Rezensionsabhandlung

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The Law and Economics of Article 82 EC and the Commission Guidance Paper on Exclusionary Conduct[1)]

This article discusses the approach to Article 82 in O'Donoghue and Padilla's book "The Law and Economics of Article 82 EC" (Hart Publishing, Oxford 2006), compares it with the new European Commission Guidance Paper on the Commission's enforcement priorities in applying Article 82 EC to abusive exclusionary conduct by dominant undertakings[2)] and addresses some aspects of competition law remedies.

Contents

I. Introduction

The European Commission's review of its policy under Article 82 EC has been at the centre of discussions in academia and private practice since its start in 2003 and even more so since the publication of the report "An Economic Approach to Article 82" by the Economic Advisory Group on Competition Policy (EAGCP)[3)] and the "DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses"[4)] in 2005. While the Commission was evaluating the contributions made during the public consultation on the 2005 discussion paper in preparation of a Communication on the enforcement of Article 82, *Robert O'Donog-*

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2) Communication from the Commission: Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, available under: http://ec.europa.eu/competition/antitrust/art82/guidance.pdf.

3) Available under: http://ec.europa.eu/competition/publications/studies/eagcp_july_21_05.pdf.

4) Available under: http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf.

hue and *A. Jorge Padilla* published their comprehensive book on "The Law and Economics of Article 82 EC" (Hart Publishing, Oxford 2006). In the meanwhile, the Commission has published its "Guidance on the Commission's enforcement priorities in applying Article 82 EC to abusive exclusionary conduct by dominant undertakings",[5] which sets out the Commission's approach to exclusionary conduct dealing with many aspects *O'Donoghue* and *Padilla* are concerned with in their book.

This article reviews *O'Donoghue* and *Padilla*'s general approach to Article 82 with particular emphasis on conditional rebates and compares it with the Commission Guidance Paper. It first sets out the concept and structure of the book and of the Guidance Paper and then addresses the general approach to abuse of dominance and particularly to conditional rebates in both texts. Subsequently, it deals with the section on remedies in *O'Donoghue* and *Padilla*'s book.

II. Concept of the book

The concept of *O'Donoghue* and *Padilla*'s book goes back to the authors' common impression that traditional competition law textbooks ignore the influence of economics while at the same time competition economics textbooks do not take account of the need for administrable rules and legal certainty.[6] Based on this idea, *O'Donoghue* and *Padilla* set out to produce a textbook useful to both lawyers and economists.

The continuous balancing of economic and legal reasoning throughout all chapters is a considerable asset of the book. The authors, a lawyer and an economist, both in private practice, are of the opinion that the practical application of Article 82 EC is "unclear in material aspects" and draw the reader's attention to the welfare cost of this "lack of clarity" and the excessive caution of firms which may result from it.[7] The book informs readers of the current law, but is more ambitious in various respects: Each chapter on the main categories of abuse includes a detailed section of the applicable economic principles. Furthermore, in some chapters, the authors have the ambition to put forward a more coherent framework for the analysis of particular types of conduct. It is *O'Donoghue* and *Padilla*'s common belief that the "choice sometimes posited between an approach based on legal form and one based on economic effects is false".[8] Relying only on legal form would lead to incorrect conclusions by ignoring the mixed economic effects of many unilateral practices. On the other hand, predictability and legal certainty would hardly exist if "each case depended on an assessment of the economic benefits and harm of conduct, most of which can only be assessed ex post (if at all)".[9] *O'Donoghue* and *Padilla* therefore advocate an intermediate approach which uses error-cost analysis based on economic evidence to structure administrable legal rules ("structured rule of reason"). In some cases, it may not be possible to devise a clear legal rule based on economic evidence. Since restricting firms' conduct without guidance on the scope of the restriction risks to "greatly chill competition", *O'Donoghue* and *Padilla* are of the

5) Communication from the Commission: Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, available under: http://ec.europa.eu/competition/antitrust/art82/guidance.pdf.

6) *O'Donoghue* and *Padilla* (2006), p. xi.

7) *O'Donoghue* and *Padilla* (2006), p. xi.

8) *O'Donoghue* and *Padilla* (2006), p. xii.

9) *O'Donoghue* and *Padilla* (2006), p. xii.

opinion that the optimal solution in such cases may be not to intervene at all, even if that implies that certain anticompetitive practices will escape censure.[10)]

It is surprising that *O'Donoghue* and *Padilla* see a "lack of clarity" with regard to the enforcement of Article 82 EC, while they argue in other parts of their book that the approach to dominance under Article 82 in the past has been overly "formalistic".[11)] In the context of rebate schemes, for example, *O'Donoghue* and *Padilla* conclude that the "case law has historically applied per se rules to many such practices, an approach that is indefensible".[12)] Besides the fact that the authors provide no further argument as to why this may be the case and contradict themselves in a later statement in their book where they claim that currently there are "virtually no practices" in the case law that could still be described as per se unlawful,[13)] per se rules as such can be very defendable because they provide legal certainty and exactly the clarity that *O'Donoghue* and *Padilla* consider to be lacking. What may or may not be defendable is the particular content of a per se rule, as such a general rule may obviously be more or less inspired by sound economics. But not only are the two arguments that there is a "lack of clarity" and that the approach to abusive conduct by dominant firms has been overly "formalistic" contradictory, but they are also equivocal. Clear and foreseeable rules have existed in the past and will exist in the future of Article 82 enforcement. They have been and will be induced by economic reasoning without which rules for market conduct should not be devised. The economic reasoning may be subject to refinement as new economic insights are gained which have to be incorporated in the existing rules. This refinement entails changes as the current reform of the application of Article 82. The existence of a purely form-based approach in the application of Article 82, however, was already a myth prior to the reform,[14)] and this will not change with the Commission's new enforcement priorities.

It is also doubtful why *O'Donoghue* and *Padilla* presume that an economic approach is always a case-by-case-approach. Already the 2005 Discussion Paper[15)] used the concept of actual or likely effects on consumers thus showing that an effects-based approach and a generalised and rule based ex-ante assessment can very well be reconciled.[16)]

III. Structure of the book

O'Donoghue and *Padilla*'s book is divided into 15 chapters. General chapters deal with market definition (chapter 2), dominance (chapter 3), and the general concept of abuse (chapter 4) before the authors address specific types of abuses as predatory pricing, margin squeeze, exclusive dealing, conditional rebates[17)] and tying and bundling. Chapters about abusive discrimination,

10) For the above see *O'Donoghue* and *Padilla* (2006), p. xiii, where these arguments are presented without empirical backing. A similarly speculative statement can, for instance, be found in the conclusions of the authors on their proposal to subject rebate and exclusive dealing cases to a predation test. They state: "This may allow some harmful practices to escape censure, but this cost is almost certainly much less than the cost of over-prescriptive or unusable rules." *O'Donoghue* and *Padilla* (2006), p. 403.

11) See for example *O'Donoghue* and *Padilla* (2006), p. 136.

12) *O'Donoghue* and *Padilla* (2006), p. 403.

13) *O'Donoghue* and *Padilla* (2006), p. 184. Fore more details see below VIII.

14) For more details see *Dreher/Adam*, (2007) European Competition Law Review, Vol. 28 (4), 280, 282 et seqq.

15) Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses, available under: http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf.

16) For more details see *Dreher/Adam*, ZWeR 2006, p. 259, 273 et seqq.

17) *O'Donoghue* and *Padilla* use the term loyalty discounts instead of rebates throughout their text. Following the common usage of the term discount as price reduction, the term rebate is used to distinguish between direct price reduction (i.e. discounts) and indirect, conditional reductions in prices.

excessive prices, other exploitative abuses and the effect on trade follow. The authors conclude with a chapter on remedies including fines and private damage actions.

IV. Structure of the Commission Guidance Paper

The Commission Guidance Paper reflects the Commission's current thinking on exclusionary abuses. It is divided into four main chapters containing an introduction and purpose statement, a chapter on the general approach to exclusionary conduct (subdivided into chapters about market power, anticompetitive foreclosure, price-based exclusionary conduct and objective necessity and efficiencies) and a chapter about specific forms of abuse, notably exclusive dealing, tying and bundling, predation and refusal to supply and margin squeeze.

V. Protecting competitors or protecting competition?

O'Donoghue and *Padilla* claim to stick to the letter of Article 82 (b) when arguing that conduct is exclusionary if it materially harms rivals or causes consumer harm.[18] In the following chapters of their book, however, the line of argument appears to shift and to centre predominantly on consumer harm.

The Commission Guidance Paper follows the consumer welfare approach already chosen in the modernisation of Article 81 EC and of the EC Merger Regulation.[19] The Commission will focus "on those types of conduct that are most harmful to consumers".[20] The emphasis of its enforcement activities is on "safeguarding the competitive process and ensuring that dominant undertakings do not exclude their competitors by other means than competing on the merits of the products or services they provide".[21] The Guidance Paper makes it clear that the Commission intends to protect an effective competitive process and not simply competitors. This may mean that "competitors who deliver less to consumers in terms of price, choice, quality and innovation will leave the market".[22] On the other hand, the references in the Commission Guidance Paper to the competitive process and to the competitors of dominant companies also highlight the importance of competitors for a well functioning of the market and therefore ultimately for the benefit of consumers.

VI. Dominance and market power

O'Donoghue and *Padilla* start their chapter on dominance (chapter 3) by juxtaposing the legal and the economic concept of dominance. The legal concept of dominance is reflected in the formula of a "position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers" emanating from the United Brands case.[23] The basic economic concept of dominance in contrast, is "associated with market power".[24] "A firm enjoys a dominant position if it has signifi-

18) *O'Donoghue* and *Padilla* (2006), p. xii.

19) Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, Official Journal L 24, 29. 01. 2004, p. 1.

20) Commission Guidance Paper, paragraph 5.

21) Commission Guidance Paper, paragraph 6.

22) Commission Guidance Paper, paragraph 6.

23) *O'Donoghue* and *Padilla* (2006), p. 107.

24) *O'Donoghue* and *Padilla* (2006), p. 107.

cant market power, i.e. if it is able to charge prices significantly above competitive levels or restrict output significantly below competitive levels for a sustained period of time".[25] *O'Donoghue* and *Padilla* add their criticism to the legal concept of dominance by noting that "strictly speaking only a monopolist operating in a market protected by insurmountable barriers to entry and facing a completely inelastic demand would be able to behave independently of its competitors, customers, and consumers".[26]

Having sketched out this tension between the legal and the economic concept of dominance, *O'Donoghue* and *Padilla* unfortunately do not offer a solution trying to reconcile the conclusions of the legal reasoning on the one hand and the economic reasoning on the other hand.

The Commission Guidance Paper, however, does exactly that by building directly on the economic concept of market power. As a result, the Guidance Paper does not contain a chapter entitled "dominance" or "dominant position". It acknowledges, however, that dominance is the trigger for a "special responsibility" of the undertaking concerned.[27] The Guidance Paper then establishes a link between the legal and the economic concept of dominance by setting forth that the notion of independence is related to the degree of competitive constraint exerted on the undertaking in question. Dominance thus entails that these competitive constraints are not sufficiently effective and hence that the undertaking in question enjoys substantial market power over a period of time. The paper then sets out the economic concept of market power more precisely, arguing that an undertaking capable of profitably increasing prices "above the competitive level for a significant period of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant".[28]

VII. The role of market shares in the assessment of dominance

After presenting the basic legal and economic concepts of dominance, *O'Donoghue* and *Padilla* turn to the assessment of dominance for single firm conduct.[29] They stress the need for a comprehensive assessment in the specific market context and that dominance cannot be assessed mechanically on the basis of a checklist or even a single factor.[30] A "comprehensive survey" of the competitive conditions on the relevant market is necessary before dominance can be assessed. On the other hand, decisional practice and case law have established a "reasonably well-defined series of steps to assess dominance". The starting point is to measure the relative strength of the firms on the relevant market on the basis of their market shares.[31]

O'Donoghue and *Padilla* approve the traditional approach that market share data are the first and most important element in the assessment of dominance. They are an easily available proxy for the measurement of the market power of firms. Both the market share of the firm under investigation and the market shares of its rivals on the same market must be examined.[32] However, there is a need for caution with market shares. They are not conclusive evidence of dominance and are therefore not a proper substitute for a comprehensive examination of market conditions.

25) *O'Donoghue* and *Padilla* (2006), pp. 107, 108.

26) *O'Donoghue* and *Padilla* (2006), p. 108.

27) Commission Guidance Paper, paragraph 10.

28) Commission Guidance Paper, paragraph 11.

29) In contrast to the Commission Guidance Paper, *O'Donoghue* and *Padilla* also deal with collective dominance in their book.

30) *O'Donoghue* and *Padilla* (2006), p. 108.

31) See *O'Donoghue* and *Padilla* (2006), p. 109.

32) See *O'Donoghue* and *Padilla* (2006), p. 109.

Most importantly, looking only at current market shares does not allow drawing conclusions regarding the question if these market shares are likely to confer lasting market power. This question can only be answered if one also looks at entry barriers.[33] Countervailing buyer power is another important factor.[34] *O'Donoghue* and *Padilla* criticise that, historically, dominance "has often been analysed in a cursory fashion" although further analysis was needed and point to an "over-reliance on market shares" in the case practice treating relatively low market shares (e.g. 40 – 50 %) as raising prima facie dominance concerns or presuming conclusively that high shares imply dominance. Moreover, *O'Donoghue* and *Padilla* oppugn that in general terms, the threshold for intervention in the EU is "too low".[35]

The Commission Guidance Paper demonstrates that such criticism is superficial and discusses market shares only as useful first indication of the market structure and of the relative importance of the various undertakings active on the market. The Commission interprets market shares "in the light of the relevant market conditions, and in particular of the dynamics of the market and of the extent to which products are differentiated".[36] The trend or development of market shares over time may also be taken into account.[37] The Commission Guidance Paper does not set out specific market share thresholds that will be considered as raising prima facie dominance concerns or even to conclusively presume that high market shares always imply dominance.

Conversely, the Commission considers that low market shares, particularly below 40 %, are generally a good proxy for the lack of substantial market power in the absence of extraordinary circumstances[38] which gives companies a fair degree of legal certainty indicating in which cases intervention by the Commission is not to be expected. Apart from market shares, the Commission will consider all other factors that may constrain the behaviour of the allegedly dominant undertaking, notably expansion by actual or entry by potential competitors and countervailing buyer power.[39]

VIII. The general concept of abuse

In the fourth chapter of their book, *O'Donoghue* and *Padilla* deal with the general concept of abuse. They sketch out three basic types of abuses under Article 82 – exploitative, exclusionary and reprisal abuses and then summarise the Community institutions' basic definition of abuse.[40] *O'Donoghue* and *Padilla* conclude that there is still an unsatisfactory "uncertainty surrounding the definition of exclusionary conduct" and cite in particular the example of unconditional price reductions.[41]

O'Donoghue and *Padilla* then turn to the economics of abusive unilateral conduct. They give a short summary of the evolution of economic thinking in the field and then address the question of how to design economically optimal rules for unilateral conduct.[42] Using examples of preda-

33) See *O'Donoghue* and *Padilla* (2006), pp. 111, 112.
34) See *O'Donoghue* and *Padilla* (2006), pp. 129, 134.
35) See *O'Donoghue* and *Padilla* (2006), p. 136.
36) Commission Guidance Paper, paragraph 13.
37) Commission Guidance Paper, paragraph 13.
38) Commission Guidance Paper, paragraph 14.
39) Commission Guidance Paper, paragraphs 16 – 18.
40) *O'Donoghue* and *Padilla* (2006), pp. 174 – 177.
41) *O'Donoghue* and *Padilla* (2006), p. 176.
42) *O'Donoghue* and *Padilla* (2006), pp. 178 – 184.

tory pricing and loyalty rebates, the authors reach the conclusion that currently there are "virtually no practices" that could still be described as per se unlawful.[43] *O'Donoghue* and *Padilla* characterise the current rules rather as "modified per se illegality or a rule of reason-type inquiry with some structural screens to eliminate unproblematic cases".[44]

1. Recent advances in defining exclusionary conduct

The recent advances in defining exclusionary conduct are outlined in the following sub-chapter. *O'Donoghue* and *Padilla* dismiss the profit sacrifice test and the no economic sense test as not in themselves capable of identifying exclusionary conduct and clearly distinguishing it from legitimate conduct. They then sketch out the equally efficient competitor test which has some basis under Article 82, e.g. in the AKZO predatory pricing rules and captures the important insight that less efficient firms should not, in general, receive protection from aggressive competition, since consumers are best served by more efficient firms. They do, however, not omit to mention valid criticisms of this test such as the problem of defining equal efficiency where the dominant firm has a first mover advantage or significant scale or scope advantages over rivals. Despite this criticism, *O'Donoghue* and *Padilla* agree with the "equally efficient competitor test" in principle as they opine that "a good case can be made" for saying that conduct harming an equally efficient firm should be presumed abusive if compelling efficiencies are absent.[45]

The last test *O'Donoghue* and *Padilla* are concerned with is the consumer welfare test. The authors note that this test seeks to shift the focus towards an assessment of whether the dominant firm's practices had, or are likely to have, a material adverse effect on consumers. The most relevant evidence is output and prices, but quality and innovation may also play a role. The consumer welfare test has been used in the case law of Article 82 EC, notably in the Microsoft case, and has some basis in the wording of Article 82 (b). Moreover, the balancing of anticompetitive effects and efficiencies would bring Article 82 EC in line with the principles now governing mergers and Article 81 EC. But *O'Donoghue* and *Padilla* also point to the problematic "lack of predictability" that would result from the need to balance anticompetitive and pro-competitive effects and to the different situation of companies in Article 82 cases as contrasted with Article 81 or merger constellations.[46]

2. The approach to exclusionary conduct in the Commission Guidance Paper

According to the Commission Guidance Paper, "the aim of the Commission's enforcement activity in relation to exclusionary conduct is to ensure that dominant undertakings do not impair effective competition by foreclosing their competitors in an anticompetitive way,[47] thus having an adverse impact on consumer welfare, whether in the form of higher price levels than would have otherwise prevailed or in some other form such as limiting quality or reducing consumer choice".[48] It is sufficient that the dominant undertaking is likely to be in a position to profitably

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43) See already above II.

44) *O'Donoghue* and *Padilla* (2006), p. 184.

45) See *O'Donoghue* and *Padilla* (2006), pp. 184 – 191.

46) See *O'Donoghue* and *Padilla* (2006), pp. 191 – 194.

47) The Guidance Paper refers to "foreclosure leading to consumer harm (anticompetitive foreclosure)" rather than foreclosure as such and thereby introduces a distinction between benign and anticompetitive foreclosure. Foreclosure could alternatively have been defined in the standard way also used in the Discussion Paper to include a priori only practices that are leading to or are likely to lead to consumer harm.

48) Commission Guidance Paper, paragraph 19.

increase prices to the detriment of consumers. "The Commission will address such anticompetitive foreclosure either at the intermediate level or at the level of final consumers, or at both levels."[49] This means that the Commission Guidance Paper takes in principle a consumer-welfare-induced approach to exclusionary conduct. On the other hand, in line with the Court's judgement in British Airways,[50] the importance of competitors for the maintenance of effective competition is also stressed in many parts of the Guidance Paper. For example, the Guidance Paper takes account of the importance of competitors also where it states that direct evidence of any exclusionary strategy is a factor to be examined[51] and along that line, that it can be inferred that conduct that can only raise obstacles to competition and that creates no efficiencies is anti-competitive.[52] The important role of competitors is also highlighted by the introduction of the equally efficient competitor test.

It should be noted, however, that there is an intrinsic tension between the equally efficient competitor test and the consumer welfare standard. While it is true that conduct driving even equally efficient competitors out of the market is probably anticompetitive and ultimately harms consumers, the same is not true the other way round: If conduct is targeted against less efficient competitors only, this does not mean a contrario that such conduct is lawful. Less efficient competitors can also constitute competitive constraints on dominant companies and are relevant for the benefit of consumers, too.[53] If there was no demand for their products or services, less efficient competitors would not be able to persist on the market in any case.

O'Donoghue and *Padilla* argue that the structure of competition and consumer harm "should amount to the same thing: unless there is consumer harm, there is no relevant harm to the structure of competition".[54] And more explicitly, they suppose that there is "no case for intervention under competition law where there is harm to the competitive process but none to consumers".[55] This suggestion conflicts with the Court's judgement in British Airways[56] and the statement made by *O'Donoghue* and *Padilla* earlier according to which conduct harming an equally efficient firm should be presumed abusive in the absence of efficiencies.[57]

3. Likely consumer harm

Where the consumer effects of a certain practice by a dominant firm are unclear, it can not automatically be implied that there is no infringement but rather that likely effects have to be looked into. This entails a prognosis and necessarily a simplification, because a rule will have to be created that allows to decide ex ante under which circumstances a certain behaviour is likely to have negative effects on consumers. In our view, the right starting point for such a rule is the conduct of the dominant firm on the market. If it applies methods that cannot be characterized as competition on the merits and thus have the potential to push even equally efficient competitors out of

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49) Commission Guidance Paper, paragraph 19.

50) Case C-95/04 P, ECR 2007, I-2331, para. 106 – British Airways plc v Commission.

51) Commission Guidance Paper, paragraph 20.

52) Commission Guidance Paper, paragraph 22.

53) See Commission Guidance Paper, paragraph 24 where the Commission "recognises that in certain circumstances a less efficient competitor may also exert a constraint which should be taken into account when considering whether particular price-based conduct leads to anticompetitive foreclosure".

54) *O'Donoghue* and *Padilla* (2006), pp. 221.

55) *O'Donoghue* and *Padilla* (2006), pp. 221 – 222.

56) Case C-95/04 P, ECR 2007, I-2331, para. 106 – British Airways plc v Commission.

57) See above VIII 1.

the market, there is prima facie little reason to believe that they will not lead to consumer harm. In order to establish clear, foreseeable and administrable rules, it is therefore appropriate to categorise the conduct of dominant firms on the market and establish a set of rules and offences likely to provoke intervention. If the Commission sees that a competitor is being eliminated by practices other than competition on the merits, it will in many instances assume that this will ultimately lead to consumer harm.

4. Harm to competitors as a key factor in the assessment of likely consumer harm

Even though the Commission follows a consumer welfare approach, it acknowledges that hampering the competitive process or harming certain competitors are important factors in the assessment of likely consumer harm. For example, a good case can be made for assuming that exclusionary pricing behaviour forcing equally efficient competitors out of the market (for example pricing below average variable cost (AVC) or average avoidable cost (AAC)) is unlikely to have sustainable positive effects on consumers. The Commission follows this line in the Guidance Paper where it lays down that it will apply the equally efficient competitor test as a proxy "to determine whether conduct is capable of harming consumers"[58] and reaches the conclusion that it is unlikely that predatory conduct will create efficiencies.[59] Consumers are therefore likely to be harmed by predatory pricing practices.

In our view, the equally efficient competitor test does, however, not provide much help with regard to less efficient competitors.[60] While the foreclosure of equally efficient competitors is clearly anticompetitive, the foreclosure of less efficient competitors may well constitute an abuse, too. As the exit of competitors generally softens competition, the analysis then has to concentrate on why consumers are switching. If consumers are forced to switch although products, average prices and other conditions remain the same, the lower efficiency of competitors can not be considered a valid excuse for the foreclosure. Following an equally efficient competitor test in such a case would amount to the paternalistic assumption that consumers are wrongly buying from less efficient competitors and that dominant firms therefore need to be called in to restore market efficiency.

IX. Conditional Rebates

In chapter 7 *O'Donoghue* and *Padilla* discuss exclusive dealing and rebate schemes, distinguishing between individualized, i.e. customer specific, all unit rebates, standardized all unit rebates and incremental discounts.[61]

Following the 2002 OECD paper on remedies,[62] *O'Donoghue* and *Padilla* define rebate schemes as "pricing structures offering lower prices in return for a buyer's agreed or de facto commitment to source a large and/or increasing share of his requirements with the discounter"[63] without being explicit about the benchmark with respect to which prices under the rebate scheme are to be considered "lower". In fact, the definition proposed sets already the wrong stage for a dis-

58) Commission Guidance Paper, paragraph 67.

59) Commission Guidance Paper, paragraph 74.

60) See already above VIII 2.

61) *O'Donoghue* and *Padilla* (2006), p. 382.

62) See OECD, Loyalty and Fidelity Discounts and Rebates, DAFFE/COMP(2002)21, http://www.oecd.org/dataoecd/18/27/2493106.pdf.

63) *O'Donoghue* and *Padilla* (2006), p. 352.

cussion of rebate schemes as it a priori excludes a particularly important potentially anti-competitive type of rebate scheme, namely rebates that, while offering price reductions vis-à-vis the list price, still result in an overall higher average price than in the absence of the rebate scheme.[64] The impression that *O'Donoghue* and *Padilla* are neglecting such a possibility is strengthened by the statement that "A low price, if it is low enough, will always create 'fidelity' or 'loyalty' in the obvious, lawful sense that it encourages buyers to purchase from the supplier offering the best terms",[65] suggesting that rebate schemes have the positive effect of lower prices for consumers even if they may ultimately be found anticompetitive due to foreclosure effects. *O'Donoghue* and *Padilla* also argue that usually these schemes have the feature of rendering the rebate conditional upon the customer buying a certain quantity "over a period that exceeds the normal purchase frequencies in the industry concerned".[66] Although rebate schemes exist, such as for instance in the BA/Virgin[67] case, where quantity targets were defined as multiple of the previous years achieved sales, it is not clear whether the frequency of purchases was affected by this way of determining the threshold. In any case it is far too restrictive a characterization of rebate schemes to include considerations of purchase frequencies in the description of what constitutes a rebate scheme.

O'Donoghue and *Padilla* are rightfully critical – and discuss several scenarios demonstrating alternative explanations – of an approach to rebates that presumes that such schemes are exclusively motivated by exclusionary considerations and that the only possible economic justification is limited to cost savings.[68] *O'Donoghue* and *Padilla*, however, also concede the problematic nature of rebate schemes under certain conditions and recall that rebate schemes "may be a cheaper form of exclusion than strategies such as predatory pricing, since the dominant firm does not need to invest in loss-making activities in the case of loyalty discounts".[69]

In their discussion of factors influencing the economic effects of rebates,[70] *O'Donoghue* and *Padilla*'s review replicates several common mistakes that cannot be discussed in detail here.[71] Among these is for instance the idea that the reference period is a crucial element in the competition analysis of rebate schemes. *O'Donoghue* and *Padilla* note in that context that "Curiously, however, the Discussion Paper now proposes to generally ignore this issue of duration".[72] If a rebate scheme is likely to lead to foreclosure and indeed, the duration as such is at best only an indirect proxy for such foreclosure,[73] the length of the reference period is of no direct relevance. The

64) In fact rebate schemes will typically exploit the quantities that a buyer will need to source from the supplier by increasing list prices as compared to a situation without rebate in order to then reduce the artificially high list price on the quantities that the buyer may be able to source from competitors. Whether overall the average price is above or below the price that would prevail in the absence of the rebate scheme depends on the parameters of the scheme.

65) *O'Donoghue* and *Padilla* (2006), p. 395. See also page 396 where it is stated that "A low price always represents a competitive challenge for competitors."

66) *O'Donoghue* and *Padilla* (2006), p. 374

67) See Case C-95/04 P dismissing the appeal against the judgment of the Court of First Instance in Case T-219/99, ECR 2007, I-2331 – British Airways plc v Commission.

68) *O'Donoghue* and *Padilla* (2006), p. 375-378. In the non-exhaustive treatment of the issue, fixed cost recovery, double marginalization, hold-up problems and agency problems are discussed.

69) *O'Donoghue* and *Padilla* (2006), p. 379.

70) *O'Donoghue* and *Padilla* (2006), p. 389 – 393.

71) For a discussion of such mistakes see *Maier-Rigaud*, (2006) Article 82 Rebates: Four Common Fallacies, European Competition Journal, Vol. 2(2), 85 – 100.

72) *O'Donoghue* and *Padilla* (2006), p. 392.

73) See *Maier-Rigaud*, (2005) European Competition Law Review, Vol. 26(5), 272 – 276 for a discussion of the role of the reference period in assessing rebate schemes.

primary concern in rebate schemes does not concern duration but rather whether contestability by competitors ex ante can be assured.[74] In line with this, the Guidance Paper sets out the relevant parameters in stating that "[t]he higher the rebate as a percentage of the total price and the higher the threshold, the greater the inducement below the threshold and, therefore, the stronger the likely foreclosure of actual or potential competitors".[75] Furthermore the Guidance Paper is very specific under what conditions a rebate scheme is to be deemed anti-competitive. When the effective price an equally efficient competitor has to pay for the relevant quantity (the Guidance Paper uses the term range although it actually has a particular quantity, i.e. a point not range prediction in mind) is below AAC, the rebate scheme is capable of foreclosing even equally efficient competitors. For effective price ranges between AAC and long run average incremental cost (LRAIC) other factors would need to be investigated in order to determine anti-competitive behaviour.[76] Although presented as a key test, the equally efficient competitor test is embedded into a general assessment that would effectively preclude a mechanic implementation.

X. Remedies

The effectiveness of any competition authorities' enforcement depends as much on the actual implementation of the adopted decisions as on the investigation of the infringements and the finding of liability. As a result, *O'Donoghue* and *Padilla* rightfully address the issue of remedies in their book in chapter 15, describing first some general principles governing the imposition of remedies and in particular the objectives of remedies and the principles of effectiveness and proportionality. The authors continue their discussion by distinguishing between Article 7, 8 and 9 decisions, i.e. infringement decisions, interim measures and commitment decisions and then go on to discuss fines,[77] structural remedies and various types of behavioural remedies to end with a discussion of "private enforcement of EC competition law".[78]

According to *O'Donoghue* and *Padilla*, the objectives of remedies are to a) terminate the identified infringement, b) prevent its repetition, c) eliminate the consequences of the abuse and d) establish a legal precedent.[79] Although it cannot be negated that fines and in the future possibly also private damage claims are an integral part of the deterrent and sanctioning system against anti-

74) If a rebate scheme is found problematic, it is not rendered less problematic by a short duration. "After the rebate" is "before the rebate" and arguing that duration matters in that context would amount to an unrealistic hope that one bad thing is not followed by another. Duration in the context of rebate schemes is therefore only considered of relevance in the Guidance Paper if sufficient competition can be secured ex ante (that is to say that all competitors are able to offer the same rebate scheme as the dominant firm) so that the problem can be treated as one of exclusive dealing. There is, however, an important distinction between exclusivity and rebates, as firms capable of competing over total demand ex ante are likely to also be able to compete within the reference period when trades have already occurred. Duration therefore only matters in exclusive dealing cases when exclusivity, while foreclosing competitors during the reference period, spans over such a long time that the number of competitors in the market ex ante is no longer assured ex post at the time the reference period ends.

75) Commission Guidance Paper, paragraph 39.

76) Commission Guidance Paper, paragraphs 42 – 43 and 66.

77) Note that the section on fines is based on the 1998 Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No 17 and Article 65(5) of the ECSC Treaty (Official Journal C 9, 14. 1. 1998, p. 3) and not on the more recent 2006 Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (Official Journal C 210, 1. 9. 2006, p. 2).

78) *O'Donoghue* and *Padilla* (2006), p. 740 et seqq. Although largely surpassed by the White Paper on Damages Actions for Breach of the EC antitrust rules, COM(2008) 165, 2. 4. 2008, http://ec.europa.eu/competition/antitrust/actionsdamages/files_white_paper/whitepaper_en.pdf, this section remains of interest despite the fact that it fails to properly introduce price and quantity effects in defining damages.

79) *O'Donoghue* and *Padilla* (2006), p. 680.

competitive conduct, they can not be considered remedies. Fines are sanctions that in themselves neither terminate the identified infringement, nor eliminate the consequences of the abuse. The same applies to private damage claims that aim at compensating the victims. It is therefore surprising that fines and damage claims are discussed in the chapter on remedies.[80)]

1. Effectiveness, proportionality and the role of structural remedies

According to established case law and as summarised by *O'Donoghue* and *Padilla*, remedies must be a) effective and b) proportionate.[81)] *O'Donoghue* and *Padilla* argue that proportionality is "largely a matter of balancing the intrusiveness of the remedy on the defendant against the importance of addressing the infringement" and that there is a "strong presumption that structural remedies are disproportionate".[82)] This is incorrect as the principle of proportionality – and the authors cite themselves the relevant case law – "means that the burden imposed on undertakings in order to bring an infringement of competition law to an end must not exceed what is appropriate and necessary to attain the objective sought, namely re-establishment of compliance with the rules infringed."[83)] It is therefore not the importance of bringing the infringement to an end by enforcing competition rules that is balanced against the burden imposed on the company but simply the idea that with equally effective remedies, that can bring the infringement to an end, the least burdensome has to be chosen. The need of compliance with the competition rules is not questioned and not balanced against the interests of the respective company. Indeed in the same judgement (Radio Telefis Eireann and Independent Television Publications Ltd (RTE & ITP) vs. Commission) – also quoted by *O'Donoghue* and *Padilla* – it is specified that the remedy was proportionate by definition as it was "the only way of bringing the infringement to an end".[84)]

Referring to considerations in the US Microsoft case, *O'Donoghue* and *Padilla* argue that "the effects of structural remedies on third parties uninvolved in the infringement – such as shareholders – should play a greater role in the proportionality assessment than the effects on the company itself".[85)] In addition to the rather strange idea that shareholders should be considered as third parties, it is not clear why this consideration should be restricted to structural remedies but more importantly the statement again reveals the erroneous belief of the authors that proportionality is related to the effect on the company as opposed to the gravity of the infringement.

As to the second argument, Article 7 of Regulation 1/2003 provides no basis for a presumption that structural remedies are disproportionate. In their treatment of remedies,[86)] *O'Donoghue* and *Padilla* misjudge the role of structural and behavioural remedies in Regulation 1/2003. Three con-

80) Remedies are not "sanctions" against undertakings in the sense of a penalty or punishment, nor do they generally compensate harmed parties. Note, however, that the term remedy is used in a wider sense in the US where fines would be considered remedies. On this see for instance the OECD paper "Remedies and Sanctions for dominant firm misconduct", DAF/COMP/2006/19, available at http://www.oecd.org/dataoecd/20/17/38623413.pdf or *Hellström/Maier-Rigaud/Bulst*, (2009) Antitrust Law Journal, forthcoming.

81) *O'Donoghue* and *Padilla* (2006), p. 680 – 683.

82) *O'Donoghue* and *Padilla* (2006), p. 682. See also page 736. On page 735 the authors even write: "in implicit recognition of their highly intrusive nature, Article 7(1) of Regulation 1/2003 makes clear that structural remedies are only to be employed in exceptional circumstances".

83) Joined Cases C-241/91 P and C-242/91 P, [1995] ECR I-743, para. 93 – Radio Telefis Eireann and Independent Television Publications Ltd (RTE & ITP) vs. Commission.

84) Joined Cases C-241/91 P and C-242/91 P, [1995] ECR I-743, para. 91 – Radio Telefis Eireann and Independent Television Publications Ltd (RTE & ITP) vs. Commission.

85) *O'Donoghue* and *Padilla* (2006), p. 737.

86) *O'Donoghue* and *Padilla* (2006), p. 718 – 737.

ditions are discussed that according to *O'Donoghue* and *Padilla* would need to be cumulatively satisfied before a structural remedy could be imposed: "(1) structural remedies are a remedy of last resort, i.e. behavioural remedies would be insufficient; (2) structural remedies must be effective; and (3) structural remedies must be proportionate".[87] The presentation of these conditions is misleading. With regard to condition 1, it is meaningless to speak of a last resort in case behavioural remedies are ineffective or more burdensome. Conditions 2 and 3 in turn also apply to behavioural remedies and are therefore not specific to structural remedies.

Although the obscure formulation of the relevant parts of Article 7 of Regulation 1/2003[88] may arguably give a wrong impression, imposing structural remedies is within the powers of the Commission. The primary substantive criterion under Article 7 is based on effectiveness: The more effective remedy has to be chosen, no matter if that remedy is of a behavioural or a structural nature. Only in case behavioural and structural remedies are equally effective, a secondary consideration comes into play giving precedence to the least burdensome remedy. As a result, if several equally effective remedies are available, the least burdensome is to be adopted irrespective of whether this happens to be a behavioural or a structural remedy. Regulation 1/2003 only precludes a priori structural remedies in case they are found to be equally (or more) burdensome than behavioural remedies in case of equal effectiveness. This hardly amounts to a presumption that structural remedies are disproportionate as *O'Donoghue* and *Padilla* want to make believe. In practice, this second leg of the test will hardly be of relevance as it can generally be questioned that remedies as different as behavioural and structural remedies will ever be equally effective, rendering the question of the burden on the company rather theoretical.[89] As a result, Article 7 indicates a preference for behavioural remedies only in the very specific and rather hypothetical case where differences between these two types of remedies actually don't exist according to the very criteria of effectiveness and burden on the company established by that Article.

2. Commitment decisions and interim measures

O'Donoghue and *Padilla* discuss Article 8 of Regulation 1/2003 in length[90] and emphasize the differences to the practice under Regulation No 17 and in particular the fact that parties can no longer request interim measures. They criticise the rather reduced role of Article 8 measures in practice. Whether this reduced role can be traced back to a deliberate policy as the authors claim is questionable. *O'Donoghue* and *Padilla* are, however, right in their assessment of the important role of interim measures – in particular in fast paced industries.[91]

In their extensive treatment of commitments,[92] *O'Donoghue* and *Padilla* embrace Article 9 decisions as a "cheaper and faster way of addressing harmful effects of anticompetitive conduct".[93]

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87) *O'Donoghue* and *Padilla* (2006), p. 735.

88) Article 7 of Regulation 1/2003 states: "Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy."

89) Although Regulation 1/2003 introduced structural remedies explicitly into the Regulation, structural remedies were already part of the Commissions' remedy portfolio under Regulation 17/1962. In that sense Regulation 1/2003 has arguably restricted the scope for imposing structural remedies although this is a rather theoretic restriction of limited practical relevance.

90) *O'Donoghue* and *Padilla* (2006), p. 683 – 690.

91) See *Lowe/Maier-Rigaud*, in: Hawk, International Antitrust Law & Policy: Fordham Competition Law 2007, Fordham University School of Law, chapter 20, 2008, p. 597 – 611.

92) *O'Donoghue* and *Padilla* (2006), p. 690 – 708.

93) *O'Donoghue* and *Padilla* (2006), p. 691.

O'Donoghue and *Padilla* list several reasons why Article 9 decisions may be appealing to the Commission and to companies without discussing the merits of the instrument in general. One of the features described by *O'Donoghue* and *Padilla*, although not recognized as a risk is that a "commitment decision creates an opportunity for a company to develop an acceptable set of conduct guidelines, approved by the competition authority, under which the company can run its business in the future."[94] If *O'Donoghue* and *Padilla*'s assessment is correct, Article 9 decisions risk re-introducing a notification system through the back door. Indeed there is a risk for the Commission to revert back to a practice of providing comfort letters in imposing overly detailed, regulatory types of behavioural remedies.

The paragraph on "better use of limited resources"[95] is setting out the advantages of a rather "informal" approach without discussing some of the more problematic aspects of such decisions. For instance, the authors play the inherent risks of an "informal" process down by ignoring the fact that Article 9 decisions are more amenable to political pressure. *O'Donoghue* and *Padilla* state that if the Commission were to "doubt its ability to prevail through a contested proceeding"[96] it may be tempted to nevertheless go ahead with an Article 9 decision without discussing the problematic nature of such an approach. Furthermore, *O'Donoghue* and *Padilla* argue that Article 9 legally leaves "scope for more creative and effective remedies".[97] In fact, the commitment practice of the Commission has been criticised on these grounds as no additional scope for Article 9 commitments is foreseen in Regulation 1/2003.[98]

There may be some truth in the notion of *O'Donoghue* and *Padilla* that Article 9 is particularly suited for solving complex cases as, in contrast to Article 7, remedies are systematically market tested and firms are more cooperative at the remedy design stage.[99] The last Article 9 commitment decisions for instance with regard to E.ON[100] have, however, been criticised on the basis of Recital 13 of Regulation 1/2003, where it is stated that commitment decisions "are not appropriate in cases where the Commission intends to impose a fine".[101]

O'Donoghue and *Padilla* write correctly that in "cases where there is substantial evidence that a company has violated a well-established, uncontroversial legal rule, the competition authority may decide that punishing the past misconduct through fines is an important element of its enforcement action. Commitment decisions are also unlikely to be attractive to the competition authority in situations where it perceives the need to set a clear and unequivocal precedent".[102]

94) *O'Donoghue* and *Padilla* (2006), p. 692.

95) *O'Donoghue* and *Padilla* (2006), p. 693.

96) *O'Donoghue* and *Padilla* (2006), p. 694.

97) *O'Donoghue* and *Padilla* (2006), p. 693.

98) Article 9 foresees a commitment decision in cases where "the Commission intends to adopt a decision requiring that an infringement be brought to an end", i.e. an Article 7 decision. It flows from this wording that commitments under Article 9 cannot go beyond what the Commission would have been able to impose under Article 7. See in this respect also Case T-170/06, ECR 2007, II-2601 – Alrosa v Commission.

99) *O'Donoghue* and *Padilla* (2006), p. 693.

100) See Commission Press release IP/08/1774 of 26. 11. 2008.

101) On the remedies in E.ON and RWE see *Hellström/Maier-Rigaud/Bulst*, (2009), Antitrust Law Journal, forthcoming.

102) *O'Donoghue* and *Padilla* (2006), p. 694. Note, however, that the Article 9 decision in the Distrigas case (see press release IP/07/1487 of 11 October 2007) has set a precedent with respect to gas contracts in the industry.

As a result, Article 9 commitment decisions are not intended for cases of substantial significance to the Commission, i.e. cases where under Article 7 the Commission would not hesitate to impose fines.[103)]

The fear expressed by *O'Donoghue* and *Padilla* that, although Article 9 does not find a violation, "the Commission will probably feel compelled to set forth its concerns in sufficient detail to justify imposing the commitments"[104)] has proven to be unjustified in recent cases. It anyhow underestimated the interests of the parties offering commitments to keep information out of the public domain. Furthermore *O'Donoghue* and *Padilla* argue that Article 9 lacks the procedural safeguards securing the rights of defence.[105)] Based on the decision of the European Court of Human Rights in Deweer v. Belgium, albeit in a different context, commitments under Article 9 may not prima facie be considered voluntary by everyone.[106)] If on the contrary Article 9 commitments are in fact voluntary, *O'Donoghue* and *Padilla*'s argument can be rejected flat out. Independent of issues concerning the rights of defence, the idea that under Article 9 the Commission may "against the threat of fines and extended investigation"[107)] seek to impose commitments that are more restrictive than what Article 82 allows is plausible but as the only credible "threat" is an Article 7 decision, it is not clear why a company would be willing to put itself in a position that can be considered disadvantageous as opposed to what would likely have occurred under Article 7 several years down the road. It is therefore crucial to distinguish between the questions whether companies are potentially coerced and bullied into accepting commitments that are to its disadvantage and the question whether the commitments imposed go above and beyond what could have legally been imposed in the context of Article 7. Obviously both, "coercing" companies into offering commitments and also accepting commitments that go beyond what could have been imposed by the Commission under Article 7 are problematic.

De facto the only possibility of an Article 9 decision going beyond what would be possible under Article 7 – besides the fact that the Commission is not entitled to accept such commitments as argued before – arises in case the company sees additional advantages of an Article 9 decision. Such advantages are likely to be seen in the absence of private damage claims and substantially reduced negative publicity. It is therefore indeed possible as *O'Donoghue* and *Padilla* argue that a company proposes commitments that the Commission can not impose under Article 7 but it can safely be excluded that such commitments are putting the company into a position that is worse

103) See also *Gippini-Fournier*, in: The Modernisation of European Competition Law (FIDE 2008), p. 375, 411. Note, however, that the Commission appears to interpret the last sentence of Recital 13 of Regulation 1/2003 in a less restrictive way in its press release (MEMO/04/217) of 17. 9. 2004 where it states that Article 9 commitment decision are an option if "the case is not one where a fine would be appropriate (this therefore excludes commitment decisions in hardcore cartel cases)".

104) *O'Donoghue* and *Padilla* (2006), p. 698.

105) Note that *O'Donoghue* and *Padilla* consider that "Companies are not required to offer commitments, and probably will in most cases have entered the settlement process voluntarily", *O'Donoghue* and *Padilla* (2006), p. 698.

106) See Judgement in Case Deweer v Belgium (1980) 2 EHRR 439 (Application no. 6903/75) 27 February 1980.

107) *O'Donoghue* and *Padilla* (2006), p. 698 and page 700 where the idea is entertained that "One can imagine a situation in which the Commission – upon threat of an infringement decision including large fines and/or onerous behavioural rules – effectively coerces a company into agreeing to commitments that go beyond what Article 82 EC could require."

than what it would have faced under Article 7.[108] The bargaining chip of the Commission is therefore wider than the threat of fines and it may subsequently face commitment proposals that are capable of solving the competition problem directly with a reduced risk of litigation although these proposals could not be envisioned as remedies under Article 7. As a result, *O'Donoghue* and *Padilla*'s conclusion that Article 9 holds "attractions for all interested parties" has to be considered with caution and it appears likely that this at least potentially excludes plaintiffs in follow-on damage claims.[109]

108) "Companies may agree to restrictions on their conduct that could not be compelled by Article 82 EC simply on grounds of pragmatism: if a particular restriction is commercially acceptable, there may be little cost in committing to abide by it, and potentially some gain." *O'Donoghue* and *Padilla* (2006), p. 706.

109) *O'Donoghue* and *Padilla* argue convincingly on page 704 that the fact that addressees of an Article 9 decision may still face enforcement action before Member States' authorities and courts has possibly been further curtailed by the qualifying addendum "provided that the uniform application of the competition rules throughout the EU is not jeopardised." (See MEMO/04/217 of 17. 9. 2004).