COMPETITION, NOT COMPETITORS: REAPPRAISING THE QUESTION OF MARKET POWER UNDER ARTICLE 82 EC

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This paper is an in–depth and comprehensive analysis of the current mechanism employed by the European competition authorities to assess whether an entity is in a dominant position for the purposes of Article 82. The author analyses in detail why the current method is conceptually and analytically flawed owing, inter alia, to the difficulties of drawing bright line rules with regard to the consequences of market share and the fluid nature of the indicators of dominance. The author suggests the "preliminary thoughts" put forward by the EU Competition Commissioner in a recent address may be the impetus for change needed to spark a review of this integral area of competition law and outlines a number of specific reforms which would go a long way towards addressing the current difficulties.

A CURRENT BACKGROUND

On September 23rd 2005, EU Competition Commissioner Neelie Kroes, in an address to the Fordham Corporate Law Institute in New York, put forward some "preliminary thoughts"[1] on a policy review of Article 82 EC. The move by the Commission to instigate a review of Article 82 policy follows recent changes in approach regarding the rules on cartels and price–fixing (under Article 81) and the Merger Regulation. It should also be seen in the light of the less interventionist approach of the US authorities in recent years (epitomised by the settlement of the case against Microsoft) and the EU's (now sadly lamented) ambition to become by 2010 "the world's leading knowledge–based economy".[2]

B CONTEXT: ECONOMIC INTRODUCTION

Antitrust (or "competition law" as it is often known outside its North American birthplace[3]) is a form of discipline aimed at maintaining the pluralism necessary to produce competition in market economies. It has been realised since before the time of Adam Smith in the 18th century that competition is economically desirable: it results in the efficient allocation of resources, and consequent increases in consumer welfare. In (static) economic

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[1] Neelie Kroes, "Preliminary Thoughts on Policy Review of Article 82" September 23rd, 2005; New York, USA. Available at http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML&aged=0&language=EN&guiLanguage=en. The Commission released a discussion paper on December 19th, 2005, available at http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf (both checked February 19th, 2006). A public consultation process will run until March 31st 2006.

[2] The so-called Lisbon agenda required progress by Member States of the EU towards certain economic goals. It is not thought likely that the objective quoted in the text will be achieved.

[3] Canada enacted the first modern antitrust statute in 1889 and the United States enacted the better-known Sherman Act in 1890.

theory, the model of perfect[4] competition represents a state of equilibrium in which, if a firm raises prices above marginal cost, it will instantly lose market share to its competitors (who are numerous) or to new firms, which will immediately enter the market and undercut the incumbent. In this model, the firm is a price–taker. It is important to note that perfect competition as such never exists in actual markets.[5] Some of its assumptions, such as perfect information and complete freedom of entry into and exit from the market are not consistent with real markets. (In even the most sophisticated modern market economies, information asymmetries are endemic and therefore so are problems of incentive compatibility.[6])

Consequently, it is not a very useful model on which to base policy.[7] In real markets it will sometimes occur that a firm is able to choose output and price levels so as to maximise profit,[8] without losing its market share to competitors.[9] Here the competitive mechanism has failed: The firm in question (though perhaps not a monopolist in strict terms) has significant market power, which has negative effects on consumer welfare and economic efficiency – mainly in the form of allocative inefficiency,[10] which results in a so–called deadweight welfare loss, which increases with the

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[4] In this context "perfect" equates to "complete": V.J.G. Power, *Competition Law and Practice*, (Butterworths, Dublin, 2001,1st Ed.) p.132 fn 69.

[5] F.A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Routledge & Kegan Paul, London, 1978) at p.182 decried the "absurdity … of starting the analysis with a situation in which all facts are … known. This is a state of affairs which economic theory curiously calls 'perfect competition'. It leaves no room whatever for the activity called competition, which is presumed to have already done its task."

[6] For an engaging discussion of these and other issues affecting how markets work, see J. Kay, *The Truth About Markets* (Allen Lane/Penguin, London, 2004). As Kay remarks, to note such asymmetries is not to attack the market economy *per se*, but to recognise the fact that the model of perfect competition is of little practical use.

[7] Klein (in Mathewson, Trebilcock and Walker, *The Law and Economics of Competition Policy* (Frazer Institute, Vancouver, B.C., Canada, 1990)) at p.421 "The model is merely an abstract economic construct, not a criteria for governmental intervention in the real world marketplace." Klein (at p. 422) compares the model with the assumption in physics of a frictionless world in order to illustrate the basic physical forces at work. Static models prevent dynamic analysis; they have no past and no future: C. Ahlborn, D.S. Evans, A.J. Padilla, 'Competition Policy in the New Economy: Is European Law Up to the Challenge?' ECLR 2001, p156 ff.

[8] The profit maximisation assumption - though readily acceptable to the layman - has been questioned by some economists who argue that firms sometimes have other motives. F.M. Scherer, *Industrial Market Structure and Economic Performance*, (Haughton Mifflin, Boston, Third Ed. 1989) p.52 concludes from empirical data that the assumption "at least provides a good first approximation in describing business behaviour". The debate was surveyed by Koch (1980, pp.56-8).

[9] See G. Stigler, *The Theory of Price* (New York: Macmillan,4th edition, 1987).

[10] Also relevant is Liebenstein's concept of 'X-inefficiency' ie internal slack resulting from the lack of incentives for cost reductions when firms enjoy insulated market positions: see Y. Bourdet, *Internationalization, market power & consumer welfare* (Routledge London, 1992) pp.11-12. On the inefficiencies caused by market power see W. G. Shepherd, *The Economics of Industrial Organisation* (Ridge Press/Random House, 1990, 3rd Ed.) pp. 126-132.

> deviation from the competitive equilibrium.[11] ... The law, then, has reason to control the conduct of a single firm, but only where the firm has passed a threshold of economic power.[12]

C INTRODUCING ARTICLE 82 EC

Article 82, to quote Ms. Kroes, "deals with unilateral conduct by an enterprise with market power which [conduct] restricts competition on the market". This essay concerns the European competition authorities' approach under Article 82 EC to discerning whether a firm has passed that "threshold of economic power", beyond which its conduct ought to be suspected of distorting competition. It is my contention that the Commission's approach to date has been analytically flawed and insufficiently flexible or focused. The ECJ has allowed questionable economic propositions become law[13] and has tended to come to its (sometimes unsatisfactory) conclusions by means of opaque reasoning. Definitions approach the status of incantations;[14] too often, findings are merely asserted and judgments lack desirably clear or persuasive reasons for the conclusions they decree. Moreover, no rigorous or methodical framework exists for assessing barriers to entry. Also, the question of whether undertakings should be allowed argue an efficiency defence, whereby it is suggested that if the particular market is looked at dynamically – rather than statically – consumers in fact stand to benefit from the efficiencies created by a dominant company, has not been addressed.

D MARKET POWER: PRESUPPOSITIONS

A determination of market dominance presupposes a number of things, which, though capable of distinct analysis, in practice influence whether an undertaking is found to be dominant. The concept of "market" has been defined as "a group of similar goods or services in a particular set of locations."[15] Any assessment of market power must begin with an attempt to delimit the relevant market. The ECJ approaches this question in terms of the relevant product and the relevant geographic area. If these are defined too narrowly, market power is easily overstated, leading to incorrect decisions and undertakings being unnecessarily sanctioned.[16] Correct analysis of the degree of competition in a market "crucially depends on how the boundaries of the

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[11] D.W. Carlton & J.M. Perloff, *Modern Industrial Organisation* (HarperCollins 1994, 2nd Ed.) p.105.
[12] S. Weatherill, *Cases and Materials on EU Law* (Oxford University Press, 2003 Sixth Ed.) p.543 (my emphasis).
[13] Van der Bergh, 'Modern industrial organization versus old-fashioned European competition Law', 1996 17 ECLR 75 p86 makes a similar comment.
[14] De Azevedo and Walker (2002, p.363): "[T]he concept of dominance is more often a mantra than an analytical framework."
[15] UK Office of Fair Trading Guidelines for Competition Assessment, cited by Kokkoris (2005, p.209).
[16] V. Korah, *An Introductory Guide to EC competition Law & Practise* (Hart Oxford, 2000, 7th Ed.) p.84 is of the view that "markets have been very narrowly defined ..." Fairburn (quoted by M. A. Utton, *Market Dominance and Antitrust Policy* (Brookfield, VT: E. Elgar Pub., 1995) p.79 has claimed that the EU authorities have tended to determine that an abuse has occurred and that then "the market grows or shrinks in such a way that the complained of firm can be identified as a dominant producer within it."

market … determine the presence and extent of competitive constraints."[17] Indeed, market definition is closely inter–related with the issue of market dominance in that two important sources of competitive constraints – substitutability of supply and of demand (the third being barriers to entry) – must be ascertained before the correct market can be identified. Indeed, Bellamy and Child[18] argue that the distinction between supply substitutability and barriers to entry is partly one of degree.

A determination of the question of market power also presupposes clear policy goals. The principal economic justification for antitrust enforcement is that it protects and increases consumer welfare by preventing allocative inefficiency. Some commentators, including the so–called Chicago school,[19] argue that efficiency should be the only goal of antitrust.[20] Others,[21] including the ECJ and the Commission, see antitrust as legitimately addressing wider socio–political goals. These mainly[22] relate to:

(i) Controlling and, if necessary, diffusing large concentrations of economic power considered undesirable in a democracy; and
(ii) Safeguarding small firms' ability to enter and survive in markets, notwithstanding any resultant costs to society in reduced efficiency.[23]
(iii) Maximising individual opportunity (as opposed to outcomes).

While the debate over these goals is on one level separate from inquiries under Article 82, I would argue that ill–conceived socio–political goals of fairness and equity have (adversely) affected the Court's assessment of market dominance. In her New York speech, Ms. Kroes commented that:

> In days gone by, "fairness" played a prominent role in Section 2 enforcement in a way that is no longer the case. I don't see why a similar development could not take place in Europe.

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[17] *Supra* n15 Kokkoris (2005, p.209).
[18] *European Community Law of Competition* (London : Sweet & Maxwell, 2001 5th Ed.) 9-021.
[19] So called because its chief advocates were based at Chicago University and followed the lead of Aaron Director. For an insider's look at the genesis and later influence of the Chicago school: see Bork (1993, pp.xi-xiv).
[20] This is Bork's view. R. Bork *The Antitrust Paradox: A Policy At War With Itself* (2nd edition, New York : Free Press, 1993) pp.81-89.
[21] See for example, J.H. Shenefield & I. R Stelzer, *The Antitrust Laws* (1996, 2nd Ed.) p10-13; N. Acocella, *The Foundations of Economic Policy: Values and Techniques* (Cambridge University Press,1998) pp.235-6.
[22] The Community authorities, uniquely, must ensure that anti-competitive behaviour does not negatively affect market integration. However, there is little reason why this objective should be inconsistent with the consumer welfare rationale: Van der Bergh *Supra* n13 p.75.
[23] This is sometimes referred to as the "efficiency-equity tradeoff" (eg D. Barnes and L. A. Stouts, *Economic foundations of regulation and antitrust law* (West Publishing Company, 1992) p.60 et seq. – though efficiency may suffer, an element of fairness or equity should be maintained in competition. Hirsch (Law and Economics 1988, quoted in T. Frazer and M. Waterson, (Prentice-Hall, 1994) p.7) has argued that "[b]esides questions of efficiency, issues of social justice and equity may also be relevant …" The Warren Supreme Court in the United States sought to protect "viable, small, locally owned businesses": *ibid* p.9. Korah has warned that the EU competition law is "based on conflicting objectives", namely efficiency and the protection of small businesses. *Supra* n16, p.102.

This sentiment is to be welcomed.

E MARKET POWER: THE TEST

In the context of the defined market, the Commission has adopted a two–stage method for assessing market dominance. It first calculates the undertaking's market share and then considers the competitive conditions in the market, in particular whether there are any barriers to entry[24] preventing (actual or potential) competitors from eroding the impugned undertaking's market share. Let us first set out the legal definition(s) of dominance:

> Undertakings are in a dominant position when they have the power to behave independently; this puts them in a position to act without taking into account their competitors, purchasers or suppliers. That is the position when, because of their share of the market, or because of their share of the market combined with the availability of technical knowledge, raw materials or capital, they have the power to determine prices or to control production or distribution for a significant part of the products in question.[25]

> The dominant position thus referred to ... relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective economic competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.[26]

F MARKET SHARES

The analysis of market shares involves examination of absolute and relative[27] levels and also of changes (if any) over time.[28] Market shares are generally measured by volume and value. Economists prefer the former method[29] and that is the one the Commission typically employs.[30] Though no one factor is determinative, market share has been treated as the most important. In the case of *Hoffman–La Roche*, the Court of Justice held, following *United Brands*,[31] that "the existence of very large market shares is

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[24] As Power (*Supra* n4) notes, the ECJ has never referred to barriers to entry by name – preferring the terminology "other factors indicating dominance" – and the Commission has used the term relatively recently.
[25] (Case 6/72) *Continental Can* [1973] ECR 215, para. II.3. (Commission decision, upheld by the ECJ). Reference to suppliers has been dropped since the Commission decision in the *A.B.G. case* [1977] 2 CMLR D1.
[26] (Case 27/76) *United Brands v Commission* [1978] ECR 207.
[27] This is an important point eg In *Virgin v British Airways* [2000] 4 CMLR 999, BA was found to be dominant at 39.7% because the market was very fragmented. See also Gottrup-Klim [1996] 4 CMLR 191, para. 48.
[28] *Supra* n18 Bellamy and Child pp9-040.
[29] C.W.F.Baden Fuller Article 86 EEC: Economic Analysis of the Existence of a Dominant Position, 1979, 4 ELR p433.
[30] Usually but not always: See, eg *Warner Lambert vs. Gillette* [1993] 5 CMLR 559, para. 22.
[31] (Case 27/76) *United Brands v Commission* [1978] ECR 207,

the most important [factor indicating dominance]."[32] The Court went on to hold (in effect) that an undertaking that has such a market share

> and holds it for some time ... without those having much smaller market shares [increasing theirs] ... is by virtue of that share in a position of strength which ... secures for it at the very least during relatively long periods, that freedom of action which is the special feature of a dominant position.[33]

This perhaps innocuous analysis was extended in the *Akzo* case,[34] to the effect that a 50% market share was "very large" for this purpose and that, in the absence of exceptional circumstances indicating the contrary, an undertaking which maintains such a market share "for some time" will be presumed to be dominant.[35] Such an undertaking will then, it seems, have the task of disproving that it is in a dominant position.[36] In *Hilti*,[37] the ECJ held a 70% market share to be conclusive proof of dominance. Jones and Sufrin rightly suggest that "the significance of [*Akzo*] isenormous."[38] While clearly a substantial market share is a prerequisite to market dominance, it is not clear why the Court has felt it can correctly presume dominance at 50%. This approach has accurately been described as "grossly out of line with economic theory."[39] Market share analysis is a necessary first step. It should not, however, remove the requirement for a full economic analysis of the competitive conditions prevailing in the relevant market. The point should be obvious: unless barriers to entry exist in a market, even a high market share may be "fragile"[40] in the face of potential new entrants to the market, should the undertaking with that share raise prices. An undertaking in such a scenario has no significant (ie worrisome) market power. A mere finding of a large market share says nothing to this possibility, ie that of potential competition. Also, the firm may simply have achieved its share of the market by the kind of legitimate means (ie superior efficiency) which competition law is supposed to promote.[41]

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[32] (Case 85/76) *Hoffman-La Roche and Co. AG v. Commission* [1979] ECR 461, para. 38.
[33] *Ibid* at para.41.
[34] (Case C-62/86) *Akzo Chemie BV v. Commission* [1991] ECR II-3359, para. 60.
[35] The Court did not use the word "presume" but later cases seem to have worked on the basis that the judgment implies a rebuttable presumption of dominance at 50% market share. See eg J. Faull and A. Nikpay, *The EC Law of Competition*(Oxford University Press,1999) Ch 3.36-3.37.
[36] Whish, *Competition Law* (Butterworths London,2003, 5th ed.) p.155; Jones and Sufrin, *Competition Law*, Texts, Cases & Materials (Oxford University Press, 2001) p. 300.
[37] (Case T-30-89) *Hilti AG v Commission* [1991] ECR II-1439, para.92.
[38] Jones & Sufrin, *supra* n36, p.300.
[39] La Cour and Mællgaard (2003, p. 132).
[40] P. Craig and G. de Burca, *EU Law: Text, Cases and Materials* (Oxford University Press, 2003, 3rd. ed) p.1003.
[41] For antitrust enforcement to avoid descending to the kind of counterproductive irony Chief Justice White warned against a century ago in *Standard Oil Co. of New Jersey v United States* 221 U.S. 1, 31 S Ct. 502 and Bork warns of in his treatise (1993, p.311), it is imperative to avoid the prosecution of companies who have garnered large market shares from "superior product, business acumen or historic accident" (*United States v. Grinnell Corp*. 384 US 563, 571) or from "skill, foresight and industry" (*United States v. Aluminium Company of America* 148 F.2d 416, 430 (2nd. Cir. 1945) – in other words through efficiency. Bock put the point

G OTHER FACTORS

The Article 82 cases shows that a large number of other factors (barriers to entry) have been held by the EC authorities to be indicative of dominance. Many of these are controversial among economists. It is axiomatic in economic commentary that "[a] firm may exercise market power in the long run only if barriers to new entry exist."[42] It is also fair to say that the European competition authorities have not formulated "a coherent and detailed framework for the analysis of barriers to entry ... the approach to dealing with questions of entry has tended to remain vague and *ad hoc*."[43]

Temporal considerations are important here too. The Commission and the ECJ use a "shorter time scale [on which] entry barriers are pervasive"[44] than would many economists. In the absence of substantial barriers to entry, market forces ensure that dominance vanishes in the long term.[45] Insufficient regard has been given to this temporal aspect in the cases. This is dangerous. It risks skewing the analysis and resulting in "competition law [having] the perverse effect of inhibiting the competitive process on the market."[46] The case law does not provide a clear definition of the concept of barrier to entry.[47] While economists do not agree on what constitutes an entry barrier, it is clear that the ECJ's conception of the phenomenon is wide. Stigler has suggested the following definition:

> [A barrier to entry is] a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry.[48]

Naturally, other definitions have been suggested exist,[49] but the following discussion will for practical purposes consider the EC jurisprudence on entry barriers from a point of view resembling Stigler's.

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well: "[T]here is a distinction between a monopolistic position that represents the destruction of competition and one that represents the flower of competition": *Supra* n20 pp59-60.

[42] D. Harbord, The Analysis of Barriers to Entry and Exit in UK Competition Policy 1995, 5 ECLR 319.

[43] *Ibid*. See also O. Arowolo, "Application of the Concept of Barriers to Entry Under Article 82 of the EC Treaty: Is there a Case for Review?" (2005) 26 ECLR 247.

[44] *Supra* n.16 p.90.

[45] Faull and Nikpay *supra* n7 ch.3.27; Baden Fuller *supra* n29; and Gyselen & Kyriazis, "Article 86 EEC: The Monopoly Power Measurement Issue Revisited" 1986 11 ELR 134 on this point.

[46] Jones and Sufrin *supra* n36, p.298.

[47] Faull and Nikpay, *supra* n45, ch.3.50.

[48] G.J. Stigler, *The Organisation of Industry* (University of Chicago, 1968) p.67.

[49] W.J.B. Baumol, J.C. Panzar & R.D. *Willig, Contestable Markets and the Theory of Industry Structure*, (Harcourt Brace Jovanovich, New York, 1988, Rev. Ed) p.282 offer a definition similar to Stigler's. J.S. Bain, *Barriers to New Competition: Their Character and Consequences in Manufacturing Industries* (Harvard University Press, 1956, 1st Ed.) defined barriers to entry as factors that allow established firms in an industry to earn supernormal factors without attracting entry. Bain – along with Mason – is usually described as one of the progenitors of the "Harvard school" of antitrust analysis, which held more factors to be entry barriers than the Chicagoans would. The Commission's analysis to date situates it

Entry barriers have been classed as either "structural" or "behavioural."[50] As the EC authorities have not invoked any such distinction, no more is said of it here. The following (in italics) are the barriers identified in the EC case law.

H LEGAL AND ADMINISTRATIVE BARRIERS

Probably the greatest source of monopoly is government. Statutory monopolisation of an industry or nationalisation (both notably less prevalent worldwide today, given the trend toward privatisation of nationally–owned enterprises over the last two decades) legally bar subsequent entry to a particular market. Exclusive access to finite resources, for example radio frequencies or airport slots[51] are obvious barriers to entry. Intellectual property rights – such as patents, trademark, trademarks and copyrights – can create entry barriers. The ECJ has held repeatedly however, that they will not necessarily confer dominance. It has concluded, quite correctly, that if the relevant market is wider than the protected product, then a legal monopoly will logically not automatically be an economic monopoly. Some forms of intellectual property rights are more likely than others to confer a dominant position.

Patents have been held several times to confer a dominant position, when there are no close substitutes.[52] Similar findings have been made in relation to copyrights.[53] On the other hand, a trademark is unlikely, in itself, to confer dominance. That said, it would likely be taken into account if it refers to a well–established brand. These are perhaps the least controversial factors.

I ECONOMIES OF SCALE

It is often argued that where the minimum efficient scale of production is large in relation to the defined relevant market, then a firm with a large

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philosophically speaking closer to Harvard than to Chicago. Richard Posner, Economic Analysis of Law (Aspen Law and Business, New York, 1998, 5th Ed.) p.338 defines a barrier to entry as "a condition that makes the long-run costs of a new entrant into a market higher than the long-run costs of the existing firms in the market …" but notes that the term is also used "as a synonym for heavy start-up costs", eg where the necessary capital, or advertising expenditure, is high.

[50] Other variations of terminology include 'innocent' and 'strategic.' Salop (1979) quoted by Geroski and Jacquemin (in A. Jacquemin & A. Sapir, *The European Internal Market: Trade and Competition Selected Readings* (Oxford University Press, 1989)) at ch.3.2; 'natural' and 'constructed' (Jacquemin, *The New Industrial Organisation* (Clarendon, Oxford, 1984) Ch.4 and, finally, 'exogenous' and 'endogenous': Shepherd *supra* n.10 p.273.

[51] See *Decca Navigator* [1990] 4 CMLR 627 and *British Midland-Aer Lingus* [1993] 4 CMLR 596 respectively.

[52] See for example *Tetra-Pak v Commission* [1994] ECR II-755; *Eurofix-Bauco (Hilti)* [1989] 4 CMLR 677, para. 69. Also, Korah [1980] 17 CMLR 395 at 406-7.

[53]] (Cases T-69 & 76/89) *RTE & ITP v Commission* [1991] ECR II-485; (Case T-70/89) *BBC v Commission* [1991] ECR II-535; and *Independent Television v Commission* [1991] ECR II-575. In (Case 22/78) *Hugin v Commission* [1979] ECR 1869 the Court was influenced in finding dominance by the fact that other firms were wary of breaching domestic copyright legislation.

market share should be viewed as dominant.[54] Lipczynski and Wilson say that "economies of scale barriers" exist "when entrants are forced to enter at a scale which puts them at a disadvantage to the incumbent firms."[55] The ECJ has taken the view that economies of scale operate as a barrier to entry.[56] Geroski and Jacquemin, based on an analysis of empirical data on scale economies, conclude that "scale economies do not seem to pose a substantial entry barrier."[57] Scale economies also fail Stigler's test, because they are not a differentially higher cost for new firms.[58] The question of scale economies is a prime example of the assumed goals of antitrust policy affecting the analysis. If protecting small firms *per se* and/or their ability to enter the market is taken as a relevant goal, then scale economies are likely to meet with blanket disapproval by antitrust enforcers. This, it is submitted, is a wrong approach.

Sunk costs of entry cannot be recovered if entry fails. They are said to create "an important asymmetry between an incumbent firm and the entrant."[59] The question of whether sunk costs act as entry barriers is important because a number of the other factors (eg advertising, technological development) that have been asserted as indicating dominance only operate as barriers if they are sunk costs. The ECJ's statements in this area[60] (typically of much of its reasoning in this area) are unclear in this regard.

Capital requirements have been taken by the EC authorities to constitute an entry barrier.[61] In opposition to this view, Robert Bork has argued that capital requirements "certainly inhibit entry – just as talent requirements for playing professional football exist and inhibit entry". Neither, he says "are in any sense artificial". Antitrust should not be concerned with capital requirements, he argues, because "capital suppliers take risks when the stakes are high".[62] It may be that there is a middle road between Bork's approach – which is implicit in his broader criticism of the use by antitrust authorities of structural entry barriers – and the overbearing one found in the EC case law. It is probably accurate to state that: "The existence of large capital requirements, of itself does not constitute an entry barrier, as long as there are well–developed capital markets which ensure that viable

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[54] This definition is taken from Baden Fuller: n.29.
[55] J. Lipczynski and J. Wilson, *Industrial Organisation: An analysis of competitive markets* (Harlow, England;New York:Financial Times/Prentice Hall,2001) p425. Bork *supra* n20 p.311) rejects the idea that economies of scale can constitute barriers to entry, calling them "a form of efficiency."
[56] *United Brands v Commission* (n.26).
[57] Geroski and Jacquemin (n.49) 3.2. Also, A. Jacquemin *The new industrial organization: market forces and strategic behavior* (Oxford:Clarendon, 1987) p98 and the sources footnoted there.
[58] *Supra* 49 p.67. By contrast the UK Office of Fair Trading in its 1994 paper "Barriers to entry and exit in competition policy" was of the view that, under modern industrial organisation theory, economies of scale can operate as entry barriers. Baumol and Blinder also class scale economies as entry barriers: W. J. Baumol, and A. S Blinder, *Economics: Principles and Policies* (Fort Worth : Dryden Press, 2000, 8th ed.) p.232.
[59] Jacquemin *supra* n57 p.100.
[60] Refer to paragraph 122 of the *United Brands* judgment (n.26).
[61] eg *La Roche* (n.32) at para.49 and *United Brands* (n.26) at para. 122. Also, *Continental Can* (n.25).
[62] Bork *supra* n20 at p.323.

projects can be financed."[63] But, where access to capital markets is uneven, "the capital requirements of building large plants may pose *substantial difficulties* for entrants."[64] The notion that capital requirements constitute the type of entry barrier with which Article 82 should be concerned is highly questionable. Worse, the EC authorities have not elaborated reasons why they indicate dominance. In a broader policy context, it would be better that action be taken to improve capital markets, where this is causing problems for competition.

Superior technology has been invoked in a number of cases as a barrier to entry, including *United Brands*, *Michelin* and *La Roche* on the basis it would appear that superior technology gives an undertaking a strategic advantage over would–be entrants.[65] There are very strong arguments against this line of reasoning. A technological lead is usually paid for through research and development and, in many instances, technology can be copied. Antitrust sanctions have the inherent capability to become a penalty for success and chill innovation. As the United States Supreme Court argued two years ago, the possession of (temporary) monopoly power and the concomitant profits are not only not *per se* illegitimate but are essential "[t]o safeguard the incentive to innovate."[66] Viewed in this light, the sanctions imposed on Microsoft by the European authorities (including a record €497 million fine) are a worrying development for the future of innovation in Europe. It is worth noting comments made on the day the EC decision in Microsoft was announced, by R. Hewitt Pate, assistant Attorney–General for Antitrust at the US Department of Justice:

> Imposing antitrust liability on the basis of product enhancements and imposing 'code removal' remedies may produce unintended consequences. Sound antitrust policy must avoid chilling innovation and competition even by 'dominant' companies. A contrary approach risks protecting competitors, not competition, in ways that may ultimately harm innovation and the consumers that benefit from it. It is significant that the US District Court considered and rejected a similar remedy in the US litigation.[67]

The only arguable basis on which investment in technology can be rationalised as an illegal entry barrier is if it is taken to constitute a sunk cost. Even then, as discussed above, the issue is not straightforward.

Vertical integration occurs when a firm owns more than one stage of production. Baden Fuller argued (as most economists would) that vertical integration, although it usually accompanies monopoly, does not raise barriers to entry.[68] Such subtle reasoning is not reflected in the EC

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[63] P. Massey and P. O'Hare, *Competition Law and Policy in Ireland* (Dublin : Oak Tree Press,1996) p23. This is Baden Fuller's view *supra* n29 p.438.
[64] Geroski and Jacquemin *supra* n57 at 3.2 (my emphasis).
[65] See Whish *supra* n.36 at p.158; Baumol and Blinder *supra* n.59 at p.232.
[66] *Verizon Communications v Law Offices of Curtis & Trinko* (2004) 540 U.S. 398 (Scalia J.).
[67] Quoted by A. Burnside and H. Crossley. Co-operation in competition: A new era? European Law Review 2005, 234 at p254.
[68] *Supra* n.29 p.440.

jurisprudence. On this point, the cases are open to the criticism, as Jones and Sufrin put it, that they "condemn an undertaking in respect of its efficiency."

J STRATEGIC ("ENTRY–DETERRING") CONDUCT

> From a policy point of view, it may be very difficult to separate [this] from mere 'efficiency.'[69]

This is a grey area. Strategic conduct doubtless takes place, but its effects often almost impossible to measure empirically. Clearly a threat of a price war in a market that requires high sunk costs of entry will provide a disincentive to enter the market. However the clarity of such a situation is the exception rather than the rule. Take the example of excess capacity. In the well–known *Alcoa* case,[70] the consistent carrying of excess capacity was held to constitute strategic entry–deterring conduct. The logic of this decision is, however, subject to one potentially fatal qualification ie the distinction between idle capacity (which is not a barrier to entry) and excess capacity. It is imperative that this distinction be made but it may be almost impossible to do so.[71]

The ECJ has on numerous occasions held conduct to be indicative of dominance. In *Michelin*, the Commission decided that the undertaking's price discrimination indicated dominance. The ECJ did not address the argument that this reasoning is circular. The Commission has continued to regard conduct as indicative of dominance: eg *Eurofix–Bauco (Hilti)*, *Akzo*. It is important to note that despite the clearly circular reasoning in *Michelin*, modern industrial organisation theory has shown that conduct is sometimes correctly indicative of dominance. Evidence of conduct may corroborate structural analysis but will likely be insufficient in itself to establish dominance.[72]

K EVIDENCE FROM PROFITABILITY

If market power is defined in terms of ability to earn supernormal profits without attracting entry,[73] then does it not follow that a dominant firm should earn such profits? It does not. The ECJ (very correctly) dismantled this argument in *United Brands*.[74] Profit levels of incumbents say nothing to the ability of other firms to enter the market. Also, losses are not necessarily a contra–indication of dominance. As a result, this factor can be disregarded in market dominance cases.

L PRODUCT DIFFERENTIATION

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[69] Utton *supra* n16 at p.31.
[70] *United States v. Aluminium Company of America* 148 F.2d 416, 430 (2nd. Cir. 1945).
[71] Baden Fuller *supra* n.28 at p.439.
[72] Wyatt and Dashwood, *European Union Law*, (London: Sweet & Maxwell, 2000,4th ed.) p.600.
[73] As by J. S. Bain, *Barriers to new competition: their character and consequences in manufacturing industries* (Cambridge, Mass. Harvard U.P.,1956) Admittedly, the above definition is of entry barriers but the point remains.
[74] (n.26, para. 126).

Often, related products have varying characteristics such that customers do not view them as perfectly substitutable.[75] Elasticity of demand is lower in such an industry. The most obvious method by which firms seek to differentiate their products is advertising. In Stigler's view, differentiation costs are an entry barrier only if they are higher for a new firm than an existing firm[76] – the particular market might bear no resemblance to when the incumbent entered. This is the rationale usually offered for treating advertising and other costs of differentiation as entry barriers, namely "the advantage of the first–mover". From this advantage, it is said, may flow customer preference and goodwill toward the incumbent's product[77] and may contribute to "switching costs"[78] for customers of the first–mover. The point made above, that the difference between entry barriers and supply substitutability is partly one of degree, is clear in this context. Bork describes the view that advertising costs operate as an entry barrier as "a fallacy."[79] There are two main arguments why advertising may be pro– competitive or neutral toward market power:

(a) Advertising is, at least in some cases, a powerful device by which new firms compete and succeed;
(b) and may just be a process of investing in consumer loyalty.[80]

Neither argument would trump an approach based on Stigler's reasoning and individual analysis of each case.

M CONCLUSION

It has been seen that the fluid and uncertain nature of the "factors indicating dominance" makes the question of market dominance under Article 82 a difficult one for jurists. But what would a better approach involve? De Azevedo and Walker argue that the real test for market power is "whether a firm can profitably price above the competitive price level."[81] However, finding the competitive price level is "notoriously difficult, both in theory and in practice."[82] This analytical wall is in reality insurmountable. For the foreseeable future, therefore, the Commission will necessarily be in the position of assessing market power indirectly. The following are the conclusions suggested by this writer's research on how better to approach the question of single–firm dominance under Article 82 EC:

(c) The Commission should look to the activity that is dynamic competition, rather than using static models suggesting competition as a state of affairs.

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[75] Carlton and Perloff (n.7), 112.
[76] *Supra* n.49 p.70.
[77] *Supra* n72 p.598.
[78] *Tetra Pak* [1988] OJ L272/37, para.37.
[79] *Supra* n.18 pp.314-320: 319.
[80] Taken from Shepherd *supra* (n.6) p.400.
[81] [2003] ECLR 640 at 641. In the economic jargon such an undertaking is not (or is no longer) subject to the discipline of the demand curve.
[82] *Ibid.*

(d) Efficiency should be the most relevant consideration.[83] Only integration has a basis as a valid separate goal.
(e) The ECJ should clarify and/or overrule the "special responsibility"[84] concept.
(f) The EC authorities should reduce their reliance on market share analysis as a means of inferring dominance. "[O]ther evidence of market power deserves equal standing with market share data."[85] The legal presumption of dominance at 50% is not justifiable. It is an economic anomaly apt to lead adjudicators astray.[86] Market share analysis should by no means negate the need for a full economic analysis. As Ms. Kroes said in her New York speech:

> A pure market share focus risks failing to take proper account of the degree to which competitors can constrain the behaviour of the allegedly dominant company.[87]

(g) The Commission must develop a policy of ensuring – and the ECJ demand – that empirical econometric evidence used in antitrust cases be clear and understandable.
(h) The examination of the central question of ease of entry (and exit) requires much greater use of the insights of modern industrial organisation (IO) economics than has been displayed to date. Ideally much of the jurisprudence on "factors indicating dominance" would be pruned back to resemble more the sceptical view advanced here. More realistically, judicial clarity as to why the factors that are held up as barriers to entry actually establish that the undertaking in question possesses significant market power would be a step forward.
(i) The competition authorities should bear in mind the following warning:

> The situation is delicate because that which might in reality be competitive may be condemned under Article [82] if carried out by a firm wrongly held to be dominant. If this happens, Article [82] will have the paradoxical effect of discouraging firms, fearful of being held to be dominant, from competing on the merits.[88]

N AFTERTHOUGHT

None of the above is intended to deny that antitrust presents considerable practical difficulties for jurists. Firstly, antitrust legislation and

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[83] Korah *supra* n16 at p.414.
[84] (Case 322/81) *Michelin v Commission* [1983] ECR 3461 para.57.
[85] Frazer and Waterson (n.22) p.41.
[86] See Utton *supra* n16 at p.82): "Antitrust authorities should guard against the seductive precision of a percentage". Cameron and Glick have argued that "the relationship between market share and market power [is] limited": F. S. McChesney (ed.), *Economic inputs, legal outputs: the role of economists in modern antitrust* (Chichester ; New York : Wiley, 1998)p.122. It is certainly the case in economic theory that market shares do not exist in a vacuum. See Landes and Posner, *Market Power in Antitrust Cases* 1981 94 HarvLR at p.947.
[87] *Supra* n.1.
[88] Competition Law 3rd. ed. p.268, quoted by M.M. Dabbah, *The Internationalisation of Anti-trust Policy* (Cambridge University Press,2003) p.45.

debate is framed in terms of economic concepts: competition, monopoly, barriers to entry and so on. Argument and adjudication in antitrust cases require (or at least should require) an economic analysis for which most lawyers – especially in this part of the world – have little or no formal training.[89]

Secondly, antitrust is a policy response intended to identify and correct the kind of 'market failure' just described, by restoring competitive conditions to the market. The main matter of contention in theoretical argument about market power – the speed with which unregulated markets are self–correcting – is one of policy ie if the forces of competition (fairly quickly) erode the inefficiencies that antitrust law seeks to avoid, it may be better to withhold any policy intervention.[90] To decide an antitrust case (such as on the question of market power) is to adjudicate on economic policy. The American scholar Hovenkamp put it thus: "[The measurement of market power] is as much art as science … and cannot avoid making controversial policy decisions."[91] Again, this is a typical subject matter for lawyers.

Thirdly, serious practical problems face those arguing and adjudicating in real cases in that it is impossible to calculate with certainty firms' marginal costs, as very little reliable information exists: Firms are unlikely to be willing to report their marginal costs.[92] Similar information problems exist to a lesser degree with regard to elasticities of supply and demand. An adjudicator can never also be sure whether firms in fact cannot enter the market or whether they have recourse to antitrust as a substitute for risk–taking.

Finally, to allow for such difficulties, however, is not to infer that the Article 82 jurisprudence on market power to pass any test of analytical rigour. It should be clear that it does not. It is to be hoped that Ms. Kroes' review is forthright in its recognition of the inadequacies highlighted above and that any resultant reform leads to a more elaborate and cautious approach to assessing market power under Article 82.

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[89] In the Australian context it has been argued that "[j]udges have had to come to grips with economic concepts not readily amenable to syllogistic reasoning and traditional fact finding processes": Justice R.S. French in Round (ed.) *The Australian Trade Practices Act 1974* (Dordrecht ; Boston : Kluwer Academic Publishers, c1994) 547. Frazer (*Monopoly, Competition and the Law* (Prentice Hall, 2nd ed.1992) p.xi) writes: "Lawyers trained in traditional legal scholarship are perhaps disquieted by the need to take account of economic principles … [b]ut this state of affairs is changing rapidly." Indeed, the problem as Korah pointed out is that the DGIV officials had little experience of competition law "when the Community precedents were being set": [1997] 2 ECLR 98 at 102 (my emphasis).
[90] *Supra* n16 p.27.
[91] See Mathewson et al. (ed.s) (n.2), p.46.
[92] Bourdet (ed.) (n.6) p.13.

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