NELLCO
NELLCO Legal Scholarship Repository

New York University Law and Economics Working Papers

New York University School of Law

12-31-2007

The Elusive Antitrust Standard on Bundling in Europe and in the United States at the Aftermath of the Microsoft Cases

Nicholas Economides
New York University, economides@stern.nyu.edu

Ioannis Lianos
Faculty of Laws, University College London, lianos@ucl.ac.uk

Follow this and additional works at: http://lsr.nellco.org/nyu_lewp

Part of the Antitrust and Trade Regulation Commons, Computer Law Commons, Economics Commons, Law and Economics Commons, and the Science and Technology Commons

Recommended Citation
Economides, Nicholas and Lianos, Ioannis, "The Elusive Antitrust Standard on Bundling in Europe and in the United States at the Aftermath of the Microsoft Cases" (2007). *New York University Law and Economics Working Papers.* Paper 115.
http://lsr.nellco.org/nyu_lewp/115

This Article is brought to you for free and open access by the New York University School of Law at NELLCO Legal Scholarship Repository. It has been accepted for inclusion in New York University Law and Economics Working Papers by an authorized administrator of NELLCO Legal Scholarship Repository. For more information, please contact tracy.thompson@nellco.org.

The Elusive Antitrust Standard on Bundling in Europe and in the United States at the Aftermath of the Microsoft Cases*

Nicholas Economides** and Ioannis Lianos***

December 31, 2007

Abstract

We analyze and contrast the US and EU antitrust standards on mixed bundling and tying. We apply our analysis to the US and EU cases against Microsoft on the issue of tying new products (Internet Explorer in the US, and Windows Media Player in the EU) with Windows as well as to cases brought in Europe and in the United States on bundling discounts. We conclude that there are differences between the EC and US antitrust law on the choice of the relevant analogy for bundled rebates (predatory price standard or foreclosure standard) and the implementation of the distinct product and coercion test for tying practices. The second important difference between the two jurisdictions concerns the interpretation of the requirement of anticompetitive foreclosure. It seems to us that in Europe, consumer detriment is found easily and it is not always a requirement for the application of Article 82, or at least that the standard of proof of a consumer detriment for tying cases is lower than in the US.

Key words: tying, bundling, foreclosure, requirement contracts, monopolization, Microsoft, predatory pricing

JEL Classification: K12, L12, L13, L41, L42, L63

* We thank Valentine Korah, Florian Wagner von Papp and the participants of the conference "The End of the Microsoft Antitrust Case?" at the Northwestern University School of Law for helpful comments on earlier drafts. The co-authors are responsible for any errors or omissions.

** Professor of Economics, Stern School of Business, New York University, visiting University of California, Berkeley, Haas School of Business; Executive Director, NET Institute, http://www.stern.nyu.edu/networks/, economides@stern.nyu.edu, http://www.NETinst.org/.

*** Lecturer, University College London, Faculty of Laws, visiting professor, CEIPI, University of Strasbourg, Associate Executive Director, Jevons Institute of Competition Law and Economics, http://www.ucl.ac.uk/laws/jevons/, i.lianos@ucl.ac.uk.

Contents

1. Introduction 3
2. Different analogies in the antitrust standards applied to bundling 4
2.1 The US antitrust standard for bundled discounts 5
2.1.1 The "modified predatory pricing rule approach" to bundling 6
2.1.2 "The anticompetitive foreclosure approach" to bundling 11
2.2. The EU antitrust standard for bundled discounts 14
2.2.1. The approach of the European Courts: the foreclosure standard 14
2.2.2. The Commission's Staff Discussion Paper on Article 82: a mixed predatory/foreclosure approach 18
2.3 Distinguishing between bundled discounts and tying: the role of the distinct products and the "coercion" tests 21
2.3.1. The separate products test. What constitutes a distinct (separate) product? 22
2.3.2. The "coercion" test 28
3. The different meaning of anticompetitive foreclosure in US antitrust and EC competition law 32
3.1. Foreclosure and the nature of bundling: a quasi-per se rule or a more flexible standard? 32
3.2. When does the foreclosure of a competitor produce anticompetitive effects? . 41
4. Preserving consumer choice: a difference in emphasis and adequate remedies 47
5. Conclusion 49

The Elusive Antitrust Standard on Bundling in Europe and in the United States at the Aftermath of the Microsoft Cases

1. Introduction

Allegations of anti-competitive tying and bundling were significant parts of the antitrust cases against Microsoft in the United States and the European Communities. Interestingly, the two cases, which had many similarities in their tying and bundling allegations, had opposite final resolutions. In the United States, the Department of Justice decided not to pursue the bundling aspect of the case (between Windows and Internet Explorer) after the DC Court of Appeals reversed the finding of a *per se* violation of the District Court and remanded the issue with instructions that it could be pursued only under a rule of reason standard.[1] In contrast, in the EU, the Commission found that Microsoft was liable for bundling Windows with Windows Media Player (WMP) and required Microsoft to produce a Windows version without WMP, in addition to the bundled version that Microsoft offered on the market.[2] Microsoft was not allowed to offer any technological, commercial or contractual term or inducement to make the bundled version the more attractive, and a monitoring trustee was required to ensure that the unbundled version of Windows works as well as the bundled version.[3] The Grand Chamber of the Court of First Instance of the European Communities (hereinafter CFI) confirmed the Commission's decision, although it annulled the part of the Commission's decision that imposed a monitoring mechanism for the implementation of the decision by a monitoring trustee, at the cost of Microsoft.[4] This sharp difference in the application of competition law arises because of different treatment of tying, bundling, single-product and multi-product (loyalty) discounts, foreclosure and exclusion in the two jurisdictions. This article discusses and contrasts antitrust and competition policy enforcement on these issues in the US and the EU in light of recent advances in economic analysis.

---

[1] *United States v. Microsoft Corp.,* 253 F.3d 34 (D.C. Cir. 2001) (hereinafter *DC Circuit*); On the US Microsoft case, see, among others, Nicholas Economides, *The Microsoft Antitrust Case*, 1(1) JOURNAL OF INDUSTRY, COMPETITION AND TRADE 7 (2001), lead article. Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/Microsoft_Antitrust.final.pdf ; Nicholas Economides, *The Microsoft Antitrust Case: Rejoinder*, 1(1) JOURNAL OF INDUSTRY, COMPETITION AND TRADE 71-79 (2001). Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/Microsoft_Antitrust.Rejoinder.pdf ; Nicholas Economides, *United States v. Microsoft: A Failure of Antitrust in the New Economy*, Symposium: Cyber Rights, Protection, and Markets, *UWLA Law Review*, (April 2001), lead article. Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/UWLA.pdf ; David S. Evans, Albert L. Nichols & Richard Schmalensee, *US v. Microsoft: Did Consumers Win?* (NBER Working Paper No. 11727, October 2005), NBER: http://www.nber.org/papers/w11727; Harry First & Andrew I. Gavil, *Re-framing Windows: The Durable Meaning of the Microsoft Antitrust Litigation*, 2006 UTAH L. REV. 679; WILLIAM H. PAGE & JOHN E. LOPATKA, THE MICROSOFT CASE – ANTITRUST, HIGH TECHNOLOGY, AND CONSUMER WELFARE (2007); A. Douglas Melamed & Daniel L. Rubinfeld, *US v. Microsoft: Lessons Learned and Issues Raised*, in ANTITRUST STORIES 287 (Eleanor M. Fox & Daniel A. Crane ed., 2007).

[2] EC Commission, *Microsoft* (hereinafter *Microsoft*) [2004], [2005] 4 CMLR 965.

[3] Id. para 1011-1012.

[4] Case T-201/04 *Microsoft v. Commission* [2007] 5 CMLR 846, para 1278. Microsoft did not appeal the decision of the CFI to the European Court of Justice (hereinafter ECJ).

We will first examine the different analogies in the antitrust standards applied to bundling in both jurisdictions and we will analyze how the different steps of the antitrust assessment of tying practices fit with the choice of a different analogy. We will then focus on the important differences that exist between EC competition law and US antitrust law with regard to the finding of anticompetitive foreclosure by a dominant firm. This part will show that although both systems of antitrust law aim to protect competition for the benefit of consumers, there are important differences in the way consumer harm is assessed in each jurisdiction. The final part will consider the remedies imposed and their effectiveness in preserving consumer choice, which seems to be the underlying objective of competition law in Europe and in the United States.

2. Different analogies in the antitrust standards applied to bundling

The area of bundled discounts has certainly been one of the most controversial issues in recent competition law enforcement against exclusionary anticompetitive practices of dominant firms.[5] Much discussion revolved on the choice of the right analogy for this category of practices in relation to other practices which may produce similar exclusionary effect, such as exclusive dealing, predatory pricing, and tying. Although one may consider that this quest for the "right" analogy asks the wrong question, as the real issue is the effect of these practices on consumer welfare,[6] which relates to the circumstances of each case, it is clear that the choice of a different analogy may explain much of the divergence between the antitrust standards on these practices in the US and in the EU.

---

[5] See, Michael Whinston, *Tying, Foreclosure, and Exclusio*n, 80 AM. ECON. REV. 838 (1990); Barry Nalebuff, *Bundling as an Entry Barrier*, 119 QUARTERLY JOURNAL OF ECONOMICS 159 (2004); Bruce Kobayashi, *Does Economics provide a Reliable Guide to Regulating Commodity Bundling By Firms? A Survey of the Economics Literature*, 1 JOCLEC 707 (2005); Bruce Kobayashi, *The Economics of Loyalty Discounts and Antitrust Law in the United States*, 1 COMPETITION POLICY INT'L 115 (2005); Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688 (2005); Daniel Rubinfeld, *3M Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243 (2005); David Spector, *Loyalty Rebates: An Assessment of Competition Concerns and a Proposed Structured Rule of Reason*, 1 COMPETITION POLICY INT'L 89 (2005); Daniel A. Crane, *Multiproduct Discounting: A Myth of Nonprice Predation*, 72 U. CHI. L. REV. 27 (2005); Kai-Uwe Kühn, Robert Stillman & Christina Caffara, *Economic Theories of Bundling and their Policy Implications in Abuse Cases: An Assessment in Light of the Microsoft* Case, 1 EUROPEAN COMP. J. 85 (2005); Christian Ahlborn & David Bailey, Discounts, Rebates and Selective Pricing by Dominant Firms: A Trans-Atlantic Comparison, *in* HANDBOOK OF RESEARCH IN TRANSATLANTIC ANTITRUST, 195 (Philip Marsden ed. 2006); Herbert Hovenkamp, *Discounts and Exclusion*, 2006 UTAH L. REV. 841; Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts*?, 2006 UTAH L. REV. 863; Frank P. Maier-Rigaud, *Article 82 Rebates: Four Common Fallacies*, 2 EUR. COMP. J. 85 (2006); Martin Bechenkamp & Frank P. Maier-Rigaux, *An Experimental Investigation of Article 82 Rebate Schemes*, 2(2) COMP. L. REV. 1; John Simpson & Abraham A. Wickegren, *Bundled Discounts, Leverage Theory and Downstream Competition*, 9 AM. L. & ECON. REV. 370 (2007); Gregory K. Leonard, The Competitive Effects of Bundled Discounts, 3, Chap. 1, *in* ECONOMICS OF ANTITRUST COMPLEX ISSUES IN A DYNAMIC ECONOMY (Laurence Wu ed., 2007); Timothy J. Brennan, *Bundled Rebates as Exclusionary, not Predatory* (June 18, 2007), SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=99290 ; Patrick Greenlee, David S. Reitman & David S. Sibley, *An Antitrust Analysis of Bundled Loyalty Discount* (Economic Analysis Group Discussion Paper No. 04-13, October 2004); Janusz A. Ordover & Greg Shaffer, *Exclusionary Discounts* (CCP Working Paper No. 07-13, June 2007), SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=995426.

[6] ROBERT O' DONOGHUE & JORGE PADILLA, THE LAW AND ECONOMICS OF ARTICLE 82 EC, 2006, at 500.

We start with a discussion of competition policy on bundled discounts in the EU and the US. This is an area where the two systems of law diverge. We then examine the relevant antitrust tests for tying and conclude that the different steps of the antitrust assessment in the EU look, at first sight, similar to those that apply to tying in the US. It is therefore important to examine what, according to the case law, distinguishes a tying from a bundled discount case as the characterization of the practice will have implications on the antitrust standard that will apply and could lead to a different outcome if the case was brought in the EU or in the US.

2.1 The US antitrust standard for bundled discounts

US law focuses on discounts available in a product bundle. Suppose that an array of products bought by the same buyer are offered *a la carte*. Additionally, buyers are offered a discount if a buyer fulfils a specific requirement contract, for example, if he buys at least 90% of his "needs" for several products from this seller. This is generally called in economics "mixed bundling." A firm dominant in one market can use this strategy to leverage its monopoly or dominant position to other products where its market position is weaker. Additionally this strategy can be used for monopoly maintenance across markets. In the US, there are divergent opinions on its legality at different appeals circuits.

On one hand, there are circuits which do not accept that discounts may amount to anticompetitive conduct if the effective price charged to one or more products in the bundle is not "predatory" or below some measure of cost.[7] The following test has been suggested: calculate the total dollar discount (across all the products of the bundle) and then apply it all to the competitive products. If the resulting hypothetical price for the competitive product of the bundle is above a measure of per unit cost, there is no antitrust violation. There are of course questions on whether the right cost measure should be marginal cost, average variable cost or average total cost, but the basic idea is that unless one can construct a predatory price analogy, there is no antitrust violation. Additionally, courts that have used this standard have not imposed a requirement of recoupment in the future. We call this the "modified predatory pricing rule" approach.

On the other hand, there are circuits that consider that bundled discounts may in some circumstances amount to anti-competitive behavior even when the dominant firm would not be liable under the modified predatory pricing rule approach.[8] A central issue in this alternative approach is the possibility that bundled pricing strategies may foreclose or exclude equally efficient rivals even if the discount results in prices that are above costs. Interestingly, these courts make an analogy between bundled discounts and tying, as all these practices may lead to anticompetitive market foreclosure. We call this the "anticompetitive foreclosure approach" to bundling.

---

[7] *Concord Boat v. Brunswick Corp*, 207 F.3d 1039, 1061-1062 (8th Cir. 2000); *Virgin Atl. Airways Ltd v British Airways,* 257 F.3d 256 (2 Cir. 2001); *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007).

[8] *SmithKline Corp v. Eli Lilly & Co*, 575 F.2d 1056 (3rd Cir. 1978); *LePage's Inc v. 3M,* 324 F.3d 141 (3d Cir. 2003), *cert. denied*, 542 U.S. 953, 124 S.Ct. 2932 (2004)*; United States v Dentsply Int'l, Inc.,* 399 F.3d 181 (3d Cir. 2005).

2.1.1 The "modified predatory pricing rule approach" to bundling

In *Cascade Health Solutions v. PeaceHealth,* the Ninth Circuit held that an antitrust plaintiff can prove that a bundled discount was exclusionary or predatory, for the purposes of a claim of monopolization or an attempted monopolization under Section 2 of the Sherman Act *only if* the plaintiff established that "after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below its average variable cost of producing them."[9] The case arose from a challenge by McKenzie to the pricing strategies of PeaceHealth, a non-profit provider of hospital care services in Lane County, Oregon. PeaceHealth and McKenzie were the only hospital care providers in the County. McKenzie offered only primary and secondary hospital care and not tertiary hospital services, which involve more complex services, such as invasive cardiovascular and intensive neonatal care. PeaceHealth offered insurance companies, which are the effective purchasers of hospital services on behalf of consumers, discounts on "tertiary" hospital services, if they made PeaceHealth their sole preferred provider for <u>all</u> hospital services: primary, secondary and tertiary. It also offered to insurance companies less favorable terms concerning the reimbursement rate if McKenzie was added as a preferred provider of primary and secondary services. The jury found in favor of McKenzie on its claim of attempted monopolization and PeaceHealth appealed the judgment.

The Ninth Circuit focused on the conduct element of the attempted monopolization claim. Remarking that bundled discounts are "a common feature" of the current economic system, as they are used by both large corporations and smaller firms,[10] the Court's opinion emphasized that they "always provide some immediate consumer benefit in the form of lower prices" and that they can also result in savings for the seller, as "it usually costs a firm less to sell multiple products to one customer at the same time than it does to sell the products individually."[11] The pervasive character of mixed bundling and the fact that "price cutting is a practice the antitrust laws aim to promote[12] "led the Court to emphasize the risks of false positives in applying §2 of the Sherman Act and to advocate a cautious approach which should not discourage legitimate price competition. It also affirmed, however, that, "it is possible, at least in theory"[13] that a firm uses a bundled discount to exclude an equally or more efficient rival and therefore reduce consumer welfare in the long run. This can be done without any sacrifice of short run profits if the multi-product firm will be able to exclude less diversified but more efficient rivals who will not be able to sell above their average variable costs the product on the market in which they compete with the multi-product firm.

---

[9] *Cascade Health Solutions v. PeaceHealth*, above n 7, at 920.

[10] Id. at fn 5. The Court also referred to the "endemic nature of bundled discounts in many spheres of normal economic activity" as a reason to decline to endorse the Third Circuit's anticompetitive foreclosure standard for bundled discounts in *LePage's Inc v. 3M,* above n 8. Id.

> "The frequency with which we see bundled discounts in varied contexts does not insulate such discounts from antitrust review, but it heightens the need to ensure that the rule adopted does not expose inventive and legitimate forms of price competition to an overbroad liability standard."

[11] Id. at 906.

[12] Id.

[13] Id.

The Ninth Circuit refused to apply an anticompetitive foreclosure test that would essentially look to the structure of the market resulting from the bundled discount but considered instead that "the exclusionary conduct element of a claim arising under §2 Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of the defendant's costs."[14] As a cost-based rule the Court adopted the "discount attribution standard" or "discount allocation standard"[15]:

> "Under this standard, the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. If the resulting price of the competitive product or products is below the defendant's incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of § 2. This standard makes the defendant's bundled discounts legal unless the discounts have the potential to exclude a *hypothetical* equally efficient producer of the competitive product."[16]

The Ninth Circuit used as "an appropriate measure of the defendant's (incremental) costs," average variable costs, the same as it uses for predatory pricing.[17]

The Ninth Circuit adopted a predatory pricing standard for bundled discounts for essentially two reasons: First, the alternative foreclosure standard will lead to false positives and it lacks clarity as it is does not provide firms with objective criteria to which they can compare their commercial strategies and determine *ex ante* if these will lead to liability under §2 Sherman Act.[18] Second, the anticompetitive foreclosure standard may have the effect of protecting a less efficient competitor as the possibility of exclusion of a rival that has higher average variable costs will lead to the application of §2 of the Sherman Act, if the effect of this exclusion will be to extend or maintain the market power of the firm employing the bundled discount practice.

In reaching this conclusion, the Ninth Circuit relied on alleged differences between bundled discounts and tying practices:

> "…one difference between traditional tying by contract and tying via package discounts is that the traditional tying contract typically <u>forces</u> the buyer to accept both products, as well as the cost savings (quoting Areeda & Hovenkamp). Conversely, the package discount gives the buyer the choice of accepting the cost savings by purchasing the package, or foregoing the savings by purchasing the products separately (quoting again Areeda & Hovenkamp). The package discount thus does <u>not constrain the buyer's choice as much as the traditional tie</u>. For that reason, the late Professor Areeda and Professor Hovenkamp suggest that "variation of the requirement that prices be below

[14] Id. at 914.
[15] Daniel A. Crane, *Multiproduct Discounting: A Myth of Non Price Predation*, above n 5, at 28.
[16] Id. at 916.
[17] Id. at 914 & 920.
[18] Id. at 913:

> "we think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct within the meaning of § 2 of the Sherman Act unless the discounts resemble the behavior that the Supreme Court…identified as predatory."

cost is essential for the plaintiff to establish one particular element of unlawful discounting – namely, that there was actually tying – that is, that the purchaser was actually coerced (in this case by lower prices) into taking the tied-up package."[19]

Areeda and Hovenkamp consider that bundled discounts are a specific form of tying but they also advocate a stricter standard to establish coercion under bundled discounts, in particular a requirement that the attributed prices are below some measure of cost, than the standard used under the traditional tying test. This is not similar to the claim that bundled discounts should be analyzed under the predatory pricing rule. However, the Ninth Circuit did not hesitate to establish an analogy between bundled discounts and predatory pricing and to refer to Supreme Court's precedents on pricing abuses,[20] notwithstanding the fact that no specific argument other than that previously mentioned was made to support this analogy.

From the case law of the Supreme Court on pricing abuses, the Ninth Circuit derived the proposition that "antitrust laws do not punish economic behavior that benefits consumers and will not cause long-run injury to the competitive process."[21] The benefits to consumers are immediate, "because the discounts allow the buyer to get more for less."[22] It does not seem clear, however, how such a requirement would be incompatible with the alternative anticompetitive foreclosure test. The existence of exclusionary conduct is but one element of an attempted monopolization claim under §2 of the Sherman Act. For the practice to be considered as violating §2 it is necessary to prove also that there was a specific intent to monopolize and that there is a dangerous probability of achieving monopoly power, the later requiring some examination of market power in the relevant market.[23] The chief purpose of these two additional elements of an attempted monopolization claim is to help courts to characterize ambiguous conduct that may be interpreted as being either pro-competitive or anti-competitive.

A possible explanation of the Ninth Circuit's position is that, in light of what some other courts have concluded, "before the conduct requirements for an unlawful attempt are met, the conduct must be sufficiently hostile to competition so as to be branded predatory."[24] If one accepts this limitation, one may argue that the Court's approach is restricted to attempted monopolization claims and does not concern monopolization claims under §2 Sherman Act. This is particularly important in establishing a comparison with the antitrust standards for bundling in EU, as EC competition law does not recognize a separate attempted monopolization offence.

The Ninth Circuit relied also on the fact that the Antitrust Modernization Commission (AMC), suggested a predatory pricing standard for bundled discounts. This standard requires that the plaintiff brings evidence that the defendant (after

---

[19] Id. at 911.
[20] *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004) "above-cost predatory pricing schemes, (are) beyond the practical ability of a judicial tribunal to control"; *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069, 1078 (2007).
[21] *Cascade Health Solutions v. PeaceHealth*, above n 7, at 913.
[22] Id. at 906.
[23] *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993).
[24] HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY, 3d ed., (2005), at 338.

attribution of the bundled discount) priced below incremental costs for the competitive product as well as that the defendant is likely to recoup these short-term losses and that the bundled discount or rebate program has had or is likely to have an adverse effect on competition.[25] However, when it came to the definition of the different steps of the analysis for bundled discounts, the Ninth Circuit refused to adopt the additional elements of the test advocated by the Antitrust Modernization Commission, other than the appropriate measure of costs for the defendant. First, it refused to integrate the recoupment test of predatory pricing in the test applied to bundled discounts asserting that the bundled discounter may not lose any profits by bundling:.[26] Second, it found redundant the third limb of the test proposed by the Antitrust Modernization Commission, evidence of a likely adverse anticompetitive effect, as this is "no different than the general requirement of antitrust injury that a plaintiff must prove in any private antitrust action."[27]

As a matter of economics, adoption of the modified predatory pricing rule can result in a finding of no liability even when there are anti-competitive actions. First, even if one believes that bundling will be anti-competitive only when allocating the discount from all products to the competitive product(s) results in an effective price below some measure of unit cost, average variable cost is not the appropriate measure of cost. Firms need to cover their fixed costs as well to stay in business. Thus, *the appropriate measure of cost should be average total cost*, which includes a per unit (average) allocation of fixed cost. For example, to say an action is not anticompetitive when a firm prices above average variable cost but below average total cost makes no sense because a firm will not be able to survive in business in the long run under this pricing. Such pricing involves a short run profit sacrifice, is not part of normal firm behavior, and is highly suspect as to its anti-competitive motive. An antitrust standard should not consider as lawful a dominant firm's behavior that imposes pricing on equally efficient competitors that does not allow them to survive in the long run.

Second, an entrant may have higher unit costs because foreclosure as a result of bundling reduced its scale of operations. Thus, specifying a test that relies on the unit costs of the dominant firm (given the higher scale of its operations) can easily result in an incorrect finding of no liability and false negatives.

Third, attention should be paid to the effects of the bundling strategies on consumers' surplus. Use of bundling strategies can lead to the exclusion of one or more competitors. This can decrease consumers' surplus, even when the excluded entrant is less efficient than the incumbent. Entry constrains pricing. Even entry by less efficient entrants can lead to lower prices. Thus, excluding entrants on the grounds of productive inefficiency (or creating tests that would exclude less efficient entrants out of hand) can reduce consumers' surplus and increase allocative inefficiency (divergence of prices from costs).[28]

---

[25] Antitrust Modernization Comm'n, *Report and Recommendations* 95-97 (2007).

[26] *Cascade Health Solutions v. PeaceHealth*, above n 7, fn 21: "we do not believe that the recoupment requirement from single product cases translates to multi-product discounting cases. Single-product predatory pricing, unlike bundling, necessarily involves a loss for the defendant…By contrast, as discussed above, exclusionary bundling does not necessarily involve any loss of profits for the bundled discounter."

[27] Id.

[28] This can be true in a variety of situations. For example, the "Efficient Components Pricing Rule" (ECPR) that determines prices for components in systems was proposed as way to keep inefficient

Fourth, even starting from monopoly in one product and competition or oligopoly in a second product (or in more products), the introduction of mixed bundling strategies, where products are offered undiscounted *a la carte* as well as at a discounted price, a customer committing to buy at least x% of his needs in all the bundled products from the same firm, can lead to a reduction of consumers' surplus.[29] The monopolist can set an *a la carte* price above the monopoly price and charge approximately the monopoly price for the monopolized good under the bundle/requirements contract. The introduction of the bundle can make consumers worse off even when they have the choice of whether or not to accept the terms of the bundle. Even when, after the introduction of the bundle, each consumer is better off buying the bundle rather than buying at the *a la carte* prices available in the presence of the bundle, the aggregate effect of these decisions to buy the bundle allow the monopolist to set pricing so that it extracts more surplus than in unbundled monopoly and harms consumers in comparison to the but for world before the introduction of the bundle.[30]

Fifth, bundling can also be used to create threats of higher *a la carte* prices, even if all consumers buy under the bundle and therefore the threat buying at higher of *a la carte* prices is not enforced at equilibrium.[31]

---

entrants out of the market – see William J. Baumol, *Some Subtle pricing Issues in Railroad Regulation*, 10(1-2) INT'L J. OF TRANSPORT ECON. 341 (1983) and Robert D. Willig, *The Theory of Network Access Pricing*, *in* ISSUES IN PUBLIC REGULATION (Harry M. Trebing ed., 1979). However, it has been shown that allowing even (moderately) inefficient entrants to enter the market increases consumers' surplus because it decreases prices and reduces the allocative inefficiency of monopoly. See Nicholas Economides and Lawrence J. White, *Access and Interconnection Pricing: How Efficient is the 'Efficient Component Pricing Rule'?*, XL(3) ANTITRUST BULL. 557 (1995),. Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/Economides_Access_and_interconnection_pricing.pdf. Nicholas Economides and Lawrence J. White, *The Inefficiency of the ECPR yet Again: A Reply to Larson*, XLIII(2) ANTITRUST BULL. 429 (1998). Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/The_Inefficiency_of_the_ECPR.pdf. Nicholas Economides, *The tragic inefficiency of M-ECPR*, *in* DOWN TO THE WIRE: STUDIES IN THE DIFFUSION AND REGULATION OF TELECOMMUNICATIONS TECHNOLOGIES (Allan L. Shampine, ed. 2003). Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/Economides_M-ECPR.pdf .

[29] See, for example, Patrick Greenlee, David Reitman & David S. Sibley, *An Antitrust Analysis of Bundled Loyalty Discounts*, (Economic Analysis Group, U.S. Department of Justice, October 2004). This paper shows how a monopolist can extend his monopoly in the first market to the second market through offering a bundling scheme with a requirement that all or almost all purchases are made from the monopolist, and simultaneously increasing the price of the monopolized product when it is offered on a stand-alone basis. Greenlee *et al*. show in Theorem 2 (page 11) that the application of this bundling scheme reduces consumers' welfare. Greenlee *et al.* show that consumers can be made worse off even when they have the choice of whether or not to take the bundle. Moreover, Greenlee *et al.* devise a test to ascertain if there are consumer losses:

> "If the firm maximizes profits and the standalone price of A exceeds the initial price of A, then we can infer that the bundled rebate reduces consumer welfare."

(at page 23). See also See Barry Nalebuff, *Bundling as a Way to Leverage Monopoly*, (Yale School of Management Working Paper 36, October 8, 2004), at 14-15.

[30] Since the prices under the bundle are better than the *a la carte* ones, it is individually rational for a consumer to buy under the bundle. However, collectively these actions of consumers strengthen the monopolist and allow him to increase both the *a la carte* and bundle prices.

[31] For example, see Barry Nalebuff, *Tried and True Exclusion*, 1(1) COMPETITION POLICY INT'L 41 (2005).

Sixth, the "discount" in the price of the bundle can be illusory as the *a la carte* price can be increased simultaneously with the offer of the bundle by more than the discount, so that, in the end the consumer who buys the bundle pays more than before the bundle was offered.[32] This strategy results in consumers buying the competitive good from the monopolist (of the first good) under the bundle resulting in (i) lower consumers' surplus; and (ii) foreclosure of competitors in the "competitive" good(s).

Seventh, the bundling strategy will tend to foreclose competitors in the second market, so that in the long run they are eliminated from the second market, and to the extent that re-entry is not easy, the monopolist will have a free reign to set an even higher price in the second market in the future. Thus, foreclosure of competitors can further reduce consumers' surplus in the medium and long run.

Eighth, bundling may be used as an entry-deterring device by making it economically unprofitable for an entrant to enter one market without simultaneously entering the second market.[33]

2.1.2 "The anticompetitive foreclosure approach" to bundling

Given these economic arguments, it is encouraging that some circuits have ruled that bundled discounts may in some circumstances amount to anti-competitive behavior even when the dominant firm would not be liable under the modified predatory pricing rule approach. Interestingly, these courts make an analogy between bundled discounts and tying, as all these practices lead to anticompetitive market foreclosure (the anticompetitive foreclosure criterion).

In *LePage's Inc*, the Third Circuit made explicit the analogy between bundled rebates and tying and adopted an abbreviated rule of reason approach. In that case, 3M, a dominant supplier of transparent tape, bundled rebates relating to the purchase of its private label tape, which was a product in which it faced important competition from LePage's, with a requirement that customers purchase other products from 3M's different product lines that LePage's did not offer. LePage's argued that 3M's behavior constituted monopolization under §2 Sherman Act, as by bundling its rebates, 3M had created a *de facto* exclusivity because the bundled rebates induced many of LePage's major customers to eliminate or reduce their purchases of tape from LePage. 3M argued that its conduct was legal as it never priced its transparent tape below its cost. The Court did not examine whether 3M's price of transparent tape was below a certain measure of its cost. It applied instead an anticompetitive foreclosure test:

> "the principal anticompetitive effect of bundled rebates… is that when offered by a monopolist they may foreclose portions of the market to a potential

[32] Rubinfeld calls such a discount a '"sham" discount.' See Daniel Rubinfeld, *3M Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243, 252 (2005).
[33] For example, see Barry Nalebuff, *Bundling as an Entry Barrier*, 119(1) QUARTERLY J OF ECON. 159 (2004), Daniel Rubinfeld, above n 32, at 256 (2005) & Aaron S. Edlin and Daniel L. Rubinfeld. *Exclusion or Efficient Pricing: The "Big Deal" Bundling of Academic Journals*, 72 ANTITRUST LAW JOURNAL 119 (2004).

competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer."[34]

The Third Circuit found that foreclosure of LePage, which was a significant competitor, could lead to higher prices and reduced output. 3M could have later recouped the profits it had forsaken with the discount scheme by selling higher priced Scotch tape. This was a possible strategy in view of evidence indicating that "significant entry barriers" prevented competitors from entering the tape market in the US.[35] According to the Court, 3M's practice had "long-term" anticompetitive effects, without 3M offering any adequate business justification for its practices.[36] The Supreme Court refused the petition for a writ of certiorari.[37]

The decision has been controversial, in particular because the anticompetitive foreclosure test applied by the Court could lead to the application of §2 Sherman Act even if the excluded competitor was not as efficient as the defendant. As Judge Greenberg remarked in his dissenting opinion, "LePage's is not as efficient a tape producer as 3M."[38] The introduction of the requirement that §2 Sherman Act should only apply if the plaintiff brings evidence that the defendant priced below its average variable costs aims therefore to take into account the possible false positives that could follow from the full application of the anticompetitive foreclosure rule.

The debate is partly about allocating the burden of proof that the defendant is at least as efficient producer as the plaintiff and that therefore the exclusion of the latter is the consequence of business acumen and superior efficiency. One could consider that the anticompetitive foreclosure rule assumes that this is the case: if the defendant were as efficient as the plaintiff in the market of the competitive product, there is no need to bundle the sale of this product with discounts in lines of products which are not within the plaintiff's product range. The defendant could have simply offered, as a least restrictive to competition alternative, single product discounts for the competitive product that could match or even be lower than the price charged by his rival.

Certainly, there may be efficiency reasons that could explain the decision of a firm to bundle products together, cost savings in production and distribution and price discrimination being the most notable ones.[39] Tying is a common practice in competitive markets as firms often compete with bundles of products and consumers are offered discounts if they buy the products that are part of the bundle. Evidence from the pervasive use of bundling in competitive markets would thus require the competition authorities or courts to adopt prima facie a positive view of such practices, unless they are used by firms with a dominant position and may exclude

---

[34] *LePage's Inc v. 3M,* above n 8 at 155.
[35] Id. at 163.
[36] Id.
[37] *3M v. LePage's Inc.*, 124 S. Ct. 2932 (2004). The decision followed a brief from the solicitor general suggesting that "there is insufficient experience with bundled discounts to this point to make a firm judgment about the relative prevalence of exclusionary versus procompetitive bundled discounts" (Brief for the United States as Amicus Curiae, 3M v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865), available at WL 1205191 at 12.
[38] *LePage's Inc v. 3M,* above n 8 at 177.
[39] David S. Evans & Michael Salinger, *Why do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. ON REG. 37, 41-43 (2005).

competitors that cannot offer the same bundle of items. The analysis of the practice under a rule of reason that would balance pro-competitive and anti-competitive effects would thus be an adequate antitrust standard.[40] This is the position taken by the Third Circuit in *LePage's*.

Some authors have nevertheless advanced the view that the application of the rule of reason -anticompetitive foreclosure standard to bundled discounts could still lead to false positives, in view of the difficulty in documenting efficiencies.[41] They suggest the adoption of a cost-based standard that would operate as a safe harbor for bundled discounts.[42] It is only if a rival as efficient as the dominant firm would be excluded from the market that the necessary costs of an extensive rule of reason inquiry should be incurred. The underlying assumption is that firms should be free in defining their pricing strategies. According to the Ninth Circuit in *Cascade Health*, it should be for the plaintiff to prove, along with the existence of anticompetitive effects, that the "challenged bundling practices would have excluded an (hypothetical) equally efficient rival, without reasonable justification."[43] The inquiry would be whether the incremental price for the tied product (that its price under the bundle reduced by the allocation of the total discount for the whole bundle to the tied product) is below the defendant's average variable cost of producing the tied product.[44] This is based on the assumption that lower prices indicate superior efficiency, unless it is otherwise demonstrated.

However, this approach does not take into account the fact that bundled discounts may be a way for a dominant firm to impair the efficiency of its rivals "because rivals that have a long run cost curve which is as low as the defendant (and therefore are equally efficient in the long run) would be unable to achieve a price as low as the defendant's average total costs, precisely because the foreclosure has relegated them to the high cost portion of their cost curve."[45] Furthermore, they impose on the plaintiff an important hurdle, as cost data of rivals may be hard to get.

One could also question the position that antitrust concerns should be limited to practices that exclude equally efficient firms. Excluding less efficient rivals may also produce a negative consumer welfare effect if that removes a competitive constraint on the market power of the defendant and thus allows the defendant to raise prices and reduce consumer surplus while the effects on total surplus are ambiguous. Indeed, the protection of the final consumer from wealth transfers may be an important objective of antitrust law, imposing a strict pass on requirement for any efficiency gains that the defendant advances as a justification for the adoption of a specific practice: a situation which is even more explicit in EC Competition Law.[46]

---

[40] In this case, the legal burden of proof will rest on the plaintiff, while the defendant will bear the evidentiary burden of substantiating the pro-competitive efficiency justifications for the bundled discount, after the plaintiff has brought evidence of an anticompetitive foreclosure effect.
[41] David S. Evans & Michael Salinger, above n 39, at 83.
[42] Hebert Hovenkamp, *Discounts and Exclusion*, 2006 UTAH L. REV. 841, 854.
[43] *Cascade Health Solutions v. PeaceHealth*, above n 7, at 917.
[44] Id., at 919 & 920.
[45] EINER ELHAUGE & DAMIEN GERADIN, GLOBAL COMPETITION LAW AND ECONOMICS, 1st ed, (2007), at 576.
[46] See, Commission, *Guidelines on the application of Article 81(3) of the Treaty* [2004] OJ C 101/8, para 85-86 (the same principles could also apply to cases brought under Article 82). See, Commission,

2.2. The EU antitrust standard for bundled discounts

We distinguish the case law of the European Courts (European Court of Justice and Court of First Instance), which seems to apply to bundled discounts the foreclosure approach courts usually employ for single product rebates, and the European Commission's staff Discussion Paper, which analyzes bundled discounts under the separate heading of bundling.

2.2.1. The approach of the European Courts: the foreclosure standard

The case law of the European Court of Justice (hereinafter ECJ) and the CFI does not draw a difference between single product rebates and bundled discounts. The case law distinguishes between volume (quantity discounts), which are legal *per se*, and loyalty rebates, which are illegal in most circumstances. The European judiciary adopts a foreclosure test that does not require evidence that the discount on the competitive product was below an appropriate measure of the defendant's cost.

A dominant firm can give quantity discounts without infringing Article 82 if these are offered on equal terms to all customers of the firm. Discounts should also reflect efficiency gains (economies of scale in production, cost savings etc). Loyalty rebates rewarding exclusivity or strongly encouraging the customer to stay with the supplier may, on the contrary, be considered in certain circumstances illegal under Article 82.[47]

A system whereby the rebate is conditional on purchasing mainly or exclusively from the dominant undertaking is abusive in principle.[48] Dominant firms may not enter into exclusive purchasing agreements and may not operate rebate schemes, which have the same effect as an exclusive purchasing agreement. In *Hoffmann La Roche v. Commission*, the discounts were conditional on the customer's obtaining all or most of its requirements on sometimes different vitamins – which were part of different relevant markets - from the undertaking in a dominant position. The Court found that these conditional rebates foreclosed the access of rival producers in the market[49] and found that such rebates amounted to an unlawful tie-in, contrary to Article 82(d).[50]

Article 82 case law has recently focused on target (individualized) retroactive discounts that produce an exclusionary and loyalty effect.[51] These are generally found to infringe Article 82 if they are capable of producing an exclusionary effect by

---

DG Competition Discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (hereinafter Discussion Paper), December 2005, para 88-89.

[47] Case 85/76, *Hoffmann-La Roche v. Commission* [1979] ECR 461; Case T-65/89, *BPB Industries and British Gypsum Ltd v. Commission* [1993] ECR II-389.

[48] Case 85/76 above n 47, para 89.

[49] Id. para 90.

[50] Id., para 110-111.

[51] Case 322/81, *Nederlandsche Banden-Industrie Michelin v. Commission* [1983] ECR 3461 (hereinafter *Michelin I*); Case T-203/01, *Manufacture Française des Pneumatiques Michelin v. Commission* [2004] ECR II-4071(hereinafter *Michelin II*); Case T-219/99, *British Airways v. Commission* [2003] ECR II-5917; Case C-95/04 P, *British Airways v. Commission* [2007] available at http://www.curia.eu

making market entry very difficult or impossible for competitors and there is no objective economic justification for the rebate system.[52] The fact that the excluded rivals may be less efficient firms than the defendant is not taken into account in the application of Article 82 EC.

In *Michelin II*, the CFI found that discounts based on standardized sales targets over a relatively long reference period were abusive under Article 82. The rebates applied to the entire turnover achieved with Michelin (thus including many different products). To be eligible, a dealer had to achieve a pre-determined turnover target. These rebates were given according to a grid, which had a large number of steps. When a dealer went up a step by hitting a particular target, he obtained not just an extra payment on the last incremental sales, but on all previous purchases in the reference period. The rebates were not paid until February in the year following that in which the tire purchases were made. It was therefore difficult for the dealers to determine the actual unit purchase price of the tires before making the last orders of the year. This uncertainty induced them to minimize their risks and purchase wholly or mainly from Michelin. The variations in the final steps of the scheme created a suction effect, as this affected the dealers' profit margins for the entire year, thus creating additional pressure to buy Michelin tires. Michelin's competitors did not have only to offer a price on a customer's marginal requirements, which matched Michelin's price for that quantity, but had to offer a price so low as to offset the loss, which the dealer would make on all its purchases from Michelin, if he bought from Michelin's rival. The purpose of the discount systems was to tie the dealers to Michelin. Those practices tended to restrict competition because they sought to make it more difficult for the applicant's competitors to enter the relevant market. The Court did not consider relevant the fact that the market shares and sales of Michelin fell during the period in question. The fall would have been greater if Michelin had not adopted the rebate scheme.[53]

The Court emphasized the need for multi-product dominant undertakings to compete on the merits with their rivals and to grant discounts only if these are economically justified, for example because the specific dealers bring an important volume of business which provides economies of scale to the producer that passes them to the dealers in the form of discounts. A central element in the Court's decision is that "not all competition on price can be regarded as legitimate,"[54] a conclusion which seems to depart from the generally positive assumption over this type of competition in US antitrust law. However, this approach is compatible with the Court's position that greater economic power creates greater responsibility.[55]

The position of the Court contrasts with that adopted by the Ninth Circuit in *Cascades v. PeaceHealth*, where the Court deemed important in evaluating the existence of anticompetitive effects the fact that bundled discounts constitute a

---

[52] Case C-95/04 P above n 51, para 68-69.
[53] *Michelin II* above n 51, para 245.
[54] Id. para 97.
[55] Id.

> "an undertaking in a dominant position has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market… An undertaking in a dominant position cannot have recourse to means other than those within the scope of competition on the merits."

"pervasive practice," used by both larger and smaller corporations.[56] On the contrary, this is not an element that the Courts take into account in Europe. In our view, this approach may be explained by the specific structure and purpose of Article 82 EC. Contrary to §2 Sherman Act, which essentially prohibits monopolization, and therefore considers that a practice which is also used by non-dominant firms cannot indicate the existence of monopoly power or an intent to expand monopoly power, Article 82 adopts a regulatory approach: it is "less concerned about the creation of dominant positions and more focused on regulating their behavior once dominance has been achieved."[57] Advocating that a practice is pervasive in the economy will not be relevant for the application of Article 82, as dominant firms have a special responsibility to preserve competition in the marketplace.[58]

The scope of the application of Article 82 seems therefore to be broader than that of §2 of the Sherman Act. First, Article 82 reaches significantly lower market shares than does §2 of the Sherman Act, so that a dominant position may be found under Article 82 with a market share as low as 40%.[59] Second, the fact that non-dominant firms also use the same practice is irrelevant, as the purpose of Article 82 is to impose specific responsibilities to dominant undertakings. This is particularly clear in *Michelin II*, where the Court of First Instance considered that "discounts granted by an undertaking in a dominant position must be based on a countervailing advantage which may be economically justified."[60] In comparison, non-dominant undertakings are able to grant discounts even if these are not based on the economic justifications envisioned by the Court, such as economies of scale, and even if the result of these discounts will be the acquisition of a dominant position. However, once the threshold of dominance has been reached, the undertaking will not be able to continue providing these rebates, unless they provide an economic justification for "the discount rates chosen for the various steps in the rebate system in question."[61] In this case, they do not constitute loyalty discounts but quantity discounts and are in conformity with

---

[56] *Cascade Health Solutions v. PeaceHealth* above n 7, fn 5.

[57] Herbert Hovenkamp, *The Legal Periphery of Dominant Firm Conduct* 4 (University of Iowa Legal Studies Research Paper, Number 07-21, 2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1014426

[58] Case C-322/81, *NV Nederlandsche Banden Industrie Michelin v Commission* [1983] ECR 3461, para 57; Case T-201/04 above n 4, para 775. See also, Opinion of Advocate General Kokott, Case C-95/04 P, above n 51, para 23:

> "(w)ithin the scope of the application of Article 82 EC, a dominant undertaking is subject to certain limitations that do not apply to other undertakings in the same form. Because of the presence of the dominant undertaking, competition on the market in question is weakened. Therefore - whatever the causes of its dominant position – that undertaking has a particular responsibility to ensure that its conduct does not undermine effective and undistorted competition in the common market. A practice which would be unobjectionable under normal circumstances can be an abuse if applied by an undertaking in a dominant position."

This constitutes one of the main factors explaining the "divide" between Article 82 EC and Section 2 Sherman Act; Eleanor M. Fox, *Monopolization, Abuse of Dominance, and the Indeterminacy of Economics: the U.S./E.U. Divide*, 2006 UTAH L. REV. 725, 728.

[59] Case T-219/99 above n 51 found that British Airways had a dominant position with a market share of 39,7%, which was moreover declining. However, this case should be put in the context of the liberalization of the airways sector in the UK and the need to protect a new entrant, Virgin, from the incumbent monopolist, which was previously State owned. See, GIORGIO MONTI, EC COMPETITION LAW, 1st ed., (2007), at 169.

[60] *Michelin II* above n 51, para 100 (emphasis added).

[61] *Michelin II* above n 51, para 109.

article 82 EC. The position of the Court could be interpreted as indicating that all loyalty-inducing discounts are illegal *per se*.[62]

The restrictive position of the Court has been slightly attenuated in *British Airways v Commission*.[63] The ECJ applied in this case a qualitative substantiality approach similar to that applied for exclusive dealing agreements in the United States[64] and balanced the exclusionary effect of the rebate system with the advantages it provided to the consumers in terms of efficiency.[65] The position of the Court in *British Airways* is remarkable, not only because the Court applied an anticompetitive foreclosure test but also because in a quite similar case involving the same parties, the Second US Circuit rejected Virgin's attempted monopolization claim that British Airways had infringed §2 of the Sherman Act by bundling its ticket sales for corporate customers on routes between the UK and the US.[66] The plaintiff's expert advanced a "predatory foreclosure" theory, according to which British Airways had priced below its *own* costs in certain routes by adding additional flights in order to deter or delay its rival Virgin's expansion and that the costs incurred by British Airways were immediately recouped by setting prices substantially above costs on other routes.[67] The Second Circuit found that Virgin failed to bring evidence of below cost pricing, as *inter alia* the correct measure of costs was Average Avoidable Costs (AAC) calculated on all the British Airways routes in the geographical market (and not only an incremental sales test as was argued by Virgin's expert).[68] The Second Circuit also refused that there was recoupment, as Virgin did not indicate how much above its costs British Airways priced the non-competitive routes.[69]

In conclusion, the Second Circuit adopted a predatory standard test, noting that "low prices are a positive aspect of a competitive marketplace and are encouraged by antitrust laws," and considered that, "as long as low prices remain above predatory levels, they neither threaten competition nor give rise to an antitrust injury." [70] This test imposes a higher standard of proof to the plaintiff than the Ninth Circuit's modified predatory pricing standard: according to *PeaceHealth* the plaintiff has to prove that the monopolist's prices are below his average variable costs in the competitive segment of the market (and therefore not his AAC for *all* sales).[71]

---

[62] See, John Kallaugher & Brian Sher, *Rebates Revisited: Anti-Competitive Effects and Exclusionary Abuse under Article 82*, (25)5 ECLR 263 (2004); Denis Waelbroeck, *Michelin II: A Per Se Rule Against Rebates by Dominant Companies?*, 1(1) JOCLE 149 (2005).
[63] Case T-219/99, above n 51 ; Case C-95/04 P, above n 51. Kelyn Bacon, European Court of justice Upholds Judgment of the Court of First Instance in the *British Airways/Virgin* Saga, 3(2) COMPETITION POLICY INT'L 227 (2007); Okeoghene Odudu, *Case C-95/04 P, British Airways plc v. Commission, judgment of the Court of Justice (Third Chamber) of 15 March 2007*, 44 COMMON MARKET L. REV. 1781 (2007).
[64] Jonathan M. Jacobson, *Exclusive Dealing, Foreclosure and Consumer Harm*, 70 ANTITRUST L. J. 311, 322 (2002)
[65] Case C-95/04 P above n 51, para 86.
[66] *Virgin Atl. Airways Ltd v British Airways* above n 7.
[67] Id. at 266.
[68] Id. at 267-269. The incremental sales test examines if the incremental revenue exceeds or not incremental cost. If this is the case, the bundled discount is found to be legal.
[69] Id. at 271-272.
[70] *Id.* 269.
[71] See, our analysis above.

A comparison of the antitrust standards used by both jurisdictions for bundled discounts shows that there is an important divergence in the dominant analogy used for these practices. Whereas some US courts examine these practices from the perspective of a modified version of a predatory pricing test, the European courts apply an anticompetitive foreclosure test which seems similar to that employed in recent exclusive dealing cases,[72] or they acknowledge, as the CFI has recently done in *Microsoft*, that bundled discounts may, in some circumstances, have an equivalent effect to tying.[73] However, the recent Discussion paper of the European Commission on Article 82 suggests a different approach for mixed bundling.[74]

2.2.2. The Commission's Staff Discussion Paper on Article 82: a mixed predatory/foreclosure approach

The Commission's staff Discussion Paper rejects the distinction between quantity, loyalty and target rebates.[75] It distinguishes instead between two types of rebate practices: First, single-product rebate systems that have their possible negative effects in the market on which the undertaking concerned is dominant and are considered as a form of price-abuse are mainly examined under a price/cost standard and mixed bundling practices or bundled discounts which produce effects on other markets than that of the dominant undertaking or they may concern different products of the same market and are analyzed in the section of the Discussion Paper devoted to tying practices [76], although the Commission also classifies them as a pricing abuse.[77]

There are two main forms of single-product rebates: unconditional rebates, that is, rebates granted only to particular customers but independently of their purchasing behavior and conditional rebates, which are rebates granted to customers to reward certain purchasing behavior. According to the staff discussion paper's proposal, both "conditional" and "unconditional" single product rebates should be assessed under a predatory pricing standard. The suggested tests look to whether the discount practice that is offered by the dominant firm covers the average total cost (ATC) of supplying the sales that are open to competition. If that is not the case and the part of the demand to which the rebate is applied is significant enough to create a foreclosure effect, an abuse will be considered likely. Article 82 will thus apply directly only if the discount leads to the foreclosure of an equally efficient competitor. The staff discussion paper, however, does not rule out the possibility to take action in cases where the discount covers the ATC of the contestable proportion of demand (sales open to competition), when it appears that the new entrant may not be as

---

[72] Case T-65/98 *Van den Bergh Foods v. Commission* [2003] ECR II-4653, para 157-160; Case C-552/03 *Unilever Bestfoods (Ireland) v. Commission* [2006] I-9091.

[73] Case T-201/04 above n 4, para 908. Although the Court does not indicate if it will apply the same standard as for tying, the language used indicates that the CFI embraces the tying analogy.

[74] The Discussion paper is a consultation document, prepared by the staff of the DG Competition. It has not been published at the Official Journal of the European Communities and therefore does not produce any legal effect. It is still unclear if the Commission will follow up this consultation phase with a Notice or Guidelines on Article 82.

[75] On the position of the European Commission to bundled discounts and rebates having a tying effect before the Discussion Paper, see RICHARD WHISH, COMPETITION LAW, 4th ed., 2001, 644-656; FAULL & NIKPAY, THE EC LAW OF COMPETITION, 2007, §§ 4.317, 4.330-4.331.The Commission applied a foreclosure test and the practices were found to be either discriminatory or equivalent to tying practices.

[76] Id. para 142.

[77] Discussion Paper, above n 46, para 142-176.

efficient as the dominant company due to certain "non-replicable advantages" or economies of scale and scope, learning curve effects or first mover advantages that later entrants cannot be expected to match even if they were able to achieve the same production volumes as the dominant company.[78] The standard applied seems to be close to a not yet as efficient as test.

The staff discussion paper's proposals mark a shift from the current approach of the CFI and the ECJ on rebates, which employ the anticompetitive foreclosure standard and do not provide for a safe harbor for discount practices.

Concerning bundled discounts (mixed bundling), the staff discussion paper acknowledges that these may have similar effects on competition than tying and that the distinction between mixed bundling and pure bundling is not "necessarily clear-cut" as mixed bundling may come close to pure bundling when the prices charged for the individual offerings are high.[79] The Commission's officials refer in some parts of the Discussion paper to mixed bundling as "commercial tying."[80] In other parts of the Discussion paper, the DG Comp's staff nevertheless remarks that there is a difference between these two practices in the sense that in mixed bundling none of the products is "tied in the traditional sense."[81] For the discussion paper, both practices have similar foreclosure effects: Mixed bundling constitutes an indirect measure to achieve the same result as contractual tying "by inducing customers to purchase the tied product through granting bonuses, rebates, discounts or any other commercial advantage."[82] It seems that, for the Commission's staff, coercion and inducement may produce the same effects and therefore should be analyzed under the same standards.

For bundling practices to be prohibited under Article 82, the presence of the following elements is usually required: (i) the company concerned is dominant in the tying market, (ii) the tying and tied goods are two distinct products, (iii) the tying practice is likely to have a market distorting foreclosure effect, (iv) the tying practice is not justified objectively or by efficiencies.[83] Therefore, if the practice is a bundled discount the antitrust standard will depend on the identification of at least two distinct products (the first one is the product on which market the firm has a dominant position and the second one is the market or product where the anticompetitive effects will be produced). It seems that the Discussion paper applies to mixed bundling a specific version of the foreclosure test that it usually applies to tying.

However, the Discussion paper differentiates commercial tying and contractual tying when it examines the third prong of the test, the market distorting foreclosure effect. It is only if the discount is so large that "efficient competitors offering only some but not all of the components, cannot compete against the discounted bundle" that a bundled discount may infringe Article 82.[84] The Commission suggests a complex modified price/cost test (based on long run incremental costs) in order to identify whether the excluded competitor is as efficient

[78] Id. para 67 & 165.
[79] Id. fn 112.
[80] Id. para 182.
[81] Id. fn 113.
[82] Id., para
[83] Id. para 183.
[84] Id. para 189.

as the dominant firm.[85] This test is in conformity with the position defended by the Commission in the Discussion paper that pricing abuses, such as mixed bundling, should be analyzed under the as efficient as competitor test.[86] The assumption is that if a price charged by the dominant company covers its incremental costs, such a price cannot normally be considered exclusionary, as an efficient competitor would be able to counteract the strategy of the dominant firm. However, the Commission's officials also recognize that "it may exceptionally be concluded that although the price exceeds the long run incremental costs the mixed bundling nonetheless is considered exclusionary."[87] This is because, as the Commission's officials also note in the Discussion paper, "it may sometimes be necessary in the consumers' interest to also protect competitors that are not (yet) as efficient as the dominant company."[88] It may also be difficult to collect the data necessary for such a finding. In this case, the discussion paper suggests that "it may be possible to show that the rival was actually excluded or marginalized following the bundling by the dominant company" and then leave to the dominant undertaking "the possibility to rebut the findings by using its own incremental costs."[89] The test proposed by the Commission's officials does not go as far as advocating the establishment of a safe harbor for mixed bundling practices that conform to a price/cost standard, but it establishes a rebuttable presumption that these discounts do not constitute an abuse of a dominant position.

The test suggested by the discussion paper may be subject to the following two criticisms. First, it seems to be fairly complex and it would be difficult to apply in practice. Second, it is based on the assumption that for pricing abuses, EC competition law adopts the "as efficient as competitor" test. This is a questionable assumption, in the sense that the case law of the ECJ or the CFI on discounts and tying do not provide any support to this specific approach and have generally accepted that the exclusion by a dominant undertaking of not equally efficient rivals may be an antitrust issue if it leads to direct or indirect consumer detriment. If the reference to the as efficient as competitor test does not hold, then there is no reason left for the Commission to maintain a modified predatory pricing test and the applicable standard should be that of anticompetitive foreclosure. The application of the anticompetitive foreclosure test should not, however, lead to the sanction under Article 82 EC of discount practices that may benefit consumers. A full-blown rule of reason analysis that will examine possible efficiency gains and that will require a likely consumer detriment before any finding of abuse is therefore required.

The position of the Commission's staff is based on the speculation that the Discussion paper will be an opportunity to subject old and more recent case law of the ECJ and the CFI to critical economic analysis. Nevertheless, one may argue that there are also economic arguments in favor of a test that recognizes that the exclusion of not equally efficient rivals may produce consumer harm (which includes not just a loss of consumer surplus but also wealth transfers from the consumers to the

[85] Id. para 190-203
[86] Id. para 66.
[87] Id. para 190.
[88] Id. para 67.
[89] Id. para 191.

dominant firms).[90] Furthermore, it is unclear whether the Commission has made use of the modified predatory pricing test its staff suggested in the Discussion paper on recent cases on bundled discounts, as its decisions have also relied on "the previous case law of the European Court of Justice."[91] This may be an implicit admission that the precedents of the ECJ and the CFI do not leave much space for the Commission to develop a test that would introduce a cost measure before analyzing the foreclosure effect of the practice. The ECJ in *British Airways* and the CFI in *Microsoft* have recently affirmed that efficiency considerations should come into play after the practice has been found to produce a foreclosure effect and that the evidentiary burden of efficiency gains should be on the dominant firm.[92] A comparative analysis of the efficiency of the dominant and excluded firm will have the effect of bringing the efficiency considerations at the first step of the analysis. However, that would be against the recent rulings of the European Courts on the allocation of the burden of proof between the parties.

An additional difficulty with the test suggested in the Discussion Paper is that it does not make clear how mixed bundling is different from tying. This is an important consideration, as it seems that the equally efficient competitor test does not apply to tying while it would apply to mixed bundling. This raises the issue of the existence of an effective and practical tool to distinguish between the two practices. It would make no sense to have a price/cost test for mixed bundling if the same practice could also be analyzed under the anticompetitive foreclosure approach of tying. The position of antitrust law in the US and the EC on this issue is not very clear, as will show the analysis of the two criteria that are generally used by the case law to distinguish between tying and single-product discount practices and between tying and mixed bundling, respectively the requirements of the existence of distinct products and that of coercion.

2.3 Distinguishing between bundled discounts and tying: the role of the distinct products and the "coercion" tests

The analysis of bundled discounts under a predatory pricing standard in the US and the Commission's staff proposals to use a cost/price standard for rebates differentiate the foreclosure test applied to tying practices in the US and the EC. This implies that a process of characterization of the specific facts of the case as constituting tying or bundled discounts (mixed bundling) should precede the step of examining the anticompetitive effects of the practice under either the foreclosure or the predation-like test. One could, however, object to any distinction between the standard that applies to tying and that to bundled discounts or mixed bundling, and could advocate a common standard for both practices. Jean Tirole suggested the adoption for both practices of a predation standard that will include the analysis of the likelihood of tying to reduce competition in the tied market (step 1) the likelihood of

---

[90] Robert Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L. J . 67 (1982); Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 328 (2006).

[91] See, *Prokent/Tomra,* COMP/38.113, IP/06/398, 29 March 2006 (no public version of the decision is available). Tomra appealed. Case T-155/06, judgment pending. See, Frank Maier-Rigaud & Dovile Vaigauskaite, *Prokent/Tomra, a textbook case? Abuse of dominance under perfect information,* (2006) 2 DG COMP COMPETITION POLICY NEWSLETTER 19. See also *Coca-Cola Undertaking* [2005] OJ L 253/21, para 34-35.

[92] Case C-95/04 P, above n 51, para 86-87; Case T-201/04, above n 4, para 688.

tying to hurt consumers (step 2), as well as a recoupment test (step 3).[93] According to this view, tying is a tool for non-price predation, which is defined as "a voluntary and temporary loss in profit that can be rationalized only through a contemplated and substantial increase in the rival's probability of exit and the subsequent ability to recoup losses."[94] However, this proposal is not clear as to which criterion should be used in order to measure loss (and the adequate measure of costs) in this circumstance.

Remarkably, both the European Commission and the US courts that advocate a cost/price standard of predation for bundled discounts continue to employ a specific anticompetitive foreclosure standard for tying. This seems to be an inconsistent approach, at least if one shares the previous point of view. If a predatory cost/price test should be the standard for bundled discounts, the same should also be true for tying. However, the application of a predation test to tying practices seems to be at least controversial, as it will conflict with well-established case law of the Supreme Court and the European Courts, and has not yet been considered as an adequate policy option by either the European or the US antitrust authorities.

Indeed, the distinct/separate product rule, which is the first step of the antitrust analysis of tying cases in EC and in the US, seems redundant if one adopts the same type of antitrust standard as in predatory pricing or single branding cases. Furthermore, a careful consideration of the coercion test, which is the second step of an antitrust claim in both jurisdictions, shows that the distinction between bundled discounts and tying practices is not as clear as it may first appear.

2.3.1. The separate products test. What constitutes a distinct (separate) product?

The judicial test for tying practices in Europe follows similar steps to that for tying in the Unites States. There is anticompetitive tying if (i) the tying and the tied products are two separate (distinct) products, (ii) the undertaking concerned is dominant (or has market power) in the market for the tying product (there is market power in the market for the tying product)[95], (iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product (coercion) and (iv) the practice in question forecloses competition (there are anticompetitive effects in the tied market). The CFI also accepted in *Microsoft* that the Commission rightly examined the objective justifications of the conduct that were advanced by Microsoft[96] and referred to this condition as the fifth step of the analysis.[97] However, the step of objective justification seems to form part of the

---

[93] Jean Tirole, *The Analysis of Tying Cases: A Primer*, 1 COMPETITION POLICY INT'L 1 (2005).
[94] Id. at 20.
[95] Although the CFI and the US courts consider that the requirement of two distinct products constitutes the first step of the competition assessment of tying, the EC Commission's Discussion paper, above n 46, reverses the order and requires first evidence of a dominant position before moving to the separate products requirement. The CFI's approach in *Microsoft* has the benefit of unifying the standard for tying for Article 81 and 82 cases because the existence of market power in the tying product market also constitutes a pre-requisite for the application of Article 81, since the adoption of the *Guidelines on vertical restraints* [2000] OJ C 291/1, para 219-220. Furthermore, it makes more sense to determine if the alleged tying and tied products are distinct before analyzing the existence of a dominant position or market power on the tying product market.
[96] Case T-201/04, above n 4, para 858.
[97] Id. para 869.

fourth limb of the test as it helps to establish the existence of anticompetitive effects (anticompetitive foreclosure).

The separate product test constitutes the first step of the analysis of anticompetitive tying for the purposes of Article 81 and 82 EC. This is also a requirement in the US for tying arrangements but this derives from *Jefferson Parish*, a §1 Sherman Act case and the case law does not seem to require a separate products test for tying under §2 of the Sherman Act.[98] The latter approach presents important advantages, as our analysis will demonstrate.

What is the purpose of the two distinct products requirement? It has been suggested that its main function is to serve as a screening device in order to take into account apparent efficiency gains that follow from the bundling of two separate products.[99] Two items may be considered to be a single product for the purposes of the law of tying when they are subject to certain economies of joint production or distribution that can be achieved only if all customers can be forced to take the entire package. However, the ECJ suggested in *Tetra Pak II* that "even where tied sales of two products are in accordance with commercial usage or there is a natural link between the two products in question (therefore they are single products in the sense of consumer demand), such sales may still constitute abuse within the meaning of Article 82 unless they are objectively justified."[100] This may indicate that even if the two items are considered to be a single product for the purposes of tying, it is still possible that Article 82 will apply if the other conditions of anticompetitive tying are fulfilled. This interpretation may find support in *Microsoft* where the CFI remarked that, "it is difficult to speak of commercial usage in an industry that is 95% controlled by Microsoft."[101] The condition of the existence of two separate products will become devoid of purpose if the commercial usage is defined by the practice of a dominant firm in the market. It seems therefore that if this requirement applies also for the application of Article 82, in situations of "super dominant position"[102], such as in *Microsoft,* it is because it fulfills an additional objective than simply being a screening device for the efficiency of the bundling practice.

The definition of what constitutes a distinct products test may shed light on the real function of this condition. The Commission officials advanced in the Discussion Paper on Article 82 and in its *Microsoft* decision the position that "products are distinct if, in the absence of tying or bundling, from the customers' perspective, the products are or would be purchased separately."[103] They also noted, however, that

> "it is not necessary that the two products belong to two separate product markets. In a market with differentiated products, two products may be

[98] HERBERT HOVENKAMP, above n 24, at 36 fn 25.
[99] *Jefferson Parish Hosp. Dist. No 2 v. Hyde*, 466 U.S. 2, 40-41 (1984) (O'Connor, J., concurring); *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 703 (7th Cir. 1984), (Judge R.A. Posner).
[100] Case C-333/94 P, *Tetra Pak International SA v. Commission* [1996] ECR I-5951, para 37.
[101] Case T-201/04, above n 4, para 910.
[102] The expression refers to a situation of a firm benefiting of an overwhelming dominant position on the market. See, Case C-395/96 P, *Compagnie Maritime Belge Transports SA v Commission* [2000] ECR I-1365, para 114 et seq.
[103] Discussion paper, above n 46, para 185. See also, EC Commission, above n 95, para 216.

sufficiently differentiated that a company can be said to tie or bundle two distinct products."[104]

The distinct product test does not therefore necessarily constitute a relevant market test. The Commission's staff relied in the Discussion paper on direct evidence of consumer demand, such as the fact that the consumers purchase the products separately, when they are given a choice, as well as indirect, such as the fact that firms in competitive markets tend to tie the products together. According to the CFI in *Microsoft*, the distinctness of products for the purpose of applying Article 82 EC "has to be assessed by reference to customer demand" and "in the absence of independent demand for the allegedly tied product, there can be no question of separate products and no abusive tying."[105] However, in *Microsoft* the Commission did not only focus on customer demand but instead accorded equal importance to the demand and the supply sides of the tied product:

> "The distinctness of products for the purposes of an analysis under Article 82 therefore has to be assessed with a view to consumer demand. If there is no independent demand for an allegedly "tied" product, then the products at issue are not distinct and a tying charge will be to no avail.
>
> The fact that the market provides media players separately is evidence for separate consumer demand for media players, distinguishable from the demand for client PC operating systems. There is, therefore, a separate market for these products. There are vendors who develop and supply media players on a stand-alone basis, separate from PC operating systems..."[106]

The CFI refused Microsoft's argument that the Commission should have examined instead if the tying product was regularly offered without the tied product or whether customers wanted Windows without media functionality. Indeed, if this were the test, complementary products could not constitute separate product for the purposes of Article 82 EC.[107]

The Court also noted that, "it is quite possible that customers will wish to obtain the products together, <u>but from different sources</u>."[108] The emphasis on the existence of different sources of supply and, in particular, existence of competing suppliers of the alleged tied product was a factor that apparently influenced the conclusion of the Court that the Windows Operating System and WMP were distinct products.[109] This is in conformity with previous case law of the ECJ that "the fact that there are on the market independent companies specializing in the manufacture and sale of the tied product constitutes serious evidence of the existence of a separate <u>market</u> for that product."[110] Although the Commission's staff also mentions in the Discussion paper on Article 82 the existence of independent suppliers as indirect

---

[104] Discussion paper, above n 46, para 185.
[105] Case T-201/04, above n 4, para 917.
[106] *Microsoft*, above n 2, para 803-804.
[107] Case T-201/04, above n 4,, para 921.
[108] Id. para 922.
[109] Although the CFI also noted that "a not insignificant number of customers continue to acquire media players from Microsoft's competitors, separately from their client PC operating system, which shows that they regard the two products as separate." Id. para 932.
[110] Case C-333/94 P, above n 100, para 293.

evidence of a separate consumer demand, this factor does not play a decisive role in the inquiry on the existence of a distinct product.[111]

The CFI's distinct product test seems to be more supply oriented than the staff discussion paper on Article 82 demand-oriented test. The approach of the Court makes sense if one considers this condition in light of the interpretation by the Court of the condition of foreclosure of competition. The Court assumed that the foreclosure of competitors in the specific circumstances of this case led to consumer detriment, in the sense that consumers' choice and innovation were restricted. A focus on consumer demand, at least as this concept is perceived in defining a relevant market, simply does not address this type of anticompetitive harm, as it generally centers on cross-price elasticity of demand.

The CFI also noted that IT and communications industries develop rapidly and over time separate products might become single.[112] However, it did not take that statement into account in the present case as "it is by reference to the factual and technical situation that existed at the time when…the impugned conduct became harmful…" that the Court assesses the existence of distinct products.[113] However, the importance of consumer demand for bundled operating systems and media players, after Microsoft released the bundled version, shows the evolution of industry practice.[114] If the Court did not finally consider that this was an important factor to take into account, it is because of the supply-oriented character of its definition of the distinct product test and because of its emphasis on the exclusion of rival suppliers of streaming media players. This seems to constitute the main difference from the interpretation of this condition in US antitrust law.

In US antitrust law, the tying and tied products are separate if "the tying item is commonly sold separately from the tied item in a well functioning market."[115] The test is whether there is sufficient consumer demand in the marketplace to support independent markets despite any efficiencies tying may bring. The DC Circuit mentioned in *US v. Microsoft* that "perceptible separate demand is inversely proportional to net efficiencies."[116] The existence on the market of independent companies specializing in the manufacture and sale of the tied product does not constitute adequate evidence of a distinct product under US antitrust law. This explains why in *US v. Microsoft* the DC Circuit found merit in Microsoft's argument that, in the circumstances of the case, the consumer demand test would chill innovation to the detriment of consumers by preventing firms from integrating into their products new functionality previously provided by stand-alone products – and hence, by definition subject to separate consumer demand. The Circuit thus found the *Jefferson Parish* separate products test to be inappropriate:

> "the per se rule's direct consumer demand and indirect industry custom inquiries are, as a general matter, backward-looking and therefore

[111] Discussion paper, above n 46, para 186.
[112] Case T-201/04, above n 4, para 913.
[113] Id. para 914.
[114] The Court accepted in para 904 that "consumers want to find a media player pre-installed on their computers."
[115] HERBERT HOVENKAMP, above n 24, at 415.
[116] *United States v. Microsoft Corp.*, 253 F.3d 34, 87 (D.C. Cir. 2001).

> systematically poor proxies for overall efficiency in the presence of new and innovative integration … the direct consumer demand test focuses on historic consumer behavior, likely before integration and the indirect industry custom test look at firms that, unlike the defendant, may not have integrated the tying and the tied goods. Both tests compare incomparables – the defendant's decision to bundle in the presence of integration, on the one hand, and consumer and competitor calculations in its absence, on the other. Because one cannot be sure beneficial integration will be protected by the other elements of the per se rule, simple application of that rule's separate-products test may make consumers worse off."[117]

However, the position of the CFI in *Microsoft* can hardly be explained by the objective to protect innovation on the market. If this were the case, the CFI should have balanced the benefits, from the point of view of the consumers, of having a new integrated product and the costs of the immediate reduction of consumer choice that the bundling of the alleged "distinct products" would have brought. This test could essentially be performed under the last step of the analysis of tying in the US and the EC: the analysis of anticompetitive effects (foreclosure of competition). The negative effects on consumers should be balanced against efficiency gains that would be passed on to consumers in the form of new products or better quality. The existence of a full rule of reason test for technological tying in the US makes possible the full consideration of these efficiencies without necessarily applying the distinct products test. The decision of the DC Circuit in *Microsoft* to abandon this condition was an immediate consequence of its decision to adopt a rule of reason instead of a *per se* rule approach. The DC Circuit thus seemed to share the view that the separate product test is essentially an obvious and significant efficiency inquiry, a position defended by Justice O' Connor in her dissenting opinion in *Jefferson Parish* and by judge Posner of the Seventh Circuit.

The fact that the CFI adopted a supply-oriented definition of the distinct product test in *Microsoft* could therefore indicate that the main focus of the enquiry is to establish if competitors could viably (profitably) operate in the tied product market. This is relatively easy to prove as the existence in the tied product market of companies that offer only the tied product indicates that there is sufficient consumer demand for the tied product (without the tying product) and therefore that the two products are distinct. It is also clear that a modified *per se* illegality test applies for tying in EC competition law. There is no point of having a distinct product test if the benefits of the single product for the consumers would in any case be examined in the next step of the analysis under a rule of reason standard.[118]

One could nevertheless object to this interpretation that an optimal allocation of the burden of proof between the plaintiff and the defendant would require that the former brings evidence of the absence of any obvious efficiency gains in bundling the products as well as of an anticompetitive effect, before the burden of proof moves to the dominant firm. The later should in this case substantiate other efficiency justifications that would balance the anticompetitive effects of the practice. This

---

[117] Id. at 89.

[118] See, *United States v. Microsoft Corp.,* above n 1, at 96, "(b)ecause courts applying the rule of reason are free to look at both direct and indirect evidence of efficiencies from a tie, there is no need for a screening device as such."

interpretation is valid only if one considers that the distinct product test focuses on consumer demand and operates as a proxy for examining the obvious and significant efficiencies that the single product would bring to consumers. However, this interpretation does not fit well with the CFI's position that the existence of independent suppliers of the alleged tied product indicates that there are two distinct products. Consequently, if the CFI adopted the distinct product rule as the first step of its assessment of bundling, it is because of its emphasis on the foreclosure of rivals from the tied market as a proxy for anticompetitive effects. This explains why the CFI did not focus only on identifying an independent consumer demand for the tied product but also considered as important evidence of the existence of distinct products the fact that there were on the market independent companies specializing in the manufacture and sale of the tied product. The distinct product test is therefore intrinsically linked to the CFI's specific approach in interpreting the requirement of anticompetitive foreclosure, an issue to be examined in the following section.

The Commission's staff Discussion paper on Article 82 employs also the requirement of distinct products in order to distinguish single branding obligations from bundled discounts and mixed bundling strategies. Rebates that are applied by a dominant company for a particular product and have their possible negative effects in the market where the firm is dominant are considered under the rubric of "single branding and rebates" and are subject to a variety of tests, including a predatory cost/price standard for certain types of unconditional rebates. On the contrary, single branding obligations and rebates that have effects in other markets are considered as a form of tying/bundling. This implies, as was previously mentioned, that the existence of distinct products will lead to the analysis of the practice under the tying/bundling rubric rather than under the single branding one.

One could compare this approach with that followed by the DC Circuit in *U.S. v. Microsoft*, when it examined the price bundling claim of Windows and Internet Explorer.[119] According to the D.C. Circuit, in case of a valid allegation of a price bundling claim,[120] the plaintiffs should demonstrate that

> "the anti-competitive effects of Microsoft's price bundling outweigh any procompetitive justifications the company provides for it. In striking this balance, the District Court should consider, among other things, indirect evidence of efficiency provided by the 'competitive fringe'. Although this inquiry may overlap with the separate-products screen under the per se rule, that is not its role here…thus, the separate-products inquiry serves merely to classify arrangements as subject to tying law, as opposed to, say liability for exclusive dealing."[121]

[119] Id, at 96-97.
[120] The allegation of such a claim will depend on evidence that Microsoft charged a price increment for Internet Explorer in Windows. The enquiry is if the price charged for Windows and Internet Explorer was higher than what would have been the price for Windows alone.
[121] Id. at 96-97.

This is essentially an anticompetitive foreclosure test.[122] The distinct product rule could thus indicate the applicable antitrust standard, if single product rebates and tying/bundling are subject to a different form of antitrust assessment. The utility of the distinct product requirement will however be limited if the same antitrust standards apply to both of these practices. As it is also clear from the position of the DC circuit on price bundling, the success of such a claim requires evidence that competing suppliers of the alleged tying product do not sell the bundled (tying and tied) product "*exclusively* at a bundled price."[123] The fact that the firms at the competitive fringe were able to offer an unbundled version of the tying product at a lower price than the bundled version would indicate that the two products can profitably be offered separately and consequently that "at least" for these rivals, the efficiency gains from bundling would "be outweighed by those from separate choice."[124] That finding would also indicate that offering a bundled version is a direct impediment to consumer choice.[125] The Court does not explain however, if this (more supply-oriented) separate product test dismisses the need to prove coercion, which is a requirement for bringing a tying claim and how the rule of reason will apply in this case.

2.3.2. The "coercion" test

It is a common feature in EC and US antitrust law that bundling of two distinct products does not constitute tying unless there has been an effective limitation of the consumers' choice (or coercion) to purchase the products separately.

In EC competition law, there is a tying violation if the undertaking concerned does not give customers a choice to obtain the tying product without the tied product. "Coercion" may arise from the refusal of the dominant firm to sell the tying product without the tied one, either as a contractual clause or *de facto*, from the unavailability of the products separately, from pressure exerted on the customer through the promise of favorable treatment to customers who take both products or threats to those who do not, or from pricing incentives which may be so powerful that no rational customer would choose to buy the products separately.[126] In *Microsoft,* the CFI considered that the consumers were unable to acquire the Windows client PC operating system without simultaneously acquiring Windows Media Player (WMP) and assumed that the requirement of Article 82(d) EC, that the conclusion of contracts is made subject to acceptance of supplementary obligations, was satisfied in this case.

The CFI took the view that the analysis of whether the dominant undertaking does not give customers a choice to obtain the tying product without the tied product, is "merely expressing in different words the concept that bundling assumes that

---

[122] In examining the anticompetitive effect of the price bundling, the Court affirmed that "there is no claim of price predation," thus indicating that price predation is a separate claim than "price bundling." It follows that there is no need to bring evidence that the price of the bundle is lower than a specific measure of costs to bring a "price bundling" claim.
[123] Id. at 97.
[124] Id.
[125] For an analysis of Microsoft's pro-competitive justifications in employing a zero-price bundling of Internet Explorer with Windows see, Benjamin Klein, *Microsoft's use of zero price bundling to fight the "browser wars," in* COMPETITION, INNOVATION AND THE MICROSOFT MONOPOLY: ANTITRUST IN THE DIGITAL MARKETPLACE 217 (eds. Jeffrey A. Eisenach & Thomas M. Lenard, 1999).
[126] HERBERT HOVENKAMP, above n 24, at 410-415.

consumers are compelled, directly or indirectly, to accept supplementary obligations such as those referred to in Article 82(d) EC."[127] It also held that the Commission was right to rely in its decision on Article 82 in its entirety and not exclusively on Article 82(d) EC.[128] Indeed, the test in Article 82 is not exhaustive.[129]

The coercion here was applied primarily to the Original Equipment Manufacturer (OEM) and it was both contractual and technical in nature. First, it was not possible for the OEMs to obtain a license on the Windows operating system without WMP. Second, it was not technically possible for the OEMs to uninstall WMP. However, the CFI also noted that coercion of OEMs indirectly restricted the choice of the end consumers.[130] The approach of the Court is less clear with regard to the first argument of Microsoft, that customers were not required to pay anything extra for WMP. The Court rejected this argument by noting that the price of WMP was included in this case in the total price of the Windows client PC operating system. This argument seems paradoxical since the Court had already accepted that the two products were distinct and should have therefore examined Microsoft's arguments from that perspective.

The CFI also adopted a broad definition of what constitutes coercion stating that, "neither Article 82(d) nor the case-law on bundling requires that consumers must be forced to use the tied product or prevented from using the same product supplied by a competitor of the dominant undertaking."[131] The theoretical possibility that consumers were not prevented from installing and using other media players instead of WMP was not enough for the CFI to conclude that there was no coercion as end consumers had a strong incentive to use WMP.[132]

The requirement of coercion is not mentioned in the Discussion paper on Article 82 for bundling/tying practices. The Commission's staff retain instead the following four criteria for the application of the bundling test:

> "… (i) the company concerned is dominant in the tying market; (ii) the tying and tied goods are two distinct products; (iii) the tying practice is likely to have a market distorting foreclosure effect; (iv) the tying practice is not justified objectively or by efficiencies."[133]

One of the reasons explaining the omission of the coercion test is that the Commission examines together mixed bundling and tying practices and considers mixed bundling as a form of "commercial tying." The main difference between tying and mixed bundling is therefore the form of the restriction of choice of consumers to obtain the tying product without the tied product. In contractual and technical tying, coercion takes a direct form, while for mixed bundling, coercion is indirect and often takes the form of an inducement of the customers to purchase the tied product through

---

[127] Case T-201/04, above n 4, para 864.
[128] Id. para 861.
[129] Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v Commission* [1973] ECR 215.
[130] Case T-201/04, above n 4, para 965.
[131] Id., para 970.
[132] Id. para 1042 referring to the Commission's analysis.
[133] Discussion paper, above n 46, para 183.

granting bonuses, rebates, discounts or any other commercial advantage. However, the Commission distinguishes the two forms of bundling when it examines the foreclosure effect of these practices, as it advocates a cost/price measure for mixed bundling practices.

The requirement of coercion is also broadly interpreted in the United States. The buyer must somehow be forced to accept the tied product. According to Herbert Hovenkamp,

> this coercion should result from (1) an absolute refusal to sell the tying product without the tied product, (2) a discount, rebate or other financial incentive given to buyers who also take the tied product; (3) technological design that makes it impossible to sell the tying product without the tied product."[134]

Coercion does not cover only contractual or technological tying but also situations of commercial tying. This does not fit well with the recent Ninth Circuit's decision in *Cascades v PeaceHealth* where the Court distinguished bundled discounts and tying practices and the antitrust standards that apply to them, based on the fact that tying requires evidence of coercion while this is not the case for bundled discounts:

> "one difference between traditional tying by contract and tying via package discounts is that the traditional tying contract typically forces the buyer to accept both products, as well as the cost savings…Conversely, the package discount gives the buyer the choice of accepting the cost savings by purchasing the package, or foregoing the savings by purchasing the products separately. The package discount thus does not constrain the buyer's choice as much as the traditional tie. For that reason…a variation of the requirement that prices be below cost is essential for the plaintiff to establish one particular element of unlawful bundled discounting – namely, that <u>there was actually tying</u> – that is, that the purchaser was actually <u>coerced (in this case by lower prices)</u> into taking the tied-up package."[135]

When the Ninth Circuit examined the same facts under the tying claim, the Court included financial incentives as a form of coercion that could be attacked as unlawful tying, if their effect was to coerce the customers to buy the tying and the tied product. Persuasion by financial incentives and coercion have similar effects and the Ninth Circuit was quick to find that "there is no doubt that PeaceHealth's practice of giving a larger discount to insurers who dealt with it as an exclusive preferred provider may have <u>coerced</u> some insurers to purchase primary and secondary services from PeaceHealth rather than from McKenzie."[136] The Ninth Circuit noted that "the fact that a customer would end up paying higher prices to purchase the tied products separately does not necessarily create a fact issue on coercion" and "additional evidence of economic coercion" is required.[137] Although "not dispositive evidence of

---

[134] Herbert Hovenkamp, above n 24, at 410.
[135] *Cascade Health Solutions v. PeaceHealth*, above n 7, at 911. Emphasis added. See also, *Virgin Atl. Airways Ltd v British Airways*, above n 7, at 270.
[136] *Cascade Health Solutions v. PeaceHealth,* at 927.
[137] Id.

an illegal tie," the fact that McKenzie's prices for primary and secondary services were lower than PeaceHealth's prices on those services was considered by the Court as constituting a "permissible inference that a rational customer would not purchase PeaceHealth's allegedly overpriced product in the absence of a tie" and therefore that if customers agreed on an exclusive relationship with PeaceHealth, it is because they were coerced by the latter.[138]

One may argue that if coercion could also be established by evidence of economic incentives, which have the potential to induce a rational consumer to buy the tying and the tied product, there is little difference between a tying and a bundled discount claim. The problem is also recognized by the Ninth Circuit, which accepts that economic coercion through inducement could be an alternative theory for McKenzie to present its tying claim. The Ninth Circuit noted that

> "…such a claim might raise the question of whether, to establish the coercion element of a tying claim through a bundled discount, McKenzie must prove that PeaceHealth priced below a relevant measure of its costs. Some commentators would require a plaintiff alleging that a bundled discount amounts to an illegal tie to prove below-cost prices. It is unclear whether the AMC intended its three-part test to apply when a plaintiff alleging an illegal tying arrangement asserts that the defendant's pricing practices coerced unwanted purchases of the tied product … The parties have not briefed this issue to us, and the parties did not raise the issue before the district court. We therefore leave it to the district court, if necessary to decide the issue in the first instance on remand."[139]

This demonstrates the internal contradiction of the Court's decision: how is it possible to think that coercion distinguishes tying from bundled discounts while considering, at the same time, that bundled discounts may constitute a form of coercion? Furthermore, should financial coercion be interpreted as covering only situations where "the pricing structure makes purchase of the tying and tied products together the only viable economic option" or is this standard "too extreme"?[140] The Ninth Circuit's adoption of a different antitrust standard for bundled discounts and for tying practices is based on shaky grounds both in terms of law and policy. As this is well explained by the Ninth Circuit: adopting the modified predatory cost/price standard for bundled discounts implies the abandonment of the anticompetitive foreclosure test for all exclusionary practices, such as tying and exclusive dealing, for a cost/price predatory test. Legal precedent, economic analysis, and policy choices constitute the main obstacles to this evolution.[141] As such re-design of the antitrust standards for exclusionary practices seems normatively undesirable and practically difficult, if not impossible, in view of strong judicial precedent, the application of the foreclosure test for bundled discounts seems to be the best alternative standard.

---

[138] Id., at 928.
[139] Id. at fn 30.
[140] *Ortho Diagnostic Systems v. Abbott Laboratories*, 920 F. Supp. 455, 471 (SDNY 1996) and fn 23.(citing Areeda).
[141] Although the D.C. Circuit acknowledged in *United States v. Microsoft Corp.,* above n 1, at 68 that, except situations of predatory pricing, "antitrust laws do not condemn even a monopolist for offering its product at an attractive price," it did not apply the predatory pricing test or a modified version of it for the nonprice exclusionary practices. See, WILLIAM H. PAGE & JOHN E. LOPATKA, above n 1, at 66.

3. The different meaning of anticompetitive foreclosure in US antitrust and EC competition law

The competitive assessment of bundling practices requires the analysis of the foreclosure of competition in the tying or tied market (depending on the theory of anticompetitive harm) in both EC and US antitrust law. The meaning of the concept of anticompetitive foreclosure has been, and still is, one of the most controversial issues in antitrust law enforcement, not only for bundling but also for all types of exclusionary practices. An important aspect of this debate has been the definition of a limiting principle for antitrust law enforcement that would perceive anticompetitive foreclosure as requiring something more than foreclosure or exclusion of a competitor. For bundling practices, the debate over the adequate standard of foreclosure has been over the following two questions: (i) should the foreclosure effect be presumed from the nature of the bundling practice?, and (ii) in which circumstances does the foreclosure of a competitor from the tied product market constitute anticompetitive foreclosure?

3.1. Foreclosure and the nature of bundling: a quasi-per se rule or a more flexible standard?

Framing competition law standards in conformity with the anticompetitive effects of commercial practices has been a consistent trend in modern competition law, not only in the United States but also in Europe. One may distinguish effects-based approaches from form-based approaches in competition law: the former require the examination of the effects of a practice before concluding that it is anticompetitive while the later focus on the nature of the practice before arriving to any conclusion with regard to its anticompetitive effects. A form-based approach is not necessarily incompatible with the analysis of the anticompetitive effects of a practice. However, instead of analyzing the effects of the specific practice within the specific market context (an *ex post* and *in concreto* analysis), the competition authority or the judge characterize the practice as falling within an *ex ante* pre-defined category of practices which are generally deemed, from previous practical experience or because of a conflict with some fundamental aims of competition law, to produce anticompetitive effects (*in abstracto* analysis).

The US and EC competition law on tying and bundling practices illustrate the evolution of antitrust standards towards a more effects-based approach. Although judicial decisions were often developed without much concern in analyzing anticompetitive effects the more recent case law in the US requires the examination of the anticompetitive effects of the practice before concluding whether there is an illegal tying. In *Jefferson Parish,* the Supreme Court adopted a modified *per se* test for contractual tying that emphasized foreclosure and the degree to which a tie-in denies market access to rivals.[142] There was a presumption of anticompetitive effects whenever a firm with market power employed bundling practices that had the effect of foreclosing rivals from significant market shares in the tied product market or of erecting barriers to entry. In *US v. Microsoft,* the DC Circuit moved to a rule of reason test for software bundles that requires from plaintiffs to demonstrate that the benefits

[142] *Jefferson Parish Hosp. Dist. No 2 v. Hyde*, above n 99, at 12-18.

of the tying practice are outweighed by the harms in the tied product market.[143] This is essentially a cost-benefit analysis test that takes fully into account the efficiency gains to the benefit of consumers and allocates the legal burden of proof to the plaintiff as the plaintiff "must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit."[144] However, it is on the defendant monopolist to "proffer a 'procompetitive justification' for its conduct" if "a plaintiff successfully establishes a *prima facie* case under §2 by demonstrating anticompetitive effect" (evidentiary burden of proof or efficiency justifications). Then "the burden shifts back to the plaintiff to rebut that claim" and if the claim stays unrebutted to prove that "the anticompetitive harm outweighs the procompetitive benefit."[145] This cost-benefit analysis test also applies to bundled discounts.[146] In essence, the anticompetitive foreclosure test in the US looks to the anticompetitive effects of the practice and concludes that there is anticompetitive foreclosure only when the costs are not outweighed by the benefits to the consumers.

EC competition law was initially hostile to tying.[147] In *Hilti* and *Tetra Pak II* the ECJ applied a *per se* test and found that by imposing on their customers numerous obligations that had "no link with the purpose of the contracts," the dominant firms in question had restricted the market access of their competitors and had deprived consumers of any freedom to make their own choice. [148] It results from this case law that if there are independent producers on the tied product market, EC competition law requires the dominant undertaking to abstain from any conduct, such as contractual tying that would have the effect of restricting the freedom of these independent producers to compete on the tied market. Dominant undertakings may claim an objective justification of their conduct, but this concept has been restrictively interpreted as not including any efficiency defense but only broad non-economic public policy concerns, such as safety or health related to the dangerous nature of the product in question.[149]

There are two steps in the abuse control of Article 82:

> "Article [82] covers practices which are <u>likely</u> to affect the structure of a market where, as a direct result of the presence of the undertakings in question, competition has already been weakened, and which, through recourse to methods different from those governing normal competition in products or services based on traders' performance, have the effect of

---

[143] *United States v. Microsoft Corp.*, above n 1, at 95-97.
[144] *Id.* at 59.
[145] Id.
[146] *LePage's Inc v. 3M*, above n 8, at 163-164.
[147] VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE, 8th ed. (2004) at 142.
[148] *Eurofix-Bauco/Hilti* [1988] OJ L 65/19, para 75; Case T-83/91, *Tetra Pak v. Commission* [1994] ECR II-755, para 140; Case C-333/94 P, above n 100, para 36.
[149] For an analysis see, Ekaterina Rousseva, *Abuse of Dominant Position Defenses – Objective Justification and Article 82 EC in the Era of Modernization*, *in* EC COMPETITION LAW – A CRITICAL ASSESSMENT 377-431 (Giuliano Amato & Claud-Dieter Ehlermann, ed.. 2007); Albertina Albors-Llorens, *The Role of Objective Justifications and Efficiencies in the Application of Article 82 EC*, 44 COMMON MARKET L. REV. 1727 (2007).

hindering the maintenance or development of the level of competition still existing on the market."[150]

The abuse test involves first the step of characterization of the conduct as being a type of conduct "likely" or "such as" to affect the structure of an otherwise concentrated market and which constitutes a (business) method "different from those governing normal competition in products or services based on traders' performance" (*in abstracto* analysis). The competition authority or judge will examine, in a second step, the anticompetitive effects of the practice (*in concreto* analysis).[151] The first limb of this test implies that for certain practices there would be a presumption of anticompetitive or pro-competitive effect if the firm has a dominant position, as it will not make sense to have a two-part test otherwise. However, it is not clear what the Court meant by "methods different from those governing normal competition in products or services based on traders' performance," what we will characterize, for the sake of our argument, as "abnormal" practices.

The concept may be explained by the ordo-liberal idea that dominant firms have a special responsibility in preserving competition.[152] Their commercial freedom is therefore restricted in comparison to non-dominant undertakings. The latter remain free to use commercial practices that are different from those governing normal competition. The focus of the test seems to be the protection of "free competition" or "complete competition" and "open markets."[153] The underlying theoretical assumption is that rivalry brings variety in the marketplace, in the sense that entrepreneurs test a certain number of hypotheses on the bundles of parameters of the "product" (price, quality, services and so on), which they think will satisfy consumers' wants; Variety preserves ultimately the choice of the consumers and their ability to test the solutions adopted by the entrepreneurs.[154] The variety of "products"

---

[150] Case 322/81, above n 51, para 70. Emphasis added. Compare with the terminology used by the European Court of Justice in Case 85/76 above n 47, para 91 & Case C-95/04, above n 51, para 66: Article 82 "…refers to conduct *which is such as to influence the structure of the market* where, as a result of the presence of the undertaking in question, the degree of competition is already weakened… ." The difference between "likely to affect" and "conduct which is such as to influence" may indicate a difference in the degree of probability of the occurrence of the outcome ("affect" or "influence" the structure of the market) as a result of the specific conduct.

[151] See, GIORGIO MONTI above n 59, at 171.

[152] Or the "system of variable thresholds" *("System beweglicher Schranken," i.e.* the concept that behaviour which may be unproblematic for competition law purposes in the hands of a firm in a competitive market need not be harmless in the hands of a dominant firm) *:* Wernhard Möschel, *Art. 82 EC* (para 120), *in* WETTBEWERBSRECHT EG PART I *(*Ullrich Immenga & Ernst-Joachim Mestmäcker ed, 4th edn, 2007); *idem*, *GWB § 19* (para 16), *in* WETTBEWERBSRECHT EG PART I. But see, Volker Emmerich, KARTELLRECHT*,* 10th ed, (2006) § 27, para. 63,.

[153] Walter Eucken, *Die Wettbewerbsordnung und ihre Verwirklichung (The Competitive Order and Its Implementation)*, 2 ORDO, JAHRBUCH FÜR DIE ORDNUNG VON WIRTSCHAFT UND GESELLSCHAFT 1-99 (1949) (translated in English by Christian Ahlborn and Carsten Grave) at 2(2) COMPETITION POLICY INT'L (2006). More recently, see Jurgen Basedow, *Konsumentenwohlfahrt und Effizienz – Neue Leitbilder der Wettbewerbspolitik?*, 57 WIRTSCHAFT UND WETTBEWERB 712 (2007). See, however, C. Christian von Weizsäcker, *Konsumentenwohlfahrt und Wettbewerbsfreiheit: Über den tieferen Sinn des "Economic Approach,"* 57 WIRTSCHAFT UND WETTBEWERB 1078 (2007).

[154] CHRIS MANTZAVINOS, INDIVIDUALS, INSTITUTIONS, AND MARKETS (2001) at 193-203. This conception of competition as a process of rivalry rather than as a market equilibrium (neo-classical theory) is not very different from that developed by the Old-Institutionalist School in the United States and that of John M. Clark, *Competition and the Objectives of Government Policy*, *in* MONOPOLY AND COMPETITION AND THEIR REGULATION 317, 326 (Edward H. Chamberlin, 1954). However, although

(or solutions suggested by the entrepreneurs) would not therefore be the outcome of the "natural" selection process of the marketplace, but the outcome of the "artificial selection" of formal and informal institutions that "channel the competitive process and give it a certain direction," thus selecting "at the same time, artificially, which entrepreneurial hypotheses will survive."[155] Dominant firms are in a position to influence directly the market activities of other economic agents and therefore may constitute an informal institution that can indirectly affect the ultimate choice of the consumers. Their freedom of action is therefore restricted to "performance competition," offering better terms to consumers, and does not extend to "impediment competition," such as loyalty rebates, predatory pricing etc, that would hinder the ability of rivals to compete, in other words, to offer their own set of solutions to the essential problem of productive activity: what "products" do the consumers prefer?[156]

The difficulty with this approach is to identify the practices that are deemed "abnormal," as in theory there is a great variety of commercial practices that may have potentially the effect of excluding rivals from the market or of substantially hindering their ability to compete.[157] The test is unworkable if there is no limiting principle that will make possible for the dominant undertakings to identify *ex ante* if their commercial practices are incompatible with competition on the merits and will therefore will examined under the second limb of the test. One could also interpret the first limb of the test as covering all practices that are likely (not just capable of) to exclude rivals from the market, a test that would require more than just establishing the mere probability of exclusion and would resemble to a balance of probabilities test.[158] Nevertheless, distinguishing the practices that, on a balance of probabilities

---

these concepts of competition are different from "perfect competition," they are not unrelated. See, John Vickers, *Concepts of Competition*, 47 OXFORD ECON. PAPERS 1, 7 (1995).

[155] CHRIS MANTZAVINOS, above n 154, at 174.

[156] The distinction between "performance competition" and "impediment competition" was suggested as an element distinguishing abusive from non-abusive practices by professor Peter Ulmer of the University of Heidelberg and was influential in the enforcement of the German Act against Restraints of Competition (GWB): DAVID J. GERBER, LAW AND COMPETITION IN THE TWENTIETH CENTURY EUROPE: PROTECTING PROMOTHEUS, 1998, at 313, citing PETER ULMER, SCHRANKEN ZULÄSSIGEN WETTTBEWERBS MARKTBEHERRSCHENDER UNTERNEHMEN, (1977). See also, John Kallaugher & Brian Sher, above n 62, at 269; Lisa Lovdahl Gormsen, *Article 82 EC: Where are we coming from and where are we going to?*, 2(2) COMP. L. REV. 5 (2006). For a criticism, from other ordo-liberals of the "impediment competition" concept, see Erich Hoppmann, *Behinderungsmissbrauch und Nichtleistungswettbewerb*, 30 WIRTSCHAFT UND WETTBEWERB 811 (1980); Wernhard Möschel, *GWB § 19*, *in* WETTBEWERBSRECHT EG PART I, above n 152, para. 102-105; Volker Emmerich, KARTELLRECHT, 10th ed., (2006), § 27, para. 68.

[157] Case C-95/04 P, above n 51, para 68 (in order to determine if there is exclusionary effect one should determine whether the dominant firm's conduct/practices are "capable, first, of making market entry very difficult or impossible for competitors of the undertaking in a dominant position and, secondly, of making it more difficult or impossible for its co-contractors to choose between various sources of supply or commercial partners"). This seems to set the standard of proof too high. Compare, however, with the French version of the decision (para 68): *"…il convient, d'abord, de vérifier si ces rabais ou primes peuvent produire un effet d'éviction, c'est-à-dire s'ils sont à même, d'une part, de rendre plus difficile, voire impossible, l'accès au marché pour les concurrents de l'entreprise en position dominante et, d'autre part, de rendre plus difficile, voire impossible, pour ses cocontractants, le choix entre plusieurs sources d'approvisionnement ou partenaires commerciaux."* (It is sufficient for Article 82 to apply that market access for the competitors became more difficult or [in certain cases] impossible.)

[158] On the terminology (e.g. likely, capable or tend to restrict competition) used by the different cases of the CFI and the ECJ in the context of a multilingual legal system, see Klaus Pfeiffer, *Reflections on British Airways v Commission*, 28 ECLR 597 (2007).

following an *in asbtracto* analysis, are likely to produce such an effect from those that are not likely to achieve exclusion is still an unclear test.

The case law on tying and loyalty rebates seems also to conflict with the more flexible position adopted by the ECJ in *Oscar Bronner* on refusals to supply. In this case, the Court took a restrictive view of the obligation of a dominant undertaking to grant access to its facilities to its competitors, compared to the previous case law.[159] Bronner, a publisher of a newspaper in Austria had refused access to a competing newspaper to the nationwide home-delivery scheme it had established. The Court stressed that the refusal "must be likely to eliminate all competition" on the part of the competitor requesting access, that access should be indispensable and not only make it harder for the requesting undertaking to compete and that it should not be capable of being objectively justified.[160] With regard to the indispensability condition, the Court held that access would have been indispensable only if it was not economically viable to create a home-delivery system for a newspaper with a comparable circulation to the dominant firm's.[161] One could argue that the conditions in *Bronner* set the outer boundaries of the special responsibility of a dominant firm and consequently of the corresponding duty, under Article 82, to abstain from any action that would be likely to exclude rivals from the market. The excluded rival would be granted access only if it would be impossible for an undertaking with a comparable output to the dominant firm to develop such facility, which indicates that the Court applied a not yet as efficient as test.

Drawing on this case law, Jean-Yves Art and Gregory McCurdy argued that the Microsoft bundling case could be re-interpreted as a refusal to supply case and that it should be examined in conformity with the limiting principles of *Bronne*r.[162] They claim that the main issue involved in the bundling part of the Microsoft case is that by offering to OEM only a bundled version of Windows and WMP, Microsoft had effectively denied to its competitors in the media player market access to the appropriate "distribution services" of the OEMs (the OEMs would operate in this case as intermediaries between the market players on the tied product market and the final consumers). However, access to the OEMs was necessary to maintain competition in the media player market. Their argument was that the application of the *Bronner* principles in the factual situation of Microsoft would not have led to an infringement of Article 82, as distribution of the player in Windows was not indispensable and that Internet downloading was a feasible and only "less advantageous" distribution channel.

There are at least two objections to this conclusion. First, even if the Bronner conditions applied in this case, it is uncertain that they would not have led to the finding of an infringement, as indispensability is measured with reference to the possibility of creating an economically viable distribution channel. It remains to be seen if Internet downloading could be considered as an economically viable alternative to access to the Original Equipment Manufacturers in order to bring the

---

[159] Case C-7/97, *Oscar Bronner GmbH & Co KG v. Mediaprint* [1998] ECR I-7791.
[160] Id. para 41.
[161] Id. para 45-46.
[162] Jean-Yves Art & Gregory S. McCurdy, *The European Commission's media player remedy in its Microsoft decision: compulsory code removal despite the absence of tying or foreclosure*, 25(11) ECLR 694, 703-707 (2004)

product to the attention of the final consumers. Second, in *Bronner* the dominant firm was refusing access to a facility it owned and which was the product of its own investment and efforts.[163] The refusal to access was therefore a legitimate exercise of the undertaking's property rights. On the contrary, if we follow Art's and McCurdy's arguments, Microsoft's refusal to supply access to the "distribution services" of the OEMs to its rivals could not be considered as the legitimate exercise of a property right for the simple reason that the OEMs were not owned by Microsoft.[164] One could thus advance the following limiting principle of the doctrine of exclusion in EC competition law: exclusionary unilateral commercial practices that are no more than a legitimate exercise of a property right are not considered as being "abnormal practices" and are therefore legal, unless they may have the effect to exclude an hypothetically efficient rival (or a not yet as efficient rival) from the market when access is indispensable for that rival to be able to carry on his activities in the downstream market and there is no actual or potential substitute for it.[165] Moreover, the refusal must be incapable of objective justification. In all other circumstances, foreclosing competitors' access to distribution channels is presumed as likely to affect the structure of the market and to hinder competition, absent any objective justification.[166] This is how one can interpret the *dicta* of the CFI in *Michelin II* that

> "…for the purposes of applying Article 82 EC, establishing the anti-competitive object and the anti-competitive effect are one and the same thing. If it is shown that the object pursued by the conduct of an undertaking in a dominant position is to limit competition, that conduct will also be liable to have such an effect."[167]

The comparative analysis of the *Michelin II* and the *British Airways'* rebates cases provides an example of how a form-based approach is different from a more effects-based test. In *Michelin II*, the CFI spent a number of paragraphs in examining if the specific target rebate scheme could be characterized as loyalty inducing. This characterization did not require from the Court an analysis of the concrete effects of

---

[163] See also, in favor of this interpretation of Bronner, Case C-552/03, above n 72, para 137.

[164] The result would not have been different in EC competition law if Microsoft decided to integrate vertically (and to own OEMs). This situation could have been analyzed as a case of refusal to supply to existing customers (in the sense that competing media players would not have access to OEMs that would have been open to them otherwise) and judged under the strict standards of *Commercial Solvents*. See, Cases 6 & 7/73, *Instituto Chemioterapico Italiano Spa & Commercial Solvents Corp. v. Commission* [1974] ECR 223.

[165] Case C-7/97, above n 159, para 41. Refusals to supply will in this case be examined under the *Bronner* test. Intellectual property rights are subject to a more lenient standard, as it is only if the refusal to license impeded the emergence of a new product that Article 82 would apply. On the different standards applying to intellectual property rights than to tangible property rights see, Case T-201/04, above n 4, para 334. See also, Ioannis Lianos, *Competition Law and Intellectual Property Rights: Is the Property Rights' Approach Right?*, *in* CAMBRIDGE YEARBOOK OF EUROPEAN LEGAL STUDIES 153-186 (John Bell & Claire Kilpatrick ed. 2006).

[166] In this sense, charging predatory prices may be considered as an illegitimate exercise of property rights, when the dominant firm is charging less than its average variable costs, as in this case there may be no other rational explanation of the firm's behavior than an intent to exclude its rivals from the market (however, this should not be an irrebuttable presumption). Such exclusionary intent is anticompetitive because of the special responsibility of the dominant firm. The approach should not be different for unconditional single-product discounts as in this case there is no coercion of the buyers (or consumers) to buy another product (tied product) and the firm exercises its property rights in fixing the price of its product.

[167] Case T-203/01 above n 51, para 241.

this specific scheme to consumers. This was not the purpose of the enquiry as it forms part of the second limb of the abuse test, which relates to the analysis of anticompetitive effects. Instead, the CFI conducted an *in abstracto* analysis of the facts of the case in order to find out if the quantity rebate system, put in place by Michelin, fitted the characterization of "loyalty inducing" rebates.[168] The CFI considered that quantity rebates that are justified by a "countervailing advantage," that is "economically justified," do not constitute in general loyalty inducing rebates and that they therefore escape the prohibition of Article 82.[169] However, this was not the case here as the Court subjected this economic justification of the rebate to a high standard of proof.[170] In the absence of an objective justification, the CFI concluded that the rebate system was loyalty inducing.[171] "Because" of its loyalty-inducing character the quantity rebate scheme "limited the dealers' choice of supplier and made access to the market more difficult for competitors."[172] The anticompetitive effect of this practice was thus presumed from the simple characterization of the rebate scheme as loyalty inducing without any analysis of anticompetitive effects and possible consumer detriment. One could compare this approach to a quasi-*per se* illegality test for loyalty-inducing rebates.

The position of the CFI, this time confirmed by the ECJ, seems to have slightly evolved in *British Airways*. The CFI referred to the *Michelin II* case and considered that

> "It can be deduced from that case-law generally that any fidelity-building rebate system applied by an undertaking in a dominant position tends to prevent customers from obtaining supplies from competitors, in breach of Article 82 EC, irrespective of whether the rebate system is discriminatory. The same applies to a fidelity-building performance reward scheme practiced by a purchaser in a dominant position in relation to its suppliers of services." [173]

However, the Court also added that even if the specific schemes had a "fidelity –building" effect, they could escape the application of Article 82 if they were based on an "economically justified consideration."[174] It would indeed be possible for the dominant undertaking to justify these fidelity-inducing rebates by referring to efficiency justifications.[175] It is remarkable that the consideration of the existence of objective economic justifications does not take place in order to determine whether the rebate scheme has a loyalty inducing effect, as it was the case in *Michelin II*, but follows the characterization step of the rebate scheme as having a fidelity-building character.[176] Moreover, it can include countervailing efficiency gains which benefit consumers.[177] In conclusion, in *British Airways* the CFI considered that the loyalty rebates schemes should not be examined under the first limb of the abuse test and that

---

[168] Id. para 95. The Court concluded that the rebate scheme offered by Michelin "has the characteristics of a loyalty-inducing discount system."
[169] Id. para 100.
[170] Id. para 108-109.
[171] Id. para 113.
[172] Id. para 110 & 240.
[173] Case T-219/99 above n 51, para 248.
[174] Id. para 271.
[175] Id. para 280.
[176] See, ALISON JONES & BRENDA SUFRIN, EC COMPETITION LAW, 3d ed (2007) 504.
[177] Case T-219/99 above n 51, para 279-280.

the competition assessment should include an analysis of their anticompetitive effects, under the second limb of the test. This is closer to a structured rule of reason approach than to a quasi-*per se* illegality rule. The ECJ confirmed the approach of the CFI and adopted a formulation of the test that resembles to a structured rule of reason approach:

> "It has to be determined whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of that system bears no relation to advantages for the market and consumers, or if it goes beyond what is necessary in order to attain those advantages, that system must be regarded as an abuse."[178]

In contrast to *Michelin II*, the Court also referred to the existence in this case of a consumer prejudice, which is an indication that it placed its analysis under the second limb of the abuse test.[179] The consideration of anticompetitive effects constitutes the main difference between the decision of the CFI in *Michelin II* and that of the ECJ in *British Airways*. However, as we will examine in the next section, examining the existence of exclusionary effects does not necessarily mean that evidence of anticompetitive effects and consumer detriment is required. In other words, the analysis of possible economic justifications of a discount with a fidelity-building effect, does not necessarily amount to the adoption of an effects-based approach.

In *Microsoft,* the European Commission was constrained in its choice of the adequate antitrust standard by hostility to dominant firms imposing a tie, following the *Hilti* and *Tetra Pak II* cases. However, instead of basing its decision on the traditional theory of tying, which advocates a quasi *per se* illegality test if there is evidence of foreclosure, the Commission proceeded to the second limb of the abuse test:

> "(t)here are indeed circumstances relating to the tying of WMP which warrant a closer examination of the effects that tying has on competition in this case. While in classical tying cases, the Commission and the Courts considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate product with the dominant product, in the case at issue, users can and do to a certain extent obtain third party media players through the Internet, sometimes for free. There are therefore indeed good reasons *not* to assume without further analysis that tying WMP constitutes conduct which by its very nature is liable to foreclose competition."[180]

The Commission effectuated therefore in this case a structured rule of reason approach by examining the anticompetitive effects of the practice, the efficiency justifications argued by Microsoft and Microsoft's incentives to foreclose, before concluding that Microsoft's conduct infringed Article 82 EC.

---

[178] Case C-95/04 P above n 51, para 86.
[179] Id. para 106.
[180] Commission Decision, *Microsoft* above n 2, para 841.

The CFI accepted the position of the Commission but uses language that limits the scope of the structured rule of reason approach in situations of technological tying. The Court mentioned that, "while it is true that neither the provision nor, more generally, Article 82 EC as a whole contains any reference to the anticompetitive effect of bundling, the fact remains that, in principle, conduct will be regarded as abusive only if it is capable of restricting competition."[181] This may be interpreted as indicating that the Court will focus its analysis of bundling in general (including contractual tying) on the second limb of the abuse test and will always examine the existence of anticompetitive effects. However, the Court also referred to the *Michelin II* case,[182] in order to substantiate this point, which is a case where, as previously mentioned, the CFI took the position that "establishing the anti-competitive object and the anti-competitive effect are one and the same thing."[183] The CFI could have referred to the *British Airways* cases, to substantiate this specific position but it didn't do so. It is reminded that the CFI and the ECJ did not apply in *British Airways* a quasi-*per se* illegality test and employed instead a structured rule of reason approach. They also used a slightly different terminology than the CFI in *Michelin II*.[184] The following paragraph of the *Microsoft* decision also indicates the ambivalence of the CFI's approach with regard to the applicable antitrust standard for tying:

> "…the applicant cannot claim that the Commission relied on a new and highly speculative theory to reach the conclusion that a foreclosure effect exists in the present case. As indicated at recital 841 to the contested decision, the Commission considered that, in light of the specific circumstances of the present case, it could not merely assume, *as it normally does in cases of abusive tying*, that the tying of a specific product and a dominant product has by its nature a foreclosure effect. The Commission therefore examined more closely the actual effects which the bundling had already had on the streaming media player market and also the way in which that market was likely to evolve."[185]

It seems therefore that the CFI accepted the structured rule of reason approach of the Commission, with regard to technological tying, but maintained its previous quasi *per se* illegality approach for all other forms of bundling (essentially contractual tying). In the French version of the same paragraph the CFI even uses the expression "*effet d'exclusion sur le marché per se*" (bundling of two products by a dominant undertaking leads to an exclusionary effect *per se*) when it refers to the "normal" approach for abusive tying cases.

In conclusion, in examining the existence of the fourth step of a tying claim,[186] the CFI did not presume that there was foreclosure of competition from the simple fact that a dominant undertaking tied two distinct products with the consequence that competitors were foreclosed but had to examine if the foreclosure of competitors led to anticompetitive effects and if there were objective justifications (efficiencies). It seems therefore that the analysis of objective (or efficiency) justifications constitutes

[181] Case T-201/04, above n 4, para 867.
[182] Case T-203/01 above n 51, para. 239.
[183] Id. para 241.
[184] On this point, see our next Section.
[185] Case T-201/04, above n 4, para 868 (emphasis added).
[186] Id. para 852 referring to para 842.

a necessary complement to the analysis of the existence of an anticompetitive foreclosure. This seems to introduce implicitly a structured rule of reason approach for technological tying. The CFI also provided indications on the way efficiencies will be included in the fourth step of the competition assessment of tying and on the allocation of the burden of proof:

> "…although the burden of proof of the existence of the circumstances that constitute an infringement of Article 82 EC is borne by the Commission, it is for the dominant undertaking concerned, and not for the Commission, before the end of the administrative procedure, to raise any plea of objective justification and to support it with arguments and evidence. It then falls to the Commission, where it proposes to make a finding of an abuse of a dominant position, to show that the arguments and evidence relied on by the undertaking cannot prevail and, accordingly, that the justification put forward cannot be accepted"[187]

The CFI seems to distinguish between the legal burden of proof that is borne by the plaintiff and the evidentiary burden of proof of objective justifications that is borne by the defendant. If the defendant "raises" these objective justifications, it is on the plaintiff to "show" that these cannot be accepted. However, there are important differences between US antitrust law and EC competition law with regard to the analysis of the anticompetitive effects, despite the fact that anticompetitive foreclosure constitutes the focus of the competitive assessment in both jurisdictions.

3.2. When does the foreclosure of a competitor produce anticompetitive effects?

The proof of the existence of anticompetitive foreclosure requires an analysis of the concrete effects of the practice adopted by the alleged monopolist (or dominant firm). This implies the analysis of how the specific practice may affect consumers. The exclusion or foreclosure of competitors is not sufficient to substantiate a claim of anticompetitive foreclosure.[188] Something more is required. This is an assertion to which both EC and US antitrust law would agree, at least for technological tying. There is, however, a significant divergence between the EC and the US approach with regard to which are these additional elements to the foreclosure of competitors that may substantiate a finding of anticompetitive foreclosure (or anticompetitive effects) and therefore of a competition law infringement. The role of objective (or efficiency) justifications was examined in the previous section. We will now focus our analysis on the two additional elements of anticompetitive foreclosure, that is: the anticompetitive harm story and the existence of a consumer detriment.

---

[187] Id. para 1144.

[188] This is particularly clear in the recent *Commission Notice, Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (2007), http://ec.europa.eu/comm/competition/mergers/legislation/nonhorizontalguidelines.pdf , para 18, where the Commission distinguishes between "foreclosure" ("any instance where actual or potential rivals' access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies' ability and/or incentive to compete," which as such does not bring evidence of a significant impediment to effective competition) and "anticompetitive foreclosure" (when as a result of such foreclosure the merging company will be able to harm consumers).

The denial of market access to rivals does not constitute by itself evidence of anticompetitive foreclosure, but only a starting point for the analysis of exclusionary abuses. Both EC and US antitrust law require an anticompetitive harm story that will link the exclusion of the competitors to the existence of a consumer detriment or to that of a negative consumer welfare effect.

An important difference between the two jurisdictions is that leveraging constitutes an anticompetitive harm story that is widely accepted in Europe while it seems to be controversial in the United States. Anticompetitive leveraging was one of the main theories of harm advanced by the Commission in the *Microsoft* case.[189] The CFI also relied on the same theory of anticompetitive harm[190] and confirmed on this basis the substantial fine imposed by the Commission.[191]

One could compare the approach of the Commission and the CFI with the US case against Microsoft, where the separate claim of monopoly leveraging was dismissed by Judge Jackson of the D.C. District Court.[192] Although the Supreme Court revived a version of the leverage theory in *Eastman Kodak*,[193] the Supreme Court has recently held in *Trinko* that for a leverage claim to succeed there must be a "dangerous probability of success" in monopolizing a second market.[194] The existence of market power on an adjacent market does not seem to be a requirement for the application of the leverage theory in Europe.[195] Consequently, the standard of proof for leverage claims is higher in the US than in Europe.[196]

The approaches of the EC competition law and US antitrust also diverge with respect to the analysis of the anticompetitive effects. The Commission claimed in its *Microsoft* decision that the tying of Windows Media Player had not only foreclosed competition in the media players market,[197] but had also "spillover effects on

---

[189] *Microsoft* above n 2, para 982.
[190] Case T-201/04, above n 4, para. 1344 & 1347.
[191] Id. para 1363.
[192] *United States v. Microsoft Corp*., 1998 WL 614485, at 1, 26-27 (D.D.C. Sept. 14, 1998), where "because the theory of "monopoly leveraging" is inconsistent with both the Sherman Act's plain text and with Supreme Court pronouncements on the general limitations of its reach," Judge Jackson granted summary judgment in favor of Microsoft and did not accept that "Microsoft had unlawfully used its operating system monopoly to obtain a competitive advantage in the browser market," as the States' complaints alleged.
[193] *Eastman Kodak Co. v. Image Technical Services,* 504 U.S. 451 (1992).
[194] *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 415 n4 (2004). In this case, the Supreme Court erred in misunderstanding the fact that Verizon was a monopolist of both the infrastructure network as well as the retail local telecommunications services that were produced using that network and for which use of that network was essential. Verizon leveraged its network infrastructure monopoly by using strategies that raised the costs and degraded the quality of rivals who leased parts of its network so as to enhance and preserve its monopoly. See Nicholas Economides, *Vertical Leverage and the Sacrifice Principle: Why the Supreme Court got Trinko Wrong*, 63(3) NEW YORK UNIVERSITY ANNUAL SURVEY OF AMERICAN LAW 379 (2005). Pre-publication electronic copy available at http://www.stern.nyu.edu/networks/Economides_Trinko.pdf; Nicholas Economides, *Hit and Miss: Leverage, Sacrifice, and Refusal to Deal and the Supreme Court Decision in Trinko*. Forthcoming, VANDERBILT J. OF ENTERTAINMENT & TECH. L. (2007). Pre-publication electronic copy at http://www.stern.nyu.edu/networks/Hit_and_Miss.pdf.
[195] Case T-201/04, para 599 (although this paragraph relates to the refusal to supply part of the case, it applies to all types of leverage theory claims, such as the bundling of Windows and WMP.).
[196] Leverage claims are rarely successful in the US. See, however, *Conwood Co. v United States Tobacco Co.,* 290 F.3d 768 (6th Cir. 2002), *cert. denied*, 537 U.S. 1148 (2003).
[197] *Microsoft*, above n 2, para 835-954.

competition in related products such as media encoding and management software (often server-side), but also in client PC operating systems for which media players compatible with quality content are an important application."[198] The Commission considered that the bundling of Windows with WMP produced the following anticompetitive effects:

"Microsoft uses Windows as a distribution channel to ensure for itself a significant competitive advantage on the media players market (recital 979 to the contested decision);

– because of the bundling, Microsoft's competitors are a priori at a disadvantage even if their products are inherently better than Windows Media Player (ibid.);

– Microsoft interferes with the normal competitive process which would benefit users by ensuring quicker cycles of innovation as a consequence of unfettered competition on the merits (recital 980 to the contested decision);

– the bundling increases the content and applications barriers to entry, which protect Windows, and facilitates the erection of such barriers for Windows Media Player (ibid.);

– Microsoft shields itself from effective competition from vendors of potentially more efficient media players who could challenge its position, and thus reduces the talent and capital invested in innovation of media players (recital 981 to the contested decision);

– by means of the bundling, Microsoft may expand its position in adjacent media-related software markets and weaken effective competition, to the detriment of consumers (recital 982 to the contested decision);

– by means of the bundling, Microsoft sends signals which deter innovation in any technologies in which it might conceivably take an interest and which it might tie with Windows in the future (recital 983 to the contested decision)."[199]

The CFI conducted a limited analysis of the alleged anticompetitive effects. This is normal practice as Article 230 EC institutes a limited control of the legality of the Commission's decisions and the intensity of the judicial review of the economic appreciations of the Commission is necessarily restricted.[200] The CFI concluded that "there was a reasonable likelihood that tying Windows and WMP would lead to a

[198] Id. para 841.
[199] Case T-201/04, para 1088.
[200] Id., para 87-89. See, Hubert Legal, *Standards of proof and standards of judicial review in EU competition* law, in BARRY HAWK (ed) ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE (2006), vol. 32, 107. Comp. however with the recent case law of the CFI and ECJ on the standard of judicial review for merger cases. See, Matteo F. Bay & Javier Ruiz Calzado, *Tetra Laval II: The coming of Age of the Judicial Review of Merger Decisions*, 28 WORLD COMP. 433 (2005).

lessening of competition so that the maintenance of an effective competition structure would not be ensured in the foreseeable future."[201] The CFI used the expression "reasonable likelihood" of anticompetitive effects, instead of the expression "capable of having" anticompetitive effects, which it had used in previous decisions.[202] It also used the expression "actual effects" when it referred to the Commission's analysis of the anticompetitive effects of bundling.[203]

A closer look to the alleged anticompetitive effects and their analysis by the Court reveals, however, that most of these negative effects to consumers were indirect and emanated from the fact that Microsoft benefited from an "unparalleled advantage with respect to the distribution of its product" that "inevitably had significant consequences for the structure of competition" on the streaming media player market.[204] First, the bundling of Windows and WMP allowed WMP to benefit "from the ubiquity of that operating system on client PCs which cannot be counterbalanced by the other methods of distributing media players."[205] The CFI noted the risk of "*de facto* standardization of the Windows Media Player" market that would follow from Microsoft's practice and the leverage of its quasi-monopoly from the PC operating system market to the media player market. Indeed, "(a)lthough, generally, standardization may effectively present certain advantages, it cannot be allowed to be imposed unilaterally by an undertaking in a dominant position by means of tying."[206] According to the Court, the emergence of a *de facto* standard should be the result of competition between the "intrinsic merits" of the products and *in fine* depend from the consumers' choice rather than from the arbitrary decision of a dominant firm to impose its own standard.[207]

Second, Microsoft's bundling practice would have restricted consumers' access to similar or better quality products than WMP.[208] The CFI noted that, because of the bundling practice, "consumers have an incentive to use Windows Media Player at the expense of competing media players, notwithstanding that the latter players are of better quality."[209] It seems that the CFI based this finding on the comparative reviews

---

[201] Id. para 1089.
[202] Case T-219/99 above n 51, para 293, where the CFI held that "it is sufficient … to demonstrate that the abusive conduct of the undertaking in a dominant position tends to restrict competition, or, in other words, that the conduct is capable of having, or likely to have, such an effect." The Commission has also referred to the "capability of conduct to foreclose" and to the "likelihood that an anticompetitive foreclosure effect results (from that conduct) in the DG Competition discussion paper on the application of Article 82, above n 46, para 59. Compare with the standard of proof when leverage through bundling is examined under the merger regulation: See, Case T-210/01 *General Electric v. Commission* [2005] ECR II-5575, para 399-473 (the Commission has to establish that the merged entity would have been likely (in other words would have sufficient incentives) to engage in bundling practices. The Commission has also to consider "the potentially unlawful, and thus sanctionable, nature of certain conduct as a factor, which might diminish, or even eliminate, incentives for an undertaking to engage in particular conduct" Id. para 304). See also on this point, Case C-12/03 *Commission v Tetra Laval* [2005] ECR I-987, para 74-78. However, both of these two requirements relate to the prospective analysis undertaken under the merger regulation and do not therefore indicate, as such, a higher standard of proof compared to that applied in Article 82 cases for bundling.
[203] Case T-201/04, above n 4, para 1035.
[204] Id. para 1054.
[205] Id. para 1036
[206] Id. para 1152.
[207] Id. para 1040 & 1046-1047.
[208] Id. para 1356.
[209] Id. para 971.

of media players presented by Microsoft during the administrative procedure before the Commission's decision. These comparative studies indicated that WMP was of lower quality than some of the other excluded media players as it had achieved a lower rank than RealPlayer in more than half of these comparative reviews.[210]

Third, the ubiquity of Windows Media Player as a result of its bundling with Windows was capable of having "an appreciable impact on content providers and software designers" because of the significant "indirect network effects" ("positive feedback loop") that existed in the WMP market.[211] According to this theory, the greater the number of users of a given software platform, the more will be invested in developing products compatible with that platform, which in turn will reinforce the popularity of that platform with users.[212] The CFI accepted that such a phenomenon existed in this case as there was evidence that the content providers and software developers chose the technology for which they develop their own products on the basis of the percentage of installation and use of media players. Furthermore, the CFI ruled that they were inclined because of the cost of additional development and administrative costs to use only one technology for their products. Encoding streamed content in several formats is expensive and time-consuming and these costs are not outweighed from the advantages resulting from encoding in terms of increasing the potential reach of content providers and software developers' products.[213]

The Court concluded that the ubiquity of Windows Media Player on Windows PCs "secured Microsoft a competitive advantage unrelated to the merits of its products" and erected a barrier to entry to new "contenders," not only on the media players market but also "on other adjacent markets," such as "media players on wireless information devices, set-top boxed, DRM solutions and on-line music delivery."[214] The Court found that the evolution of the market consistently pointed to "a trend in favor of WMP and Windows Media formats to the detriment of the main competing media players (and media technologies), such as RealPlayer and QuickTime Player.[215] In addition, the RealPlayer installed base was significantly lower than that of WMP, as it was present on only 60-70% of home PCs in the US, while the rate of installation of WMP was 100% on Windows client PCs and more than 90% on client PCs.[216]

The CFI did not discuss the existence of direct consumer harm and seemed to infer consumer detriment from the alteration of the competitive structure of the media player market. This is in conformity with the approach generally followed by the European Courts for exclusionary abuses under Article 82.[217] The preservation of the competitive process constitutes an important objective of competition law. Advocate General Kokott in *British Airways* has eloquently explained this position:

---

[210] *Microsoft*, above n 2, para 949-951.
[211] Case T-201/04, above n 4, para 1061.
[212] Id.
[213] Id. para 1065-1066.
[214] Id. para 1076.
[215] Id. para 1078-1081.
[216] Id. para 1087.
[217] Case C-95/04 P, above n. 51, para 106 ("… Article 82 is aimed not only at practices which may cause prejudice to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure, such as is mentioned in Article 3(1)(g) EC").

> "The starting-point here must be the protective purpose of Article 82 EC. The provision forms part of a system designed to protect competition within the internal market from distortions (Article 3(1)(g) EC). Accordingly, Article 82 EC, like the other competition rules of the Treaty, is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the *structure of the market* and thus *competition as such (as an institution)*, which has already been weakened by the presence of the dominant undertaking on the market. In this way, consumers are also indirectly protected. Because where competition as such is damaged, disadvantages for consumers are also to be feared."[218]

The ECJ and the CFI take a long-term perspective of consumer detriment and protect competitors instead of short-term efficiencies. This approach contrasts with the dominant approach of the US courts, where although preserving the competitive process is an objective of antitrust law, it is also required to bring evidence of at least an increase of prices or reduction of output on the market.[219] However, the perspective of the European Courts is that competition is a process of discovery of the most efficient solution to the benefit of the consumers and that restricting competition (in the sense of less rivalry in the market) is presumed to reduce efficiency and be detrimental to the consumers in the long term, in particular if the undertaking has an overwhelming dominant position.

The obvious shortcoming of this approach is the absence of clear boundaries for competition law enforcement. This approach may also explain why EC competition law considers that anticompetitive effects may result not only from practices that restrict output or increase prices, but also those that restrict more broadly consumer choice.[220] However, it is not clear if choice is valued as such or if it is preserved only when more choice is likely to lead to identifiable consumer benefits, such as better quality products, lower prices, additional services. The CFI's *Microsoft* decision seems to indicate that choice was valued in this case with the purpose to preserve the continuing offer on the market of media players that were at least of similar, if not better, quality than WMP.[221] However, what would have been the position of the Commission and the CFI if there were no evidence that the excluded media players were better or at least similar quality products than WMP? It is also unclear if the preservation of consumer choice is, for the CFI, the same thing as the preservation of the competitive structure of the market and therefore protecting competitors from being marginalized. The language used by the Court seems to indicate that this is the case.[222] However, if this interpretation is correct, there is

---

[218] Case C-95/04 P above n 51, Opinion of Advocate General Kokott, para 68.

[219] See, *United States v. Microsoft Corp*., 253 F.3d 34, 84 (D.C. Cir. 2001). Section 1 cases: *NCAA v. Board of Regents of the Univ. of Okla.,* 468 U.S. 85 (1984); *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986) (requiring evidence of anticompetitive effects in the form of reduced output, higher prices or diminished quality). For a comparison, Barry E. Hawk, *Article 82 and Section 2*, in OECD, DAF/COMP(2005)27, COMPETITION ON THE MERITS, 253.

[220] See, European Commission, *Guidelines on the application of Article 81(3) of the Treaty* [2004] OJ C 101/08, para 24 (interpreting anticompetitive effects as including negative effects on prices, output, innovation or the variety or quality of goods and services).

[221] Case T-201/04, above n 4, at 1356.

[222] Id. para 664 (the interoperability part of the decision) "Microsoft impaired the effective competitive structure on the work group server operating systems market by acquiring a significant market share on that market."

finally little difference between the previous quasi *per se* illegality approach for tying and the CFI's position in Microsoft for technological tying.

4. Preserving consumer choice: a difference in emphasis and adequate remedies

Antitrust and competition law are for the benefit of consumers and not necessarily the benefit of competitors.[223] Consumers benefit from lower prices. Consumers also benefit from having choices both in abundance of varieties offered as well as from availability of an array of goods of different quality levels.[224] The effects of tying and bundling are complex and require significant economic analysis to be fully understood, as discussed earlier. The effects of these practices have not yet been fully analyzed by economists and the legal understanding of economic analysis suffers from significant lags. In the two *Microsoft* cases, the issue of consumers' harm was particularly complicated because, in both the US and EU cases, both the tied products (Internet Explorer and Windows Media Player respectively) and the competing products (Netscape and RealAudio) were offered (at least in their basic versions) at no charge.

The fact that the incremental cost of licensing software is negligible allows it to be distributed for free with the expectation or hope that the software development cost will be recouped if (i) in the future the product will be sold at a positive price, or (ii) the firm will be able to sell upgraded versions of the software (with more features) at a positive price, or (iii) the firm will be able to sell products or services complementary to the free product (for example, sell music or video downloads at a positive price). The EU case was additionally complicated by the fact that the WMA format (which is the default format for the WMP) was also publicly available, and a number of firms competing with Microsoft distributed players that played content in this format among others. In fact, in the peculiar world of freely distributed software, and in particular in media players, we observe a number of companies distributing players that each has a "favored" format and at the same time can play in a number of other formats, to the extent that the other format owners allow it. So, for example, WMP plays WMA and MP3 formats among others but does not play the RealAudio format because its specifications have not been made public. Similarly, RealAudio plays its proprietary format, as well as WMA, MP3, and others. Additionally, the distribution advantage that any player enjoys is limited because each media player can be downloaded and installed in a few minutes. And, in the aftermath of the *US v. Microsoft* settlement, any consumer as well as any computer manufacturer can set up any media player as the default one.

The lack of friction in the distribution of all media players, the zero price, the quick download and installation time, the ability of the consumer to designate the default media player, and the fact that many media players each play many formats, make it likely that the potential loss to consumers of a skewed distribution of market shares in the media players market will be small. The fact that many players play many formats each and the fact that they can be downloaded freely and easily has resulted in many consumers having installed in the same computer and using in the

[223] Case T-168/01, *GlaxoSmithKline Services Unlimited v. Commission* [2006] ECR II-2969, para 121 & 171.
[224] Neil W. Averitt & Robert H. Lande, *Using the Consumer Choice Approach to Antitrust Law*, 74 ANTITRUST L. J. 175 (2007).

same time period more than one media player. In this setup, it is much more difficult to foreclose rival media players. Similarly, the fact that many media players from different producers each play many formats reduces the chance that some formats will be marginalized or foreclosed.[225]

Indeed, in a market where all products are priced at zero, it is hard to make an argument of consumer loss because of an anti-competitive price change. It is also hard to make a convincing argument of anticompetitive effects based on pricing below cost by Microsoft since all firms in this market were pricing below cost. There are only two potentially credible consumers' detriment arguments: (i) that there is a restriction of variety or reduction in quality because of the tying of WMP with Windows, and (ii) that there will be a clear detriment to future consumers if WMA becomes the dominant standard in media players. The Commission argued that the eventual dominance of WMP (which it incorrectly predicted) would create a restriction of quality in media players. Not only are these quality differences difficult to establish factually in a high technology market where product specifications change frequently, but blaming a zero priced product for its low quality is going a bit far. The Commission also made the argument that future consumers will lose because of less innovation. From an economics point view, it is not always easy to sustain such an argument since there are published economic models where a monopolist innovates more than a perfectly competitive industry.[226]

The Commission imposed as a remedy on Microsoft the requirement to produce and distribute in the EU a version of Windows without a media player, which became known as Windows-N. The Commission's remedy allowed Microsoft to continue producing and distributing in the EU the US version of Windows that was subject to the requirements of the consent decree that resolved *United States v. Microsoft*. The EU did not mandate a specific price difference between Windows and Windows-N.[227] The two versions of Windows were sold at the same price and practically no OEM bought and adopted Windows-N. Thus, the remedy imposed by the Commission had no noticeable effect in the marketplace. At the same time, the dire predictions of expanded dominance of WMA never materialized in the long period between the beginning of the EU case and the Commission's decision. In

---

[225] If RealAudio was trying to get the largest market share for its format, it is surprising that RealAudio did not license its format to be used (among other formats) in rival players.

[226] Additionally, in the software industry (and in other high technology industries) there are plenty of examples of innovative small new firms being acquired by larger and established firms and using the distribution channels of the established firms. An assessment of innovation incentives without such consideration could lead to the wrong conclusions. See, however, Richard Gilbert, *Looking for Mr. Schumpeter: Where Are We in the Competition-Innovation Debate?*, *in* 6 INNOVATION POLICY AND THE ECONOMY 159 (Adam B. Jaffe, Josh Lerner & Scott Stern, eds. 2006); Richard J. Gilbert, *Competition and Innovation* (*Competition Policy Center.* Paper CPC07-069, January 27, 2007). *available* at http://repositories.cdlib.org/iber/cpc/CPC07-069

[227] The lack of a price difference requirement is in sharp contrast with the proposal to the District Court of the nine states ("litigating states") that did not agree with the USDOJ-Microsoft settlement that was also signed by nine other states. The litigating states proposed to "freeze Windows" to its 1998 state and impose on Microsoft to sell any additional functionality at an additional price. It is interesting, however, that the CFI noted in its decision that "(s)hould Microsoft now decide to sell the unbundled version of Windows at the same price as the bundled version, the Commission would examine that price by reference to the present market situation and in the light of Microsoft's obligations to refrain from any measure having an equivalent effect to tying and, if necessary, adopt a new decision pursuant to Article 82 EC." Case T-201/04 above n 4, para 908.

contrast, a new proprietary format promoted by Apple (tied to hardware also produced by Apple!) has become the dominant format in the market for song downloads, a key market for goods that are complementary to media players. Additionally, "flash player," a new player from Adobe has become the standard video player in Internet browsers.

The most surprising element in the EU's decision was the remedy. It was almost mathematically certain that Windows-N (without WMP), sold at the same price as Windows (with WMP), would not sell well, and therefore would have no impact. It is also hard to imagine how depriving consumers of WMP in Windows-N in the post-US-settlement environment, where both the OEM and the final consumer can designate any media player as the default one, would have enhanced consumers' choice. To the extent that the OEMs purchasing decisions express the desires of consumers, the devastating failure of Windows-N to sell is evidence that consumers in fact liked to have WMP in Windows and the imposed remedy was misguided.

Surprisingly, in negotiations before the Commission's decision was announced, the Commission rejected a reported Microsoft proposed remedy to include in the distribution of Windows three rival media players besides WMP and let the consumer designate the default player.[228] This proposal that would have guaranteed as wide distribution of RealAudio and other players as WMP, would have completely erased any distributional advantage of WMP, would have dispelled any tying concerns, and would have given full decision power to consumers. Such a remedy would have addressed the competition law concerns raised by Microsoft's abuse most effectively and precisely.[229] From an economics point of view, this proposal would have eliminated the Microsoft's distribution advantage. At the same time, its adoption would have at least guaranteed the ability of even a dominant firm to innovate and distribute in the way it finds most appropriate. The benefits of this proposal both for consumers and innovation are obvious and substantial in comparison to the imposed remedy.[230] This seems a much more consumer-friendly remedy than the one imposed.

5. Conclusion

It is widely accepted that existing doctrinal categories or concepts emerge in order to serve a specific (analytical or other) purpose, intrinsically linked to the meta-principle that inspires the particular disciplinary field.[231] There are two objectives to

---

[228] See USA Today, Regulators want Microsoft to pull media player out (3/25/2004), available at http://www.usatoday.com/money/industries/technology/2004-03-25-msoft-cover_x.htm .

[229] Indeed, the issue in this case was not that Microsoft integrated WMP in Windows, but that it offered on the market only a version of Windows in which WMP was integrated, "that is to say, that it does not allow OEMs or consumers to obtain Windows without WMP or, at least, to remove WMP from the system consisting of Windows and WMP." Case T-201/04, above n 4, at 1149. The remedy could have identified a number of media players from those existing at the time of the commitment of the abuse that would have been integrated to Windows. It is in this respect different from a common carrier obligation, as it would not necessarily have extended to media players that would have been commercialized after the termination of the abuse.

[230] This is particularly surprising since Prof. Mario Monti, head of the Commission at the time, was quoted as to the objectives of the Commission in the decision: "In the end, we decided to do what's best for innovation and European consumers." USA Today, Regulators want Microsoft to pull media player out, above n 228.

[231] Roscoe Pound, *Classification of Law*, 37 HARVARD L. REV. 933, 939 (1924).

be served by classifying: first an instrumental one, which "looks to the reasons that the categories were formulated in the first place" and recognizes that "behind the different categories lie distinct objectives, principles"; second, an analytical one, as the aim of classifying is also to create and maintain "a rational structure for doctrine" that would be rigorous enough to fit in different factual contexts.[232] Both of these objectives should be fulfilled if the operation of classification is to be useful.

The comparative analysis of the antitrust standards applying to bundling practices in Europe and in the US show that the debate over the "right" analogy for bundled discounts or over the definition of the constitutive elements of a tying antitrust law infringement, such as the separate products and the coercion test, are profoundly interlinked with the "prior beliefs" or the first principles of competition law in each jurisdiction.[233] It is certainly true that, in order to fulfil their analytical objective, categories in antitrust should "have empirical support" and should "communicate valuable information to courts about the competitive effects of a general practice."[234] It is also true, however, that "categorical analysis" should also accomplish an instrumental objective. When the aims of competition law are still evolving and unclear, as it is still largely the case in EC competition law,[235] the relative weight of the analytical or instrumental objectives of classification will depend on the availability of empirical evidence on the pro- or anticompetitive effects of the given practice. If there is sufficient empirical support and broad consensus in the economic profession over the competitive virtues or the anticompetitive effects of the practice, the analytical objective of classification will be more compelling than the instrumental one and the specific conduct will be analyzed according to the precepts of economic analysis. Nevertheless, if empirical evidence or broad consensus is insufficient, the classification process will emphasize the instrumental element, the objectives of competition law and the input of economic analysis will be less significant. The relative discord of economic analysis on bundled discounts and tying therefore explains why EC competition law and US antitrust law have adopted different approaches, as each jurisdiction seems to have different prior beliefs on the existence and/or the degree of the duty of dominant firms to preserve the competitive process.

This is particularly clear in the way each jurisdiction deals with the issue of anticompetitive foreclosure. It seems to us that in Europe the causal link between anticompetitive foreclosure and consumer harm is easily found, that consumer detriment is interpreted very broadly, and that it is not always a requirement for the application of Article 82, or at least that the standard of proof of a consumer detriment is very low in bundling cases compared to the US approach. This, as well as the broad interpretation of the coercion requirement for tying cases, may lead to the risk of over-enforcement of Article 82, and consequently to false positives, as rivals may use Article 82 in order to extract favorable terms in settlements or to impose an important

---

[232] Jay M. Feinman, *The Jurisprudence of Classification*, 41 STANFORD L. REV. 661, 672-677 (1989)
[233] Ken Heyer, *A World of Uncertainty: Economics and the Globalization of Antitrust*, 72 ANTITRUST L. J. 375 (2005).
[234] Mark A. Lemley & Christopher R. Leslie, *Categorical Analysis in Antitrust Jurisprudence* (John M. Olin Program in Law and Economics, November 2007) at 5, *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1026967
[235] CLAUD-DIETER EHLERMANN & LARAINE L. LAUDATI (eds.), EUROPEAN COMPETITION LAW ANNUAL 1997 : THE OBJECTIVES OF COMPETITION POLICY, 1st ed., (1998).

litigation burden on the dominant firm. This can be avoided if the Courts examine in depth the cost and benefits for the consumer of the given practice, put in its specific economic context (an anticompetitive foreclosure test). In the meantime, the hostility of the CFI to bundling practices in *Microsoft* will certainly lead to a number of cases being brought to the European Commission and Courts by marginalized rivals because of Microsoft's significant distribution advantage. As the CFI recognized in *Microsoft:*

> "Since Microsoft is very likely to maintain its dominant position on the client PC operating systems market, at least over the coming years, it cannot be precluded that it will have other opportunities to use leveraging vis-à-vis other adjacent markets. Furthermore, Microsoft had already faced proceedings in the United States for a practice similar to the abusive tying at issue, namely the tying of its Internet Explorer browser and its Windows client PC operating system, and the possibility cannot be precluded that it might commit the same type of infringement in future with other application software."[236]

The recent complaint at the European Commission by Opera Software against Microsoft for tying its browser to the Windows Operating System[237] may reveal that the only possible limiting principle for the application of article 82 EC to the bundling practices of Microsoft is international comity for practices that have been the object of the US settlement, to the degree that the settlement has resolved the competition concerns identified.[238] Without doubt, the CFI's decision does not mark the end of the Microsoft case(s)!

---

[236] Case T-201/04, above n 4, para 1363. See also, the reaction of the European Commissioner for Competition Policy, Neelie Kroes, Press Conference, Brussels, October 22, 2007, "…the March 2004 Decision, as confirmed by the Court of First Instance last month, also sets a precedent with regard to Microsoft's future market behaviour in this and other areas. Microsoft must bear this in mind."

[237] *Microsoft hit by complaint over browser*, The Walt Street Journal, Europe, Friday-Sunday, December 14-16, 2007.

[238] In *Microsoft* the CFI adopted a restrictive position on the sufficiency of the US settlement: to put an end to the abuse. Case T-201/04, above n 4, para 272, 274 & 1227.