Patrick Rey

Université des Sciences sociales – Toulouse, France

On the Right Test for Exclusive Dealing

European University Institute
Robert Schuman Centre for Advanced Studies
2007 EU Competition Law and Policy Workshop/Proceedings

To be published in the following volume:
Claus-Dieter Ehlermann and Mel Marquis (eds.),
European Competition Law Annual 2007:
A Reformed Approach to Article 82 EC,
Hart Publishing, Oxford/Portland, Oregon (in preparation).

Please do not quote or circulate without permission
© Patrick Rey. All rights reserved.

12th Annual Competition Law and Policy Workshop
Robert Schuman Centre, 8-9 June 2007
EUI, Florence

Patrick Rey*

On the right test for exclusive dealing

8 June 2007

I. Background: Modernizing the enforcement of Article 82[1]

The EAGCP report argued in favour of an economics-based approach to Article 82 to match the reforms made in connection with Article 81 and merger control. In particular, we supported an effects-based rather than a form-based approach to competition policy. Such an effects-based approach should focus on the presence of anticompetitive effects that harm consumers, and it should be based on an examination of the economic reality of the markets in question; it should rely on sound economics, and it should be grounded on facts.

One of the main merits of an effects-based approach is that it avoids confusing the protection of competition with the protection of competitors. Competition is a means to an end, which is the satisfaction of consumer needs. It is a process that forces firms to be responsive to consumers' needs with respect to price, quality, variety, and so forth. Over time, it also acts as a selection mechanism, with more efficient firms replacing less efficient ones. The application of competition rules should therefore contribute to fostering this process and, in particular, it should place consumers at the heart of the analysis when agreements and conduct are assessed.

The Court of First Instance recalled this principle last September in a case involving a restriction on parallel trade,[2] an area in which the overriding principle of market integration had until then led the Commission (and the Community Courts) to follow a quasi-*per se* illegality approach. The CFI asserted that, although "parallel trade must be given a certain protection," this is the case only insofar as "it gives final consumers the advantages of effective competition in terms of supply or price".[3] The court then added:

---

[1] This introduction builds partly on the EAGCP report "An economic approach to Article 82", available at http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf. All errors or omissions are mine.
[2] Case T-168/01, *GlaxoSlmithKline Services Unlimlited v Commission,* judgment of 27 September 2006, not yet reported. The CFI's judgment has been appealed to the Court of Justice by the Commission, by GSK and by the interveners (EAEPC, Bundessverband ver Arzneimittell Importeure eV and Aseprofar). See Cases C-501/06, C-513/06, C-515/06 and C-519/06 (judgment pending).
[3] *Ibid.*, para. 121

> "Consequently, while it is accepted that an agreement intended to limit parallel trade must in principle be considered to have as its object the restriction of competition, that applies [only] in so far as the agreement may be presumed to deprive final consumers of those advantages."[4]

These observations, and the specific situation of the markets concerned, led the court to reject the qualification of a restriction by object in the application of Article 81(1), and to condemn the Commission for failing to review in detail the economic evidence and reasoning put forward by the parties when applying Article 81(3). Thus, the court rejected the traditional doctrinal stance that any measures restricting parallel trade must automatically be condemned as inimical to the single market. That is, even for parallel trade restrictions – one of the last two types of restrictions (together with minimum resale price maintenance) which are still blacklisted by the Commission after its review of the application of Article 81 to vertical agreements – the court is urging the Commission to take proper account of the actual or likely effects of those provisions on the markets.

The application of Article 82 to exclusive dealing and other potentially exclusionary practices should reflect the same principle: it should foster the competitive process as a means to enhance consumer welfare, rather than as a means to protect particular competitors, suppliers or intermediaries. This is all the more important – and unfortunately all the more difficult – given that, like most of the practices usually falling under Article 82, exclusive dealing can also, in many contexts, contribute to enhancing efficiency and foster innovation, and can thus serve rather than impede the competitive process. Thus, for example, a predator may try to get rid of a rival through a price war; and yet, one of the most often mentioned benefits of competition is precisely to exert downward pressure on prices. Thus, one cannot decide whether a "low" price is, by itself, a good thing or a bad thing. Similarly, tying is present everywhere: who is willing to build her or his own watch, car, etc., from assorted spare parts? Still, in specific circumstances, the same practice may serve anticompetitive purposes. Exclusive dealing is no exception, since, as further discussed below, it can be adopted for a series of efficiency-based reasons but can also be used in some situations to raise entry barriers and distort competition.

Given this basic ambiguity, a purely form-based approach is likely to either generate many false positives, which would impede the competitive process and thus harm consumers, or to miss those cases in which a practice is driven by anticompetitive purposes. In contrast, an effects-based approach ensures that competition rules will be enforced in an effective manner, without unduly thwarting pro-competitive strategies. By the same token, it generates consistency, since any specific practice is assessed in terms of its outcome, so that practices leading to the same result will be subject to a comparable treatment. This makes it more difficult for companies to circumvent competition policy constraints by playing around with different commercial practices.

---

[4] *Ibid.*

In terms of procedure, these considerations led us in the EAGCP to emphasize the need for a verifiable and consistent account of significant competitive harm, based on sound analysis and grounded on facts. This requirement is an essential step for distinguishing when a practice is indeed used for anticompetitive purposes rather than for pro-competitive, efficiency-enhancing, considerations. In particular, since many practices can have pro-competitive as well as anticompetitive effects, merely alluding to the possibility of an anticompetitive story is not sufficient. The required ingredients of the story must therefore be properly spelled out and shown to be present. While this first step may be perceived as somewhat constraining the competition authority's leeway, it is however necessary to ensure the consistency of the treatment of the various practices that can serve the same anticompetitive effects. It also contributes to enhancing predictability and, consequently, it contributes to providing legal certainty and making competition policy enforcement more effective.

The intrinsic ambiguity emphasized above also counsels in favour of a balanced approach, where potential pro- and anticompetitive effects are treated equally (although possibly assessed sequentially, starting with anticompetitive effects). This would contrast with an "efficiency defence" approach, since that approach would tend in practice to put more weight on anticompetitive effects.

Furthermore, in contrast to a form-based approach, an effects-based approach needs to put less weight on a separate verification of dominance, except as a screening device. The structural indicators traditionally used in the first steps of the procedure are merely proxies for dominance. They may provide an appropriate measure of market power in some instances, but not in others, in which case competition authorities' intervention is likely to be inappropriate. In contrast, if an effects-based approach provides evidence of an abuse which is only possible if the firm has a position of dominance, that can be regarded as more direct and reliable evidence of dominance. This is not to say that traditional considerations about the presence or absence of dominance become moot; rather, they become part of the procedure for establishing competitive harm resulting from the practice under investigation.

Likewise, an effects-based approach naturally captures the notion of "special responsibility" in the sense that certain practices would be prohibited when carried out by a dominant firm but would be lawful if practiced by smaller competitors. Focusing on the exclusionary effects of market practices gives a robust foundation to this notion, since certain practices will then be prohibited when they generate exclusionary effects, whereas they will be permitted as long as no competitive harm is involved.

Below I discuss the implications of relying on an effects-based approach in exclusive dealing cases.

II. An effects-based approach to exclusive dealing

As discussed above, when a complaint arises or when a competition authority suspects an abuse of dominance, the first question should be: what is the nature of the competitive harm involved in that case? Insisting on a consistent anticompetitive scenario brings several benefits.

First, while creative imagination can generate an infinite number of practices, there are not that many types of competitive harm and, for each one, the established toolbox of relevant, consistent arguments is relatively limited. Second, this requirement allows a clear identification of the key facts that need to be checked. Third, this approach guarantees a consistent treatment of alternative practices that could serve the same anticompetitive purpose. Thus, overall, identifying the nature of the competitive harm at stake can facilitate and speed up the investigation process while promoting high levels of predictability.

1. The Chicago critique: capability versus incentives

Since many practices can serve pro-competitive, efficiency-enhancing purposes as well as anticompetitive purposes, alluding to the mere possibility of an exclusionary effect is not sufficient. One needs to spell out a scenario in which the dominant firm would indeed have an incentive to engage in the practice for anticompetitive reasons. While this may seem a rather weak requirement (after all, why would a firm pass up an opportunity to enjoy extra market power?), this is not as obvious as it may sound.

Consider, for example, the case of a manufacturer supplying a good to a given customer, and denote by C the cost of producing the good and by S the surplus it gives the customer. Suppose further that a potential entrant may enter with a superior technology that yields a cost advantage, A. In the absence of entry, the incumbent manufacturer could exploit its market power and appropriate the full value of the good it produces (by charging a price equal to the customer's surplus, S) and thus earn a profit equal to $S - C$. If instead entry occurs, competition drives the price down to the incumbent's cost (which represents the best price it can offer), C. The customer then obtains a net surplus equal to $S - C$, while the entrant drives the less efficient incumbent out of the market and earns a profit reflecting its cost advantage, A. To prevent entry, the incumbent manufacturer could try to lock in the user by means of an exclusive dealing contract. However, anticipating that it will no longer benefit from competition if it signs an exclusive contract, the customer will not accept an exclusive contract at a price higher than C. It follows that such an exclusive dealing contract cannot be profitable for the manufacturer. That is, there is no exclusive dealing contract that would be both profitable for the manufacturer and acceptable to the customer.

This illustration is the essence of the so-called "Chicago critique" to many traditional exclusionary concerns; it generalizes to a variety of situations in which competing manufacturers deal with several customers or intermediaries such as retailers. Imposing, for example, a "single-branding" obligation on a retailer, thus preventing that retailer from carrying rival brands, certainly appears at first glance to benefit the manufacturer. By the same token, this benefit for the manufacturer would appear come at the expense of the retailer (at least in the absence of any negative externalities from one brand to another, as well as any diseconomies of scope that may arise from carrying multiple brands, and so forth) and at the expense of consumers. However, the retailer will be unwilling to accept the single-branding obligation without compensation.

The general thrust of the argument is that there is a single source of profit in the vertical structure as a whole, and moreover it "takes two to tango": therefore, a restraint that would exclude rivals but deprive contracting partners from the additional profits that they could derive from dealing with the rivals in question is unlikely ever to be adopted – unless, the critique goes, it generates some efficiency in the relationship, in which case antitrust authorities should not step in. In particular, a manufacturer that is tempted to impose exclusive dealing on its retailers, for example, must take into account the compensation it will have to grant to these retailers for their lost trade opportunities; put another way, it will have to take into account that it could extract better terms from these retailers if this loss of profitability were not imposed on them.

This critique has triggered economists to reconsider the foreclosure argument and to put it on firmer ground.[5] But it demonstrates the above-mentioned need to not only describe the possible effects of exclusive dealing on rivals, but moreover to spell out a consistent scenario explaining the anticompetitive rationale for the parties involved. That it to say, *capability* is not sufficient – all the more so since many practices can have both adverse effects and positive ones – due attention must be paid as well to the parties' incentives to engage in this or that practice.

This can be contrasted with some of the wording of the Discussion Paper that was circulated by DG Comp.[6] For example, paragraphs 58-59 refer to dominance, capability, incidence, network effects, scale/scope economies, and so on, and then the passage concludes that these factors will lead to the presumption of "likely effects". This basically switches the burden of proof to the defendant, who must then establish an "efficiency

[5] For example, Aghion and Bolton have shown that, in contexts such as that illustrated by the above simple example, the incumbent manufacturer could use semi-exclusive contracts (e.g., in the form of penalties for breach) to extract some of the entrant's efficiency gains, which can then be shared with the customer; furthermore, in the presence of uncertainty about the magnitude of these efficiency gains, the practice may well result in the exclusion of moderately more efficient rivals. See Philippe Aghion and Patrick Bolton, "Contracts as a Barrier to Entry", 77 *American Economic Review* 388 (1987).

[6] See *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, document released for public consultation in December 2005, available at the Commission's website: http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf.

defence", without any prior account made by the enforcer of any specific anticompetitive "story". This can be seen, for example, in paragraph 149 on single-branding obligations, which states:

> "Where the dominant company applies [such an] obligation to a … substantial part of the market, the Commission is likely to conclude that the obligation has a market distorting foreclosure effect and thus constitutes an abuse of the dominant position."

To be sure, one could interpret this sentence as suggesting that a proper reasoned analysis will indeed be likely when ascertaining the existence of a consistent exclusionary scenario; however, the same paragraph 149 then goes on to state:

> "In its assessment the Commission will not only look at the capability of the obligation, the degree of dominance and level of the tied market share, but will also take into account evidence why for particular reasons no market distorting foreclosure effect may result."

This tends to turn the analysis "upside down": once "capability" is established, rather than insisting on a consistent scenario of an actual anticompetitive effect, or studying possible alternative efficiency motivations, the paragraph merely asks whether there are "particular reasons" why the presumed market distorting effects would not be there.

2. Anticompetitive scenarios: vertical foreclosure

The kind of competitive harm usually involved in exclusive dealing cases corresponds to "vertical foreclosure", i.e. the exclusion of a competitor from a market that is vertically related to the market on which the incumbent firm is dominant. Usual features characterizing vertical foreclosure concerns are the following: (i) the firm in question controls a "bottleneck" facility, that is, an input that is necessary to operate in upstream or downstream markets; and (ii) the firm forecloses these vertically related markets by denying or otherwise limiting access to the bottleneck input. For example, the owner of infrastructure such as rail tracks or port facilities may deny access to this infrastructure to rail transportation service operators, thereby preventing them from providing their services in an effective way. In other cases, a key retailer may control access to consumers in a particular area; entering into an exclusive purchasing deal with a given manufacturer then *de facto* denies rivals' access to those consumers.

Exclusive dealing is only one among many other instruments in the "forecloser's toolbox". The bottleneck owner can, for example, integrate vertically into the target market and refuse to deal with potential competitors, as in the case of airlines' computerized

reservation systems. Alternatively, the forecloser may make the bottleneck input incompatible with competitors' products or technologies, or it may engage in tie-ins and refuse to unbundled the tied products. In the presence of economies of scope or scale requiring cooperation among firms in the same market, a dominant group of firms may put its competitors at a disadvantage by refusing to cooperate. In the absence of integration, and short of exclusive deals with given partners, the bottleneck owner can favour some competitors over others; this discrimination can be explicit, e.g., through individualized rebates, or implicit, e.g., through loyalty programmes or growth-based rebates that are formally available to all but tailored to the needs of specific users. Similarly, substantial quantity discounts may allow the survival of only a few customers; for instance, a large enough fixed fee can transform a potentially competitive downstream industry into a natural monopoly industry.

The traditional foreclosure concern is that the owner of the bottleneck input may leverage its market power in related markets. There again, however, the Chicago School critique applies: there is a single final market and thus only one profit to be reaped, which the dominant firm can secure by exerting its market power over the bottleneck. Therefore, the dominant firm has no incentive as such to distort competition in the other markets. On the contrary, imperfect competition in these markets may actually create distortions and reduce the profitability of the bottleneck, e.g., by reducing the variety or quality of the goods and services produced.

While the Chicago critique is correct, anticompetitive effects may still arise in specific circumstances.[7] For example, the bottleneck owner may deter competition in a vertically related market to protect its home market. This may happen in situations where entry in the home market is facilitated by competition in the other market.[8] Alternatively, a bottleneck owner may face a commitment problem, which makes it difficult for the firm to exercise its monopoly power without engaging in exclusionary practices: once it has sold access to a first downstream firm, it has an incentive to provide access to other firms as well, even though downstream competition will then reduce the first competitor's profits; this opportunistic behaviour will however be anticipated, and this reduces the bottleneck owner's profit. More generally, competition in downstream markets may "percolate" upstream and prevent the upstream bottleneck firm from making a profit. To address this commitment problem, the bottleneck owner may then wish to restrict or eliminate competition in the downstream markets through the types of practices mentioned above,[9] e.g., by entering into an exclusive dealing agreement with a particular firm – in order to

[7] For an overview of the modern economic literature on vertical and horizontal foreclosure, see Patrick Rey and Jean Tirole, "A Primer on Foreclosure", in Mark Armstrong and Robert Porter, eds., *Handbook of Industrial Organization*,3rd edition, North Holland, forthcoming 2007.

[8] See Dennis Carlton and Michael Waldman, "The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries", 33 *Rand Journal of Economics* 194 (2002).

[9] See Oliver Hart and Jean Tirole, "Vertical Integration and Market Foreclosure", *Brookings Papers on Economic Activity (Microeconomics)* 205 (1990).

restore its market power in the upstream market, rather than to *leverage* it in the downstream market. However, it should be kept in mind that here again, exclusive dealing constitutes only one of the possible options open to the owner of the bottleneck. In this context, it should be pointed out that banning discrimination would help the bottleneck owner to resist demands for selective price cuts, and that this would contribute to the maintenance of high prices. Vertical integration also constitutes an alternative solution to the upstream firm's commitment problem.

Interestingly, this line of reasoning suggests that foreclosure may be more of a concern when the bottleneck lies upstream rather than downstream, where "downstream" and "upstream" are defined with reference to the proximity of end users – the downstream segment being the closer to final consumers. Indeed, the opportunism described above applies when an upstream dominant firm deals with competing downstream firms. It does not arise when the dominant firm is in the downstream segment, at the direct interface with final consumers, since the firm then enjoys both monopoly power *vis-à-vis* consumers and monopsony power *vis-à-vis* its suppliers. The firm therefore does not need to distort competition in the upstream market in order to exert its market power (on both sides), and would instead presumably benefit from intense competition among its suppliers; any access restriction is then likely to be driven by efficiency reasons. By contrast, if the dominant firm is upstream and when it relies on downstream intermediaries to reach final consumers, then, as just discussed, competition for final consumers among these downstream intermediaries may dissipate profits and prevent the upstream bottleneck from fully exercising its market power; in that case, the upstream firm may indeed have an incentive to distort or limit competition in the downstream market. This "scenario" may therefore support foreclosure concerns in the case of access to an essential facility, but not when, say, a key retailer or travel agency enters into special agreements with particular product suppliers or service providers.

Another possible scenario relies on buyers' coordination problems",[10] in situations where new entrants need a minimum share of the market in order to operate a viable business (e.g., because of large fixed costs). Suppose, for example, that there are multiple buyers and that an incumbent supplier offers each buyer a (small) rebate in exchange for exclusive dealing. A buyer will accept this offer if the rebate is larger than his expected loss due to the reduced likelihood of entry, but typically he will not take into account the negative externality on the other buyers' resulting restriction of choices. If buyers cannot coordinate their behaviour, entry might then be deterred even though it would benefit buyers as a whole. Exclusive dealing contracts can thus be anticompetitive when buyer coordination is needed. While this line of reasoning was initially developed in the contexts where the "buyers" were not competing against each other, it is tempting to apply it as well

---

[10] See, e.g., Aghion and Bolton, *supra* note 5; Eric B. Rasmussen, J. Mark Ramseyer and John S. Wiley, "Naked Exclusion", in 81 *American Economic Review* 1137 (1991); Ilya Segal and Michael Whinston, "Naked Exclusion: Comment", 90(1) *American Economic Review* 296 (2000).

to situations where the “buyers” are themselves competing in a downstream market, as in the case of retailers that may carry one or several brands. Interestingly, however, Fumagalli and Motta have stressed that, in such a case, there may be less of a need for buyer “coordination” when one retailer, for example, is able on its own to cover a substantial part of the market when being offered competitive wholesale conditions.[11] In that case, the incumbent would have to lock in most if not all of the retailers, and then the original Chicago critique applies again.

Spelling out a precise anticompetitive scenario helps to identify the required key ingredients. For example, the last scenario just described requires a number of facts:

- there must be many small buyers;
- there must be no communication or coordination between them on procurement of inputs. This would not be verified where, for instance, supermarkets delegate the power of listing products to a centralized agency and even negotiate the transaction on aggregate sales with this agency;
- “buyers” must not be competing against each other, or else they must be unable to increase much their respective market shares even when being offered a competitive advantage over rival retailers; and
- on the supply side, the magnitude of the efficient size for an entrant should also be evaluated. If it appears that a competitor can enter the market even if it sells only a small number of units, for instance because the required fixed costs are small, then exclusive dealing contracts are unlikely to prevent entry. On the other hand, exclusive dealing contracts are more likely to be anticompetitive where there are large fixed costs.

As can be seen from this example, spelling out the specific anticompetitive scenario not only permits a consistency check, it also helps to identify those particular instances where there is a serious risk of consumer harm.

In the various anticompetitive scenarios described above, the intervention of competition authorities may foster competition in the related markets and thus in the industry as a whole. This intervention can benefit consumers, e.g., through lower prices in the short run or through higher rates of innovation in the related markets in the long run. However, such intervention also affects the bottleneck owner’s rate of return. In the long run it may thus have an adverse impact on that firm’s incentives to invest or innovate, and

[11] See Chiara Fumagalli and Massimo Motta, “Buyers’ coordination, exclusive dealing and entry, when buyers compete”, London CEPR Discussion Paper (2002) and forthcoming, *American Economic Review*.

it may, for example, impede the development of key infrastructure. Competition authorities may therefore wish to refrain from prosecuting foreclosure conduct when it compensates the bottleneck owner for its investment or innovative activity. This is similar to the logic underlying the patent system: prospective licensees are not willing to pay much for the use of a new technology if they know that the licensor will "flood the market" with similar licences; therefore, mandating access through additional licences would reduce the innovator's profitability and consequently its incentives to invest in R&D.

The source of the bottleneck owner's market power may thus help to determine when or whether a competition authority should intervene. In particular, intervention aimed at preventing foreclosure, and consequently at reducing the bottleneck owner's profit, seems more warranted when the firm's market power derives from increasing returns to scale or scope (as may be the case with respect to a bridge, a stadium, or a news agency), or when it derives from a historical accident, than when it results from an innovative strategy.

3. Pro-competitive motivations

Competition authorities should also verify whether there are efficiency defences justifying the exclusive dealing arrangement. In particular, even when exclusive dealing generates anticompetitive effects, it may still give rise to countervailing efficiencies. Competition authorities should intervene only if this possibility can be ruled out.

Various lines of efficiency defences can be put forward for exclusive dealing arrangements. For example:

- *Free-riding on the investment of the dominant firm*. This argument is a variant of the argument described above of forbearance as a reward to investment, and it is basically linked to the need of the dominant firm to recoup marketing or similar expenses that benefit its partners.

- *Protecting reputation*. A related argument stems from the fear of being associated with inferior products or services which might hurt the firm's reputation. Misbehaviour by a rival may spoil the reputation of the dominant firm as well as that of its other partners.

- *Relationship-specific investments*. A manufacturer may, for example, refrain from investing in information and training for its distributors if this investment can then be used to benefit its rivals. The manufacturer may then insist on an exclusive arrangement in order to protect such an investment. Similarly, a manufacturer may adopt an exclusivity clause in order to promote "retailer loyalty", i.e. to encourage the retailer to tailor its promotional efforts towards the manufacturer's product.

- *Excessive entry*. In the absence of foreclosure, excessive entry might occur, generating an inefficient duplication of fixed costs, due to so-called "business-stealing" effects. When contemplating whether to enter the relevant market, a firm does not take into account the fact that part of its prospective customers will simply switch away from existing products; the revenue generated by the entrant's product may thus exceed its social value.[12] However, the validity of this argument may be difficult to assess in practice, since the characterization of the socially optimal number of firms is generally a complex matter.

- *More intense head-to-head competition*. In addition to the foregoing efficiency considerations, exclusive dealing may well lead rivals to compete more intensely against each other. In particular, competition "for the market" may lead a manufacturer to grant better wholesale terms to retailers, which are then at least partly passed on to consumers. Thus, one should not necessarily conclude, from the mere observation of actual market shares, that competition is not working in the interest of end users. In addition, competition "in the market" between rival manufacturers, each engaged in exclusive deals with different retail networks, may well be more effective in disciplining firms and contributing to consumer welfare than when rival brands are carried by a same retailer, which can act as a "common agent" for supposedly competing manufacturers.

There again, the diversity of arguments and of cases in which they may or may not be relevant calls for an assessment based on the economic reality of the market in which exclusive dealing takes place.

III. Concluding remarks

To sum up, there is a basic ambiguity regarding most of the practices usually involved in Article 82 cases. This ambiguity calls for an effects-based approach that balances pro- and anticompetitive effects. Such an approach requires as a first step a consistent story of anticompetitive behaviour resulting in consumer harm, based on sound reasoning and supported by the facts of the case. Spelling out a coherent story, which should moreover distinguish between mere capability and incentives to engage in anticompetitive conduct, ensures consistent enforcement.

This approach can be contrasted with the analysis proposed in DG Competition's Discussion Paper. For example, when dealing with all-units conditional rebates, the Discussion Paper quickly focuses on the so-called "required share", defined as the "share of customers' requirements on average the entrant at least should capture so that the

[12] For detailed analyses of this issue, see Steven Salop, "Monopolistic Competition with Outside Goods", 10 *Bell Journal of Economics* 141 (1979); N. Gregory Mankiw and Michael D. Whinston, "Free Entry and Social Inefficiency", 17(1) *Rand Journal of Economics* 48 (1986).

effective price is at least as high as the average total cost of the dominant company".[13] This prompts several queries. For example, this presumes that the most effective way for entering the market consists of seeking a comparable share of the various consumers' orders. Yet in practice, one would expect a new entrant to "target" specific customers (e.g., those that are more inclined to be interested in the entrant's alternative offer), rather than trying to supply all of them uniformly; in that case, the targeted customers would be more likely to meet the "required share", while the other ones, for which the threshold might not be met, would be less relevant anyway. In addition, the focus on "average total cost", rather than the alternative cost measures suggested for other practices, raises some concern about the overall consistency of the proposed approach across practices that may well be used interchangeably for similar anticompetitive purposes. But more importantly, this proposed approach bypasses any account of why the firm adopted such rebate schemes in the first place. The discussion focuses on "capability", illustrated by methodological boxes on how to measure required shares, without discussing whether or how the firm could and would successfully offer these rebates for anticompetitive purposes.

The Discussion Paper then proposes that the Commission should assess the "commercially viable share" that an efficient competitor or entrant can be expected to supply.[14] This again calls into question the presumed "entry scenario", which appears to rely on more or less uniform supply of the various customers. In addition, no mention is made of a need to explain the reasons why an efficient competitor could not achieve the same share as the incumbent. This reinforces the risk of confusion between protecting competition, for the benefit of consumers, and protecting competitors. Not only should these reasons be accounted for, one would moreover need to check their consistency with a coherent story of anticompetitive harm.

---

[13] See DG Discussion Paper, *supra* note 6, at para. 155: "As a first step the Commission will endeavour to calculate how big a share of customers' requirements on average the entrant at least should capture so that the effective price is at least as high as the average total cost of the dominant company ("the required share"). [...] In case the shares of the customers' requirements purchased from actual rivals are smaller than the required share, the rebate scheme is likely to have a foreclosure effect where there is in addition no indication that these rivals are less efficient."

[14] See *ibid.,* para. 156: "[T]he Commission will endeavour to assess the commercially viable share an efficient competitor or entrant can be expected to supply and to compare this with the required share…. Where the required share exceeds the commercially viable share the rebate system is likely to have a foreclosure effect which reduces competition as the effective price that results from the rebate system over this commercially viable share will be below the average total cost of the dominant company. "