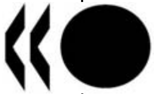

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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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ROUNDTABLE ON REFUSALS TO DEAL

-- Note by the European Commission --

This note is submitted by the Delegation of the European Commission to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 17-18 October 2007.

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1. Introduction

1. The starting point for any discussion of the extent to which European competition law may intervene to require a company with market power to supply an input or grant access to its property is to recall the general principle that enterprises should be free to do business – or not to do business – with whomsoever they please, and that they should be free to dispose of their property as they see fit. This general principle derives from the market economy which is the central economic characteristic of the European Union and of each of its Member States, and the principle has been explicitly referred to by the European courts in competition cases[1].

2. It is therefore only in the carefully limited circumstances described below that EU law allows this freedom of contract to be over-ridden in the interest of ensuring that competition between enterprises is not unduly restricted to the long-lasting detriment of consumers. Refusal to deal is very often justifiable for good commercial reasons having no anti-competitive intent or effect. Moreover, when it comes to obliging a company to deal with a particular customer, particular attention must be paid to the impact which such an interference might have on the incentives for investment and innovation in the markets concerned. Any adverse impact on those incentives would generally not be likely to be in the long-term interests of consumers. In particular, intervention would not be justified if an obligation to supply would do no more than allow the dominant firm's technology to be duplicated, thereby giving its competitors a "free ride" on its investment.

1.1 Article 82 of the EC Treaty

3. The basis in European law for intervention against the unilateral conduct of companies enjoying substantial market power is Article 82 of the EC Treaty, which prohibits the "abuse" of a "dominant position". The European Commission and the European courts have interpreted the Article as being principally concerned with ensuring that competition is not distorted at the expense of consumer welfare. More specifically, the legal instrument has been used primarily to tackle unilateral conduct aimed at excluding competitors from a market with a consequent adverse impact on competition and ultimately consumers, but has also been used to address direct exploitation of customers in the form, for example, of imposing excessive prices.

4. In what is regarded as a seminal ruling, the European Court of Justice has defined the concept of abuse in the following terms: *"The concept of an abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition"*[2]. In essence, this definition makes it clear that the notion of an abuse is an objective one in the sense that the conduct must be shown to have an anti-competitive effect.

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[1] In Case T-41/96 *Bayer AG* v *Commission* (2000) ECR II-3383, par 180, the European Court of First Instance stated that *"The case law of the ECJ indirectly recognizes the importance of safeguarding free enterprise when applying the competition rules of the Treaty where it expressly acknowledges that even an undertaking in a dominant position may, in certain cases, refuse to sell (...) without failing under the prohibition laid down in Article 82"*.

[2] Case 85/76 *Hoffmann-La Roche v. Commission* [1979] ECR 46, para. 91.

2. Defining refusal to deal

2.1 Exclusionary abuse

5. Refusal to deal is most accurately categorised as a form of exclusionary abuse in that such a refusal will only be considered unlawful under European law to the extent that it is liable to exclude competitors, thereby seriously undermining effective competition in a market. There is a wide array of commercial conduct that can be classified as refusal to deal. The following is a non-exhaustive list of types of refusal that might be caught by Article 82: refusal to supply key input products and services; refusal to provide essential proprietary information; refusal to license intellectual property rights; refusal to grant access to an essential facility or network, or only doing so on uneconomic terms. The common thread tying these various types of behaviour together is that what is refused – be it a product, service, information, access right, or whatever - is essential for competing in another market.

2.2 Effect on competition in a "downstream" market is the primary concern

6. The primary competition concern likely to arise as result of a refusal to supply is that competition will be distorted in a market downstream from the (upstream) market for the refused input[3]. If, for example, a port owner refuses access to port facilities to a ferry operator, there may be an anti-competitive impact in the downstream market for ferry services. Such competition problems typically arise where the firm which is dominant on the upstream market for the refused input is at the same time a competitor of the customer it refuses to supply in the downstream market.

7. However, Article 82 may more rarely constitute a basis for intervention where a refusal to supply also results in an anti-competitive impact on the upstream market where the company refusing to supply is dominant. If, for example, the refusal to supply customers on the downstream market forecloses them as competitors on the downstream market, that foreclosure may have an adverse impact on competition in the upstream market for the refused input by foreclosing access to customers by the dominant company's upstream rivals. This might be characterised as an additional, or secondary, anti-competitive effect to the primary anti-competitive effect in the downstream market. Competition in the upstream market for the refused input might likewise be adversely impacted if the dominant company uses the refusal as a means of foreclosing the potential entry of the downstream customer as a competitor into the upstream market.

2.3 Exclusive dealing or tying distinguished

8. To the extent that the purpose of the refusal to deal is to punish customers in the downstream market for dealing with upstream competitors of the dominant firm, such conduct is generally categorised as an exclusive dealing or tying abuse[4]. If, for example, a dominant soft drinks supplier refuses to deliver his brands to retailers who also stock the brands of other soft drinks suppliers, this conduct is more usually characterised as exclusive dealing than refusal to deal. Similarly, if a company refuses to supply a customer with a product unless he agrees to purchase it together with another distinct product/s, such conduct is properly categorised as the possible abuse of tying or bundling. These abuses will therefore not be treated as refusal to supply for the purposes of this paper.

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3 In this paper, the term "downstream" is used as shorthand to denote a market in which the product refused by the dominant firm constitutes an input essential for competitors to be able to compete effectively.

4 Case 27/76 *United Brands*, [1978] ECR 207, para. 192.

2.4 Constructive refusal

9. The concept of a refusal to deal covers not only situations of pure or straightforward refusal, but also instances of agreement by the dominant company to deal but under unreasonable or uneconomic conditions. Charging excessive prices (as well as being potentially abusive in itself), may amount to an effective refusal to deal. In particular, a so-called "margin squeeze" (discussed in more detail below) - whereby the level of the price charged for an essential input does not allow the customer to compete in the downstream market - is properly characterised as a refusal to deal.

10. The Commission has also acknowledged that inexplicable or unjustified delays in responding to a request for access may constitute an abuse[5]. Likewise, an obligation imposed by a dominant supplier to indicate the geographical destination of the goods supplied and the identity of the final customers may – in appropriate circumstances – be considered as amounting to a constructive refusal, and hence an abuse of a dominant position[6].

2.5 De novo refusals versus withdrawal of supply

11. A distinction can also be made between a refusal to supply an existing customer and a refusal to supply a potential customer. Put another way, a refusal to deal can take the form both of a refusal to start dealing *de novo*, as well as of the unilateral termination of an ongoing deal, i.e. a withdrawal of supply. While, in conceptual terms, treatment of these two types of situations under Article 82 should be the same, certain inferences may be drawn from the rupture of an existing supply relationship. The existing relationship may, for example, be indicative of the essential or indispensable nature of the input, in particular if the customer had made particular investments in order to use the input. Moreover, it may in such a case be easier to demonstrate that the refusal has given rise – or is likely to give rise – to an anti-competitive effect.

3. Conceptual framework

12. The conceptual framework for the approach to refusal to deal in European law has developed via a number of important Commission decisions and rulings of the European courts over the years. In essence, the approach developed in this regard provides: *first*, that the firm supplying the refused input must be in a dominant position in relation to the supply of that product; *second*, that the refusal leads or is likely to lead to the elimination of effective competition in the downstream market and hence to long-lasting consumer harm, and; *third*, that the refusal is not objectively justifiable. These three analytical steps are examined in turn below.

3.1 Dominance on the part of the company refusing to supply

13. The *sine qua non* for the application of Article 82 is that the enterprise from whom supply is requested must enjoy substantial market power in the market for the refused input, not simply by reference to its market share but also by taking account of the full range of constraints which it faces, and in particular the ease with which its position may be challenged by existing or potential competitors. It should in this context be added, however, that the refused input need not have been traded previous to the refusal; it is sufficient that there be actual demand for it on the part of potential purchasers.

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[5] Notice on the application of the Competition Rules to access agreements in the telecommunications sector (1998) OJ C 265/02, paragraph 95.

[6] *Polaroid/SSI Europe*, European Commission's 13th Report on Competition Policy, paragraphs 155-157.

3.2 Anti-competitive effect and long-lasting consumer harm

14. A refusal to deal will only be unlawful if it can be shown that it will have an anti-competitive effect, with consequent long-lasting consumer harm. This does not mean that any competition must be altogether excluded from the market, but rather that *effective competition* is significantly diminished or eliminated. In some cases, the relevant question will therefore be whether there is a sufficient likelihood that competitors, by investing in actual or potential substitutes for the refused input, could counter in the foreseeable future the negative consequences of the refusal on consumer welfare.

15. Long-lasting consumer harm is in general only likely to arise if the refused product in question is *essential* for the customers to be able to compete effectively in a downstream market. This means that the refused product must constitute an *objectively indispensable input* for such competitors, and not merely a particularly suitable or convenient one. Put another way, there must be no economically viable[7], actual or potential, alternatives to the refused input.

16. Typically, the Commission's concern will be that the refusal to supply is likely to lead to consumer harm on a *downstream* market via so-called *input foreclosure*. Such a refusal would normally preclude downstream rivals from obtaining supplies of the input altogether, thereby forcing them to exit the market, or only enable them to do so on terms that would not allow them to compete effectively with the dominant firm.

17. Concerns may likewise arise where foreclosure on the downstream market also leads to anti-competitive foreclosure on the *upstream* market for the refused input if it gives rise to so-called *customer foreclosure* – in other words, if it becomes more difficult for potential entrants on the upstream market to find customers and the refusal to supply thus raises entry barriers on the upstream market. This in turn may have anti-competitive effects downstream if as a result downstream rivals to the firm face higher input prices and are therefore obliged to charge higher output prices. Another scenario where consumer harm may occur is where the dominant firm uses refusals to supply in order to punish downstream competitors who are trying to enter upstream, and this punishment mechanism is credible in the light of the factual circumstances of the case.

18. The imposition of an obligation to supply may have an adverse *impact on the incentives of a firm to invest in the supply activity in question*, given the risk that competitors may "free ride" on that investment. At the same time, consumer harm may also arise where the competitors that the dominant firm forecloses are as a result of the refusal prevented from bringing to market innovative goods or services, and the refusal to supply thus stifles *follow-on innovation* to the detriment of consumers. This may be the case if the firm which requests supply does not intend to limit itself to essentially duplicating the goods or services already offered on the downstream market by the dominant firm, but intends to produce new goods or services for which there is a potential consumer demand[8]. Indeed, supplying access to the input may spur incentives to invest and innovate in the downstream market by both the dominant firm and its competitors.

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7 It is not, however, necessary that a substitute for the refused input be as efficient as the refused input. It suffices that it enables effective competition to take place. See Case 7/97 *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. K, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG*, [1998] ECR I-7791, para. 43.

8 Case C-418/01 *IMS Health, GmbH & Co. OHG v NDC Health GmbH & Co. KG*, [2004] ECR I-5039, paragraph 49.

19. In some cases, it is rather clear that the incentives for the dominant firm to innovate will not be adversely impacted by the imposition of an obligation to supply, notably where its upstream market position has been developed under the protection of special or exclusive rights or has been financed by State resources and not been purchased by the dominant firm for a price reflecting its real market value. In such cases, the anti-competitive effect of a refusal can be more readily assumed. In other cases, however, an obligation to supply should only be imposed in the presence of exceptional circumstances[9]. In principle, for the refusal to be found abusive it should then be established not only that it is likely to cause competitors to be foreclosed from the market, but that the consumer harm resulting from such foreclosure is likely to be *long-lasting.* In other words, market forces should be unlikely, at least in the foreseeable future, to bring prices, production, quality or innovation to the level where they would have been absent the refusal. Particular attention must therefore be given to the possible long-run effects that imposing an obligation to supply will have on the investment incentives of both the dominant firm and its competitors.

3.3 Objective justification, including an assessment of efficiencies

20. A refusal to deal will often be objectively justified on unimpeachable commercial grounds. If this is the case, the refusal does not constitute an abuse of a dominant position. There are numerous possible instances in which a refusal to deal would not give rise to objections. The customer may, for example, not be considered a reliable trading partner, perhaps because of a history of not honouring its debts. The dominant firm may have difficulties in meeting all the demand it faces: it may, for example, be experiencing a shortage of raw materials[10], production capacity constraints, or its production or distribution capabilities may be disrupted.

21. A decision by the dominant firm to itself enter a downstream market in which it had not previously been present will not, however, be considered an objective justification for refusing to supply an essential input to an existing customer active in the same downstream market. In its judgment in *Commercial Solvents*[11], the European Court of Justice held that *"an undertaking being in a dominant position as regards the production of a raw material and therefore able to control the supply to manufacturers of derivatives, cannot, just because it decides to manufacture these derivatives (in competition with its former customers) act in such a way as to eliminate their competition which in the case in question, would amount to eliminating one of the principal manufacturers of [the downstream product] in the common market"*.

22. More importantly, evidence tending to demonstrate that an obligation to supply will, on balance, have an adverse impact on the incentives or ability of market participants, including those of the dominant firm itself, to innovate must be taken into consideration before deciding whether a refusal to supply is objectively justified. This involves consideration of evidence put forward by the dominant firm regarding any *efficiencies* associated with a refusal, and in particular any evidence showing that the refusal to supply is necessary to allow the dominant firm to realise an adequate return on the investments required to develop the input supply business, thus generating incentives to continue to invest in the future, taking the risk of failed projects into account. The refusal may also provide incentives for the dominant firm itself to invest in follow-on innovation on the downstream market.

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[9] Joined cases C-241/91 P and C-242/91 *Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission (Magill)* [1995] ECR 743, paragraph 50; Case C-418/01 *IMS Health, GmbH & Co. OHG v NDC Health GmbH & Co. KG*, [2004] ECR I-5039, paragraph 35.

[10] In *BP v The Commission*, Case 77/77 [1978] ECR 1513, the European Court of Justice held that it would not be abusive for an oil company to supply regular customers in preference to other customers in the event of a supply shortage.

[11] Cases C-6/73 & 7/73 *Istituto Chemioterapico and Commercial Solvents Corporation v Commission* [1974] ECR 223.

4. Particular instances of refusal to deal

23. As indicated above, the concept of refusal to deal applies to a variety of types of commercial conduct, some of the principal examples of which are identified and briefly discussed below.

4.1 Refusal to supply products or services constituting essential inputs

24. A refusal to supply will sometimes occur in a market for the supply of intermediate products or services. For example, a dominant company might refuse to supply an *essential input* to a downstream competitor, i.e. an input without which a market participant would have difficulties effectively competing in that downstream market. This type of situation was encountered in *Commercial Solvents*[12], the first instance in which the European Court of Justice dealt at length with the concept of refusal to deal. In that case, the ECJ held that it was an abuse of a dominant position for the dominant supplier of aminobutamol, a chemical used in the production of ethambutol and drugs based on this component, to terminate an existing supply relationship with a company active in these downstream markets.

4.2 Refusal to licence intellectual property rights or to supply essential information

25. Particular caution is required before intervention should be contemplated in relation to firms whose dominant position results from the possession of intellectual property rights. IP rights grant a temporary monopoly in the technology developed by a firm as a reward for innovation, and hence provide a critical incentive for firms to innovate. However, in exceptional circumstances, European law will permit *intervention to oblige a firm to license its IP rights to competitors*, if a refusal to do so would effectively eliminate competition in a related market, but not one protected by those rights. These exceptional circumstances were first delineated some 20 years ago, when the Commission decided that the British and Irish State broadcasting companies must provide magazine publishers with information concerning TV programs in sufficient time to allow them to produce weekly publications competing with those of the broadcasters. The European Court of Justice agreed with the Commission that a compulsory license limited to the information required to compete in the non-protected market for weekly magazines could not be refused without objective justification, given in particular that the refusal prevented the emergence of a new product for which there was potential consumer demand and that the broadcasters were essentially reserving the non-protected market for themselves[13].

26. The same conceptual framework outlined above is applicable in like manner to a *refusal to supply essential proprietary information*, irrespective of whether or not that information is protected by IP rights. In the *Microsoft* decision[14], the Commission found that interoperability information was needed to allow Microsoft's competitors to compete with it in markets downstream from the market for personal computer operating systems. In a ruling issued on 17 September 2007[15], the Court of First Instance upheld the Commission's decision finding that Microsoft had abused its virtual monopoly in the market for personal computer operating systems, *inter alia* by seeking to leverage that position into markets for work group operating systems by refusing to give its downstream competitors access to the minimum interoperability information necessary to allow them to effectively compete in those other markets. The Court confirmed that "exceptional circumstances" have to be present before finding an abuse when

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12 Cases C-6/73 & 7/73 *Commercial Solvents* [1974] ECR 223.

13 Joined cases C-241/91 P and C-242/91 *Magill* [1995] ECR 743. This approach has most recently been confirmed by the ECJ in Case C-418/01 *IMS Health* [2004] ECR I-5039.

14 Commission Decision 2007/53/EC of 24.03.2004.

15 Judgement of the CFI of 17.09.2007 in Case T-201/04, *Microsoft v Commission*.

intellectual property rights are involved: *"It follows (...) that the refusal to deal by an undertaking holding a dominant position to licence a third party to use a product covered by an intellectual property right cannot in itself constitute an abuse of dominant position within the meaning of Article 82 EC. It is only in exceptional circumstances that the exercise of the exclusive right by the owner of the intellectual property right may give right to such an abuse".* The Court goes on to explain that *"It also follows from that case-law that the following circumstances, in particular, must be considered to be exceptional: in the first place, the refusal relates to a product or service indispensable to the exercise of a particular activity on a neighbouring market; in the second place, the refusal is of such a kind as to exclude any effective competition on that neighbouring market; in the third place, the refusal prevents the appearance of a new product for which there is potential consumer demand".* The judgement is therefore a comprehensive confirmation of the Commission's effects-based approach to exclusionary conduct of this kind.

4.3 Refusal to grant access to essential facilities

27. The Commission has defined an essential facility as a "facility or infrastructure which is essential for reaching customers and/or enabling competitors to carry on their business, and which cannot be replicated by any reasonable means"[16]. In accordance with the application of the general principles applying to other types of refusals to deal, a refusal to grant access to such an essential facility which eliminates competition in a downstream market and which is not objectively justified is prohibited by Article 82. It is not, however, sufficient that the dominant undertaking's control over the facility gives it a competitive advantage; it should give it a genuine stranglehold on the market in question. The duplication of the facility must be either impossible or extremely difficult owing to physical, geographical or legal constraints[17]. As to the latter, it must be shown that it is uneconomical to duplicate the facility, in other words that the total income generated in the market in question would not generate profits from two facilities. It is not however sufficient to demonstrate that it is not economical for a given competitor to duplicate the facility, for example because that competitor has a limited turnover.

4.4 Margin squeeze

28. If a dominant firm charges a price for a product on the upstream market which, compared to the price it charges on the downstream market, does not allow a downstream competitor which is as efficient as itself to trade profitably on a lasting basis, this is known as a "margin squeeze" and is liable to constitute an abuse of a dominant position. Before reaching this conclusion, however, the true costs of the dominant firm must be carefully examined. When new products or services are launched, for example, firms may have substantial upfront costs that will only be recovered over time. It may therefore be normal in such a situation to have a period of negative margins until demand expands, in which case it may not be appropriate to characterise the conduct as a margin squeeze.

29. In a recent decision, for example, the Commission found that the Spanish telecoms provider Telefonica had broken European law by charging a wholesale broadband access price to its competitors which did not allow them to compete effectively in the retail broadband access market: the margin between this wholesale price and the retail price of Telefonica made it impossible for the other providers to operate profitably, despite being at least as cost-efficient as the dominant firm[18].

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16 Notice on the application of the Competition Rules to access agreements in the telecommunications sector (1998) OJ C 265/02, paragraph 68.

17 See Case 7/97 *Oscar Bronner* [1998] ECR I-7791.

18 See European Commission Press Release IP/07/1011 of 4 July 2007.