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Treaty: divergence without end, or
change we can believe in?**

By

**Richard Duncan, Craig Coleman, Horst Daniel and Philip
Haleen**


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Litigating Single-Firm Conduct under the Sherman Act and the EU Treaty: divergence without end, or change we can believe in?

*Richard Duncan, Craig Coleman, Horst Daniel and Philip Haleen**

 Abuse of dominant position; Competition policy; EC law; Monopolies; United States

Introduction

Section 2 of the Sherman Act, 15 USC s.2, regulates the unilateral conduct of a firm which “monopolize[s] or attempt[s] to monopolize” a market. The scope of conduct prohibited by s.2 has, however, never been clearly defined in the same way in which co-ordinated anti-competitive conduct by independent firms has been—as, for instance, in the per se rule against horizontal price fixing and customer or territorial allocation schemes under s.1 of the Sherman Act, 15 USC s.1. The reasons for the lack of clarity in s.2 standards are many, reflecting a lack of consensus on the types of conduct that are unreasonably exclusionary, whether and how to incorporate cost-based tests into identifying such conduct, and what judicially created remedies can maintain and not chill competitive processes.

The past three years saw an ambitious, but ultimately failed, attempt by the two US antitrust enforcement agencies, the Federal Trade Commission (FTC) and the

Department of Justice (DOJ), to gather information and seek consensus for enforcement approaches under s.2, which in turn would be expected to influence judicial decisions in private monopolisation litigation. In September 2008, the DOJ issued its own report, “Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act” (hereinafter, “DOJ Report”),¹ which the FTC refused to join. Three of the five FTC Commissioners went so far as to issue a public statement rebuking the DOJ Report as placing the interests of firms with monopoly power “ahead of the interests of consumers”.²

The inability of the FTC and DOJ to issue a joint report on s.2 conduct after hearings stretching from mid-2006 to mid-2007 has been termed an instance of “domestic divergence”.³ However, from the perspective of private litigants, much of the content of the DOJ Report reflects simply the increasingly limited scope of s.2 left by recent Supreme Court and federal appellate court decisions, and logical extrapolations from them. The real divergence revealed in the DOJ Report is between the current state of US law on exclusionary conduct under s.2 of the Sherman Act, and EU law on single firm conduct under art.82 of the EU treaty. The DOJ Report reflects, more than creates, continuing divergence between US and EU law on single-firm conduct.

As if to underscore the divergence, in December 2008, the European Commission issued its own report on predatory single-firm conduct, “Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings” (hereinafter, “EC Guidance”).⁴ This guidance document, while advocating enhancement of consumer welfare and favouring competition, not competitors,⁵ shows no sign of a shift away from, nor contains any criticism of, past Commission enforcement actions against practices such as exclusive dealing, loyalty rebates, tying, etc. Nor in the viewpoint of our

1 Available at the DOJ website, <http://www.usdoj.gov/atr/public/reports/236681.htm> [Accessed June 24, 2009].

2 See Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (“Commissioners’ Statement”) (September 8, 2008), p.1, available at the FTC website, <http://www.ftc.gov/os/2008/09/080908section2stmt.pdf> [Accessed June 24, 2009].

3 See (2008) 23(1) *Antitrust* 3 (American Bar Association).

4 Available online at <http://ec.europa.eu/competition/antitrust/art82/guidance.pdf> [Accessed June 24, 2009].

5 See, e.g. EC Guidance at 4, para.5 (“the Commission will focus on those types of conduct that are most harmful to consumers”); and 4–5, para.6 (“the Commission is mindful that what really matters is to protect an effective competitive process and not simply protecting competitors”).

* Mr Duncan and Mr Coleman are partners in the Minneapolis office of Faegre & Benson LLP; Mr Daniel and Mr Haleen are partners in the Frankfurt office of Faegre & Benson LLP.

EU colleagues is there a need for the Commission to retreat from its past prohibitions of abusive practices.

Most recently, in remarks delivered at the Center for American Progress in Washington, DC, on May 11, 2009, Christine Varney, the recently confirmed Assistant Attorney General of the Antitrust Division for the Obama Administration, *withdrew* the DOJ Report, declaring that it and its conclusions “should not be used as guidance by courts, antitrust practitioners, and the business community”.⁶ As justification, Ms Varney stated that the “Report advocates extreme hesitancy in the face of potential abuses by monopoly firms”.⁷ Echoing other Obama Administration calls for change, as to s.2 enforcement, she continued: “We must change course and take a new tack.”⁸

In particular, Ms Varney rejected the concern for over-deterrence expressed in the DOJ Report, citing Judge Richard Posner against type in support of the proposition that “antitrust enforcers are able to separate the wheat from the chaff in identifying exclusionary and predatory acts”.⁹ She also expressed scepticism about the claimed “efficiencies” that might be lost through curbs on monopolists’ conduct, expressing “the protection of consumer welfare” as a higher (and perhaps inconsistent) goal.¹⁰

The EU antitrust regime, similar to the United States, is principally comprised of two statutory sections: art.81, which prohibits anti-competitive conduct through “agreements or concerted practices”; and art.82 (our topic here), which is concerned with the restraint of competition through the exercise of economic power by single firms. From the viewpoint of a European antitrust practitioner, the similarities between a Sherman Act s.2 and an art.82 infringement action would be greater but for the focus of s.2 law on the empirical measurement of monopoly, and of monopoly power.¹¹ “Monopoly” is a status; the language of

art.82 is a prohibition of an action, of an “abuse” by a dominant firm. The European antitrust authorities are prepared to accept “dominance”; but draw the line at conduct which can cause economic harm if that dominance is abused. In the European context, then, economic harm does not arise simply because of dominance, nor should dominance be proscribed. It is often pro-competitive under discernable standards. The Court of First Instance (CFI) stated it well in the 2007 *Microsoft* case:

“Article 82 is intended to prohibit a dominant undertaking from strengthening its position by recourse to means other than those based on competition on the merits.”¹²

This state of legal affairs, one of ongoing uncertainty as to whether and if standards for judging single firm conduct will converge, leaves large multinational firms in the continued position of having to assess their antitrust exposure separately between the United States and the European Union. Multinational firms need to monitor not only their degree of “monopoly power” or “dominance” separately in the United States and European Union, but also the competitive actions which they undertake to extend or to defend their market shares. They will need to assess separately their potential legal exposure for distribution, sales and marketing practices—which arguably act in some fashion to exclude rivals—often leading to a situation where distribution, marketing and pricing practices will have to be tailored separately for the United States and for Europe.

The publication of the DOJ Report and the EC Guidance, and now the recent recantation of Bush Administration s.2 policy by the Obama Administration (with its attendant possibilities for renewing both US domestic enforcement priorities and efforts towards international convergence), provide an opportune time to review US and EU law on a number of the key issues of single-firm conduct in the areas of distribution, sales and marketing. This article will review US and EU law on the subjects of: (i) exclusive dealing; (ii) unilateral refusals to deal with rivals; and (iii) bundling (whether through discounts or technological tying) and loyalty/fidelity discounts and rebates, with the aim of delineating the factors courts and regulators will look to

6 Available at the DOJ website, <http://www.usdoj.gov/atr/publicspeeches/245777.htm> [Accessed June 24, 2009] (“Varney Address”).

7 Varney Address, p.8.

8 Varney Address, p.8.

9 Varney Address, p.7.

10 Varney Address, p.8.

11 See, e.g. Thomas O. Barnett and Hill B. Wellford, “The DOJ’s Single-Firm Conduct Report: Promoting Consumer Welfare Through Clearer Standards for Section 2 of the Sherman Act”, available at the DOJ website, <http://www.usdoj.gov/atr/publicspeeches/238599.htm> [Accessed July 8, 2009], in which the second bullet point to the “Key Findings of the Report”, p.5, states:

“While market share does not itself prove the existence of monopoly power, it is an important factor. When a firm has maintained a

market share in excess of two-thirds for a significant period and its market position would not likely be eroded in the near future, the Department normally will presume that the firm possesses monopoly power, absent convincing evidence to the contrary.”

12 *Microsoft Corp v Commission of the European Communities* (T-201/04) [2007] E.C.R. II-03601 at [1070] (“*Microsoft*”).

in assessing whether such programmes, when employed by a monopolist or other dominant firm, unreasonably exclude competitors.

Background: monopoly power and dominance

Before beginning the analysis of particular sales and distribution practices, we begin with a brief discussion of the terminology of s.2 and art.82 law. The economic and legal concepts of monopoly power, market power and dominance are related, indeed overlapping, but not coterminous.

As a general matter, the manufacturer conduct discussed in this article can be unlawful, if at all, only when undertaken by a monopolist (in the United States), or a dominant firm (in the European Union). Monopoly or monopoly power has been judicially defined as “the power to control prices or exclude competition”.¹³ Further, “[m]onopoly power under [Sherman Act] § 2 requires . . . something greater than market power under § 1”.¹⁴ Market power is reflected in a seller’s ability to control price to some degree, and manufacturers of differentiated products almost always have at least a small degree of market power.

To distinguish the modest levels of market power that do not give rise to susceptibility to a s.2 claim from the monopolist’s power to exclude competitors and control prices, US courts have always relied heavily (although not exclusively) on market share data to serve as a filter or screen.¹⁵ The DOJ in its s.2 report adopts a two-thirds (or 67 per cent) market share as the threshold over which, absent unusual circumstances, it believes there is a rebuttable presumption that a firm has monopoly power.¹⁶ Conversely, the DOJ argues for a judicially as-yet unrecognised safe harbour, namely that a market share below 50 per cent cannot sustain a finding of

monopoly power.¹⁷ While Assistant Attorney General Varney criticises the DOJ Report’s reliance on safe harbours,¹⁸ this safe harbour proposal is, if anything, a restrained reading of the case law on the subject. Over 60 years on, Judge Learned Hand’s dictum that, “it is doubtful whether [a market share] of sixty or sixty-four percent would be enough”,¹⁹ remains a relatively true guide to defining the minimum share necessary for a finding of monopoly power (however, it is fairer to say that a 50 per cent market share states a functional minimum for a firm to be deemed to have a sufficiently dangerous probability of success to support a claim of attempted monopolisation).²⁰

As discussed, in Europe, art.82 proscribes exclusionary conduct—“abuse”—by a dominant firm or by firms acting in concert.²¹

A standard definition of “dominance” is:

“... a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.”²²

17 DOJ Report, p.24.

18 Varney Address, pp.7–8.

19 *United States v Aluminum Co of America*, 148 F.2d 416, 424 (2d Cir. 1945) (“*Alcoa*”).

20 See, e.g. *United States v Empire Gas Corp*, 537 F.2d 296, 305 (8th Cir. 1976) (45–50% market share “alone is not sufficient to show a dangerous probability of success”); *U.S. Anchor Mfg. Co v Rule Indus.*, 7 F.3d 986, 1001 (11th Cir. 1993) (share less than 50% insufficient “as a matter of law”); *Indiana Grocery v SuperValu Stores*, 864 F.2d 1409, 1415 (7th Cir. 1989) (50% share insufficient); and *Broadway Delivery Corp v UPS*, 651 F.2d 122, 129 (2d Cir. 1981) (same, absent unusual circumstances).

21 Article 82 reads in full:

“Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.”

22 EC Guidance at 5, para.10, citing *United Brands Co and United Brands Continentaal v Commission of the European Communities* (27/76) [1978] E.C.R. 207 at [65]; and *Hoffmann-LaRoche & Co v Commission of the European Communities* (85/76) [1979] E.C.R. 461 at [38]. The same principle is stated in *Microsoft* [2007] E.C.R. II-03601 at [229].

13 *United States v E.I. DuPont de Nemours & Co*, 351 U.S. 377, 391 (1956).

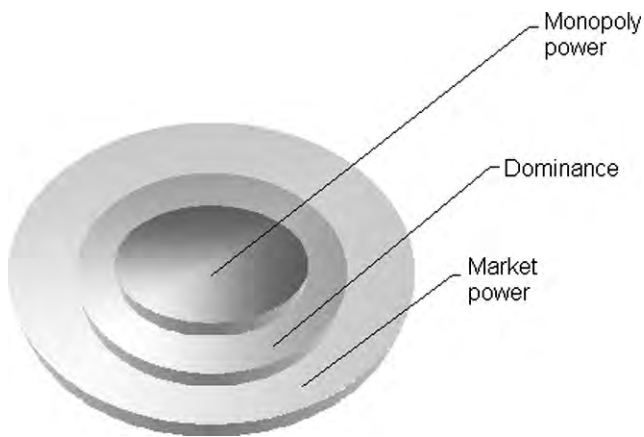
14 *Eastman Kodak Co v Image Technical Servs., Inc.*, 504 U.S. 451, 481 (1992).

15 Notably, regardless of share, barriers to entry into a market must exist for a monopolist to charge supra-competitive prices over time; otherwise new entrants attracted by the monopolist’s profits will out-compete them. See *Matsushita Elec. Indus. Co v Zenith Radio Corp*, 475 U.S. 574, 592 n.15 (1986) (“[W]ithout barriers to entry it would presumably be impossible to maintain supra-competitive prices for an extended time”).

16 DOJ Report, p.23.

The dominance itself, however, is not illegal, it is only any abusive trade practice that stems from the exercise of that dominant position, whether exercised directly to the detriment of individual suppliers or customers or indirectly through measures which reduce competition, that is proscribed.²³

In practice, while dominance requires market power, it can be less than monopoly power. Diagrammatically, while all firms manufacturing differentiated products (and all monopolists) have some degree of market power, legally, dominant firms are a subset of all firms with market power, and monopolists a subset of dominant firms:



The EU authorities, in assessing whether a firm is dominant in a relevant market (which, as in US law, is a combination of a product market and a geographical territory), so as to call into play the proscriptions of art.82, have been willing to look at lower shares as evidence of dominance than US courts generally will consider when defining monopoly power—including shares concededly less than 50 per cent. The EC Guidance acknowledges that “dominance is not likely if the undertaking’s market share is below 40%”.²⁴ Furthermore, in actual practice, a fair reading of the case law indicates a practical market share of 50 per cent, or a share of 40 to 45 per cent if the undertaking is several times larger than its nearest competitors, as necessary for a finding of dominance.²⁵ In general, the

²³ EC Guidance, p.4, para.1.

²⁴ EC Guidance, p.7, para.14.

²⁵ See *AKZO Chemie BV v Commission of the European Communities* (62/86) [1991] E.C.R. I-3359, for the principle that a very large market share is 50%; and *United Brands*

more serious the abuse, the lower the required market share threshold.

“What’s mine is mine; what’s yours is mine”: seller requirements for exclusive dealing

Exclusive dealing contracts involve a seller’s requirement that customers purchase much or all of the relevant product from the seller. In various contexts, the US Supreme Court has found that contracts containing exclusivity provisions can have pro-competitive benefits, and exclusive contracts are widely used throughout the economy.²⁶ However, when used by a monopolist, exclusive contracts can foreclose competition by denying competitors access to customers.

Courts widely invoke the Supreme Court’s principle that exclusive dealing contracts are unlawful if the “competition foreclosed by the contract . . . constitute[s] a substantial share of the relevant market”.²⁷ Thus, cases addressing exclusive dealing by monopolists generally examine whether the challenged contracts substantially foreclose the market.²⁸ The outcomes of exclusive dealing claims generally rise and fall on two issues: (i) whether the defendant possesses a dominant share of the market and monopoly power; and (ii) whether the monopolist’s exclusive dealing provisions have a scope, severity and reach to preclude competitors from effectively entering the market and competing. If plaintiffs cannot demonstrate substantial exclusion from all channels of distribution, they must show exclusion from a particular channel of distribution critical to market success.

The DOJ Report would require plaintiffs to show either no pro-competitive benefits to the exclusive dealing at issue, or that those benefits are outweighed

[1978] E.C.R. 207; *Hoffmann-LaRoche* [1979] E.C.R. 461; and *Tetra Pak International SA v Commission of the European Communities* (T-83/89) [1995] E.C.R. II-729, for cases finding dominance based on a market share in the mid-40% range coupled with a size significantly larger than competitors.

²⁶ See, e.g. *Continental T.V., Inc v GTE Sylvania Inc*, 433 U.S. 36, 55 (1977); and *Standard Oil Co v United States*, 337 U.S. 293, 306-07 (1949).

²⁷ *Tampa Elec. Co v Nashville Coal Co*, 365 U.S. 320 (1961). *Tampa Elec. Coal Co* was decided under Clayton Act s.3, and the Supreme Court has not addressed whether different standards apply to exclusive dealing claims under Sherman Act s.2 involving a monopolist.

²⁸ See, e.g. *Geneva Pharms. Tech. Corp v Barr Labs.*, 386 F.3d 485 (2d Cir. 2004); *United States v Microsoft*, 253 F.3d 34 (D.C. Cir. 2001); and *Ryko Mfg. Co v Eden Servs.*, 823 F.2d 1215, 1233 (8th Cir. 1987).

by “substantially disproportionate” harms.²⁹ Further, the DOJ Report endorses a safe harbour for exclusive dealing arrangements that foreclose less than 30 per cent of the market, based on the more recent case law.³⁰ Assistant Attorney General Varney rejects the use of such a “disproportionality test” in favour of reliance on the *Microsoft* and *Dentsply* cases discussed later in this article.³¹

In cases where the defendant is found to possess monopoly power, courts have held that broad exclusive dealing may substantially foreclose the market and violate s.2. These decisions focus on the monopolist’s dominant share of the market, combined with a finding that the scope and reach of exclusivity provisions has effectively shut out competitors from distributing competing products. Recent successful exclusive dealing cases have generally been the result of government enforcement actions, not private litigation.

In *United States v Microsoft Corp*, the DC Circuit Court of Appeals held that Microsoft’s exclusive dealing agreements with internet access providers were unlawful under s.2, given Microsoft’s monopoly power.³² In particular, Microsoft established exclusive contracts with nearly all internet access providers, which “constitute one of the two major channels of distribution” in the relevant market, namely internet browsers. The court offered specific guidance on the quantum of market foreclosure sufficient to prove a violation of s.2:

“[A] monopolist’s use of exclusive contracts, in certain circumstances, may give rise to a § 2 violation even though the contracts foreclose less than the roughly 40% or 50% share usually required to establish a § 1 violation [for exclusive dealing].”³³

Beyond a finding of Microsoft’s monopoly power, the key factual findings underlying the court’s decision were the absolute exclusion of rivals from a channel of distribution that the court deemed crucial to effective competition.

Similarly, in *United States v Dentsply International, Inc*, the Court of Appeals for the Third Circuit first held that Dentsply dominated the market for artificial teeth with a 75–80 per cent market share and sales 15 times

greater than the next largest competitor.³⁴ Against that backdrop, the court found that Dentsply’s efforts to establish exclusive distributors effectively foreclosed the market and violated s.2. Key factual findings included:

- given Dentsply’s control of the market, its threat to terminate dealers selling rival products amounted to coercive exclusive dealing;
- Dentsply’s exclusive dealing locked up virtually all of the dealer distribution network used by most laboratories to purchase artificial teeth; and
- alternative channels of distribution were ineffective and precluded rivals from expanding market share.³⁵

While *Microsoft* and *Dentsply* upheld liability for exclusive dealing by monopolists, most exclusive dealing claims fail for one of several reasons.³⁶ First, courts reject claims for failing to show coercive exclusivity imposed by a firm with market power, rather than competition on price.³⁷ Secondly, courts reject exclusive dealing claims where the terms are not sufficiently restrictive and do not effectively preclude a competitor from selling to customers.³⁸ Thirdly, courts reject exclusive dealing claims where competitors have alternative channels of distribution that have not been foreclosed by exclusive contracts.³⁹ Finally, courts may accept exclusive dealing

34 *United States v Dentsply Int’l, Inc*, 399 F.3d 181, 184–85 (3d Cir. 2005).

35 *Dentsply* at 191–193. Several courts have pointed to exclusive contracts of less than one year’s duration as being significantly less exclusionary than multi-year contracts, e.g. *Roland Mach. Co v Dresser Indus.*, 749 F.2d 380 (7th Cir. 1984). The DOJ Report, reiterating the Department’s position in the *Dentsply* litigation, is that nominally short-term exclusivity can evolve into de facto long-term and anti-competitive exclusivity (DOJ Report, p.140).

36 And notably, private plaintiffs have had relatively little success in piggy-backing on the Government’s success in the *Microsoft* and *Dentsply* cases.

37 See, e.g. *Nicsand, Inc v 3M Co*, 507 F.3d 442 (6th Cir. 2007) (rejecting exclusive dealing claim challenging price discounts offered for multi-year exclusive agreements because the plaintiff could compete by offering the same discounts); and *Concord Boat Corp v Brunswick Corp*, 207 F.3d 1039 (8th Cir. 2000) (casting exclusive dealing claim as complaint about price discounting in exchange for exclusivity and rejecting claim).

38 See, e.g. *Barry Wright Corp v ITT Grinnell Corp*, 724 F.2d 227, 237 (1st Cir. 1983) (rejecting challenge to volume discount as insufficiently exclusive); *CDC Techs. v IDEXX Labs.*, 186 F.3d 74, 80 (2d Cir. 1999) (rejecting exclusive dealing claim because, inter alia, the exclusive contracts were terminable); and *Ryko Mfg. Co v Eden Servs.*, 823 F.2d at 1232–1233 (foreclosure of 8–10% of total sales for automatic car wash systems did not create a risk that exclusive distribution agreements substantially foreclosed the market).

39 See, e.g. *CDC Techs.*, 186 F.3d at 80–81 (noting that distributors subject to exclusive agreements “have never been

29 DOJ Report, p.140.

30 DOJ Report, p.141.

31 Varney Address, pp.8 and 13.

32 *United States v Microsoft Corp* 253 F.2d 34, 70 (D.C. Cir. 2001).

33 *United States v Microsoft Corp* 253 F.2d 34, 70.

when a defendant establishes that exclusivity is justified by efficiency or compelling pro-competitive benefits.⁴⁰

US exclusive dealing case law does not yield bright-line rules, but general principles emerge. Courts will look more closely at exclusive dealing by bona fide monopolists with dominant market shares. For such firms, stringent exclusive contracts that foreclose access to a significant share of customers, or a critical channel of distribution, will likely be struck down, particularly if challenged by the government.

The EU experience: exclusive dealing

“Exclusive Dealing” as defined in the EC Guidance⁴¹ includes both exclusive purchasing obligations and the granting of rebates. “Exclusive Purchasing”, sometimes referred to as “single-branding”, requires a customer in a particular market to source all or most of its needs from a particular undertaking. When the market share of the undertaking is under 30 per cent, the single-branding requirement will be assessed as a non-compete obligation.⁴² While it is likely to be a violation of art.81(1), the single-branding requirement will also likely be exempted from prohibition under art.81(3) by regulation.⁴³ The anti-competitive effects

critical to [the plaintiff’s] sale strategy” and the plaintiff “successfully reached customers by a variety of marketing techniques”; and *Omega Environmental, Inc v Gibarco, Inc*, 127 F.3d 1157, 1164 (9th Cir. 1997) (rejecting exclusive dealing claim based on evidence that competitors successfully developed alternative distribution networks).

40 See, e.g. *Barr Labs. v Abbott Labs.*, 978 F.2d 98, 111 (3d Cir. 1992) (approving exclusive contracts because customers freely agreed to exclusivity in order to achieve better service, price and convenience). Such decisions beg the question of whether exclusivity is necessary to achieve the claimed efficiencies.

41 EC Guidance, p.13.

42 Commission Notice, *Guidelines on Vertical Restraints* [2000] OJ C291/01, paras 138–160.

43 Regulation 2790/1999/EC, exempting such agreements and concerted practices under art.81(3). A short explanation of the interplay between arts 81 and 82 is appropriate. Article 81(1) prohibits agreements and concerted practices which “have as their object or effect the prevention, restriction or distortion of competition”. However, certain agreements and concerted practices, otherwise prohibited under art.81(1), can be exempted under art.81(3) if such agreements and concerted practices contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit. Furthermore, the restrictions imposed must be indispensable to the attainment of these objectives and may not afford the undertaking the possibility of eliminating competition with regard to a substantial part of the products in question. See Commission Notice, *Guidelines on Vertical Restraints* [2000] OJ C291/01, para.134.

of “exclusive dealing” are more serious in the high-market share situation of a dominant undertaking. When used by a dominant firm, exclusive dealing may impair competition by foreclosing access by actual or potential competitors to supplies or markets. In such cases, the exclusionary conduct is referred to as “anti-competitive foreclosure”⁴⁴ and is an infringement of art.82.

The leading case illustrating the application of art.82 to cases of exclusive dealing continues to be the *Hoffmann-La Roche “Vitamins”* case.⁴⁵ Hoffmann-LaRoche was found to have a dominant position in the then-Common Market in a number of vitamins in which it had a market share of between 41 and 51 per cent, and in Vitamin B₆, in which its market share exceeded 80 per cent. LaRoche had concluded exclusive or preferential agreements (“fidelity agreements”) with its customers. Under the terms of these agreements, the customers would receive a rebate if during the applicable period they had purchased all or most of their vitamin requirements from LaRoche; but they would lose the rebate entirely as to all products purchased from LaRoche if they purchased their requirements for even one product from another supplier.⁴⁶

According to the Commission, the agreement interfered with competition by removing all freedom of choice of purchasers in their selection of sources of supply and tied them to one supplier. Furthermore, the exclusivity denied any access to these customers by other vitamin manufacturers. The granting of fidelity

Article 82, on the other hand, contains a generalised, illustrative list of actions which can be prohibited as an antitrust violation because, through the market power (“dominance”) of the undertaking, such actions may distort competition, hence the reference to “abuse of a dominant position.” Article 82 does not contain an equivalent provision to art.81(3) which can exempt such actions. However, the dominant firm is permitted to assert an objective justification of the assessed exclusionary conduct, i.e. that its conduct is objectively necessary or produces substantial efficiencies which outweigh any anti-competitive effects on consumers. In this context, the Commission will assess whether the conduct in question is indispensable and proportionate to the goal allegedly pursued by the dominant undertaking, which is rather similar to the test as provided under art.81(3) for an exemption of an otherwise infringing agreement or concerted practice under art.81(1). See EC Guidance, p.12, paras 27–29. See also Commission Notice, *Guidelines on the Application of art.81(3) of the Treaty* [2004] OJ C101/08.

44 EC Guidance, p.8, para.19.

45 Commission Decision 76/642 relating to a proceeding under art.86 of the Treaty establishing the European Economic Community (IV/29.020-Vitamins) [1976] OJ L223/27; confirmed in *Hoffmann-LaRoche* [1979] E.C.R. 461.

46 IV/29.020-Vitamins, paras 12 and 24.

rebates, in return for exclusivity to LaRoche, fulfils the conditions of art.82(c), as dissimilar conditions that are applied to equivalent transactions with other trading partners, placing them at a competitive disadvantage.⁴⁷

The *LaRoche* agreements also included a so-called “English” clause,⁴⁸ requiring the buyer to report any better offer and allowing acceptance only if LaRoche would not match it. The Commission was well aware of the commercial effect of the price transparency of the market thereby granted to LaRoche. In learning through the “English clause” of competitors’ prices, LaRoche—with its dominance in the market for vitamins—could adjust its price and so preserve its exclusivity of supply to the customer in question. In short, LaRoche controlled the extent of access of a competitor to the market which it had reserved for itself.⁴⁹

On appeal, the Commission decision in *Hoffmann-LaRoche* was upheld, although the imposed fine was reduced. In its findings, the European Court of Justice (ECJ) found that when, through a dominant position, the structure of competition has already been weakened, any further weakening may constitute an abuse of a dominant position.⁵⁰ Furthermore, the prohibitions contained in arts 81 and 82 must be interpreted and applied so as to assure that “competition in the Common Market is not distorted”.⁵¹ Article 82 therefore covers “not only abuse which may directly prejudice consumers but also abuse which indirectly prejudices them by impairing the effective competition structure”.⁵² These were fatal pronouncements later in the *Microsoft* case.⁵³

Another leading case is *Van den Bergh Foods Ltd.*⁵⁴ The company, an Irish subsidiary of Unilever,

maintained an extensive network of ice cream freezer units which were put at the disposal of retailers at little or no direct cost, but subject to the condition that the units were to be used exclusively for the storage of Unilever products. The case analysed both art.81(1) and (3), and art.82 aspects of the agreements, and the Unilever subsidiary’s market behaviour.

In its findings, the Court of First Instance (CFI) determined that the retailers were unlikely either to replace existing units (whether with Unilever’s or with those of a competitor) or to install additional ones. Unilever’s competitors were consequently denied access to those outlets, with the result that their products were not offered for sale from a substantial portion of retail outlets in Ireland (estimated by Unilever to be 40 per cent).⁵⁵

The decision therefore found that the exclusivity condition, as applied in relation to outlets whose only ice cream freezer units had been provided by Unilever, infringed art.81(1) of the EC Treaty and could not be exempted under art.81(3). The court moreover found that Unilever had abused its position of market dominance in Ireland, contrary to art.82 of the EC Treaty, by inducing retailers to enter into exclusive arrangements in which the dominant supplier (Unilever) induced the retail customer, through the gratuitous furnishing of a freezer unit, to accept exclusivity, with the result that Unilever was able to foreclose other suppliers over a lengthy period of time from competition.⁵⁶ In summary as to the art.82 infringement, the court added that:

“... although a finding that an undertaking has a dominant position is not in itself a recrimination, it means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market.”⁵⁷

IV/35.436-*Van den Bergh Foods Ltd*) [1998] OJ L246/1, upheld in *Van den Bergh Foods Ltd v Commission of the European Communities* (T-65/98) [2003] E.C.R. II-4653.

55 *Van den Bergh Foods* [2003] E.C.R. II-4653 at [154]–[155].

56 *Van den Bergh Foods* [2003] E.C.R. II-4653 at [159]–[160].

57 *Van den Bergh Foods* [2003] E.C.R. II-4653 at [158], citing *N.V. Nederlandsche Banden-Industrie Michelin v Commission of the European Communities* (322/81) [1983] E.C.R. 3461 at [57] (“*Michelin I*”). This wording was adopted in greater part in the EC Guidance at p.4, para.1. The holding in *Van den Bergh Foods* also had consequences for *Microsoft*. In citing *Van den Bergh*, the court in *Microsoft* held that it:

“follows from . . . *Van den Bergh Foods* . . . that it is acceptable to take into account the likely reactions of third parties, and in particular competitors or customers, to the unilateral action of a dominant

47 IV/29.020-*Vitamins*, para.26.

48 For additional information about the antitrust treatment of “English” clauses, see the Commission *Guidelines on Vertical Restraints* [2000] OJ C291/01, para.152. The Commission’s concluding statement that “English” clauses and “fidelity” agreements are prohibited for dominant undertakings under art.82 is an indirect reference to the *Hoffmann LaRoche* case.

49 IV/29.020-*Vitamins*, para.25.

50 *Hoffmann-LaRoche* [1979] E.C.R. 461 at [123].

51 *Hoffmann-LaRoche* [1979] E.C.R. 461 at [125].

52 *Hoffmann-LaRoche* [1979] E.C.R. 461 at [125].

53 See *Microsoft* [2007] E.C.R. II-03601 at [664] (“Last, it must be borne in mind that it is settled case-law that Article 82 EC covers not only practices which may prejudice consumers directly but also those which indirectly prejudice them by impairing an effective competitive structure (*Hoffmann-LaRoche* [1979] E.C.R. 461 at [125], and *Irish Sugar Plc v Commission of the European Communities* (T-228/97) [1999] E.C.R. II-2969 at [232]”).

54 Commission Decision 98/531 relating to a proceeding under arts 85 and 86 of the EC Treaty (IV/34.073, IV/34.395 and

The concern about foreclosure through exclusive long-term contracts expressed in the EC Guidance⁵⁸ continues; but recent enforcement efforts of the Commission appear to focus on those cases in which the exclusive contracts entered into by dominant companies have network effects.⁵⁹ In cases in which the Commission has found abuse, it has sought to remedy the anti-competitive impact through appropriate restrictions on contract length and the percentage of the market thereby foreclosed.⁶⁰ In *Distrigas*,⁶¹ concerning long-term gas supply contracts in the Belgian market, the company entered into commitments to ensure that it does not tie up an excessive proportion of customers for more than one year. At the end of 2008, the Commission confirmed that it had sent a Statement of Objections to the French EdF group, the largest supplier of electricity in France.⁶² The Statement of Objections relates to contracts concluded by EdF with industrial customers in France. The Commission expressed concern that the contracts may prevent customers from switching to other providers, thereby reducing competition in the market, in particular when considering the exclusive nature and duration of the contracts and the share of the market that is tied up by them.⁶³

From the foregoing cases, one sees expressed the political mission of the Commission to force the integration

undertaking when assessing whether that action is likely to lead to foreclosure" (*Microsoft* [2007] E.C.R. II-03601 at [1013]).

58 EC Guidance, p.8, para.35.

59 Network effects arise when consumers place greater value on larger networks than small ones. See "DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses" (2005), para.146 and its accompanying fn.91, available at <http://ec.europa.eu/competition/antitrust/art82/index.html> [Accessed June 24, 2009].

60 Report on Competition Policy 2007, COM(2008) 368 FINAL, para.9.

61 Commission Decision, *Distrigas*, Case COMP/B-1/37966 [2007].

62 A Statement of Objections is a formal step in Commission antitrust investigations in which the Commission informs the parties concerned in writing of the objections raised against them. The addressee of a Statement of Objections can reply in writing to the Statement of Objections, setting out its defence. The party may also request an oral hearing. The Commission may then make a decision on whether the conduct is compatible with the EC antitrust rules. Sending a Statement of Objections does not pre-judge the final outcome of the procedure.

63 See MEMO/08/809, December 29, 2008, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/809&format=HTML&aged=0&language=EN&guiLanguage=en> [Accessed July 8, 2009]. Following its ex officio investigation, the Commission opened formal proceedings in July 2007 (see MEMO/07/313, July 26, 2007, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/313> [Accessed July 8, 2009]).

of the Common Market through its competition policy; but the need for greater economic analysis has also received acknowledgement at the Commission level. As already announced by Competition Commissioner Neelie Kroes in her speech of September 23, 2005 to the Fordham Corporate Law Institute, the enforcement of art.82 should be on the basis of a sound economic assessment for the most frequent types of abusive behaviour.⁶⁴ The EC Guidance provides significant guidance to its methods for the assessment of anti-competitive foreclosure through exclusive dealing, including the cost benchmarks which it is likely to employ, namely the "average avoidable cost (AAC)" and the "long-run average incremental cost (LRAIC)".⁶⁵ However, the basic EU case law on exclusive dealing, starting with *Hoffmann-LaRoche* itself, does not impose any cost-based tests for finding abuse of dominance.

Under such analysis, the failure by a dominant undertaking to cover its AAC (which includes the product-specific fixed costs for the period in which the conduct occurs) indicates that the undertaking is sacrificing current profits; and an equally efficient competitor would not be able to compete at that price without incurring a loss. Failure to cover the LRAIC (which also includes the product-specific fixed costs incurred prior to the conduct in question) indicates that an equally efficient competitor could be foreclosed from the market. The finding of either factor is indicative of an antitrust infringement. This new "economic analysis of the market" for use in assessing art.82 infringements has already been applied in the *Microsoft* case, as well as to "price squeeze" abuse found in the *Telefónica* case, both of which are discussed later in this article.⁶⁶

"I'll just take my ball and go home": unilateral refusals to deal

Historically, US Supreme Court cases hold that a monopolist has violated s.2 by refusing to sell or license its products to rival firms, when such a refusal to deal tends to create or perpetuate a monopoly. Quoting the

64 Available on the Competition Authorities website: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML&aged=0&language=EN&guiLanguage=en> [Accessed July 8, 2009].

65 EC Guidance, p.11, para.25. The EC Guidance builds on much of the analysis in the December 2005 "DG Competition Discussion Paper".

66 Commission Decision of 4 July 2007 relating to a proceeding under art.82 of the EC Treaty (Case COMP/38.784-*Wanadoo España v Telefónica*).

1919 *Colgate* decision, a federal s.1 enforcement action, the court expressed this position in a negative sense in the 1985 *Aspen Skiing* decision:

“In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”⁶⁷

By the early post-World War II era, a monopolist’s unilateral refusal to deal with rivals or customers of rivals was a recognised species of s.2 violation and target of government enforcement efforts. In the *Lorain Journal* case,⁶⁸ the Government successfully sought to enjoin an Ohio newspaper with a local news and advertising monopoly from refusing to sell advertising space to firms which purchased radio ads from the sole local station offering a competing advertising outlet. The Supreme Court’s unanimous decision was considered unremarkable even by many critics of the antitrust jurisprudence of the era. Robert Bork, for instance, stated blandly that, “[t]he decision seems entirely correct”,⁶⁹ a comment picked up on by Assistant Attorney General Varney to support the continued vitality of *Lorain Journal*.⁷⁰

The high point of s.2 refusal-to-deal jurisprudence came in 1985, when the Supreme Court affirmed a plaintiff’s jury verdict in the *Aspen Skiing* case. *Aspen Skiing* involved four ski areas. The defendant owned three of the areas and the plaintiff owned one. The two competitors had co-operated for a number of years in the issuance of a joint, multiple-day, all-area ski ticket.⁷¹ After continued disputes regarding the allocation of proceeds, the defendant Aspen Skiing Co chose to offer a multi-day ticket including only its three ski areas. The defendant refused not only to offer the joint ticket, but also refused to allow plaintiff Aspen Highlands to buy Aspen Skiing Co’s tickets at retail price in an effort to put together its own multi-area pass.⁷² Justice Stevens’ unanimous opinion reasoned that:

“The jury may well have concluded that [the defendant Aspen Skiing Co] elected to forgo these short-run

benefits because it was more interested in reducing competition . . . over the long run by harming its smaller competitor.”⁷³

Meanwhile, growing up beneath this tolerant canopy of Supreme Court precedent, lower federal courts had begun to carve out a doctrine of “essential facilities”—capital investments of a monopolist, often protected by regulation, to which would-be rivals claimed access was necessary for competition to thrive. While the Supreme Court has expressly refused to recognise the doctrine in s.2 law,⁷⁴ the leading case, the Seventh Circuit *MCI* decision, identified four factors which could lead to a successful s.2 claim to compel a monopolist to deal with a rival:

“(1) control of the essential facility by a monopolist; (2) a competitor’s inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.”⁷⁵

The Seventh Circuit found that local telephone distribution facilities met the definition of essential facilities, and affirmed a jury’s finding that AT&T’s refusal to interconnect long-distance carrier MCI with the local distribution facilities of Bell operating companies violated s.2.⁷⁶

Like other aspects of refusal-to-deal law, the essential facilities doctrine draws arguably misplaced strength from s.1 jurisprudence involving concerted refusals to deal by horizontal competitors—arguably misplaced because unilateral refusals to deal do not raise the concern present in s.1 cases over the co-ordination of economic activity among ostensibly competing actors. The *Terminal Railroad* case, in which the Government challenged the refusal of a consortium of railroad owners to provide access to facilities they owned in St Louis to permit trans-shipment of cargo and passengers across the Mississippi River, is the classic example.⁷⁷ In that case, the Supreme Court permitted the consortium to continue, but only if it allowed access on non-discriminatory terms to non-member competitors.⁷⁸

The Supreme Court’s 2004 *Trinko* decision, however, represents a dramatic step back from these decades of

67 *Aspen Skiing Co v Aspen Highlands Skiing Co*, 472 U.S. 585, 602 (1985); quoting *United States v Colgate*, 250 U.S. 300, 307 (1919) (emphasis by court).

68 *Lorain Journal v United States*, 392 U.S. 143 (1951).

69 R. Bork, *The Antitrust Paradox* (New York: Basic Books, 1978), p.345.

70 Varney Address, pp.9–11.

71 *Aspen Skiing*, 472 U.S. at 589–594.

72 *Aspen Skiing* at 592–594.

73 *Aspen Skiing* at 608.

74 See, e.g. *Aspen Skiing*, 472 U.S. at 611, fn.44.

75 *MCI Communications Corp v AT&T*, 708 F.2d 1081, 1132–1133 (7th Cir. 1983).

76 *MCI Communications* at 1132–1133.

77 *United States v Terminal R.R. Ass’n of St Louis*, 224 U.S. 383 (1912).

78 *Terminal R.R. Ass’n of St Louis* at 411. See also *Associated Press v United States*, 326 U.S. 1 (1945) (striking down byelaws

earlier s.2 precedent.⁷⁹ There, the court held that Verizon Communications (a local exchange carrier descended from the old AT&T) did not violate s.2 by failing to share its local telephone network with competitors. In so holding, the court recognised a tension between compelling even monopolists to grant access to their unique infrastructure and the purpose of antitrust law, if doing so decreases the incentive to innovate of the monopolist or its rivals.⁸⁰ This time, when citing *Colgate*, Justice Scalia's opinion for the majority omitted the language tempering the "long recognized right of [a manufacturer] freely to exercise his own independent discretion as to parties with whom he will deal", with the injunction not to refuse to deal for "any purpose to create or maintain a monopoly".⁸¹ *Trinko* arose out of the regulated telecommunications industry, but the concern expressed by the court that forced sharing of a monopolist's infrastructure threatens incentives to innovate and places judges in the role of "central planners"⁸² are more than industry-specific. They signal the beginning of an era of laissez-faire treatment of unilateral refusals to deal.

The DOJ Report mirrors the *Trinko* court's concerns and outcome. It asserts a judicial and academic consensus that "[a]ntitrust law generally does not restrict a firm's right to choose those with which it will deal";⁸³ that compelling a firm to deal with a rival diminishes incentives for all firms to innovate; and that antitrust agencies and the judicial system are "ill-equipped to act as industry regulators".⁸⁴ In particular, the DOJ Report's hostility to forced-sharing is directed at compelled licensing of intellectual property rights.⁸⁵ The DOJ Report concludes that "antitrust

liability for unilateral, unconditional refusals to deal with rivals should not play a meaningful part in Section 2 enforcement".⁸⁶

The first—and likely last—notable expression of the DOJ Report's position in litigation came in the December 3, 2008 oral argument in the *linkLine* case, in which the United States appeared as amicus supporting Pacific Bell, the alleged vertically integrated monopolist and perpetrator of a price squeeze scheme on a would-be retail telephone service competitor. The Government argued that a monopolist should never be liable under s.2 under a "price squeeze" theory, where the alleged exclusionary conduct is the refusal to sell to rivals at a wholesale price that enables competition at the retail level.⁸⁷

linkLine, the Supreme Court's most recent foray into the law of unilateral refusals to deal, continues the course set in *Trinko* of generally permitting monopolists to refuse to deal with rivals.⁸⁸ In *linkLine*, another telecommunications case, the plaintiffs sued Pacific Bell (doing business as AT&T California), alleging that the terms on which Pacific Bell sold DSL internet connection transport service pursuant to a prior merger-related consent agreement violated s.2 of the Sherman Act, because the wholesale price was so high that the plaintiffs could not profitably compete with Pacific Bell in the business of reselling the DSL transport service at retail; i.e. plaintiffs alleged they were victims of a "price squeeze" between the monopolist's wholesale and retail pricing. The Supreme Court essentially divided the claim into its component parts, stating that where there was no "antitrust duty to deal with its competitors",⁸⁹ citing only *Aspen Skiing*, a monopolist did not have to sell to its rivals at any price, so no claim could arise over the wholesale price at which Pacific Bell did sell. The court concluded that this reasoning was a "straightforward application" of *Trinko*.⁹⁰ As to retail pricing, only predatory pricing under the *Brooke Group* standard is proscribed.⁹¹

of AP which prohibited members from supplying news to non-members, and gave incumbent members veto power over new members).

79 *Verizon Communications Inc v Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

80 *Verizon Communications* at 407–408.

81 *Verizon Communications* at 408, quoting *Colgate*, 250 U.S. at 307.

82 *Verizon Communications* at 408.

83 DOJ Report, p.123 and fn.37.

84 DOJ Report, p.123.

85 DOJ Report, p.124. While the DOJ Report claims support from the FTC in this regard, the three FTC Commissioners' statement concerning the DOJ Report disputes this contention. See Commissioners' Statement, pp.8–9. The FTC has in recent years used compulsory licensing of intellectual property as a remedy for perceived or threatened monopoly. See, e.g. *In the Matter of Ceridian Corp*, FTC Docket No. C-3933, Decision and Order dated April 5, 2000, available at <http://www.ftc.gov/os/2000/04/ceridian.do.htm> [Accessed June 24, 2009] (directing royalty-free licensing of intellectual property required to process over-the-road trucking fleet card transactions).

86 DOJ Report, p.129.

87 *Pacific Bell Tel. Co v linkLine Communications, Inc*, No. 07-512 (U.S. December 8, 2008), Tr. at 26. As part of its argument, the Government urged the Supreme Court to overrule the 1946 *Alcoa* decision, 148 F.2d 416 (2d Cir. 1945).

88 *Pacific Bell Tel. Co v linkLine Communications, Inc*, 129 S. Ct. 1109 (2009).

89 *Pacific Bell* at 1118.

90 *Pacific Bell* at 1119.

91 *Brooke Group Ltd v Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993) (requiring both below-cost pricing and a dangerous probability of recoupment of foregone profits if the predation succeeds).

linkLine is disappointing in its curtness as to the circumstances when antitrust law will infer a duty to deal by a monopolist. However, the court's view of the case as a logical extension of *Trinko*, its failure to cite earlier decisions such as *Lorain Journal*—in which liability for refusal to deal was found—and its shunting aside of one such case, *Alcoa*, in a footnote,⁹² call into question whether there is any s.2 life left in refusal-to-deal claims.

Assistant Attorney General Varney specifically cited *Aspen Skiing* as well as *Lorain Journal* as continuing to define the limits on monopolists' conduct in the realm of exclusive dealing and unilateral refusals to deal. She even contended that *Trinko* and *linkLine* could be read to affect only "limited, specific sectors subject to significant and specialized regulatory overlay", and that:

"... there is no question that [*Trinko* and *linkLine*] reaffirmed *Aspen Skiing's* limits on a monopolist's ability to engage in exclusionary or predatory conduct."⁹³

However, a realistic assessment of *Trinko* and *linkLine* suggests that at the high court level the Obama Administration has a significant persuasive task ahead of it to reinvigorate unilateral refusal to deal claims. In this instance, the DOJ Report was reflecting where the US courts were already headed.

The EU experience: unilateral refusals to deal

The principles cited in the previous section as to unilateral refusals to deal under US antitrust law in theory find their counterparts in decisions reached in the European Union. The Commission also follows the general principle that any undertaking, even one holding a dominant position, "should have the right to choose its trading partners and to dispose freely of its property".⁹⁴ In taking a restrictive view of what action could constitute an abuse of a dominant position, the Commission acknowledges that overly aggressive enforcement may have a counter-productive effect and that the imposition of:

"[a] duty to supply against their will may lead dominant undertakings—or undertakings who foresee that they may become dominant—not to invest, or to invest less."⁹⁵

92 *linkLine*, 129 S. Ct. at 1120, fn.3.

93 Varney Address, p.11.

94 EC Guidance, p.22, para.74.

95 EC Guidance, p.22, para.74.

However, there can be no argument but that a dominant manufacturer has significantly less room to refuse to deal with rivals or customers in the European Union than similarly situated firms would in the United States. Concepts which appear now to be mythical beasts in s.2 jurisprudence—price squeezes, essential facilities, refusals to deal—are alive and well and living in Europe.

In the EC Guidance, the concept of refusal to deal includes refusals to supply new or existing customers, the grant of access to "essential facilities" or to a network and the forced licensing of intellectual property rights.⁹⁶ In assessing whether enforcement action may be necessary, the EC Guidance lists the following three factors:

- the refusal relates to a product or service that is objectively necessary to be able to compete effectively in a downstream market;
- the refusal is likely to lead to the elimination of effective competition in the downstream market; and
- the refusal is likely to lead to consumer harm.⁹⁷

In the first refusal to supply case from the early 1970s, *Commercial Solvents*,⁹⁸ a dominant US-based manufacturer of a raw material for industrial production of pharmaceutical products ceased to supply such material within the EC in order to manufacture and sell the same products itself through a subsidiary. The case held that the refusal to supply, even under the circumstances of vertical integration and own-manufacture of the products based on this raw material itself, was an abuse of a dominant position. The refusal to deal risked eliminating all competition on the part of an important manufacturer of the derivative products. A fine was levied as well as the obligation to resume supplying the raw material.

In another case from the 1970s, *United Brands*,⁹⁹ the dominant supplier of bananas argued that its decision to cease to supply Chiquita bananas to a Danish distributor-riper had an objective justification and was not abusive as the decision did not adversely impact

96 EC Guidance, p.24, para.77.

97 EC Guidance, p.24, para.80.

98 Commission Decision 72/457 (IV/26.911-Zoja/CSC-ICI) [1972] OJ L299/51; "*Commercial Solvents*"; upheld on appeal in *Instituto Chemioterapico Italiano SpA and Commercial Solvents Corp v Commission of the European Communities* (6/73 & 7/73) [1974] E.C.R. 223.

99 *United Brands* [1978] E.C.R. 207 (on appeal from Commission Decision 76/353 relating to a procedure under art.86 of the EEC Treaty (IV/26699-*Chiquita*) [1976] OJ L95/1).

competition in the Danish market. The ECJ responded in its decision:

“... an undertaking in a dominant position . . . cannot stop supplying a long standing customer who abides by regular commercial practice, if the orders placed by that customer are in no way out of the ordinary.”¹⁰⁰

While the ECJ accepted theoretically the justification of a firm's defence of its own competitive position, it went on to state that the measures taken must not have an actual purpose to strengthen the dominant position and abuse it.¹⁰¹

The foregoing cases represent the traditional types of unilateral refusals to deal; and only these are also addressed in the EC Guidance. Other types of possible unlawful refusals to supply, such as “conditional” refusals, punitive halting of supplies, non-delivery if tying is refused, restriction of supplies to hinder parallel trade or to enforce resale prices, are expressly not subjects of guidance.¹⁰² Absent from the traditional analysis is the proof of foreclosure required under even the most lenient of the older US refusal-to-deal cases.

There is a subset of refusals to deal which are placed on the operator of an “essential facility”, the access to which is critical in order for competitors to serve the market. The application of these rules has been limited to restricted fact situations. The best summary of the criteria for the finding of an abuse is found in a 2001 Commission Decision:

- the refusal of access to the facility is likely to eliminate all competition in the relevant market;
- such refusal is not capable of being objectively justified; and
- the facility itself is indispensable to carrying on a business, as there is no actual or potential substitute for that facility.¹⁰³

100 *United Brands* [1978] E.C.R. 207 at [182].

101 *United Brands* [1978] E.C.R. 207 at [189]. In a later case from 1987, the Commission held that:

“A dominant undertaking may always take reasonable steps to protect its commercial interests, but such measures must be fair and proportional to the threat. The fact that a customer of a dominant producer becomes associated with a competitor or a potential competitor of that manufacturer does not normally entitle the dominant producer to withdraw all supplies immediately or to take reprisals against that customer.”

Commission Decision 87/500 relating to a proceeding under art.86 of the EEC Treaty (IV/32.279-BBI/*Boosey & Hawkes: Interim measures*) [1987] OJ L286/36, para.19. A termination of the relationship upon the giving of “adequate notice” was suggested as an acceptable alternative.

102 EC Guidance, p.23, para.76.

103 Commission Decision 2001/165 relating to a proceeding pursuant to art.82 of the EC Treaty (COMP D3/38.044-NDC

In an essential facility case that was settled through the acceptance of corrective commitments, the Coca Cola Co committed to allow its customers (retail points of sale), at which there was no other chilled beverage capacity directly accessible to consumers, the right to use up to 20 per cent of the space in a cooler unit that Coca Cola provided for free to cool other brands of soda.¹⁰⁴ For any cooler units leased by the customer, the customer could use without any restriction up to 20 per cent of the space for other brands. Should the customer have purchased the unit, there could be no restriction on the brands stocked.

In the Commission decision in the *Tetra Pak* case,¹⁰⁵ the agreed terms of the leases, with durations from a minimum of three years to nine years, were found to be excessive and constituted a further abuse under art.82. The initial term of the leases of nine years was considered to equal or exceed the technological (up to obsolescence) if not the physical life of machines. Even a minimum term of three years was considered as possibly abusive in an industry sector in which there is rapid technological development. *Tetra Pak* is instructive because the duration with which the market was closed to new entrants was a major factor in the finding of an “abuse” and exemplifies the Commission's impatience with contracts distorting competition over the middle-term (three to five years), an area in which, as is seen in the *NicSand* case, US courts may be becoming less active.

The recent *Telefónica* case is of interest as it sets forth the type of economic analysis which the EC Guidance has announced, and which Commissioner Kroes said in her 2005 speech at Fordham would not remain just a “policy statement”; and because of its divergence from *linkLine*, in which the Supreme Court buried price squeeze claims under US antitrust law. *Telefónica* concerned the supply to the retail market of broadband

Health/IMS Health: Interim measures) [2002] OJ L59/18. But see also *Bronner GmbH & Co KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co KG* (C-7/97) [1998] E.C.R. I-7791 at [41], which established the third criterion of indispensability in finding that there was no abuse of a dominant position.

104 Commission Decision 2005/670 relating to a proceeding pursuant to art.82 of the EC Treaty and art.54 of the EEA Agreement (COMP/A.39.116/B2-Coca Cola) [2005] OJ L253/21, para.46.

105 Commission Decision 92/163 relating to a proceeding pursuant to art.86 of the EEC Treaty (IV/31.043-Tetra Pak II) [1992] OJ L72/1, paras 104-141, upheld by the CFI, *Tetra Pak International SA v Commission of the European Communities (Tetra Pak I)* (T-83/91) [1994] E.C.R. II-755; and by the ECJ, *Tetra Pak International SA v Commission of the European Communities (Tetra Pak II)* (C-333/94) [1996] E.C.R. I-05951.

internet access in Spain in which Telefónica was the only Spanish telecommunications operator that had a nationwide fixed telephone network.

The alleged abuse under art.82 was a “price squeeze” (using the US terminology), in which *Telefónica* set its wholesale price at an allegedly inadequate level below its retail price, such that new entrants were denied what they considered to be a sufficient margin in order to operate within the market. According to the Commission, a price squeeze can be demonstrated by showing that the dominant company’s own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company (“equally efficient competitor test”). A price squeeze can also be demonstrated by showing that the margin between the price charged to competitors in the upstream market for access and the price which the downstream arm of the dominant operator charges in the downstream market is insufficient to allow a reasonably efficient service provider in the downstream market to obtain a normal profit (“hypothetical reasonably efficient competitor test”).¹⁰⁶

The methodology used in the case to assess the existence of the margin squeeze considered five main aspects:

- the level of efficiency of the competitor: profitability should be assessed on the basis of the dominant company’s downstream costs (the “equally efficient competitor” test);
- the appropriate cost standard;
- the profitability analysis to be made on the basis of two methods: namely the period-by-period method and the discounted cash flow (DCF) method;
- the level of aggregation to be used in the price squeeze test was conducted on the basis of a mix of the retail services marketed by Telefónica; and
- the upstream input when testing the replicability of the downstream prices: Telefónica’s retail prices must be replicable by an equally efficient operator on the basis of at least one Telefónica product in each relevant wholesale market.¹⁰⁷

The Commission determined that the relevant cost measure for the assessment of a price squeeze in the telecommunications sector is the LRAIC¹⁰⁸; and further

106 COMP/38.784-*Wanadoo España v Telefónica*, para.311.

107 COMP/38.784-*Wanadoo España v Telefónica*, para.310.

108 COMP/38.784-*Wanadoo España v Telefónica*, para.318, and as also suggested in the EC Guidance at 21–22, paras 66–70.

concluded that, for the purposes of establishing an infringement of art.82, it is not necessary to wait until there are concrete observable effects resulting from a margin squeeze before concluding that such conduct is abusive.¹⁰⁹

Under the specific circumstances of the case, Telefónica’s conduct comprised a prima facie price squeeze and was capable of, or likely to, restrict competition by making the continued presence of equally efficient competitors difficult to sustain. Competitors may ultimately have had to exit; or they may have been constrained in their ability to invest and increase their market share. Even if they had been able to meet the dominant undertaking both on prices and marketing expenditure, they were likely to be poorly placed in the long run to offer a vigorous competitive challenge to the dominant undertaking as a result of their continuing losses.¹¹⁰

The Commission found that the conduct of Telefónica constituted an abuse of its dominant position.¹¹¹ Absent the distortions resulting from Telefónica’s price squeeze in this case, the retail market for broadband services was likely to witness more vigorous competition between independent service providers, with consequent benefits for consumers in terms of lower prices and more choice.¹¹²

Finally, most controversially, the “essential facilities” doctrine is also the basis for decisions requiring the forced licensing of intellectual property. Indeed, the three-factor test cited earlier is from a case in which a copyright-protected asset constituted the “essential facility”. A fair reading of the cases, however, confirms that the forced licensing of intellectual property rights in the European Union by a dominant undertaking remains a reluctantly ordered remedy.

The groundwork for the legal extension of the “essential facilities” doctrine into the forced licensing of intellectual property rights was laid in the *Volvo* case, on a reference for a preliminary ruling to the ECJ.¹¹³ The court was asked whether the refusal by the proprietor of a design right to license third parties to supply products incorporating the protected design must be considered to be an abuse of a dominant position within the meaning of art.82. In its judgment, the court emphasised that

109 COMP/38.784-*Wanadoo España v Telefónica*, para.614.

110 COMP/38.784-*Wanadoo España v Telefónica*, para.615.

111 COMP/38.784-*Wanadoo España v Telefónica*, paras 692–694.

112 COMP/38.784-*Wanadoo España v Telefónica*, para.616.

113 *AB Volvo v Erik Veng (UK) Ltd* (238/87) [1988] E.C.R. 6211.

the right of a proprietor to prevent third parties from manufacturing and selling or importing, without his consent, products incorporating the design constituted the very subject matter of its exclusive right. The court added, however, that:

“... the exercise of an exclusive right by the proprietor of a registered design in respect of car body panels [might] be prohibited by Article [82 EC] if it involve[d], on the part of an undertaking holding a dominant position, certain abusive conduct such as the arbitrary refusal to supply spare parts to independent repairers, the fixing of prices for spare parts at an unfair level or a decision no longer to produce spare parts for a particular model even though many cars of that model [were] still in circulation, provided that such conduct [was] liable to affect trade between Member States.”¹¹⁴

The court’s reasoning in *Volvo* was adopted and applied in the leading EU case on forced licensing, *Magill*.¹¹⁵ The decision unleashed a storm of largely hostile commentary, accompanied by the wishful thinking that the case would be limited to its facts. The facts themselves are straightforward. Three UK and Irish television broadcasting companies each published a separate individual weekly guide of only their own programming and refused to license their respective programme listings (protected under copyright) to *Magill TV Guide*. *Magill* intended to provide a comprehensive weekly guide of TV broadcasts to the public. The Commission in *Magill* concluded that: (i) the three companies were attempting to protect their individual product markets; (ii) they together constituted a dominant position; and (iii) they used (“abused”) that dominant position to prevent the introduction of a new product.¹¹⁶

Upon review by the CFI, the decision was confirmed, but the court made clear that the exercise of the exclusive right to republish the copyrighted materials could not itself be an abuse. The abuse lay in the pursuit through the exercise of that copyright of an objective contrary to the purposes of art.82, in excess of that which was required to fulfil the essential purpose of the copyright.

The ECJ confirmed the judgment of the CFI, but stated that a forced licence could only occur

under “exceptional circumstances”, defining those circumstances as having the following four elements:

- no actual or potential substitute for the product which itself was indispensable for the carrying on of the business;
- the refusal prevents the appearance of a new product for which there is potential consumer demand;
- there is no objective justification for the refusal; and
- the refusal excludes all competition on the market for the product.¹¹⁷

The standards for the finding of the exceptional circumstances necessary to order a compulsory licensing of IP rights were refined in the *Bronner* and *IMS Health* cases,¹¹⁸ but in neither case was a compulsory licence ordered.

Forced licensing was again litigated in the *Microsoft* case, Part I, concerning the refusal of Microsoft to supply its competitors with “interoperability information” and to authorise the use of that information for the purpose of developing and distributing products competing with Microsoft’s own products in the work group server operating systems market. Again, the basic rule was asserted that undertakings are free to choose their business partners, although the limitation was added that under certain circumstances a refusal to supply by an undertaking in a dominant position could constitute an abuse within the meaning of art.82. Under “exceptional circumstances”, such refusal could furthermore be regarded as a refusal to supply to third parties a licence relating to intellectual property rights.¹¹⁹

Based on the foregoing, the CFI in *Microsoft* defined that the following elements must be present for the circumstances to be considered “exceptional”:

- the refusal relates to a product or service indispensable to the exercise of a particular activity on a neighbouring market;
- the refusal is of such a kind as to exclude any effective competition on that neighbouring market;
- the refusal prevents the appearance of a new product for which there is potential consumer demand.¹²⁰

114 *AB Volvo* [1988] E.C.R. 6211 at [9].

115 Commission Decision 89/205 relating to a proceeding under art.86 of the EEC Treaty (IV/31.851-*Magill TV Guide/ITP, BBC and RTE*) [1989] OJ L78/43; confirmed by the CFI in *Radio Telefis Eireann v Commission of the European Communities (“Magill”)* (T-69/89) [1991] E.C.R. II-485; and upon appeal by the ECJ, *Radio Telefis Eireann v Commission of the European Communities* (C 241 & 242/91 P) [1995] E.C.R. I-743.

116 IV/31.851-*Magill TV Guide/ITP, BBC and RTE*.

117 *Radio Telefis Eireann* [1995] E.C.R. I-743 at [50]–[57].

118 COMP D3/38.044-NDC *Health/IMS Health: Interim measures; Bronner* [1998] E.C.R. I-7791.

119 *Microsoft* [2007] E.C.R. II-03601 at [107] and [331].

120 *Microsoft* [2007] E.C.R. II-03601 at [332].

The CFI upheld the decision of the Commission, and found that Microsoft's conduct in failing to disclose to competitors "interoperability information" prevented the appearance of a new product on the market.¹²¹ This action, the court held, is covered by art.82(b), which prohibits abusive practices which limit "production, markets or technical developments to the . . . prejudice of consumers".¹²² The court further equated "new product" as envisioned in *Magill* and *IMS Health* to the limitation on "technical development" found in *Microsoft*.¹²³

Once a forced licence is required, to what is the licensor obligated? In *Microsoft*, the interested parties are to be granted licences under reasonable and non-discriminatory conditions, which does not require that the conditions must be the same to all interested parties. The conditions may be adapted to the specific situation of each interested party and vary, for example, according to the extent of the information to which they seek access or the type of products in which they intend to implement the information.¹²⁴

Forced licensing as a remedy has had relatively modest success in the United States.¹²⁵ Given the inevitable dampening of the incentive to innovate that forced sharing of intellectual property entails (particularly intellectual property developed in-house as opposed to obtained through acquisition), and the administrative difficulties of lengthy oversight of such a process, *Microsoft* may be the high water mark for such a remedy in the European Union, with future cases placing it back on the shelf as the truly extraordinary remedy the Commission has stated it should be.

Bundled discounts: the search for consistent standards in US law

Bundled discounts remain among the most controversial areas of s.2 litigation, with conflicting judicial guidance in the United States. A firm offers a bundled discount when it provides customers with price reductions or incentives to purchase multiple products that could be sold separately. The discount is conditioned on buying multiple products in a "bundle", and it enables the customer to buy all items in the bundle for a

price less than the sum of prices for the constituent pieces of the bundle purchased separately. Bundled pricing is ubiquitous: familiar examples include fast-food "value" meals, vacation packages or computer software bundles. Bundled price discounts can reflect efficiencies that sellers realise by selling products in concert, including lower distribution costs, reduced sales overhead and related transaction costs.¹²⁶ As a price discount to customers, bundling is generally pro-competitive.

Bundled discounts can undermine competition, however, if used by a monopolist to disadvantage a competitor that does not offer all products in the bundle. A firm offering multiple related products may be able to spread a discount or rebate across products and, in so doing, offer a price reduction that a single-product competitor cannot profitably match. In fact, even a new market entrant capable of producing a single product more efficiently than the monopolist may be unable to compete against bundled discounts.¹²⁷ As a result, bundled rebates have the potential to exclude competition, or dramatically raise barriers to entry, by effectively eliminating new entrants lacking the capital, scale, technology, rights or know-how to sell all products in the bundle.

US case law remains in flux regarding the standards for determining the legality of bundled discounts offered by a monopolist. Relatively few cases squarely address the subject, with differing treatment. There appears to be at least general agreement across cases and in the scholarship that bundled pricing can constitute anti-competitive conduct proscribed by s.2.¹²⁸ With the realisation that bundled discounts generally constitute pro-competitive price reductions, courts have adopted divergent rules for determining when bundled rebates are unlawful if used by a monopolist.

The granddaddy of bundling law, the Third Circuit's decision in *SmithKline v Eli Lilly*,¹²⁹ was the first US decision explicitly recognising the potentially anti-competitive, and therefore illegal, nature of bundled

121 *Microsoft* [2007] E.C.R. II-03601 at [665].

122 *Microsoft* [2007] E.C.R. II-03601 at [643].

123 *Microsoft* [2007] E.C.R. II-03601 at [647].

124 *Microsoft* [2007] E.C.R. II-03601 at [811].

125 See, e.g. the *Ceridian* consent decree, FTC Docket No. C-3933, Decision and Order dated April 5, 2000.

126 *Cascade Health Solutions v PeaceHealth*, 515 F.3d 883, 895 (9th Cir. 2008).

127 See Thomas A. Lambert, "Evaluating Bundled Discounts" (2005) 89 *Minnesota Law Review* 1688, 1696–1999 (providing examples of the impossibility of an as-efficient competitor profitably matching bundled discounts with single-product price reductions).

128 *Cascade Health Solutions*, 515 F.3d at 906; *LePage's Inc v 3M*, 324 F.3d 141 (3d Cir. 2003); and *Ortho Diagnostic Sys., Inc v Abbot Labs., Inc*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996).

129 *SmithKline Corp v Eli Lilly & Co*, 575 F.2d 1056 (3d Cir. 1978).

rebates when employed by a monopolist. *SmithKline* involved bundled discounts offered on prescription antibiotic drugs sold to hospitals. The defendant, Eli Lilly, held patents on certain antibiotics that hospitals had to purchase, but it confronted competition from SmithKline on one particular antibiotic. Eli Lilly offered bundled rebates to hospitals for volume purchases of the patented, monopolised antibiotics bundled together with the antibiotic that competed against SmithKline's product. Given the high volume of Eli Lilly's sales, SmithKline would have been forced to discount its single competing antibiotic 16 to 35 per cent to match Eli Lilly's 3 per cent rebate on multiple antibiotics bundled together.¹³⁰ The Third Circuit found the bundled rebate programme to be an illegal attempt to avoid competition with SmithKline on the competing product.¹³¹

The Third Circuit reaffirmed the seminal *SmithKline* decision in *LePage's, Inc v 3M*. *LePage's*, the plaintiff, was a relatively new entrant in the market for transparent tape, in which 3M concededly possessed monopoly power. The decision focused on 3M's bundled pricing programme that offered discounts for volume purchases of six different lines of products sold by 3M, ranging from health care to retail auto products:

“In addition to bundling the rebates, both of 3M's rebate programs set customer-specific target growth rates in each product line. The size of the rebate was linked to the number of product lines in which targets were met, and the number of targets met by the buyer determined the rebate it would receive on all of its purchases.”¹³²

The Third Circuit upheld a jury verdict for *LePage's* by focusing on the evidence supporting a conclusion that the bundled rebate programme had anti-competitive effects. The court noted that high barriers existed to entering the transparent tape market and relied on evidence that *LePage's* suffered dramatically reduced sales as a result of the bundled pricing programme. *LePage's* did not require the plaintiff to demonstrate that 3M's bundled discounts resulted in products priced below cost or that *LePage's* produced transparent tape as efficiently as 3M.¹³³ Rejecting 3M's argument that it could not be found liable for monopolisation absent evidence of below-cost pricing, the court declined to provide a specific test for determining when bundled pricing is illegal. Instead, the court relied on a general

analysis of anti-competitive effects to affirm the jury's verdict of a violation of s.2.¹³⁴

The *LePage's* decision generated substantial criticism for its failure to adopt a rule protecting above-cost bundled discounts.¹³⁵ Most notably, the Antitrust Modernization Commission (AMC), commissioned by Congress to propose recommended changes to the antitrust laws, supported a test requiring plaintiffs to prove that the monopolist priced below cost:

“To prove a violation of Section 2, a plaintiff should be required to show each one of the following elements (as well as the other elements of a Section 2 claim): (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.”¹³⁶

This proposed test was intended to offer sellers clear rules for determining the legality of bundled pricing, while also safeguarding discounting and bundling that is generally pro-competitive.

In the wake of the criticism of *LePage's*, the Ninth Circuit departed from it by adopting a below-cost test for bundled pricing in *Cascade Health Solutions*. This case involved markets for the provision of hospital services. The plaintiff, *Cascade Health Solutions*, had only one hospital in the relevant geographic market, and it offered only primary and secondary acute care services. The larger defendant, *PeaceHealth*, had multiple hospitals offering primary, secondary and tertiary services. For certain tertiary services, *PeaceHealth* possessed a greater than 90 per cent market share.¹³⁷ The challenged conduct involved *PeaceHealth's* offer of substantial discounts to insurers for tertiary services if *PeaceHealth* was designated as the sole preferred provider for all hospital services in the geographic market.¹³⁸ Thus, the bundled services included primary, secondary and tertiary hospital services, and *PeaceHealth* discounted the services in

¹³⁴ *LePage's* at 163–164.

¹³⁵ See, e.g. Daniel Crane, “Mixed Bundling, Profit Sacrifice, and Consumer Welfare” (2006) 55 *Emory Law Journal* 423; “Antitrust Modernization Commission, Report and Recommendations” (2007), p.97, available at <http://govinfo.library.unt.edu/amc/report-recommendation/amc-final-report.pdf> [Accessed June 24, 2009] (“AMC Report”).

¹³⁶ AMC Report, p.99.

¹³⁷ *Cascade Health*, 515 F.3d at 891.

¹³⁸ *Cascade Health* at 892.

¹³⁰ *SmithKline Corp* at 1065.

¹³¹ *SmithKline Corp* at 1065.

¹³² *LePage's*, 324 F.3d at 154.

¹³³ *LePage's* at 162–163.

which it dominated the market in exchange for exclusivity.

The Ninth Circuit's test requires plaintiffs to prove that, when totalled and applied to the competitive product, discounts result in below-cost pricing:

“[A]s our cost-based rule, we adopt what amici refer to as a ‘discount attribution’ standard. Under this standard, the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. If the resulting price of the competitive product or products is below the defendant’s incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of § 2.”¹³⁹

Cascade Health Solutions went on to define incremental cost as average variable cost.¹⁴⁰ Unlike the AMC’s proposed test, the court did not require plaintiffs to prove likely recoupment of profits or that plaintiffs are more efficient producers.¹⁴¹

The Third and Ninth Circuits are the only appellate courts to have squarely addressed bundled pricing, and their divergent approaches to assessing its legality remain. There appears to be a drift of authority in favour of a below-cost test,¹⁴² but the split of authority will remain until the Supreme Court weighs in.

European litigation over tying and bundling

Unlike in the United States, recent concern in the European Union over “bundling” has focused not on bundled discounts, but on bundling as a species of the practice of tying the sale of two products together. In the European Union, tying was never a per se antitrust violation. However, tying may constitute an abuse under art.82 if the tying is not objectively justified by the nature of the products or commercial usage.¹⁴³ As the Commission believes that a dominant undertaking may try to foreclose its competitors by tying or bundling,

included in the EC Guidance are the circumstances most likely to prompt enforcement action.¹⁴⁴

In determining an alleged tying or bundling violation of art.82, the following factors need be shown:

- the tying and tied products are two separate products;
- the undertaking concerned is dominant in the market for the tying product;
- the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and
- the practice in question forecloses competition.¹⁴⁵

Finally, the undertaking has an opportunity to prove that the tying is objectively justified. Typical objective justifications are found when the tying and bundling practices of dominant undertakings lead to savings in production or distribution that benefit customers, reduce transaction costs for customers who would otherwise need to buy the components separately, enable substantial savings on packaging and distribution costs for suppliers, or allow the supplier to pass on efficiencies arising from its production or purchase of large quantities of the tied product. Finally, the combination of two separate products into one may enhance the ability to bring the product to the market to the benefit of customers.¹⁴⁶

In the EC Guidance, the Commission further distinguishes between technical and contractual tying.¹⁴⁷ The first EU case to address technical tying, doing so under the rubric of “bundling”, is the *Microsoft* case. In *Microsoft*, the bundling consisted of the integration into a single product of what had existed before as two separate products, Windows and Windows Media Player. Companies would generally consider such bundling to be product innovation. To the Commission and the CFI, however, Microsoft’s innovation was an art.82 antitrust abuse.

How does product innovation become an “abuse”? Under the facts of the case, Microsoft in its WINDOWS

139 *Cascade Health* at 906.

140 *Cascade Health* at 910.

141 *Cascade Health* at 910, fn.21.

142 See, e.g. *J.B.D.L. Corp v Wyeth-Ayerst Labs., Inc*, No.1:01-CV-704, 2005 WL 1396940 (S.D. Ohio June 13, 2005), *aff’d*, 485 F.3d 880 (6th Cir. 2007); and *Info. Res., Inc v Dun & Bradstreet Corp*, 359 F. Supp. 2d 307 (S.D.N.Y. 2004).

143 See, e.g. *Tetra Pak II* [1996] E.C.R. I-05951, and cited in *Microsoft* [2007] E.C.R. II-03601 at [942]. In the United States, while tying technically can be either a per se or a rule of reason antitrust violation, many observers, including the authors, foresee the day when the Supreme Court will hold that the practice should be addressed solely under the rule of reason.

144 EC Guidance, Chapter IV(B), paras 46–61.

145 *Hilti v Commission of the European Communities* (T-30/89) [1991] E.C.R. II-1439, upheld in *Hilti v Commission of the European Communities* (C-53/92 P) [1994] E.C.R. I-667; and *Tetra Pak I* [1994] E.C.R. II-755 and *Tetra Pak II* [1996] E.C.R. I-05951. See also EC Guidance, pp.17–18, paras 46–49; and *Microsoft* [2007] E.C.R. II-03601 at [842] and [859].

146 EC Guidance, pp.19–20, para.61.

147 EC Guidance, p.17, para.47. Technical tying occurs when the tying product is designed in such a way that it will not work with the alternatives offered by competitors.

98 Second Edition (released May 1999), and in all subsequent Windows versions, integrated the Windows Media Player 6 (and subsequent versions) in such a fashion that the Windows Media Player could not be removed by original equipment manufacturers (OEMs) or by users.¹⁴⁸ The Windows Media Player 9 Series, introduced in January 2003, also does not support the RealPlayer or the QuickTime formats.¹⁴⁹

The Commission, as summarised by the CFI:

- found that Microsoft has a dominant position in the client PC operating systems market;
- asserts that streaming media players and client PC operating systems are two separate products;
- states that Microsoft does not give customers the choice to purchase Windows without Windows Media Player; and
- held that the tying of Windows Media Player to the Windows operating system forecloses competition in the media player market.¹⁵⁰

From an art.82 perspective, the key issues Microsoft faced were whether the first and fourth elements of a tying case are fulfilled. Is Windows with a “bundled” media player actually two products; and does the offering of only an integrated version foreclose competition?

As to the separate products issue, the legal precedents are generally long-standing. The distinctiveness of the product(s) for purposes of art.82 must be by reference to consumer demand.¹⁵¹ In the absence of independent demand for the allegedly tied product, there can be no question of “separate” products and therefore no abusive tying.¹⁵² A refinement to the prior case law is the CFI’s observation that tying through the technical integration of one product into another does not, for the purpose of assessing the impact of the integrated product on the market, prevent its qualification as the bundling of two separate products.¹⁵³

148 *Microsoft* [2007] E.C.R. II-03601 at [837].

149 *Microsoft* [2007] E.C.R. II-03601 at [832].

150 *Microsoft* [2007] E.C.R. II-03601 at [854]–[857].

151 *Microsoft* [2007] E.C.R. II-03601 at [917]; see also EC Guidance, p.18, para.50.

152 *Microsoft* [2007] E.C.R. II-03601 at [918].

153 *Microsoft* [2007] E.C.R. II-03601 at [935]. Microsoft acknowledged that its decision to supply Windows Media Player 6 as a functionality integrated in the Windows operating system was not the consequence of a technical constraint. At that time there was nothing to prevent Microsoft from distributing Windows Media Player 6 in the same way as it had distributed its previous player, NetShow, which had to be installed separately by users from Windows if they wished to use it. *Microsoft* [2007] E.C.R. II-03601 at [936].

Microsoft sought to counter the Commission’s findings, claiming that the integration of media functionality is a “natural step” in the evolution of PC operating systems and that it was constantly seeking to improve Windows in response to technological advances and to changes in consumer demand.¹⁵⁴ Furthermore, Microsoft submitted, there was no evidence that there would have been a demand for a version of Windows that, at the same price, would have had fewer features.¹⁵⁵

The CFI rejected Microsoft’s arguments that Windows with “media functionality” is a single product. In particular, it emphasised that the integration was not a technical requirement.¹⁵⁶ Other factors also pointed towards a determination that these were separate products, including that:

- there were independent producers specialising in the manufacture and sale of streaming media players¹⁵⁷;
- Microsoft itself develops and markets versions of its Windows Media Player for its competitors’ PC operating systems;
- Windows Media Player can be downloaded from the Microsoft internet site independently from its PC operating system;
- upgrades to Windows and to the Windows Media Player are released independently from one another; and, finally,
- despite the bundling, “a not insignificant number of customers continue to acquire media players from Microsoft’s competitors”.¹⁵⁸

Therefore, the CFI concluded, “client PC operating systems and streaming media players constitute two separate products for the purposes of Article 82 EC”.¹⁵⁹

As the CFI acknowledged that despite the bundling, customers continue to acquire media players from Microsoft’s competitors, is then the fourth factor, foreclosure of competition, satisfied? The CFI made clear that the legal standard to be applied in an action under art.82 was that set forth in *Michelin II*; namely,

154 *Microsoft* [2007] E.C.R. II-03601 at [895].

155 *Microsoft* [2007] E.C.R. II-03601 at [891]. The CFI took judicial notice that the offering of an unbundled Windows, initiated as part of the remedy agreed upon with the Commission, had not been successful. *Microsoft* [2007] E.C.R. II-03601 at [943].

156 *Microsoft* [2007] E.C.R. II-03601 at [1341].

157 Under the *Hilti* cases and *Tetra Pak II*, the existence of independent producers constitutes serious evidence of the existence of a separate market for the product.

158 *Microsoft* [2007] E.C.R. II-03601 at [922]–[934].

159 *Microsoft* [2007] E.C.R. II-03601 at [933].

“in principle, conduct will be regarded as abusive only if it is capable of restricting competition”.¹⁶⁰

The CFI, in finding evidence sufficient to establish the fourth element, foreclosure of competition, relied upon the *Hilti* and *Tetra Pak II* cases¹⁶¹ and the market data gathered during the Commission proceedings.¹⁶² Before Microsoft acquired VxTreme in 1997,¹⁶³ it had been unable to develop an effective streaming media player using its own technology; only with the acquisition could it compete with the industry leader, RealNetworks, and its “RealPlayer” product.¹⁶⁴ RealPlayer had a usage share in the second quarter of 1999 of nearly twice as many users as Windows Media Player or a third player, QuickTime.¹⁶⁵ Following introduction of bundling, Windows Media Player usage by March 2005 had risen to over 80 per cent, while that of RealPlayer had fallen below 40 per cent and QuickTime to just over 10 per cent.¹⁶⁶

The CFI attributed the significant growth to foreclosure, enabled through bundling, which allowed the Windows Media Player to enjoy:

“... an unparalleled presence on client PCs throughout the world, because the bundling allows that media player automatically to achieve a level of market penetration corresponding to that of the dominant undertaking’s client PC operating system, without having to compete on the merits with competing products.”¹⁶⁷

In summary, the CFI concluded that the Commission had demonstrated to the requisite legal standard that the bundling of Windows and Windows Media Player from May 1999 onwards inevitably had had significant consequences for the structure of competition. The

bundling allowed Microsoft an unparalleled advantage with regard to the distribution of its product and to ensure the ubiquity of Windows Media Player on client PCs throughout the world, thus providing a disincentive for users to make use of third-party media players and for the OEMs to pre-install such players on client PCs.¹⁶⁸ In light of the foregoing considerations, the CFI concluded that the Commission’s findings were sufficient to establish that the fourth constituent element of abusive bundling—foreclosure—had been shown.¹⁶⁹

Microsoft will be the seminal precedent for tying and bundling cases under art.82 for years to come, with particular relevance for the technology industry. Only the future will show whether there is truth in Microsoft’s contention that the Commission’s policy as to bundling “punishes dominant undertakings which improve their products by integrating new features in them”, with a consequent chilling effect on product innovation.¹⁷⁰ For now, however, the overriding lesson of *Microsoft* as to tying and bundling is the reaffirmation by the Commission and the CFI that art.82 is intended to prohibit a dominant undertaking from strengthening its position by recourse to means other than those based on competition on the merits.¹⁷¹ Furthermore, it is clear that the Commission will not hesitate to act when there is a reasonable likelihood that tying will lead to foreclosure of competition affecting the markets for either the tying or the tied products.¹⁷²

Loyalty and fidelity discounts and rebates

Distinct theoretically from multi-product bundled discounts—but often combined with them in practice and in case law—are discounts granted by a manufacturer to customers who purchase progressively larger shares of their needs for a single product from the manufacturer. The practice has been variously called “loyalty” or “fidelity” discounts, “market share” discounts, or more recently, “conditional rebates”. A 2008 Organisation for Economic Co-operation and Development (OECD) study generically defines “loyalty discounts” as follows:

168 *Microsoft* [2007] E.C.R. II-03601 at [1054]. See also [1069] for the same statement as to downstream markets: that:

“[u] biquity of [Windows Media Player] on Windows PCs therefore [secured] Microsoft a competitive advantage unrelated to the merits of its product” and that “[once] content based on a given format [was] widespread, the competitive standing of compatible media players [was] reinforced [and] entry for new contenders [was] difficult.”

169 *Microsoft* [2007] E.C.R. II-03601 at [1058].

170 *Microsoft* [2007] E.C.R. II-03601 at [888].

171 *Microsoft* [2007] E.C.R. II-03601 at [1070].

172 EC Guidance, pp.18–19, paras 51–57.

160 *Microsoft* [2007] E.C.R. II-03601 at [867]. See *Michelin v Commission of the European Communities* (T-203/01) [2003] E.C.R. II 4071 (“*Michelin II*”).

161 *Microsoft* [2007] E.C.R. II-03601 at [1354].

162 *Microsoft* [2007] E.C.R. II-03601 at [1058] and [1335].

163 *Microsoft* [2007] E.C.R. II-03601 at [911].

164 *Microsoft* [2007] E.C.R. II-03601 at [1046].

165 *Microsoft* [2007] E.C.R. II-03601 at [1022]. As possibly illustrative of Microsoft’s corporate strategy, in January 1997 a senior Microsoft executive sent an email message to Bill Gates proposing to “reposition [the] streaming media battle from NetShow vs. Real to Windows vs. Real” and to “follow the [Internet Explorer] strategy wherever appropriate” (*Microsoft* [2007] E.C.R. II-03601 at [911]).

166 *Microsoft* [2007] E.C.R. II-03601 at [1027]. For additional information concerning the competition between RealPlayer and Windows Media Player, see also [1046].

167 *Microsoft* [2007] E.C.R. II-03601 at [1038] (including market penetration data showing that from October 2001 through March 2003 Windows Media Players were installed on 196 million of the total 207 million PCs shipped in the world).

“[In] single product ‘loyalty discounts,’ [the] purchaser receives a lower price when purchasing more than a certain volume of a product. This lower price may apply either to purchases above the threshold [‘incremental discount’] or it may apply to all the previous purchases too. Where the lower price applies to all sales, the discount is sometimes referred to as a ‘retroactive,’ ‘rollback,’ or ‘first dollar’ discount.”¹⁷³

Most case law and commentary has focused on the exclusionary potential of “first dollar” loyalty rebates when employed by a monopolist or other dominant firm. The principal analytical difference between single-product loyalty rebates and bundled-product pricing is that the allegedly anti-competitive impact from a single-product loyalty rebate comes from the exclusionary effect of the rebate on another manufacturer who is otherwise able to produce a competing product, while in the bundled-product rebate, the exclusionary impact typically occurs because of the inability of a single competitor to provide all of the products in the bundle.

Loyalty rebates contain elements of both predatory pricing and exclusive dealing, and courts and commentators tend to break down along lines of which element they view as predominant—those for whom loyalty rebates at the extreme resemble predatory pricing generally viewing the practice as benign, and those stressing their kinship to exclusive dealing finding the practice more problematic.¹⁷⁴

A review of the recent US case law on the subject of single-product loyalty discounts leads to the conclusion that the practice is essentially per se legal. The only open question appears to be when courts will expressly apply the analytical paradigm for predatory pricing set forth in *Brooke Group*,¹⁷⁵ requiring both below-cost pricing and a dangerous probability of post-predation recoupment,

to single-product loyalty discounts. The DOJ Report concludes: “the standard [*Brooke Group*] predatory-pricing approach to single-product loyalty discounts has a number of advantages.”¹⁷⁶ As in the area of bundled discounts, the Obama Administration has yet to signal the extent, if any, of its disagreement with the prior administration’s approach to loyalty rebates, although from the concern in Assistant Attorney General Varney’s comments over exclusive dealing, this administration will likely tilt towards viewing loyalty rebates as carrying the same potential for anti-competitive impact as exclusive dealing.

Two appellate cases, *NicSand v 3M*¹⁷⁷ and *Virgin Atlantic v British Airways*,¹⁷⁸ are representative of US courts’ current treatment of loyalty discounts under the Sherman Act.¹⁷⁹ The *Virgin Atlantic* case is of particular interest, due to the divergent holding of European competition authorities reviewing the same conduct.

In *NicSand v 3M*, the plaintiff, a marketer of do-it-yourself retail automotive coated abrasives, brought suit against 3M alleging that certain exclusive dealing contracts executed by 3M with large distributors constituted monopolisation or attempted monopolisation in violation of s.2 of the Sherman Act. Rather than manufacturing products itself, the plaintiff engaged in a business of purchasing do-it-yourself automotive coated abrasives, which it cut and then packaged for the retail consumer. The plaintiff alleged that it was 3M’s sole competitor in the retail automotive coated abrasives market before it went out of business. According to *NicSand*, 3M provided “big box” retailers with large discounts in return for multi-year exclusive dealing agreements. During the relevant period, the six largest retailers accounted for 80 per cent of the market for the products in question. Between 1997 and 2001, 3M secured long-term exclusive contracts to supply do-it-yourself retail automotive coated abrasives to four of these retailers. Rather than attempt to compete in such an environment, *NicSand* exited the market in 2001 and sought bankruptcy protection. *NicSand* did not allege that the discounts given by 3M to obtain the big

173 Organisation for Economic Co-operation and Development, “Policy Roundtables: Fidelity and Bundled Rebates and Discounts” (2008) (“OECD Report”), Executive Summary, p.7, available at <http://www.oecd.org/dataoecd/41/22/41772877.pdf> [Accessed July 9, 2009].

174 Compare Herbert Hovenkamp, “Discounts and Exclusion” [2006] *Utah Law Review* 841, 848 (“above-cost discounts on single products should be regarded as lawful”), with Willard K. Tom, David A. Balto and Neil W. Averitt, “Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing” (2000) 67 *Antitrust Law Journal* 615 (arguing that market-share discounts “should be judged according to the same economic principles that govern exclusive dealing” and containing no cost-based test for liability). See also Robert H. Lande, “Should Predatory Pricing Rules Immunize Exclusionary Discounts?” [2006] *Utah Law Review* 863 (rebutting Hovenkamp).

175 *Brooke Group Ltd v Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993).

176 DOJ Report, p.117.

177 *NicSand, Inc v 3M Co*, 507 F.3d 442 (6th Cir. 2007).

178 *Virgin Atl. Airways Ltd v British Airways Plc*, 257 F.3d 256 (2d Cir. 2001).

179 For a more comprehensive review of US case law on loyalty discounts, including cases addressing the practice under the Clayton Act and the Robinson Patman Act, see Richard Duncan and Brian McCormac, “Loyalty and Fidelity Discounts in the U.S. and EU: Will Divergence Occur Over Cost-Based Standards of Liability?” (2008) 9 *Sedona Conference Journal* 133, 137–144.

box retailers' business resulted in any sales below 3M's cost.

The Sixth Circuit en banc dismissed the plaintiff's claims. While decided in terms of the lack of antitrust injury, the court's opinion addressed at length the subject of loyalty discounts and exclusive dealing. The court held that a complaint alleging discounts which are non-predatory (defined as "not . . . below cost with the goal of recouping . . . losses . . . later"¹⁸⁰) fails to state an antitrust claim. The court showed little concern that a loyalty discount was used as part of a package to induce "multi-year" (duration greater than one year, but less than five years) exclusive supply agreements.¹⁸¹ The Sixth Circuit concluded that, where a market was already characterised by functional annual exclusive dealing, the offering of multi-year, formal exclusive deals to a substantial majority of the available distribution channel's members was pro-competitive, entry-inducing conduct.¹⁸² Even the dissent in *NicSand* only argued that the plaintiff should be allowed discovery to see if it could fit its claim into the *Brooke Group* framework.¹⁸³

In *Virgin Atlantic v British Airways*, Virgin Atlantic alleged that British Airways employed incentive agreements with travel agents and corporate purchasers to monopolise or restrain trade in the air travel market for flights from the United States to London in violation of ss.1 and 2 of the Sherman Act. Under the British Airways incentive system, discounts or commissions were awarded when certain levels of sale were reached, as specified in applicable contracts. Virgin alleged that these incentive agreements substantially delayed its entry into the market for air services between five cities in the United States and London's Heathrow airport. The US Court of Appeals for the Second Circuit upheld the district court's grant of summary judgment in favour of British Airways, holding that "Virgin submitted insufficient proof to permit a factfinder to render a verdict in its favor" and, critically, that "Virgin failed to show how British Airways' competition harmed consumers".¹⁸⁴

With regard to Virgin's s.2 claims, the court was not persuaded by Virgin's argument that the incentive agreements resulted in below-cost pricing on certain air travel routes, holding that:

" . . . a factfinder would necessarily conclude that the decision to offer incentives was nothing more than an

attempt to generate increased business on the whole by limiting profitability on selected sales."¹⁸⁵

The court went on to question Virgin's theory of recoupment, finding that British Airways' incentives were not coercive, and that British Airways did not compensate for lower prices on the routes Virgin was contesting by charging higher prices on other routes or the same routes before Virgin's entry into the market.¹⁸⁶

In fact, there appears to be only one unpublished US District Court decision which affirms antitrust liability for single-product market share discounts. That case is *Masimo v Tyco*.¹⁸⁷

Masimo v Tyco involved claims against Tyco, a manufacturer of pulse oximetry systems and other medical products, which progressed to a jury trial. The plaintiff alleged, inter alia, that Tyco provided "loyalty discounts" to hospitals in exchange for promises not to purchase more than a specified percentage of the hospital's requirements for oximetry products from Masimo or other Tyco competitors.¹⁸⁸ Masimo also charged that Tyco entered into certain exclusive dealing and equipment financing arrangements with various hospitals, which effectively foreclosed Masimo's ability to compete.¹⁸⁹ Finally, the plaintiff alleged that Tyco offered "bundled rebates" which linked oximetry sales to completely unrelated Tyco products.¹⁹⁰

The jury found Tyco liable for violations, inter alia, of s.2 of the Sherman Act.¹⁹¹ Tyco moved for judgment as a matter of law or, alternatively, a new trial. The court rejected Tyco's motions as to liability, although it found the jury's award of \$140 million in damages (before trebling) to be unsustainable and ordered a new trial on damages.

As to market share discounts, the district court concluded:

"The jury had to decide whether Masimo's difficulties were the result of anticompetitive Market Share Discounts, or instead, whether Masimo's difficulties stemmed from the fact that it was trying to win business from customers with pre-existing investments in a competitor's product (i.e., Tyco monitors). Irrespective of the Market Share Discounts, in most cases, hospitals

180 *NicSand, Inc v 3M Co.*, 507 F.3d at 452.

181 *NicSand* at 453.

182 *NicSand* at 453-454.

183 *NicSand* at 463.

184 *Virgin Atl. Airways v British Airways*, 257 F.3d at 259.

185 *Virgin* at 269 (The court dismissed Virgin's s.1 claims for lack of proof of concerted action: 263-265).

186 *Virgin* at 271-272.

187 *Masimo Corp v Tyco Health Care Group, L.P.*, 2006 WL 1236666 (C.D. Cal. 2006).

188 *Masimo Corp* at p.1.

189 *Masimo Corp* at p.1.

190 *Masimo Corp* at p.1.

191 *Masimo Corp* at p.2.

already had strong incentives to buy a certain percentage of their sensor requirements from Tyco in order to support their Tyco compatible monitors. Although the court might have reached a somewhat different conclusion, the jury concluded the Market Share Discounts were anti-competitive. The jury could reasonably have reached that conclusion.”¹⁹²

The court also concluded that the jury could reasonably have found Tyco’s market share discounts to “in practical effect” have required hospitals to deal exclusively with Tyco.¹⁹³

The court analysed under s.2 the allegations that Tyco engaged in anti-competitive product bundling. The court noted that “[i]nsufficient evidence was presented for a jury to reasonably conclude that the bundling programs were compulsory, predatory in nature or tying arrangements”.¹⁹⁴ Finally, the court sustained the jury’s monopolisation verdict, stating that:

“A jury could reasonably have determined that the Market Share Discounts and Sole Source contracts . . . were designed to and did maintain monopoly power.”¹⁹⁵

The court did not impose any price-cost test upon Tyco’s conduct, treating the market share discount claim essentially as one for de facto exclusive dealing. The DOJ Report treats *Masimo*, appropriately, as an outlier among the US loyalty rebate cases due to the absence of any price-cost test.¹⁹⁶

EU authorities, on the other hand, have recently reaffirmed in the EC Guidance that loyalty rebates (termed “Conditional Rebates”¹⁹⁷), “when granted by a dominant undertaking [can] have actual or potential foreclosure effects similar to exclusive purchasing obligations”, and that in contrast to predatory pricing, “[c]onditional rebates can have such effects without necessarily entailing a [profit] sacrifice for the dominant undertaking”.¹⁹⁸ The EC Guidance thus eschews any strict requirement of below-cost pricing before a dominant firm’s loyalty rebate programme can violate art.82, a position consistent with 30 years of decisions by the ECJ.

The ECJ has long treated loyalty and fidelity discounts and rebates as a potential abuse of a dominant

position, in violation of art.82. *Hoffmann-LaRoche v Commission*¹⁹⁹ from 1979 and *Michelin I*²⁰⁰ from 1983 set forth the basic rationale and treatment.

In *Hoffmann-LaRoche*, the company used both traditional exclusive supply and requirements contracts, as well as loyalty rebates, with purchasers of its vitamin products in which it had dominance. The loyalty rebates were “first dollar” rebates, and generally applied cumulatively to the purchase of more than one kind of vitamin.

As discussed earlier, the ECJ concluded that the exclusive dealing and requirements contracts were an abuse of dominance by LaRoche and—applying a lens of exclusive dealing law to the practice—concluded likewise with regard to the loyalty rebates. The court identified three reasons for this conclusion:

- the loyalty rebate is “designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers”;
- it constituted price discrimination based on exclusivity; and
- it extended dominance “by means of a form of competition which is not based on the transaction effected and is therefore distorted”.²⁰¹

In *Michelin I*, the ECJ found that the tyre manufacturer had abused a dominant position by price discrimination through discounts. In order to maintain sales, Michelin devised a system of variable discounts based on annual sales tailored to each dealer. The court found that this discount system put pressure on the dealers to meet their targets, or risk a loss for the entire year. The court further found that Michelin’s large size prevented competitors from offering commensurate levels of discount, sufficient to entice year-end purchases from dealers. The court also pointed to the vagueness of Michelin’s programme as being calculated to coerce dealers into compliance.

The court concluded that Michelin’s loyalty discounts:

“. . . limit [. . .] the dealers’ choice of supplier and makes access to the market more difficult for competitors.

192 *Masimo Corp* at p.5.

193 *Masimo Corp* at p.5.

194 *Masimo Corp* at p.9. See also p.12 (dismissing claims of impermissible bundling under a s.2 analysis, and distinguishing *LePage’s* and *SmithKline v Eli Lilly*).

195 *Masimo Corp* at p.11.

196 DOJ Report, p.107.

197 EC Guidance, p.14, para.36.

198 EC Guidance, p.14, para.36.

199 *Hoffmann-LaRoche* [1979] E.C.R. 461.

200 *Michelin I* [1983] E.C.R. 3461.

201 *Hoffmann-LaRoche* [1979] E.C.R. 461 at [540]. See generally Eleanor M. Fox, “Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity and Fairness” (1986) 61 *Notre Dame Law Review* 981, 1006–1007, for an insightful discussion of *Hoffmann-LaRoche* and *Michelin I*.

Neither the wish to sell more nor the wish to spread production more evenly can justify such a restriction of the customer's freedom of choice and independence. The position of dependence in which dealers find themselves and which is created by the discount system in question, is not therefore based on any countervailing advantage which may be economically justified."²⁰²

Neither case attempted to identify the relationship of the discounts offered to the costs of production of LaRoche or Michelin.

More recently, in 1993, Virgin Atlantic Airways lodged a complaint under art.82 with the European Commission and, as discussed earlier, filed suit in the United States against various discounting practices of British Airways. As described later by the US Court of Appeals for the Second Circuit:

"Part of the way in which British Airways competes in the airline industry is through the use of incentive agreements entered into with travel agencies and corporate customers . . . As British Airways describes its own agreements, commissions or discounts are awarded when specified thresholds of sales are reached, but the agreements contain no set mandatory minimum . . . In some agreements, travel anywhere on British Airways will count towards the thresholds, while in other agreements certain routes are specified. 'Back-to-dollar-one' provisions allow the discount or rebate to apply retroactively to all sales under the agreement once a performance target is met."²⁰³

The European Commission focused its analysis on the British travel agent services market, concluding that British Airways was a necessary business partner to such agents. The Commission then concluded that British Airways' incentive payments were "loyalty discounts as condemned in the *Michelin I* and *Hoffmann-LaRoche* cases and abusive [price] discrimination between travel agents."²⁰⁴ The Commission stated that *Michelin I* and *Hoffmann-LaRoche*, "taken together, establish that a dominant company can only give rebates in return for efficiencies realized and not in return for loyalty."²⁰⁵

202 *Michelin* [1983] E.C.R. 3461 at [3518] [1983-1985 Transfer Binder] Common Market Report (CCH) para.14,031 at 14,521.

203 *Virgin Atl. Airways v British Airways*, 257 F.3d at 261.

204 Decision 2000/74 relating to a proceeding under art.82 of the EC Treaty (IV/D-2/34.780-*Virgin/British Airways*) [2000] OJ L30/1, para.96, available at <http://eur-lex.europa.eu/en/index.htm> [Accessed June 24, 2009]. See also *British Airways v Commission of the European Communities* (T-219/99) [2003] E.C.R. II-5917.

205 IV/D-2/34.780-*Virgin/British Airways*, para.101. See also *Michelin II* [2003] E.C.R. II-4071.

The European Commission had no trouble finding the incentive payments of British Airways to be loyalty-based, and struck them down, fining British Airways €6.8 million and banning the unlawful behaviour. The ECJ upheld the ruling and the fine in the spring of 2007.²⁰⁶

The EC Guidance's discussion of conditional rebates cites favourably *Michelin I*, *Michelin II* and the *British Airways* Commission Decision to support its analogy of the foreclosure effect of loyalty rebates to exclusive dealing, and to support its conclusion that:

"... retroactive rebates may foreclose the market significantly, as they may make it less attractive for customers to switch small amounts of demand to an alternative supplier, if this would lead to loss of the retroactive rebates."²⁰⁷

Nevertheless, the EC Guidance does not purport to condemn all loyalty rebates by dominant firms as per se violations of art.82. Rather, the Commission indicates that it will apply in modified form the price-cost guidelines that it has developed for predatory pricing allegations, on a case-by-case basis, to determine:

"... whether the rebate system is capable of hindering the expansion or entry even of as efficient competitors by making it more difficult for them to supply part of the requirements of individual customers."²⁰⁸

To implement this analysis, the Commission states:

"[T]he Commission will estimate what price a rival would have to offer in order to compensate the customer for the loss of the conditional rebate if the latter would switch part of its demand ('the relevant range') away from the dominant undertaking. The effective price that the rival will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate it loses by switching, calculated over the relevant range of sales and in the relevant period of time."²⁰⁹

The Commission then states that where this "effective price" is below the dominant firm's average avoidable cost, the rebate scheme will be condemned as "capable of

206 *British Airways Plc v Commission of the European Communities* (C-95/04 P) [2007] 4 C.M.L.R. See also *Irish Sugar Plc v Commission of the European Communities* (T-228/97) [1999] E.C.R. II-2969 at [213] (holding that a loyalty rebate "by an undertaking in a dominant position . . . constitutes an abuse of that dominant position").

207 EC Guidance, p.15, para.39.

208 EC Guidance, p.15, para.40 (as efficient competitor test), and pp.10-11, paras 22-26 (predatory pricing guidelines).

209 EC Guidance, p.15, para.40.

foreclosing even as efficient competitors”.²¹⁰ Where the effective price remains above the dominant firm’s long-run average incremental cost, “this would normally allow an equally efficient competitor to compete profitably notwithstanding the rebate”.²¹¹ Where the effective price falls between the dominant firm’s average avoidable cost (AAC) and long run average incremental cost (LRAIC), the Commission will investigate whether factors unique to the market at issue cause the rebate scheme to be capable of foreclosing equally efficient competitors.²¹²

The Commission’s modulated approach to analysing loyalty rebates, starting from a framework of concern over their foreclosure effects, but relying on a cost-based analysis to set boundaries around the ultimate inquiry, is a principled way to bring the more subjective reasoning behind *Hoffmann-LaRoche* and *Michelin I* and *II* into the modern era of cost-based analysis of predatory conduct. The Commission foreshadowed this approach in a 2005 DG Competition discussion paper,²¹³ but its formal adoption in the EC Guidance is an important instance of convergence in principle, if not in all details—loyalty rebates still carry substantially more risk of being struck down in the European Union than in the United States—with US law’s recent emphasis on cost-based analysis of predatory conduct.

The most recent major antitrust enforcement action of the European Commission, the May 13, 2009 imposition of a fine of €1.06 billion on Intel Corp, comes in a case in which loyalty rebates figured extensively. The Commission found that Intel had engaged in illegal actions to exclude rival chip-maker AMD from the market for certain central processing units. Among Intel’s unlawful actions were the use of loyalty rebates to computer manufacturers who purchased all or almost all (enough not to leave a viable share for AMD to compete over) of their needs from Intel. Intel was also found to have made direct payments to manufacturers if they would forego use of rival products. In addition to the record fine, the Commission enjoined the practices at issue.

In the memorandum announcing the *Intel* decision, the Commission cited *Hoffmann-LaRoche*, *Michelin I*, *British Airways* and *PLC Sugar* as the legal basis for

condemning exclusionary rebates.²¹⁴ The Commission stated:

“What is at stake here are loyalty or fidelity rebates, granted on condition that a customer buys all or most of its requirements from the dominant undertaking, thereby preventing that customer from purchasing from competitors.”

The Commission then reiterated that it “acts in the interests of consumers”.²¹⁵ While the Commission stated that the EC Guidance did not formally apply to the *Intel* case, which pre-existed publication of the Guidance document, it did take pains to note that:

“The Decision is nevertheless in line with the orientations set out in the guidance paper, and includes a rigorous, effects-based analysis which has demonstrated that Intel’s conduct has reduced consumer choice and limited innovation in the market.”²¹⁶

Finally, the Commission noted its close co-operation with the Federal Trade Commission on matters related to both agencies’ Intel investigations, a sign of a post-Bush administration thaw, and of hope for renewed efforts at convergence on single-firm conduct standards.

Conclusions

As a new American administration assumes power in 2009, multinational firms and the lawyers who counsel and litigate for them face sharply divergent treatment of sales and distribution policies by dominant firms in the United States and European Union. Exclusive dealing, refusals to deal, bundled rebates, loyalty rebates and tying all entail significantly greater risk of being found unlawfully exclusionary in Europe in violation of art.82 than they do in the United States under Sherman Act s.2. While the DOJ Report, as a summary of the outgoing views of the Bush Administration, firmly rejects any move towards convergence for the sake of convergence,²¹⁷ to the extent that the antitrust policies of emerging nations outside the United States and European Union serve as an intellectual barometer, recent trends in countries such as China and South Korea indicate greater sympathy for the EU

210 EC Guidance, p.16, para.43.

211 EC Guidance, p.16, para.42.

212 EC Guidance, p.16, para.43.

213 See European Commission, “DG Competition Discussion Paper”, para.162.

214 See MEMO/09/235, May 13, 2009, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/235> [Accessed July 9, 2009]. As this article went to press, the Commission’s official decision had not been published.

215 MEMO/09/235.

216 MEMO/09/235, p.2.

217 DOJ Report, pp.179–180.

authorities' subjective legal assessments of exclusionary impacts than for the cost-based analysis of exclusionary conduct in favour among US courts and commentators, obsessed with a fear of condemning pro-competitive "false positives". The Obama Administration, through Assistant Attorney General Varney, has now signalled an intent to reinvigorate s.2 enforcement efforts, which, one would conclude, will result in additional efforts—at least administratively—towards convergence. Whether the US judicial system will come along for the ride is a significant open question.

Larger firms already need to run separate sales and distribution programmes in the United States and European Union if they desire to pursue aggressive programmes of exclusive dealing, bundled discounts, loyalty rebates or tying. As a practical matter, however, functional convergence may be occurring as multinational firms increasingly eschew such tactics so as to maintain uniform, albeit more conservative, sales and distribution policies worldwide.²¹⁸

EU competition authorities continue to move towards an explicit acceptance of cost-based guidelines to assess exclusionary conduct by dominant firms. However, as the recent *Intel* decision demonstrates, the Commission

continues to adhere to the guidance of the chain of past decisions stretching from *Hoffmann-LaRoche* and *Michelin I* in the 1970s and 1980s through to the *Virgin Atlantic* and *Irish Sugar* decisions of the 1990s, with their fairly subjective assessments of the exclusionary effect of the practices at issue in each case.

For litigators representing multinational firms, the continuing uncertainty and divergence between US and EU law on sales and distribution practices means that there will be continued forum shopping between jurisdictions, in the hopes of obtaining a favourable (plaintiff or defence) ruling from one set of authorities before engaging the other. However, the divergence that has occurred most directly in the *Virgin Atlantic v British Airways* and *Microsoft* litigation, but also indirectly in the *Telefónica* and *linkLine* cases over whether a price squeeze can constitute an antitrust violation, can be expected to recur absent co-ordinated effort between the United States and European Union to agree to, and accept the results of, a system for adjudicating dominant firms' sales and distribution practices jointly, in one jurisdiction or the other.

218 The notable lack of interest of large US manufacturers in pursuing resale price maintenance strategies following the Supreme Court's decision to grant rule of reason treatment to them recently—see *Leegin Creative Leather Prods., Inc v PSKS, Inc*, 127 S. Ct. 2705 (2007)—may be indicative of a trend towards not pursuing sales and distribution strategies in the United States that still fall afoul of foreign antitrust law.