – would be better suited than total aggregate welfare for the purpose of Article 82 EC, other considerations suggest caution at this regard.

While reference to microeconomics is extremely useful lawyers do not have to forget that models are often quite far away from reality.

This is because every economic *model* – even the monopolistic model – is based on certain assumptions. The assumptions of this model are that the monopolist decides her strategy only through two variables, namely price and quantity. This model does not tell us that a monopolist may also decide to under-price her product in order to gain a wide installed based and than in a later moment be able to increase her prices. This is because the model not only does not consider other variables like competition on qualities and performances, product differentiation and so on; but

[104] KRATTENMAKER/LANDE/SALOP, note 55, 246. At this regard *see infra* para 7.3.

especially because this model is *static*, in the sense that it only works if the assumptions are met and only within a single time framework (i.e. it does not tell us how the monopolist would react in a later stage of the game when, for example, a new product might be launched on the market).

Clearly a static notion of consumer welfare would appear poorly suited to deal with determination of anticompetitive effects determined by exclusionary unilateral conduct whose eventual detrimental effects for consumers should be assessed in a dynamic framework.[105]

7.2 Consumer welfare and market power in information technologies markets

The criticism just outlined becomes even more compelling for today's economic leading sectors such as new information technologies markets where firms engage in strategic behaviors that go well beyond mere price competition.

To be more precise, companies active in such markets probably still compete on prices to some extent, but the core business strategies to maximize profits, to steel consumers away from rivals or to simply keep consumer loyal to the undertaking's products, they all evolve around other variables: namely, product variety, updates, superior quality, increased features the competing product does not have, compatibility with vast array of complementary products which increases the utility the consumer might get. To put it differently, and just with a simple word, competition is played through *innovation*. The tools to compete in this new scenario are IPRs in all their possible forms and strategic behaviors intended to capture and preserve the largest possible installed base of consumers.[106]

As I have explained elsewhere, the special feature of this new way of competing is that often firms play simultaneously in more than one market so that the assessment of the overall anticompetitive character of the business maneuver becomes more complex to assess.[107] Furthermore, often these sectors are characterized by high initial sunk costs in the form of R&D expenses and negligible marginal costs, usually due to economy of scales in production. In addition, because such markets are often characterized by strong network effects, often even big companies decide to price at fairly low levels or to give away a product for free because this will lead

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[105] The first debate on market power followed Posner's and Landes' paper mentioned *supra*, note 49. Criticisms against their model have been presented by several scholars. Schemalensee, in particular, attacked the model for being static and unable to take into account market dynamics. *See* SCHEMALENSEE, "Another Look at Market Power", (1982) 95 Harv. L.Rev. 1789.

[106] FARRELL/SALONER, "Standardization, Compatibility and Innovation", (1985) RAND Journal of Economics 70; PERITZ, "Dynamic Efficiency and US Antitrust Policy", in: CUCINOTTA/PARDOLESI/VAN DEN BERGH (eds), "Post-Chicago Developments in Antitrust Law", (2002); PITOFSKY, "Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy", (2001) Berkeley Tech. L. J. 535; PITOFSKY, "Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property", (2001) Antitrust Law Journal 913.

[107] GHIDINI/AREZZO, "On the Intersection of IPRs and Competition Law with regard to Information Technology Markets", forthcoming in: EHLERMAN/ATANASIU (eds), "The Relation Between Competition Law and Intellectual Property Law", (2006).

to the creation of a niche of consumers that will be later locked-in the product and will be probably unwilling to switch to a different item in the future.[108]

With these premises in mind, it is easy to understand that firms might not be interested in pricing a lot over marginal cost because even a small margin can yield them good profits when they are able to get the whole market for long time. At this regard, it is important to consider that (dominant) undertaking marginal costs might well be below rivals' therefore a price which is fairly above the firm's marginal costs might be right at rivals' marginal costs so that the dominant undertaking is able to set a price that allows it to be competitive on the market while earning profits. In such scenario, a focus on the price-effect of the conduct to see whether it reduces or increases consumer welfare could be misleading. Indeed, at this regard it is important to distinguish an analysis where competition authorities look at whether the conduct is (ultimately) aimed at strengthening or maintaining market power (intended as power over price), from an analysis where competition authorities look at the actual undertaking's power over price as sole and exclusive parameter to infer anticompetitiveness of the conduct.

7.3 Dominance as the ability to harm rivals in order to gain substantial market power

While the current debate on exclusionary abuses in Europe has mostly centred on whether to adopt the new *effects-based* approach or rather keep the current one, it is interesting to see that the same debate in the United States, which has surely influenced the European one, has much broader contours. In particular, for the purpose of our discussion, it is interesting to notice that not only some theories have been strongly debated, like the "profits-sacrifice-test",[109] which are completely new to

[108] Many studies have been dedicated to the economic analysis of network effects in new economy markets. In particular *see* KATZ/SHAPIRO, "Network Externalities, Competition, and Compatibility", (1985) 75 Am. Econ. Rev. 424; SHAPIRO/VARIAN, "Information Rules, a Strategic Guide to the Network Economy", (1999); KATZ/SHAPIRO, "Antitrust in Software Markets", in: EISENACH/LENARD (eds), "Competition, Innovation and the Microsoft Monopoly: Antitrust in the Digital Market Place", (1999); LEMLEY/MCGOWAN, "Could Java Change Everything? The Competitive Propriety of a Proprietary Standard", (1998) 43 Antitrust Bull. 715; LEMLEY/MCGOWAN, "Legal Implication of Network Economic Effects", (1998) 86 Calif. L. Rev. 479; FARRELL/KATZ, "The Effects of Antitrust and Intellectual Property Law on Compatibility and Innovation", (1998) 43 Antitrust. Bull. 609.

[109] Just to mention some of the most relevant voices in the debate, s*ee* PATTERSON, "The Sacrifice of Profits in Non-Price Predation", (2003) 18 Antitrust 37; EHLAUGE, "Defining Better Monopolization Standards", (2003) 56 Stan. L.R. 256; HOVENKAMP, "Exclusion and the Sherman Act", (2005) 72 U. Chi. L. Rev. 147; EPSTEIN, "Monopoly Dominance or Level Playing Field? The New Antitrust Paradox", (2005) 72 U. Chi. L. Rev. 49; MELAMED, "Exclusionary Conduct under the Antitrust Laws: Balancing, Sacrifice, and Refusal to Deal", (2005) 20 Berkeley Tech. L.J. 1247; FOX, "Is There Life in Aspen After Trinko? The Silent Revolution of Section 2 of the Sherman Act", (2005) 73 Antitrust L.J. 153; WERDEN, "Identifying Exclusionary Conduct Under Section 2: The 'No Economic Sense' Test", (2006) 73 Antitrust L.J. 413; SALOP, "Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard", (2006) 73 Antitrust L.J. 311.

European horizons, but also that even the views that at a first glance might seem close to the European *effects-based* approach are in practice quite distant. I am referring to a recent article of prof. Steven Salop where he sketches his personal theory of consumer welfare balancing test as methodology to investigate exclusionary conducts.[110]

Prof. Salop embraces the notion of antitrust as a consumer welfare prescription but he drafts it his own way. In particular, starting from the assumption that an antitrust evaluation involves an analysis centred on consumer welfare, hence market power, Salop explains that different conceptualizations of market power do exist although they have not received equal attention and respect from the economic literature.[111] In particular, he explains that often exclusion takes the form of raising rivals' costs. His point is that to be anticompetitive, an undertaking's conduct needs not be aimed at raising her own prices, but to raise her rivals' costs. Therefore, he explains that a consumer welfare analysis would evaluate whether the conduct harms competitors by raising their costs and whether those higher costs harm consumers and competition by allowing the defendant to achieve, maintain or enhance monopoly power.[112]

Without entering into the details of Salop's proposal, it is interesting to notice that although he also believes that consumer welfare should be the benchmark to evaluate the effects of an anticompetitive conduct, he draws a different economic methodology. In fact, he also intends to actually measure the ultimate effect the conduct will have on consumers, but within his framework market power is not assessed through an inquiry of overall rivals' efficiencies and their capability to offset the anticompetitive potentials inherent the behavior; rather, he intends to measure the effects the unilateral practice is going to directly assert towards rivals and see how this, in turn, affects the whole market, in terms of prices and quantities supplied. In fact, he argues that even though rivals might not be forced to immediately exit the market, they could be induced by the unilateral practice to compete less vigorously: for example, rivals may be forced to raise their price to reflect the internal increase in costs or, for the same reason, they could be forced to reduce the quantity produced and offered to the market, always to the benefit of the dominant firm. Salop argues that these are short-terms effects that directly damages consumers and must be taken into account in the overall balancing analysis.

Clearly, although an economist, Salop's position appears radically distant from mainstream economic thinking and from the European *effects-based* approach. For example, he emphasizes that the legal standard of proof of consumer harm placed on the plaintiff should not be excessive and that consumer harm might also be

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[110] SALOP, "Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard", (2006) 73 Antitrust L.J. 311.

[111] Salop distinguishes market power as power over price, which he calls Stiglerian market power, from a second form of market power, which he calls Bainian market power. This second form is present whenever a firm raises its price or prevents it from "falling to a lower competitive level by raising its rivals' costs and thereby causing them to restrain their output ('exclude competition')." KRATTENMAKER/LANDE/SALOP, note 55, 250.

[112] SALOP, note 110, 319.

threatened rather than actually realized.[113] This finds its rationale in the assumption that a conduct which foreseeably leads to consumers' benefits but it later turns out to harm consumers would not be punished in a merely *ex ante* perspective which only punishes a conduct if its actual and immediate effect is to damage consumers. He is one of the few to advocate that false negatives have a strong negative impact on competition because allowing anticompetitive exclusionary conduct to accomplish its goal means destroying the very same rivals who could innovate and, by asserting competitive pressure on the monopolist, could force the latter to keep ameliorating its product, hence competing on the merits rather than spending money in strategies only intended to preserve its position of strength.[114]

7.4 Consumer welfare and the exclusion paradox

A likely interpretation and assessment of market power as the power to harm rivals in order to obtain economic strength as a result would probably be more in line with the traditional definition of dominance whose special feature has been identified with the power to behave independently which, in turn, would vest the undertaking with the power to distort competitive equibrium in the market.

This concept would appear more apt to deal with the specific case of exclusionary conduct as it is seems more suited to make dynamic considerations and consider the foreclosure effects of the anticompetitive conduct in the long run.

The possibility that dominance takes indeed this specific form has been briefly acknowledged by some commentators in the current debate although the idea has not received particular consideration. Even the Commission Discussion Paper seems, at a certain point, to introduce a rather broad definition of foreclosure as the act of discouraging entry or expansion of rivals or encouraging their exit; and it clearly explains that foreclosure can also be found when rivals are not forced out of the market but they are simply disadvantaged and led to compete less aggressively.[115]

On the contrary, assessment of foreclosure under the *effects-based* approach would compel competition authorities to immediately look at the actual effect of the conduct: hence, to see first of all whether a competitor has actually been driven off the market because of the allegedly abusive conduct. Secondly, supporters of a more economics-based assessment of competition law explain that even though the practice may actually lead to exclusion of a competitor from the market, the anticompetitive nature of the conduct must be evaluated with focus on the competitor commercial strength and the position it holds on the market, not on the goals the allegedly dominant firm wants to achieve. Because the outmost blueprint is efficiency in order to better serve consumer welfare, competition on the merits needs not protect inefficient competitors from aggressive competition, even if it comes from a far

[113] SALOP, note 110, 350.
[114] SALOP, note 110, 351.
[115] EUROPEAN COMMISSION, note 56, 58.

stronger firm which holds substantial commercial and economic advantages on the market.

Although this reasoning seems to have its own logic, I am afraid that if stretched to the extreme might lead to circular reasoning. Indeed, if competitors are not driven off the market or they are efficient and (at least in theory) capable to constraint a likely exclusionary manoeuvre undertaken by the dominant firm, this is a proof that the firm does not hold a sufficient degree of market power (or – which should be the same – is not dominant) so the conduct cannot qualify for abuse; conversely, if competitors are not efficient and the firm is capable of asserting market power (hence, it can be said to be dominant), eventually causing one of them (or maybe even all of them) to leave the market, banning the likely abuse would equate protecting these inefficient firms from aggressive competition coming from an efficient partner (because the implicit assumption is that dominance is a synonym of efficiency).

8 Conclusions

As well known, the European Commission has engaged in a long and substantial reform of EC competition laws in light of a more economics-based assessment. This process has begun at the end of the nineties with the adoption of the Regulation on vertical agreements in restriction of competition and its related guidelines. Today the momentum has come for exclusionary practices ex Article 82 EC. The overall scenario, however, does not appear clear. The European Commission Discussion Paper is a very complex document whose style makes it incredibly hard to decipher the changes made to current practice nor does it explain the rationale behind such changes, if any. On the contrary, the apparent changes proposed by a group of very influential European economists (the Economic Advisory Group for Competition Policy) are crystal clear and very much worrying.

The approach they propose, the so called *effects-based* approach, evolves around three concepts all strictly related one another: consumer welfare, significant market power and significant anticompetitive harm. In fact, in the neoclassical economics, measurement of market power gives direct account of the degree of consumer welfare that is diminished as result of the conduct. Significant anticompetitive harm, in turn, is directly measured per inference to consumer welfare. This is because the effects-based approach calls for a balancing test whereby positive pro-consumers effects of the conduct are to be balanced against harms to consumer welfare, which is measured through market power.

This approach would sign a strong departure from the current assessment of abuse under Article 82 EC as it would completely eliminate the old definition of dominance and the list of presumptively abusive conduct listed at Article 82 EC, in order to adopt a test exclusively concerned about the final effect the conduct is likely to assert on consumers. Clearly, this approach would not have room for concepts well rooted in EU competition law, such as the protection of “competition as an institution” or dominance intended as “special responsibility”.

However, while economists of the EAGCP present this the new effects-based approach as the *more economic approach* to the assessment of unilateral practices,

it is interesting to note that other economic considerations have not been taken into account which would probably suggest more caution in adopting such approach. In fact, it seems that the approach of the EAGCP instead of being simply in favor of more economics in general, it is more inclined to support the adoption of certain economic theories rather than others.