Volume 2 | Number 2 | Autumn 2006

Competition Policy International

Review of O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*

Richard Whish

Published in *Competition Policy International* (print ISSN 1554-0189, online ISSN 1554-6853), Autumn 2006, Vol. 2, No. 2. *Competition Policy International* is a free publication. For additional copies, please visit cpi.esapience.org or call +1.617.844.1800.

Review of O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*

Richard Whish

The extent to which EC competition law has been modernized in the last decade is really quite breathtaking. In the first half of the 1990s, the realization that there was something seriously wrong with the way in which the rules were applied in practice began to become widely recognized, including within the European Commission itself. An obvious problem was that the rules were applied with insufficient attention both to economic principles and to quantitative techniques. A paper at the 1996 Fordham Conference by David Deacon, an economist at the Commission's Directorate General IV (as it then was), was a major event, when he effectively denounced the entire approach towards vertical agreements that historically had been taken by the Commission, based on formalism and excessive concentration on the wording of clauses in agreements, rather than the economic impact of those agreements. There followed the reform of the vertical restraints regime, which involved a major repositioning of the law and economics of the subject and which appears to have worked well in practice. Numerous policy initiatives followed—new block exemptions for research and development and specialization agreements, guidelines on horizontal cooperation, a new regime for technology transfer, the recast merger regulation, and the horizontal merger guidelines. Most radical of all, perhaps, was the Modernization Regulation, a product of the Commission being prepared to think the unthink-

The author is Professor of Law at King's College London.

able: to dismantle the notification system established in 1962 and in its place to create a Community-wide system of cooperation and power-sharing.

This brief history of the last decade of change leads to the obvious question: what about Article 82 of the EC Treaty, which prohibits the abuse of a dominant position? The most difficult question in competition law is probably to determine when the individual behavior of a firm with significant market power crosses the line from being legal to being illegal, with all the consequences that that entails (for example, the possibility of lengthy and intrusive investigation, fines, remedies, and damages actions). As the authors of this book frequently state, pro- and anticompetitive behavior often look the same: the price cut that may or may not be predatory, the combination of products that may or may not amount to an illegal tie-in. Depending on where the line is placed, the law may condemn perfectly competitive behavior and so chill competition; but unduly lenient treatment could lead to the exclusion of efficient competitors and, in some cases, to the market tipping in favor of the dominant firm, perhaps with long-term adverse consequences for consumer welfare. Whatever system of rules is adopted needs to take into account this problem of false negatives and false positives, or type I errors and type II errors.

Reforming Article 82 is no easy matter. The reforms of the law of agreements and mergers were all based on legislative changes—for example, the adoption of Regulation 2790/99 on vertical agreements and the recast merger regulation, Regulation 139/2004. These were accompanied by helpful guidelines, but it was the legislation in question that changed the substance of the law. The same is true, of course, of the Modernization Regulation. Article 82 cannot be changed by legislation—unless, of course, the Treaty itself were to be amended, which the events of recent years in France and the Netherlands suggest is all but impossible. It follows that reform of Article 82 is a rather different exercise, in which the existing case law of the Community Courts and the administrative behavior of the Commission need to be analyzed, with a view to a possible change in the Commission's prosecutorial practice and in the jurisprudence of the Courts. The Commission decided in 2004 to conduct such a review, and a huge amount of time and intellectual effort has been expended in trying to make sense of the existing law, its origins, purpose, deficiencies, and strengths. Draft guidelines may become available in 2006, although it is more likely that nothing will issue until 2007.

Many (though not all) commentators share the view that there are numerous problems with Article 82. Market definition—and more specifically the hypothetical monopolist (or the Small but Significant and Non-transitory Increase in Price (SSNIP)) test—is more appropriate for the prospective analysis of markets in merger cases than for the predominantly retrospective analysis of alleged infringements of Article 82: this is where the so-called "cellophane fallacy" is relevant. The threshold of dominance is not easy to determine, and perhaps there has been too much emphasis on market share figures (and a presumption of dominance at levels that are too low) rather than on an overall assessment of market

power, including barriers to entry, buyer power, and other factors indicating dominance. The question of whether there is a concept of super-dominance over and above mere dominance is also controversial, as has been the meaning of collective dominance. And then there is the really complex question: when is the behavior of a dominant firm abusive? There are numerous associated questions: for example, are there some types of conduct that are so obviously abusive that they should be illegal per se? Cartels are held to have as their object the restriction of competition under Article 81(1), so perhaps sales at less than cost should be illegal per se under Article 82 when effected by a dominant firm. However it is important to note that even an agreement by object could be saved by an efficiency argument under Article 81(3), provided that there is convincing evidence to support the claim;[1] and that there may be good reasons—that is to say reasons other than a strategic attempt to eliminate a rival—to explain even below-cost sales (start-up prices, end-of-season sales, etc.). However, if per se rules are inappropriate in Article 82 cases, it is necessary to determine what type of rule-of-reason analysis should be undertaken. If every case were to require the demonstration of adverse economic effects, to a high standard of proof, the enforcement of Article 82 might become all but impossible, which would bring one back to the problem of false negatives and false positives. In the post-Chicago era, there is widespread recognition that there is such a thing as abusive behavior, and that, therefore, Article 82 and its various progeny—in Europe and beyond—do have an important role to play in the maintenance of competitive markets. The challenge is to devise administrable rules that capture those types of conduct that may be harmful to welfare; to avoid rules that might inhibit perfectly reasonable types of competitive behavior, including, of course, most price cuts; to do so within a framework which gives a reasonable degree of certainty to companies, professional advisers, competition authorities, and to courts; and, furthermore, to do so in a way that blends together the respective roles of both economics and law. Fortunately, we have evolved to the point where there is now a widespread recognition that both economics and law—and therefore both economists and lawyers—have a part to play in designing a workable system of EC competition law. Legal rules about competition that fail to reflect sound economic principles are likely to be harmful to welfare, but economic theories without predictability or due process may also be. So too are turf wars between these two interest groups, who should be cooperating in order to achieve correct outcomes for clients and/or competition authorities.

This lengthy preamble brings us to Robert O'Donoghue and Jorge Padilla's *The Law and Economics of Article 82 EC*.[2] This book is an admirable achievement, and the authors are to be congratulated on producing a work of high class and great interest. It is handsomely produced, easy to read, and comprehensive in its scope.

1 *See e.g.*, Case T-17/93, Matra Hachette v. Commission, 1994 E.C.R. 595 (CFI).

2 Robert O'Donoghue & A. Jorge Padilla, The Law and Economics of Article 82 EC (2006).

Its publication now is timely, as we await the next stage of the Commission's review of Article 82. The authors anticipate, in their preface, a second edition "sooner rather than later," and this would be most welcome. Not only will the Commission probably provide guidance on the application of Article 82 in the fairly near future, but there are also a number of very important appeals in the pipeline before the Community Courts, including *Microsoft*, *Deutsche Telekom*, *Wanadoo*, *AstraZeneca*, and *British Airways*, in each of which very significant issues regarding the scope of Article 82 are under consideration. These cases provide the Courts with a great opportunity to develop the existing jurisprudence of Article 82. It is a well-known problem that the existing case law is fairly sparse, and that a lot of it is fairly old and somewhat formalistic; furthermore much of the past decisional practice of the Commission was concerned with the old economy, whereas most of the cases just mentioned are about innovation or information technology markets, where different economic analysis may be called for. A great deal of improvement could be achieved if the Community Courts were able, in these cases, to refine some of the earlier jurisprudence in the light of the debate that has taken place as a result of the Commission's review over the last couple of years. Much of that debate has been of a very high standard, with the interested parties—representing a number of different interest groups—genuinely trying to find workable solutions to the complex conundrums raised by Article 82. This book makes an enormous contribution to that debate. However, how the Courts will react to the challenge of the times remains to be seen. The European Court of First Instance's judgments in *Michelin II v. Commission* and *British Airways v. Commission*[3] do not seem to suggest much of an appetite for change. A second edition of this book in 2008 or early 2009, by when judgments in these cases are likely to have been handed down, would be most helpful.

All of the issues discussed above—and many others—are dealt with in *The Law and Economics of Article 82 EC*. It begins with some basic economics and a review of the scope of application of Article 82 and the procedural framework in which it is applied. Chapters on market definition and dominance, and an excellent one on the general concept of abuse, follow. The book then has detailed accounts of different types of abuse—predatory pricing, margin squeeze, exclusive dealing, refusal to deal, tying and bundling, exclusionary non-price abuses, abusive discrimination, excessive pricing, and other exploitative abuses. Each of these chapters is immensely useful, examining the arguments for and against condemnation of the practice in question, discussing the economic theories, and proposing workable solutions. The final two chapters deal with the concept of effect on trade between EU Member States and with remedies. There is no bibliography, which might be a useful addition to the second edition: there is ample reference to academic literature, speeches, and conference papers in the footnotes to the text, but it would be quite helpful to draw these together at some point.

3 Case T-203/01, Michelin II v. Commission, 2003 E.C.R. II-4071. Case T-219/99, British Airways v. Commission, 2003 E.C.R. II-5917.

Throughout the book, the law and economics are appropriately interwoven, as would be expected of a team representing both disciplines. The authors explicitly recognize the need for there to be rules that are administrable, with the consequence that a pure-effects approach would not be workable. They are opposed to per se rules and in favor of a so-called "structured rule of reason." They have produced a first-rate piece of work that will be highly influential in the years ahead, and that will be gratefully referred to by everyone interested in this fascinating but difficult topic. It is very highly recommended.