



BUNDESKARTELLAMT

“The future of abuse control in a more economic approach to competition law”

**Meeting of the Working Group on Competition Law
on 20 September 2007**

- Discussion Paper -

I. Introduction

For some time now discussions have taken place both within Europe and worldwide on a more economic approach in competition law practice. At first view, the discussion which is now taking place in Europe about the aims of competition law and the relation between legal and economic criteria in the application and interpretation of competition law is reminiscent of the old US debate between the so-called *Havard School* and the so-called *Chicago School*. Under the catchphrase *Post Chicago Era* this confrontation has meanwhile been declared ended, at least by the advocates of the *Chicago School*, because there are no other serious competition law perspectives (*Posner*). However, this position can still be challenged as regards competition law practice in the USA. Indeed, examples such as the recent highly controversial decision of the US Supreme Court not to categorise *per se* vertical resale price maintenance agreements as being in violation of competition law but to call for a rule of reason analysis, are a clear indication that there is no sight of an “end to the debate” in the USA either.

The reorientation of European competition policy has progressed over several stages. In the late nineties the Commission fundamentally reformed its approach to vertical agreements. This was based on the realization that many vertical agreements ultimately proved to be conducive rather than harmful to competition. Furthermore, the block exemption regulations in existence until then were very formalistic and even described, not unjustifiably, as having a “straightjacket effect”. A further step, above all, was the publication in 2000 of the Commission’s guidelines on horizontal mergers, followed by further block exemption regulations and guidelines. In merger control the introduction of the SIEC test in the 2004 Merger Regulation and the respective guidelines marked the beginning of the “more economic approach” in European competition policy. In close connection with the development of a more economic approach was the explicit focus of the competition policy concept on consumer welfare. The reorientation of European competition law practice is now to be completed with a “modernisation” of abuse control. In December 2005 the Directorate General for Competition published a first discussion paper. This was prompted by a European Competition Network working group and consultations with the national competition authorities. The discussion paper deals with exclusionary abuse.

The discussion is by no means restricted to Europe. Within the International Competition Network a working group has dealt since 2006 with the issue of “Unilateral Conduct”. A first report on the aims of abuse control, market dominance and state-created monopolies is now available. The highly controversial discussions about the mere representation of the various standpoints within the working group, which left participants with the impression of a clash of cultures, bear witness to the fundamental importance of this topic.

II. What levels are affected by the “new” approach ?

The debate about a greater “economisation” of competition policy affects competition law in two respects: Firstly, it affects the relation between economic and legal considerations in the decision-making and law enforcement practice of the competition authorities and courts. In this respect it affects the methods and requirements for proving a violation of competition rules. Secondly, at a higher theoretical/conceptual level, it affects the normative concept of competition policy, which in so far affects competition law in that it is meant to define the role and protective aim of competition rules.

III. Which positions are represented ?

In the debate a number of catchphrases are used, whose substantive content is often unclear. Nonetheless, they are used to illustrate the different layers of the discussion even if a keen distinction between the different levels of argument is not always possible.

a) Conceptual Level

Protection of the institution of competition v. focus on results

As regards protecting competition as an institution, the aim is to maintain competitive structures or to protect competition as a process. This perspective still seems to form the starting basis and point of reference for European law. According to First Advocate General Kokott in the British Airways case

“Article 82 EC 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”. (Opinion of First Advocate General Kokott of 23.2.2006, case no. C-95/04 P – British Airways/Commission, para. 68).

Prior to this, in the hearing before the European Court of First Instance in 2003, the Commission advocated that

“Article 82 EC does not require it to be demonstrated that the conduct in question had any actual or direct effect on consumers. Competition law concentrates upon protecting the market structure from artificial distortions because by doing so the interests of the consumer in the medium to long term are best protected.” (Court of First Instance, judgement of 17.12.2003, case no. T 219/99 - British Airways/Commission, para. 264).

The argument used in objection to this approach is that competition is not an end in itself but merely a means for achieving specific economic objectives. The only specific objectives deemed worthy of consideration are (consumer) welfare and efficiency. A differentiation is to be made between the following types of efficiency: Effective competition normally guarantees allocative efficiency, provides incentives for dynamic efficiency and thus creates the best possible (consumer) welfare. At corporate level increases in productive efficiency only result in an increase in consumer welfare if the efficiency gains are passed on to the consumer.

Protection of Freedom of Competition and Increase in Welfare

Closely linked to the discussion about protecting competition as an institution or as a means to an end is the question whether competition law should pursue merely economic objectives or whether there are other objectives to be taken into consideration whereby freedom of competition and welfare orientation are often regarded as separate or complementary aims. The issue here is not the choice between the protection of freedom of competition or welfare orientation but whether safeguarding freedom is given its own weight as an objective. The protection of freedom is sometimes understood not merely as the protection of individual economic liberties. Insofar there is a direct link between the principle of liberalism and the socio-political disempowering function of competition. This function of competition is intended to help prevent state power from being instrumentalized to further the interests of powerful companies. In this respect the principle of free competition is also about securing political freedom.

Even though historically the freedom principle played an important role in American and in German competition law, this concept is still very controversial. Firstly, it is argued that this approach is hardly operationable. Exercising the liberties of individuals or specific groups would always be limited by the liberties of others; furthermore, there is no generally accepted standard for the operationalisation of this approach. Can the protection of freedom be limited to protection from private power,

i.e. from a dominant company? What about the freedom of the dominant company? How relevant in this connection is the statement in European case law that emphasizes the special responsibility of the dominant company in a competitive structure which is already weakened?

Consumer Welfare v Overall Welfare

Even under the absolute primacy of economic objectives the focus can alternatively be placed on increasing consumer surplus (*consumer welfare*) or on the sum of producer and consumer surplus (*total welfare*). In the debate about protecting freedom and increasing welfare as targets of German and European competition policy, the discussion has up to now pivoted almost exclusively on consumer welfare. Advocates of the *total welfare* concept criticize that an orientation towards consumer welfare constitutes a decision about welfare distribution which might have to be examined from a political viewpoint, which has little to do with competition as such. In addition they argue that by taking efficiency aspects into account not only the short-term but also long-term effects on consumer welfare could be considered. On the other hand the fact that the economic instruments are inadequate to reliably assess the mid to long-term effects on consumer welfare, is recognised as problematic.

b) Level of application

Standard for “optimal” application practice

The (welfare) economic point of reference in the debate about the degree of “economisation“ to be strived for in the specific application of competition law are considerations about the consequences of wrong decisions in competition law, whereby a differentiation is made between two types of wrong decisions. Firstly, competition authorities can wrongly regard business conduct as abusive and as a result prohibit admissible and desirable intensive competition (type I error, or synonymous terms - *over-enforcement, false positive, over-deterrence*). Secondly, the competition authority might not identify and fail to prohibit abusive behaviour as such (type II error, or synonymous terms - *under-enforcement, false negative, under-deterrence*).

The disadvantages of a type I error result primarily from the fact that inefficient companies are artificially kept in the market, whose business resources applied otherwise would generate greater overall welfare (“static-allocative inefficiency”). The

negative welfare effects of type II error arise from the loss of consumer surplus due to insufficient competition. In addition, welfare deficits should be taken into consideration that can result from a possible squeezing-out of more efficient suppliers and from a weakening of innovative competition (“dynamic inefficiency”).

The positions on the appropriate degree of economisation of competition law application reflect varying weightings of the risks and consequences of type I and type II errors. In view of the relative low number of abuse cases in Germany and Europe considerable *over-enforcement* and, accordingly, an overbalance of type I errors would be rather hard to prove. Nevertheless this is where the focus of the debate currently lies.

Form based v. effects based approach

In the discussion one main criticism is that former Commission practice focussed solely on certain types of conduct classified as anti-competitive (such as loyalty discounts) without looking in detail at the competitive effects of the activity in question on the relevant market environment. Scientific examinations increasingly prove that much of the conduct considered abusive is in fact ambivalent in competition terms, i.e. it can also be conducive to competition.

Per-se rules v. rule of reason

The same line of argument applied to abuse control poses the challenge to break from the *per se* rules and to replace them with an all-embracing *rule of reason*. Efficiency defence should generally be admissible or endeavours made to focus significantly also on possible efficiency effects when establishing abusive conduct (integrated examination).

“Autonomy of law” v. single case analysis

From a legal perspective, the approach focussing on effects and an overall assessment of the situation is criticized for insufficient consideration of aspects of legal certainty and the area of conflict between a strict application of the law and deciding a case on its individual merits. In a legally constituted system it is important for those subject to it to know what is allowed and what is prohibited. This is, if at all, only possible with considerable effort due to the ambivalence of many forms of conduct observed in the modern economy. From a (welfare) economic perspective the respective considerations can be integrated into the concept of optimal application practice by explicitly considering the fact that state action / application of the law is associated with costs. The challenge posed is therefore to minimize the

risk of wrong competition law decisions under consideration of the administrative costs involved.

This theoretical consideration ultimately constitutes the heart of the debate about requirements for proof in specific abuse proceedings. It is probably the most important point of the current discussion. However, it cannot be discussed in isolation of the above areas of controversy.

Structural aspects v. consumer harm

Advocates of a more economic approach demand that in a specific case, abuse control should only intervene where there is a proven (and at best quantified) case of consumer harm. Competition practice in Europe, on the other hand, primarily focuses on effective competitive structures without deciding *a priori* to what extent an analysis of the concrete competitive situation in the market affected is required.

Actual effects v. likely effects

The following questions are closely linked to this debate: Is there a need for specific market analyses on the actual effects of certain conducts, which may require data that can only be reliably provided *ex post*? Or could and should, in the sense of toned-down *per se* rules, certain types of conduct be classified as conduct which can be expected to weaken the intensity of competition? Is a risk analysis sufficient, i.e. a presentation of all possible effects, which, following the established practice of the Federal Court of Justice, includes a weighing up of all interests “under consideration of the objective of the ARC to protect the freedom of competition”? The claim that only likely effects have to be proved does not indicate as such how elaborate the analyses of authorities and courts should be and, in particular, to what (necessary) extent they should apply industrial economic theories.

IV. Which position does the discussion paper of DG Competition take?

The Commission’s Discussion Paper of December 2005 on the application of Art. 82 EC Treaty to exclusionary abuses indicates a shift of focus in abuse control matters towards the protection of consumer welfare and the effects-based approach. In its Discussion Paper the Commission defines the protective purpose of Art 82 EC as follows: „... “... the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources” (paras. 4, 54 of the Discussion Paper). The paper lays down analytical framework conditions for case

assessment. The key elements stipulated are the proof of a foreclosure effect on the basis of actual and likely effects of the abusive conduct, and the permission of extensive possibilities of justification granted to the company concerned, including a general efficiency defence in line with Art. 81 (3) EC.

V. What is the significance of recent ECJ case law?

In its decision in the British Airways case, while commenting on abusive bonus/rebate schemes, the European Court of Justice (ECJ) expressed its opinion on several relevant issues, among them the protective purpose of Art 82 EC (ECJ, Judgement of 15.3.2007, Case C-95/04-P – British Airways/Commission). The Court mainly confirmed the more structure-oriented approach also adopted by the Commission in its decision and by the European Court of First Instance. Accordingly, Article 82 EC is aimed at maintaining a competitive market structure.

“Moreover, as the Court has already held in paragraph 26 of its judgment in *Europemballage and Continental Can*, Article 82 EC is aimed not only at practices which may cause prejudice 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 (1) (g) EC.” (para. 106 of the Judgment).

Also with regard to requirements for evidence, the Court clearly supports the structure-oriented or process-oriented approach. According to the ECJ, damaging effects of a company conduct for the consumer is not a necessary requirement for assuming that the conduct at issue is abusive. Even with regard to evidence of foreclosure effects, i.e. with regard to examining the impact of the conduct at issue on competition, the Court found an assessment of the *probable* effects to be sufficient. These were ascertained by rather abstract considerations of the general mechanisms of the bonus schemes in question (para. 96 ff. of the Judgment). According to the Court, there is neither an obligation to prove actual effects or to quantify them (para. 123 of the Judgment), nor is there an obligation to use certain methods to prove foreclosure effects, as was suggested by the Commission in its Discussion Paper.

As far as the issue of efficiencies is concerned, the Court questions whether there is an objective (economic) justification for the conduct at issue, because it is based on an economically justified counter performance, for which the company bears the burden of proof. (para. 69 of the Judgment). In contrast to previous case law, which

focused on criteria on the supply side to determine an objective economic justification (CFI, loc.cit., paras.280, 284), the Court now focuses on efficiency gains for competition and consumers:

“It has to be determined, whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of that system bears no relation to advantages for the market and consumers, or if it goes beyond what is necessary in order to attain those advantages, that system must be regarded as an abuse.” (para. 86 of the Judgment).

The exact criteria for assessing an efficiency justification remain unspecified.

VI. How relevant is the discussion for German practice?

The Bundeskartellamt also applies Art. 82 EC but is not bound by the administrative practice of the Commission or its corresponding guidelines. It is, however, bound by the case law of the ECJ. In addition, there is considerable pressure within the Network of Competition Authorities (ECN) not to adopt approaches that diverge too far from those adopted by the Network. In extreme cases, the Commission could withdraw a case from the national authorities by instituting its own proceedings. Moreover, the interpretation of German abuse provisions is likely to be influenced by Art. 82 EC, even though a formal connection between § 19 ARC and Art. 82 EC (and the principles of European competition law in general), as was initially envisaged in a new § 23 of the Draft Amendment to the 7th Amendment to the ARC, has not been made.

VII. Questions for discussion

Conceptual Level

- 1) Should the protection of undistorted competition as an objective or task be deleted from the EC Treaty – how relevant is this for this discussion?
- 2) Is the conflict between *consumer welfare* and structural approach an artificial one? Can the structural approach also be understood as a *long-term consumer welfare* approach? Do the differences between the two approaches outweigh the common features or vice versa? Is the differentiation between the protection of competition as an institution/orientation towards results not ultimately a shift of emphasis which can be attributed to a difference in the time dimension? (R. Posner: *“Efficiency is the ultimate goal of antitrust, but competition a mediate goal that will often be close enough to the ultimate goal to allow the courts to look no further.”*)¹
- 3) The concept of freedom as a non-economic objective has been historically immanent both in American and German law (ordoliberalism). At which levels does this approach take effect? Does it justify a more pro-intervention approach (acceptance of type I errors) as market dominance tends to be classified as a threat to freedom? Can the concept of freedom and consumer

¹ Antitrust Law, 2nd edition 2001, p. 29.

orientation be reconciled with one another by using consumer benefit as a standard for exercising freedom?

- 4) Is there necessarily a connection between the structure-oriented approach and requirements for proof in an abstract and likely form on the one hand and the consumer-welfare oriented purpose of protection and *effects-based approach* on the other? Is it not possible to combine both approaches with varyingly strong requirements of proof via the protective purpose of competition law?
- 5) Is it correct to refer to an efficiency *defence*, or does the efficiency analysis already have to be assessed within the framework of the concept of abuse? Isn't a *performance* forecast in individual cases generally superfluous as the competition mechanism carries out these functions in a better and more reliable way? Will it be possible to develop "robust" rules in the area of abuse control which, without any complex analysis of effects, could serve as "guidelines" for the companies?

Aspects of antitrust law enforcement

- 6) What effect does the *effects-based approach* have on the competition authorities' possibilities of intervention in terms of time? Are interventions still possible in the case of ongoing practices?
- 7) How does the consideration relating to the "freedom of competition" applied in individual cases of German legal practice differ from an *effects-based approach*?
- 8) How are private plaintiffs expected to meet the increased requirements? In which way is the concept of promoting private antitrust law enforcement compatible with substantive regulations which are hardly manageable for private individuals? Does this perhaps pose a potential breach of the efficiency postulate (ECJ 'Manfredi' decision)? So far there has been a relatively high number of private antitrust claims in Germany with regard to the prohibition of discrimination. Does this also provide for a basis for a *more economic approach*?
- 9) To what extent should the courts use economic expert opinions?

- 10) Are more severe sanctions (fines and private damages claims) the reason for placing a special focus on the avoidance of type I errors? In purely prohibition proceedings / declaratory judgments or judgments focused on a specific competitive activity, is greater acceptance of type I errors justified by more abstract rules and a lower level of proof?
- 11) Is a separate determination of market dominance dispensable in a comprehensive analysis of effects?
- 12) The business sector has been calling for *safe harbours*. Does the “*as efficient competitor*” test represent a safe harbour for price-related abuses? In practice, the *as efficient competitor test* would in most cases lead to a price/cost analysis of the dominant company. Is this a practicable and desirable approach? Are other *safe harbours* conceivable and appropriate? Should there be absolute *safe harbours* in the form of market share thresholds?
- 13) So far the discussion has focussed in particular on price-related types of abuse such as cut prices and rebates. What effects does the *more economic approach* have on non-price-related types of abuse such as e.g. exclusive dealing agreements?
- 14) How can the dilemma be resolved that, on the basis of economic insights, per se rules are deemed to be too general as pro-competitive aspects cannot be taken into account, while on the other hand economic insight is not (yet) sufficiently capable to meet the crucial demand of legally constituted systems for rules?
- 15) Can the efficiency-oriented approach claim that it is in a better position to do justice in each individual case, although there is probably unanimous agreement that economic science cannot achieve a comprehensive quantifying analysis of the positive and negative effects of a certain conduct either in theory or in practice?
- 16) Is it not true that the *more economic approach*, sailing under the flag of consumer welfare, leads to less consumer welfare due to *underenforcement*?
- 17) In view of insufficient structural control carried out by a policy of non-intervention in merger cases, abuse control has gained great importance. Are the demands on abuse control as a corrective too high?