

# Chapter Eight

## REFUSAL TO DEAL

### 8.1. INTRODUCTION

**Basic scope of the duty to deal under Article 82 EC.** It is well established under Article 82 EC that undertakings in a dominant position may, in limited circumstances, be required to deal with third parties with whom they do not wish to enter into or continue contractual relations. This duty is highly controversial, since it interferes with freedom of contract, as well as basic property rights that are indispensable to a free market economy. It is therefore only applied in extraordinary circumstances, i.e., where there is some exceptional harm to competition that merits intervention. An obvious, but rare, example is where a facility cannot be duplicated due to physical constraints (e.g., a port or tunnel). A more common example concerns inputs that have traditionally been regarded as “natural monopolies” – a facility for which total production costs would rise if two or more firms produced – such as utility networks (e.g., telecommunications, gas, electricity, and water).<sup>1</sup> Intellectual property (IP) rights may also be subject to compulsory sharing in exceptional circumstances. In each case, however, the *sine qua non* for sharing is the same: the facility cannot be duplicated for physical, legal, or economic reasons and the refusal to share it would substantially eliminate competition.

The duty to deal under Article 82 EC has strong parallels with the “essential facilities” line of case law recognised by certain courts in the United States.<sup>2</sup> The Community Courts have thus considered it “helpful” to refer to the doctrine when elaborating the scope of the various duties to deal under Article 82 EC.<sup>3</sup> Under this doctrine, a single firm, or group of firms, controlling an input at an upstream level of production that is essential for competitors on a downstream market may be obliged to deal with third parties where a refusal to do so would eliminate competition on the relevant downstream market. The “essential facility principle” is not, however, a new or distinct rule under Article 82 EC: it is primarily a convenient label for cases which have in common the fact that they raise the question of

---

<sup>1</sup> For a detailed treatment of the concept of a natural monopoly in industrial organisation, see Carlton & Perloff, *Modern Industrial Organisation*, (2005) (Pearson, Fourth Edition), p.104 (hereinafter “Carlton & Perloff”).

<sup>2</sup> The origin of the essential facilities doctrine is commonly traced to the Supreme Court’s decision in *United States v. Terminal Railroad Ass’n*, 224 U.S. 383 (1912), which concerned the acquisition by a consortium of railroads of railroad switching and terminal facilities in St. Louis that served both local and interstate railroads and industries. The Court determined that the owners of the facilities adopted policies that discriminated against some other railroads who needed access to these facilities to compete in the market for the interstate transportation of goods to and from St. Louis. The Court therefore required the owners of the facilities to permit other railroads to participate in ownership of the assets on terms equivalent to those of the existing owners. Although the Supreme Court did not use the term “essential facility” in *Terminal Railroad*, the case has been invoked by many lower courts interpreting and applying the legal principles enumerated in the case. See, e.g., *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1132 (7<sup>th</sup> Cir. 1983) (“A monopolist’s refusal to deal under these circumstances is governed by the so-called essential facilities doctrine. Such a refusal may be unlawful because a monopolist’s control of an essential facility (sometimes called a ‘bottleneck’) can extend the monopoly power from one stage of production to another, and from one market to another.”). The Supreme Court has, however, recently cast serious doubt on future reliance on the “essential facilities” doctrine by stating that it had only been applied by lower courts and not the Supreme Court itself. See *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko LLP*, 540 U.S., 2, 682, (2004).

<sup>3</sup> See, e.g., Opinion of Advocate General Jacobs in Case C-7/97 *Oscar Bronner GmbH v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH* (hereinafter *Bronner*), para. 45. See also Case T-374/94 *European Night Services* [1998] ECR II-3141, para. 191 and See Case T-52/00 *Coe Clerici Logistics SpA v Commission* [2003] ECR II-2123, para. 62, where the Court of First Instance specifically used the term “essential facilities.” The Advocates General of the Court of Justice have used the term “essential facilities” in several opinions, but the Court of Justice itself has not.

when an enterprise in a dominant position can be required to contract with another company with which it does not wish to contract.

The duty to deal under Article 82 EC is not a duty merely to assist competitors: it can only be invoked where the refusal to deal would cause some serious harm to competition in the relevant downstream market for the final product in which the input is an essential component. As Advocate General Jacobs stated in his opinion in *Bronner*, it is important not to lose sight of the fact that “the primary purpose of Article 8[2] is to prevent distortion of competition – and in particular to safeguard the interests of consumers – rather than to protect the position of particular competitors.”<sup>4</sup> A duty to deal under Article 82 EC is therefore an example of limiting competitors’ production “to the prejudice of consumers” within the meaning of Article 82(b) EC.

The requirement for harm to competition and consumers has a number of important implications for the scope of the duty to deal. In the first place, a duty to deal is only appropriate and necessary where the downstream market is not competitive: if it is already competitive, no useful purpose would be served by imposing a duty to deal. A second important corollary of the need to focus on consumer interests is that a duty to grant access should lead to more competition than it discourages. A duty to deal involves interference with basic property rights and inevitably, to some extent, affects the incentives of the owner (and potentially others, including the requesting party) to make valuable investments in future. There must therefore be “some exceptional harm to competition,” and, correspondingly, a clear benefit to competition that outweighs the harm to the property owner, for a duty to deal to arise.<sup>5</sup>

**The Community institutions’ statements on the duty to deal.** The Community institutions have made a number of general statements on their understanding of the duty to deal under Article 82 EC. The earliest and clearest statement was set out in the Commission’s interim decision in *Sea Containers-Stena Sealink*:<sup>6</sup>

“An undertaking which occupies a dominant position in the provision of an essential facility and itself uses that facility (i.e. a facility or infrastructure, without access to which competitors cannot provide services to their customers), and which refuses other companies access to that facility without objective justification or grants access to competitors only on terms less favourable than those which it gives its own services, infringes Article 8[2] if the other conditions of that Article are met. An undertaking in a dominant position may not discriminate in favour of its own activities in a related market. The owner of an essential facility which uses its power in one market in order to protect or strengthen its position in another related market, in particular, by refusing to grant access to a competitor, or by granting access on less favourable terms than those of its own services, and thus imposing a competitive disadvantage on its competitor, infringes Article 8[2]....”

**Basic rationale for a duty to deal.** The basic rationale for a duty to deal is straightforward. If an input is essential for the production of a product or service in a downstream market – in the sense that it is either impossible or prohibitively expensive to duplicate – it would, if denied to an undertaking operating in the downstream market, effectively remove that undertaking as a competitor from the downstream market. Early cases thus referred to essential transport infrastructure for which there was no effective alternative, e.g., a railroad bridge over a significant natural barrier,<sup>7</sup> or a strategically-located port.<sup>8</sup> Recently, the doctrine has become important with the liberalisation of public utilities, where access to the network or parts of the network are essential if downstream competitive services are to be provided over them. This is particularly the case with telecoms networks, where the network owner is almost invariably a network service provider, and hence competing in the downstream

<sup>4</sup> Opinion of Advocate General Jacobs in *Bronner*, *ibid.*, para. 58

<sup>5</sup> *Ibid.*, para. 66.

<sup>6</sup> *Sea Containers-Stena Sealink*, OJ 1994 L 15/8, para. 66.

<sup>7</sup> *Terminal Railroad*, above note 2.

<sup>8</sup> See, e.g., *Port of Rødby*, OJ 1994 L 55/52..

market with others who need access to the network.<sup>9</sup> But access obligations have been imposed on undertakings in a wide range of situations under secondary Community legislation.<sup>10</sup>

Where the owner of an essential facility also operates in the downstream market (e.g., an operator of a port facility and downstream shipping services operator), there may be a temptation to deny access to competitors, thus reserving the downstream market to a monopolist that is able to raise prices above the competitive level that would otherwise prevail. If a facility supplied on one market is a truly essential input for the production of goods or services in a downstream market, then a competitor with control of that facility would not be competing “on the merits”—that is, by offering better goods or lower prices—on the downstream market if it restricts access to the facility, or cuts off supplies to competitors in that market. The owner of the facility is allowed to extract profits from the market on which the facility is sold – otherwise there would be no incentive to create it – but has no right to use it to monopolise a vertically related market. Essential facility cases therefore have a strong vertical element, i.e., an upstream market for the input and a downstream market in which that input is essential for competition.<sup>11</sup> Such conduct can harm competition and ultimately consumers.

**Basic objections to a duty to deal.** Despite the relatively small number of cases in which a duty to deal has been upheld, the issue has raised enormous controversy, in particular for IP rights. This has prompted some leading commentators to suggest that all unilateral refusals to deal should be treated as legal.<sup>12</sup> This is not, however, the case under Article 82 EC. The controversy stems from the fact that a duty to deal seems to conflict with a number of well-established general principles of competition

<sup>9</sup> See Notice on the application of the competition rules to access agreements in the telecommunications sector, OJ 1998 C 265/2, para. 88 (“If there were no commercially feasible alternatives to the access being requested, then unless access is granted, the party requesting access would not be able to operate on the service market. Refusal in this case would therefore limit the development of new markets, or new products on those markets, contrary to Article 8[2](b), or impede the development of competition on existing markets. A refusal having these effects is likely to have abusive effects.”). See also Article 12 of Directive 2002/19 on access to electronic communications networks and associated facilities, OJ 2002 L 108/7.

<sup>10</sup> See, e.g., Article 6(1) of Council Directive 91/250 on the legal protection of computer programs, OJ [1991] L 122/42; Articles 6 and 9 of Directive 96/9 of the European Parliament and of the Council on the legal protection of databases OJ [1996] L 77/20; Article 1(6) of Commission Directive 96/19 with regard to the implementation of full competition in telecommunications markets OJ [1996] L 74/13; Article 10 of Council Directive 91/440 on the development of the Community’s railways OJ [1991] L 237/25; Article 11 of Directive 97/67 of the European Parliament and of the Council on common rules for the development of the internal market of Community postal services OJ [1998] L 15/14; Article 10 of Council Regulation 95/93 on common rules for the allocation of slots at Community airports OJ [1993] L 14/1; Article 6 of Council Directive 96/67 on access to the ground handling market at Community airports OJ [1996] L 272/36; Article 3 of Commission Regulation 3652/93 on the application of Article 85 (3) of the Treaty to certain categories of agreements between undertakings relating to computerised reservation systems for air transport services OJ [1993] L 333/37; Articles 16-18 of Directive 96/92/ of the European Parliament and of the Council concerning common rules for the internal market in electricity OJ [1997] L 27/ 20; and Articles 14-16 of Directive 98/30 of the European Parliament and of the Council concerning common rules for the internal market in natural gas, OJ [1998] L 204/1.

<sup>11</sup> A leading treatise on U.S. antitrust law describes the essential facilities doctrine in the following terms: “It should be clear from the outset that the essential facility doctrine concerns vertical integration - in particular, the duty of a vertically integrated monopolist to share some input in a vertically related market, which we call market #1, with someone operating in an upstream or downstream market, which we shall call market #2. If the facility is truly “essential,” then the #1 monopoly facility also establishes a #2 monopoly ... Understanding the ‘vertical’ nature of essential facility claims helps to focus the analysis: The essential facility claim is about the duty to deal of a monopolist who is able to supply an input for itself in a fashion that is so superior over anything else available that others cannot succeed unless they can access this firm’s input as well.” See Areeda & Hovenkamp, *Antitrust Law*, Vol. III A (1996), at 172 and 174.

<sup>12</sup> See, e.g., Posner, *Antitrust Law*, (Chicago University Press (2001)) (Second Edition), p.242-244. Another leading antitrust scholar argued that unilateral refusals to deal should be treated as *per se* legal except, perhaps, in the case of natural monopolies. See Areeda, “Essential Facilities: An Epithet In Need Of Limiting Principles,” 58 *Antitrust L. Jour.*, 841. Both commentators agree, however, that collective refusals to deal (or unlawful boycotts) are a proper cause for concern, at least where they are used to facilitate a practice that is itself exclusionary.

law and industrial organisation. In the first place, freedom of contract is a fundamental principle enshrined in EC competition law and the laws the Member States. As Advocate General Jacobs stated in *Bronner*, “the right to choose one’s trading partners and freely to dispose of one’s property” are “generally recognised principles in the laws of the Member States, in some cases with constitutional status.”<sup>13</sup> A contrary rule, which would effectively require a dominant firm to sell to any and all available buyers, would be an onerous and unjustified interference with a company’s freedom to organise its commercial activities in the manner it best sees fit. The right to property is also protected under Article 295 EC and many Member States’ laws.<sup>14</sup>

With regard to IP rights, the Community and its Member States have also accepted a number of bilateral and multilateral obligations ensuring a common minimum level of protection. The most notable agreement is the World Trade Organisation’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which, *inter alia*, incorporates the provisions of the Berne Convention into Community law.<sup>15</sup> Article 13 of TRIPS requires that limitations and exceptions to the use of exclusive rights in intellectual property must: (1) be confined to certain “special cases;” (2) not conflict with a normal exploitation of the work; and (3) not unreasonably prejudice the legitimate interests of the right holder. These conditions apply cumulatively. “Special cases” under the TRIPS must be clearly defined and narrow in scope and reach in respect to the category of persons to whom the exception potentially applies.<sup>16</sup> Any *general* policy on forced sharing of IP rights would therefore be contrary to the Community’s international obligations.

A second, obvious problem is that a duty to deal may adversely affect the incentives of innovators to develop tangible and intangible assets that enhance consumer welfare. If innovators knew in advance that valuable property would be subject to mandatory sharing, they may decide not to innovate or to do so at a sub-optimal rate or scope.<sup>17</sup> In other words, there is a dynamic benefit at the core of IP rights, i.e., the notion that the perspective of ownership and the right to exclude in future creates an incentive *ex ante* to engage in (often costly) investment into innovation. While forced sharing of valuable property may have some short-term benefit in the form of lower prices (although even this is

<sup>13</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, at para. 56. See also Opinion of Advocate General Rozes in Case 210/81 *Oswald Schmidt v Commission* [1983] ECR 3045 at 3072 (“the applicant cannot [. . . claim a right [. . .] to be supplied by the intervener” and that “the applicant fails to appreciate that the prohibition of agreements which restrict competition provides, as such, no legal basis for intervening in the contractual freedom of traders.”). See also Case T-41/96 *Bayer AG v Commission* [2000] ECR II-3383, para.180 (“Under Article 8[2], refusal to supply, even where it is total, is prohibited only if it constitutes an abuse. The case-law of the Court of Justice 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 or change its supply or delivery policy without falling under the prohibition laid down in Article 8[2].”).

<sup>14</sup> Article 295 of the EC Treaty provides that the *existence* of property rights under national law, including intellectual property, is not affected by the provisions of the EC Treaty. The Community Courts have therefore consistently held that the determination of the conditions and procedures under which intellectual property is protected is a matter for national law. See, e.g., Case 262/81 *Coditel 2* [1982] ECR 3381, para. 13 (“the existence of a right conferred by the legislation of a Member State in regard to the protection of artistic and intellectual property...cannot be affected by the provisions of the Treaty.”). See also Case 144/81 *Keurkoop v. Nancy Kean Gifts* [1982] ECR 2853, para. 18.

<sup>15</sup> See Council Decision 94/800/EC of December 22, 1994, concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay round (1986-1994) OJ 1994 L 336/1.

<sup>16</sup> See WTO Panel Report in *United States–Section 110(5) of the U.S. Copyright Act*, WTO Document WT/DS160/R of June 15, 2000.

<sup>17</sup> The dominant policy justifying the grants of intellectual property protection to creators and innovators is utilitarianism. Under this approach, lawmakers must “strike an optimal balance between, on the one hand, the power of exclusive rights to stimulate the creation of inventions and works of art and, on the other, the partially offsetting tendency of such rights to curtail widespread public enjoyment of such creations.” See Fisher, “Theories of Intellectual Property,” in *Essays in the Legal and Political Theory of Property* (Cambridge University Press, 2001), p. 168. *Id.* at 169

not axiomatic), the long-term adverse effects of reduced innovation on consumer welfare could be substantial. As Advocate General Jacobs stated in *Bronner*, incursions on the fundamental right to choose one's own trading partners requires a "careful balancing of conflicting considerations."<sup>18</sup>

A third issue is that competition based on several undertakings using the same inputs may actually preserve monopolies by removing the requesting party's incentive to develop its own inputs. Not only is it generally pro-competitive to allow companies to keep assets for their own exclusive use, but it is also pro-competitive to expect other companies to develop their own assets.<sup>19</sup> Consumer welfare is not merely enhanced by price competition, but may also be significantly improved by new products for which there is unsatisfied demand. Competition based on different facilities and product offerings is much more preferable to competition based on sharing the same facility. More generally, cooperation among competitors is subject to a strict rule under competition law, since it will always, to some extent, remove each undertaking's scope for independent action.

The fourth criticism is that property rights themselves already incorporate a trade-off between the need to promote competition by granting control to the owner on the one hand and protecting any excesses resulting from such control by limiting the scope and duration of such rights on the other. As Advocate General Jacobs noted in *Bronner*, a property right "...in itself involves a balancing of the interest in free competition with that of providing an incentive for research and development and for creativity."<sup>20</sup> In economic terms, the protection afforded to property rights already incorporate a balance between *ex ante* incentives for innovation (so-called dynamic effects) and *ex post* inefficiencies from the exercise of market power (so-called static effects). In simple terms, the "exclusion" caused by property rights is central to the reason why such rights are granted in the first place. This balance is resolved under property laws and attempts at second-guessing it under competition law should, in general, be avoided.<sup>21</sup>

A fifth criticism is that the Community institutions' elaboration of various duties to deal is curious in circumstances where they have not actively pursued excessive pricing cases. If a facility is truly essential for competition, and so allows a firm to monopolise a relevant market, the ultimate harm to

<sup>18</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, para. 57. See also Posner, "Antitrust in the New Economy," 68 *Antitrust L.J.* 925, 929 (2001) ("The first to come up with an essential component of a new-economy product or service will have a lucrative monopoly, and this prospect should accelerate the rate of innovation, in just the same way that, other things being equal, the more valuable a horde of buried treasure is, the more rapidly it will be recovered.").

<sup>19</sup> *Ibid.*, para. 58.

<sup>20</sup> *Ibid.*, para. 62. See also Opinion of Advocate General Poiras Maduro, Case C-109/03 *KPN Telecom BV v. Onafhankelijke Post en Telecommunicatie Autoriteit (OPTA)*; July 14, 2004 (not yet reported), para. 39 ("A balance should be kept between the interest in preserving or creating free competition in a particular market and the interest in not deterring investment and innovation by demanding that the fruits of commercial success be shared with competitors."); and Opinion of General Gulmann in Joined Cases C-241/91 P and C-242/91 P *Radio Telefis Eireann and Independent Television Publications Limited (RTE & ITP) v. Commission* [1995] ECR I-743, footnote 10 ("it must not be forgotten copyright law – like other intellectual property rights also serves to promote competition.").

<sup>21</sup> Exceptions may, however, be appropriate. Property laws typically grant the same scope and duration of protection for each category of property right and therefore represent a somewhat crude and imperfect way of achieving the trade-off between free competition and the right to exclude. Anomalies and aberrations may therefore occur where the nature, scope, or duration of a property right is excessive. For example, a number of the leading refusal to deal cases under Article 82 EC have involved functional copyrights. It seems anomalous that a copyright – which, unlike a patent, does not protect the underlying subject-matter, but only an original expression of the subject-matter by the author – should allow the owner to monopolise a relevant market. Another important issue in the so-called new economy is the proliferation of new types of IP rights, many of which represent the outcome of vigorous (and sometimes unmeritorious) lobbying by vested interests. Many leading IP commentators argue that the increasingly broad number and scope of IP rights make it important that competition law should retain a residual role in egregious cases. See Cornish & Llewellyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, Sweet & Maxwell, 5th ed., (2003), at 755. This does not and should not mean that competition law should be used to reshape the *existence* of property rights, but it is well-established that the *exercise* of a property right may be reviewed under Community competition rules. See sources collected at note 14 above.

consumers is, at worst, monopoly pricing. But tools already exist under Article 82(a) to control excessive prices and, in general, these are easier to apply, and less controversial than a mandatory obligation on a dominant firm to share assets developed or acquired by legitimate means. And yet the Commission has not routinely pursued excessive pricing claims in recent years, while it has adopted a number of decisions on refusal to deal.

A sixth, fundamental criticism is that the sharing of a monopoly among several competitors does not in itself increase competition unless it leads to improvements in price and output. Where a monopoly is merely shared among two or more undertakings, nothing has been achieved in terms of enhancing consumer welfare. Competition would only be improved if the terms on which access is offered allow the requesting parties to effectively compete with the dominant firm on the relevant downstream market. This raises the issue of whether the dominant firm is entitled to charge the requesting parties the previous monopoly rate or whether, in addition to granting access, there is a duty to offer terms that allow efficient rivals to make a profit. The price of access raises complex issues, discussed in Chapter Twelve (Remedies), but it is sufficient to note here that: (1) the Community institutions have not elaborated any clear criteria for the determination of the price of access; (2) a price that would lead to the continuation of the previous monopoly price does nothing to help consumers; (3) a price that expropriates some of the property owner's reward may produce long-term inefficiencies; and (4) all prices require on-going monitoring, which the Commission has said that it does not wish to do.<sup>22</sup>

The final criticism is pragmatic in nature and concerns the limited abilities of competition authorities and courts to decide whether a facility is truly non-replicable or merely a competitive advantage. Deciding whether a facility can be duplicated or not is by nature a difficult and uncertain exercise that involves bold predictions as to future market evolution. Competition authorities and courts have no particular skills in this regard and the information available to them is often limited and may be skewed by the adversarial process. Further, there are no reliable economic or evidential techniques for testing whether a facility can be duplicated. For example, it is often difficult to distinguish situations in which customers simply have a strong preference for one facility from situations from those in which objective considerations render their choice unavoidable. Thus, a more practical reason why duties to deal should be generally avoided is that the rate and cost of error is likely to be high.

## 8.2. THE ECONOMICS OF REFUSAL TO DEAL

### 8.2.1. IP Rights

**Basic rationale for IP rights.** The rationale for granting and protecting IP rights is well understood in economics.<sup>23</sup> An IP right, like any other property right, gives its holder the ability to exclude others from using that property and thereby enables the holder to appropriate the value of the property for himself. That seldom matters much because the majority of IP rights are not valuable.<sup>24</sup> But some IP rights are immensely valuable: the right to exclude results in monopoly prices. In these circumstances, IP rights offer the prospect of monopoly profits and thereby stimulate socially-valuable innovation and creation.

The right to exclude has a direct positive impact on the incentives for innovation. Innovators must receive a reward for their risky and costly investments. This is why society generally allows, and at

<sup>22</sup> See, e.g., Vth Report on Competition Policy (1975), para. 76.

<sup>23</sup> See Carlton & Perloff, above note 1, chapter 16 and references therein.

<sup>24</sup> See Lemley, *Rational Ignorance at the Patent Office*, 2000-16, The Berkeley Law and Economics Working Papers, 2000. In addition, according to USPTO data, from 1999-2003 more than one sixth of the patents up for renewal were left to expire. In that period, over 260,000 patents expired because of non-renewal. See data available at [http://www.uspto.gov/web/offices/com/annual/2003/060401\\_table1.html](http://www.uspto.gov/web/offices/com/annual/2003/060401_table1.html). Roughly 40% of all U.S. patents are maintained though the entire 20-year period, see <http://www.uspto.gov/web/tws/tsr99/43pat.htm>. Similarly, most new books published by a traditional publisher do not sell more than 5,000 copies. Furthermore, only 10% of New York published books sell enough copies to pay royalties beyond the author's advance – nine out of ten books return no royalties to the author. From Union Hill Press, *Industry Facts*, available at <http://www.unionhillpress.com/industry.html>.

times even enables, firms to have market power.<sup>25</sup> The reward must be high for innovations that require great investments. Getting a new drug to market, for example, costs an average of \$800 million in capitalized costs for pre-regulatory approval research and development and \$95 million for post-approval research and development.<sup>26</sup> A Hollywood film now costs an average of \$80 million to make and market.<sup>27</sup> Investors can only recover the sunk costs incurred at the R&D stage if they can charge prices that exceed the incremental costs of production when the innovation is ready to be marketed.

The more important reason rewards loom large is that most efforts that could be subject to IP protection do not succeed. Most inventive efforts fail. Many of these failures are invisible: inventors who do not make something that could get a patent, much less a valuable one, songwriters whose tunes are never played, and artists whose works are never seen. But the failures show how fleeting success can be. Of every Hollywood movie released into the theatres, only 10% ever turn a profit.<sup>28</sup> Only one in approximately every 435 drugs that are considered ever makes it to the market.<sup>29</sup> Inventors and investors will thus enter into such efforts only if they expect that the rewards for the few successes will compensate for the many failures.

The right to exclude has another important effect on the incentives for innovation. Without it, people would tend to wait for others to incur the costs and risks of innovation and then free ride on the resulting creations. In the extreme case, everyone waits for others to invest and, as a result, investment and innovation cease, and the economy stagnates.<sup>30</sup> An economy cannot function indefinitely on imitation: in the end, there would be nothing left to imitate.

**The costs and benefits of IP protection.** Economics, law and policy have long recognised the relevance of two important and related distinctions in evaluating the role of IP rights.<sup>31</sup> The first distinction is *ex ante* versus *ex post*. After IP has been created, it is often most efficient to make it widely available – *ex post*, full dissemination and disclosure is optimal. But if that approach is adopted as a general policy, the IP will not be created in the first place – *ex ante*, the ability to exclude and control dissemination and disclosure is optimal for the creation of IP. The second, related distinction is *short run* versus *long run*. In the short run, it is possible to make consumers better off by making IP freely available, because there are benefits and no costs. In the long run, making IP freely available will likely make consumers worse off because innovation will decline.

<sup>25</sup> Note that an IP right creates a legal monopoly over a period of time, but does not necessarily give rise to a dominant position because its scope (or breadth) may not span the entire relevant product market. To equate intellectual property grants with monopoly power therefore confuses the distinct concepts of property, which is a legally enforceable power to exclude others from the object of ownership, and monopoly, which is power over price. See e.g., Landes & Posner, *The Economic Structure of Intellectual Property Refusals to Deal in Intellectual Property: Why Law* (Harvard University Press, 2003). The Court of Justice reached the same conclusion in Case 24/67, *Parke Davis v. Probel* [1968] ECR 81 ([A]lthough a patent confers on its holder a special protection at national level, it does not follow that the exercise of the rights thus conferred implies the presence together of all three elements [*i.e.*, the existence of a dominant position, its abuse and its impact on intra-Community trade] required for the prohibition of Article 82 to apply.”).

<sup>26</sup> Dimasi, Hansen, & Grabowski, “The Price of Innovation: New Estimates of Drug Development Costs,” *The Journal of Health Economics*, 2003.

<sup>27</sup> “Mutating,” *The Economist*, April 24, 2003. The success rate for European movies is apparently even lower.

<sup>28</sup> “A Fine Romance,” *The Economist*, March 29, 2001.

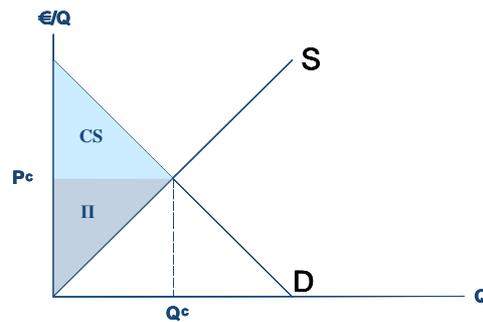
<sup>29</sup> Based on figures from Grabowski, “Patents, Innovation and Access to New Pharmaceuticals,” mimeo Duke University, July 2002; and Dimasi, “Research and Development Costs For New Drugs by Therapeutic Category,” *Pharmacoeconomics*, 1995.

<sup>30</sup> This is a variant of the well-known tragedy of the commons. See Hardin, “The Tragedy of the Commons,” *Science*, 1968. See also Aghion & Howitt, *Endogenous Growth Theory*, MIT Press, 1997.

<sup>31</sup> See Nordhaus, *Invention, Growth, and Welfare – A Theoretical Treatment of Technological Change*, The MIT Press, 1969; and Shapiro, “Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard-Setting,” in Adam Jaffe et al. (eds.), *Innovation Policy and the Economy*, 2001.

Successful innovations can and do benefit society substantially. The traditional demand and supply diagram helps to show why (see Figure 1 below). When a new product is introduced, the value created is the area between the demand curve (D) and the cost curve (S). That is, each unit of output has a social value that is the difference between the value shown by the demand curve and the cost of producing it. The overall social value of a product innovation is the sum of those differences: the area CS + II.

**Figure 1: Social Value of New Product**



The competitive equilibrium is at  $(P_c, Q_c)$  and it is located at the intersection of the supply curve, S, which is given by the incremental costs of production, and the demand curve D. Social value equals the sum of consumer surplus, CS, and producer surplus, II.

Modern economic research has documented that new products result in remarkable increases in social welfare.<sup>32</sup> The potential gains in consumer surplus through innovation can be enormous. A study in 1997 found that a new cereal – one made by adding apple and cinnamon to an existing cereal – created value of \$78.1 million per year in the United States.<sup>33</sup> Innovative drugs can lead to more dramatic results: empirical data show that the value of saving or improving lives greatly exceeds the seemingly exorbitant prices of some drugs.<sup>34</sup> Likewise, technical change (due to product and process innovations) has resulted in rapid increases in productivity and improved standards of living around the world.<sup>35</sup>

These social rewards come at an obvious cost. Successful IP rights may allow the holder to raise the price above the competitive level by restricting output below the competitive level. The result is the well known “monopoly-loss triangle,” given by the value that consumers do not get from the output the monopolist does not produce (see area L Figure 2 below.) In a concrete example, one can imagine the value that society loses when pharmaceutical companies charge prices for pills that far exceed of the cost of manufacturing those pills.

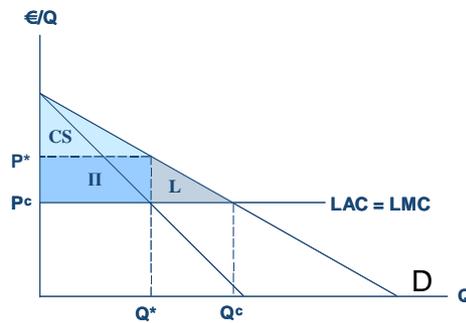
<sup>32</sup> See, e.g., Hausman & Greg Leonard, “The Competitive Effects of a New Product Introduction: a Case Study,” *Journal of Industrial Economics*, 2002, and Petrin, “Quantifying the Benefits of New Products: The Case of the Minivan,” *Journal of Political Economy*, 2002.

<sup>33</sup> Hausman, “Valuation of New Goods under Perfect and Imperfect Competition,” in Bresnahan & Gordon (eds.), *The Economics of New Goods*, 1997.

<sup>34</sup> The estimated social value of increases in life expectancy due to advances in medical research from 1970 to 1990, was estimated to amount to \$2.8 trillion per year. Murphy & Topel, “The Economic Value of Medical Research,” in Murphy & Topel (eds.), *The Gains from Medical Research: An Economic Approach*, 2003.

<sup>35</sup> Fare, Grosskopf, Norris & Zhang, “Productivity Growth, Technical Progress, and Efficiency Change in Industrialized Countries,” *American Economic Review*, 1994; Gliberman, “Linkages between productivity change and productivity growth,” *Industry Canada Research Publications Group*, Occasional Paper, May 2000.

Figure 2: Monopoly-loss Triangle



The competitive equilibrium is at  $(P_c, Q_c)$ . The monopoly outcome results in a higher price and lower quantity given by  $(P^*, Q^*)$ . The result is a deadweight loss of welfare to society given by  $L$ , commonly known as the monopoly-loss triangle.  $II$  is the monopoly profit and  $CS$  is consumer surplus. The negative impact of monopoly power on consumer's welfare is equal to the sum of the supra-competitive profits  $II$  and the deadweight loss  $L$ .

**Balancing the costs and benefits of IP protection.** Policymakers must decide whether or not the gains from stimulating investment in innovation outweigh the losses from allowing a monopoly to persist. Industrial societies have long balanced these considerations and reached a general consensus that the benefits of IP protection greatly exceed the costs. What differences remain lie mainly at the margin. The current consensus may be summarised as follows.

First, societies rely on a number of “social” or “policy” instruments to stimulate intellectual creations. These include prizes, honours, social prestige, and government funding. Copyrights, patents, and trade secrets fill out the arsenal in promoting creations where exclusive control over the subject-matter is necessary to stimulate innovation and investment.

Second, governments have made complex economic policy judgments regarding IP rights, which they have chosen to enforce through laws and institutions. The logic behind this choice is that innovations – and the new and improved products and processes they entail – are valuable. While some may bemoan the high cost of pharmaceuticals, the fact is that, in the absence of patent protection, few of these drugs would have been produced, put through clinical trials, and brought to market.<sup>36</sup> Yet, as observed above, these drugs have brought enormous benefits in extending and improving the quality of life.<sup>37</sup> The same conclusion may be drawn for many modern industries – IP protection has brought tremendous value to consumers.

Finally, governments have defined certain limits to the protection afforded by the law: IP protection comes with conditions attached. This is most obvious in the case of a patent, which allows the invention to be used by third parties 15-20 years after the patent filing. Similarly, copyrighted material can eventually be reproduced and distributed at no cost (although the duration for which exclusive rights should be protected is debated). Copyright is also limited in scope: it only grants exclusive control over the *expression* of an original idea rather than the subject-matter of the idea itself. There are also categories of intellectual matter for which it is not possible to obtain property rights.<sup>38</sup>

<sup>36</sup> Grabowski, “Patents and New Product Development in the Pharmaceutical and Biotechnology Industries,” mimeo Duke University, 2002; Grabowski, “Patents, Innovation and Access to New Pharmaceuticals,” mimeo Duke University, 2002; Mansfield, “Patents and Innovation: an Empirical Study,” *Management Science*, 1986. Testimony of the Biotechnology Industry Organization on Competition and Intellectual Property Law and policy in the Knowledge e-based economy before the federal Commission and the Department of Justice (February 2002).

<sup>37</sup> Murphy & Topel, above note 34.

<sup>38</sup> Some creations of the mind may be so valuable from a social standpoint that we do not want to restrict their use. For example, it is not possible to obtain protection for theorems or discoveries of general laws of nature. That is why Einstein could obtain patent protection for his many refrigerator innovations but not for the general theory of relativity. And one must be careful not to assign property rights unnecessarily or to obvious

**Identifying situations in which compulsory licensing can enhance welfare.** From the foregoing, it should be clear that compulsory licensing has two main and opposing effects on welfare.<sup>39</sup> First, it reduces the incentives to innovate in the long run.<sup>40</sup> The impact on social welfare of a fall in the incentives for innovation is potentially very large and equal to the reduction in total surplus (area II + CS in Figure or 2) that results from a lower number of product and process innovations. A lower rate of innovation means less profits (area II) and lower consumer satisfaction (area CS). This negative effect will be largest when the products that competitors manufacture when having access to the requested IP are close substitutes to those of the IP holder.

The second, beneficial effect is that compulsory licensing may increase competition in the short term, thus contributing to eliminate the deadweight loss of market power (area L in Figure 2) and to increase consumer welfare in the short term (area II). This effect will be largest when the degree of market power derived from the exercise of the IP right is greatest.<sup>41</sup> That is, when the right to exclude embodied in the IP right leads to the exclusion of all competition in the downstream market, such as when access to the IP is indispensable to carry on business on that market. Compulsory licensing may also have a positive effect on consumer welfare in the long run if it facilitates the development of new products for which there is potential demand.

Determining which of the two effects is quantitatively most important is extremely difficult, since the welfare-increasing and welfare-decreasing effects of a compulsory licence cannot be accurately balanced, either *ex ante* or *ex post*.<sup>42</sup> Approximations are therefore necessary. A first approximation involves comparing areas CS + II (the welfare cost of compulsory licensing) and II + L (the welfare benefit of compulsory licensing), or simplifying areas CS and L, which is no doubt a complex exercise. However, in general, compulsory licensing is likely to have an overall negative impact on welfare (i.e., area CS is likely to be large than area L). This is true for two reasons. First, the available evidence indicates that innovators do not generally appropriate the entire social value of their innovations, and that most of the value of the new products and processes are sooner or later passed on to consumers.<sup>43</sup> Second, area L may also be small because compulsory licensing may not

---

ideas. For example, McDonald's could not protect the fast-food franchise idea, nor Wal-Mart the idea of having large superstores.

<sup>39</sup> "Welfare" in this context refers to social welfare (the sum of consumer and producer surpluses)--the measure economists mainly advocate for evaluating competition policy. See Motta, *Competition Policy: Theory and Practice*, 2004; Williamson, "Economies as an Antitrust Defence: The Welfare Tradeoffs," *American Economic Review*, 1968; Schmalensee, "Sunk Costs and Antitrust Barriers to Entry," *American Economic Review*, 2004. Most of what follows does not depend on whether we use social welfare or the more narrow measure of consumer welfare that the courts and competition authorities typically use for evaluating antitrust issues.

<sup>40</sup> See, e.g., Gilbert & Shapiro, "An Economic Analysis of Unilateral Refusals to License Intellectual Property," *Proceedings of the National Academy of Sciences USA*, 1996, page 12754 ("An obligation to deal does not necessarily increase economic welfare even in the short run. In the long run, obligations to deal can have profound adverse incentives for investment and for the creation of intellectual property. Although there is no obvious economic reason why intellectual property should be immune from an obligation to deal, the crucial role of incentives for the creation of IP is reason enough to justify skepticism toward policies that call for compulsory licensing.") See also Motta above note [ ], page 64 ("If antitrust agencies tried to eliminate or reduce market power whenever it appeared, this would have the detrimental effect of eliminating firms' incentives to innovate.").

<sup>41</sup> When that is the case, the difference between the price that would prevail under compulsory licensing ( $P^c$  in Figure 2) and the price without compulsory licensing ( $P^*$  in Figure 2) is largest, and hence consumer surplus (CS) is smallest.

<sup>42</sup> Evans, "How Can Economists Help Courts Design Competition Rules? An EU and US Perspective," *World Competition*, forthcoming 2005.

<sup>43</sup> Professor Nordhaus of Yale University, one of the classical authors on the economics of innovation, finds using data from the U.S. non-farm business sector that innovators are able to capture about 2.2 percent of the total surplus from innovation. These findings imply, first, that the private incentives to innovate are likely to be lower than the socially optimal. But also that the degree of market power *de facto* enjoyed by innovators

only reduce welfare in the long run, but also in the short term,<sup>44</sup> e.g., by facilitating entry of inefficient producers, reduced product variety, and collusion.

Balancing these competing economic considerations leads to the conclusion that forced disclosure of IP is only likely to increase long-run consumer welfare when the following cumulative conditions are met: (1) the requested IP is indispensable to compete; (2) the refusal to license causes the exclusion of all competition from the downstream market; (3) the refusal prevents the emergence of markets for new products for which there is substantial demand; and (4) the products to be developed by the licensees are sufficiently differentiated from those of the IP right holder, e.g., because they satisfy needs that the existing products failed to address. Conditions (1) and (2) ensure that the short-term welfare loss resulting from a refusal to license is maximal (area L is large). Condition (4) implies that the refusal has a long-run cost as well as a short-term cost. And condition (4) says that the long-run cost of compulsory licensing – the reduction in the incentives to innovate is low.

The last two conditions are, arguably, the most important. When (1) and (2) fail to hold, the obligation to deal is bound to have a significant adverse effect on the incentives for innovation and the creation of IP, and no social benefit, or at least a questionable one, in the short term. However, one would expect no unilateral refusal to licence when (3) and (4) hold. In those circumstances the IP holder is likely to be better off by licensing its IP reaping some of the rents generated by the new products at no cost for its own existing business. In other words, when (3) and (4) hold, there is likely to be a mutually acceptable license since total industry profits when there is a license exceed total industry profits when the IP holder refuses to license.

### 8.2.2. Physical Property

**Basic rationale for protecting physical property.** The basic rationale for protecting investments in physical property is essentially the same as for IP rights. Property rights grant the owner the prospect of returns above marginal cost in the long-run, which is necessary to stimulate socially beneficial investment decisions *ex ante*. Again, there is an established consensus in industrialised societies that the positive effects of welfare-enhancing investments in physical property outweigh the negative effects of prices above marginal cost for the period in which the property right benefits from protection. Similarly, while the sharing of physical property through a duty to deal will always look attractive *ex post* once a valuable asset has been created, any such general policy risks undermining the important social benefits of investment and innovation *ex ante*. As with IP, physical property rights thus create a generally desirable right to exclude.<sup>45</sup> What differences remain lie at the margin and are therefore the exception, not the rule.

**The general equivalence of physical property and IP rights under the duty to deal.** It is frequently argued that unilateral refusals to licence IP rights merit a higher form of deference under competition law than refusals to supply physical assets.<sup>46</sup> Several reasons are typically advanced, but

---

is rather limited. Consequently, compulsory licensing is likely to depress innovation from levels that are inefficiently low, without any significant pro-competitive effect in the short-term. In terms of Figure 2 above, this suggests that area CS is likely to be large and area L small. See Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement," *Cowles Foundation Discussion Paper No. 1457* (2004), page 4 and references in footnote 6.

<sup>44</sup> Gilbert & Shapiro, "An Economic Analysis of Unilateral Refusals to Licence Intellectual Property," *Proceedings of the National Academy of Sciences USA*, 1996,

<sup>45</sup> See, e.g., Demsetz, "Barriers To Entry," *72 American Economic Review* 47, 48-52 (1982). For an overview of the literature discussing the economic justification for the protection of property rights, see Elhauge, "Defining Better Monopolisation Standards," *56 Stanford Law Review*, 253 (2003), at 294-305.

<sup>46</sup> See, e.g., Lipsky & Sidak, "Essential Facilities," *51 Stanford Law Review* 1187 (1999); Gleklen, "Per Se Legality for Unilateral Refusals to License IP Is Correct as a Matter of Law and Policy," *The Antitrust Source*, (July 2002), available at <http://www.arnoldporter.com/pubs/files/Legality.pdf>; Hovenkamp, Janis & Lemley, *IP and Antitrust: an Analysis of Antitrust Principles Applied to Intellectual Property Law* 13-16 (Aspen Law & Business, New York (2002)).

they are not particularly compelling, whether taken alone or in combination.<sup>47</sup> First, it is said that the very purpose of IP rights is to grant a reward to the owner by restricting competition, in return for the benefits that valuable innovations bring to society.<sup>48</sup> But the same general justification can be advanced for physical property: the nature, scope, and duration of protection is the result of a legislative consensus that property rights confer net benefits to society in the form of desirable investment activity.

Second, it is said that the basic purpose of IP rights is to exclude competition and that competition law should therefore recognise that a legal monopoly is central to the reason why IP rights are granted. This reason confuses, however, the legal monopoly granted by the IP laws and the economic monopoly that competition law is concerned with. IP rights do not grant an economic monopoly: this is only the case where other products on the relevant market are not effective substitutes. Moreover, there is no intrinsic reason why IP rights should lead to a higher incidence of economic monopolies than physical property rights. The question in each case is whether consumers are willing to pay a sufficient premium for one product over other actual or potential substitutes. The acquisition of market power by IP owners is thus not automatic but is an empirical matter,<sup>49</sup> depending on market conditions faced by the output embodying the creation or innovation, and the existence of substitutes.<sup>50</sup> The same analysis applies to physical property.<sup>51</sup> It should also be emphasised that Article 82 EC is generally agnostic towards economic monopolies: only the abuse of a dominant position is illegal and the mere fact of holding an economic monopoly is not, in itself, unlawful. Additional elements are needed.

A third reason advanced is that IP merits a higher level of protection because it can generally be copied easily and inexpensively and cannot be exhausted. Physical facilities are generally more difficult and expensive to copy and are generally subject to capacity constraints that limit the scope for misappropriation. These differences are no doubt true, as a general matter, but they are simply a reason why IP rights grant their owner the *exclusive* right to reproduce the protected matter. Such exclusivity is not required for physical property, since the problems of misappropriation and non-exhaustion do not arise, to the same extent or at all. The fact that exclusivity may be necessary to protect an IP right from reproduction does not therefore offer a convincing basis for saying that Article 82 EC should treat unilateral refusals to deal in IP rights more leniently than physical property.

The same comment can be made with respect to the suggestion that IP rights merit different treatment because they are limited in time.<sup>52</sup> The duration of protection of property rights – whether physical or

---

<sup>47</sup> See Katz, “Intellectual Property Rights and Antitrust Policy: Four Principles for a Complex World,” 1 *Journal on Telecommunications & High Technology Law*, 325 (2002), at 349 (“[T]he arguments for special treatment of intellectual property are incomplete. Indeed, the arguments for imposing less of a duty to deal on intellectual property than on other forms of property have been disappointingly superficial to date. ... [M]ore rigorous analysis is needed if one is to take seriously arguments that intellectual property is deserving unique treatment.”).

<sup>48</sup> See Kaplow, “The Patent-Antitrust Intersection: A Reappraisal,” 97 *Harvard Law Review* 1813 (1984), at 1817.

<sup>49</sup> See Kitch, “Elementary and Persistent Errors in the Economic Analysis of Intellectual Property,” *Vanderbilt Law Review*, Vol. 53 (2000), p. 1727.

<sup>50</sup> See e.g., Landes & Posner, *The Economic Structure of Intellectual Property Refusals to Deal in Intellectual Property: Why Law* (Harvard University Press) (2003).

<sup>51</sup> See 1995 Department of Justice & Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property*, section 2.1 (The United States enforcement agencies attempt to “apply the same general antitrust principles to conduct involving intellectual property rights that they apply to conduct involving any other form of tangible or intangible property.”), available at <http://www.usdoj.gov/atr/public/guidelines/ipguide.htm>.

<sup>52</sup> See Derclaye, “Abuses of Dominant Position and Intellectual Property Rights: a Suggestion to Reconcile the Community Courts Case Law”, 26 *World Competition* 685 (2003) at 700-701 (“More caution must be exercised when further limiting these rights. ... there are reasons to be more prudent when imposing compulsory licences on copyright holders rather than on owners of other types of property. A difference in

intellectual – simply represents the *outcome* of the balance made by the legislature between the need to provide incentives for beneficial social activity and the adverse welfare effects of granting owners exclusive rights or other forms of control over property. It does not in itself offer a basis for immunising certain types of rights from competition law scrutiny or applying more lenient standards. Moreover, there is no hard and fast distinction between IP rights and physical property in this regard: many leases or other rights over physical property are shorter in duration than IP rights (e.g., copyrights, which last for the life of the author plus 50-70 years thereafter depending on the applicable legal term).

The final reason put forward is that IP rights involve more risky and costly *ex ante* investment decisions than physical property. However, there is no clear empirical basis for this assertion and a good deal of real world evidence to suggest that it is not true, or at least not universally true. For example, one of the largest investments in industrial societies in recent years has been the infrastructure and government permits required for broadband Internet access and third-generation mobile telephony. These investments compare favourably with research and development costs for valuable IP rights such as pharmaceuticals.

In sum, while the legal definition of IP rights necessarily differs in certain respects from physical property, there is no clear basis in economics for saying that IP rights merit different (i.e., more lenient) treatment in respect of unilateral refusals to deal. What matters in each case is the impact of forcing access on the incentives to invest, and not the nature of the property rights at stake. Economics therefore provides a sound basis for saying that IP rights and physical property should be treated essentially the same in analysing unilateral refusals to deal under Article 82 EC.

### 8.3. THE BASIC LEGAL FRAMEWORK UNDER ARTICLE 82 EC

**Refusal to deal generally under Article 82 EC.** Issues of refusal to deal traverse a number of abuses under Article 82 EC. The abuse of price squeeze, discussed in Chapter Five, in essence concerns a refusal to deal except on terms that would render downstream rivals' activities unprofitable. Tying and bundling practices, discussed in Chapter Ten, may also raise issues of refusal to deal. For example, an offer to sell product A at a more favourable price where product B is also purchased at the same time could amount to a refusal to supply product A where the price for product A on a stand-alone basis is excessive. Under certain circumstances, some or all of these practices may amount to a violation of Article 82 EC.

The legal principles concerning the circumstances in which a refusal to deal constitutes a substantive violation of Article 82 EC are, however, narrower in scope than the various other abuses that, in some sense, involve elements of refusal to deal. In essence, there are four main categories of abuse: (1) the duty to grant a first licence or contract to a competitor of the dominant firm; (2) the duty to grant a second or subsequent licence or contract to a competitor in circumstances where the dominant has granted a first licence or contract (whether voluntary or compulsory); (3) the dominant firm's duty to deal with downstream trading parties with whom it does not compete; and (4) a duty to deal as a remedy for another abuse. The decisional practice and case law to date has primarily dealt with category (1). In practice, however, categories (2), (3), and (4) are also important and, perhaps, even more important than category (1) given the extremely small number of cases in which compulsory first contracts have been imposed. The basic scope of each category of abusive refusal to deal under Article 82 EC is discussed below.

**The duty to deal with competitors: first contracts or licences.** The first category of abusive refusal to deal under Article 82 EC concerns the dominant firm's duty to grant a first licence or contract to a competitor that needs the essential input to compete on a downstream market with the dominant firm. In this situation, the dominant firm has not previously dealt with any rival, but may be compelled to do so where, *inter alia*, it owns or controls inputs that are essential for competition on a

---

treatment, most probably in the direction of a lower incursion of competition law into copyright's scope than into the scope of other forms of property, is therefore justified.”).

downstream market, the refusal to deal would have serious enough adverse effects on competition, and no objective reasons are capable of justifying the refusal to deal. These cases, broadly speaking, raise issues under the so-called “essential facility” doctrine. A refusal to grant a first licence to a competitor is an example of “limiting production” to the “prejudice of consumers” under Article 82(b); in other words, a case of unlawful foreclosure.<sup>53</sup> This category of abusive refusal to deal is discussed in detail in Section 8.4 below.

**The duty to deal with competitors: subsequent contracts or licences.** The second category concerns the duty to grant a second or subsequent licence or contract to a competitor in circumstances where the dominant has already granted a first licence or contract (whether voluntary or compulsory) to one rival. The refusal to offer subsequent licences or contracts to other competitors involves elements of foreclosure under Article 82(b) and discrimination under Article 82(c). Although both provisions may apply simultaneously, the core legal issue is not so much discrimination, but whether that discrimination gives rise to unlawful foreclosure of a rival. Discrimination is mainly a vehicle for causing foreclosure and thus part of the overall conduct. The important legal consequence of this is that the dominant firm’s duty to make a subsequent contract with rivals is subject to essentially the same principles as the duty to make a first contract. This category of abusive refusal to deal is detailed in Section 8.4 below.

**The duty to deal with downstream trading parties with whom the dominant firm does not compete.** The third category concerns the dominant firm’s duties towards downstream trading parties with whom it does not compete. In contrast to the duty to deal with rivals, the dominant firm in this scenario is *not* active on the same level of trade as the customer. The relevant legal provision is Article 82(c), which prohibits a dominant firm from applying dissimilar conditions to equivalent transaction without objective justification. A duty to deal under Article 82(c) only arises if the dominant firm has already made a first contract or licence: if it has not, it cannot be discriminating, either in favour of its own downstream operations or between customers.<sup>54</sup> An unresolved question concerns the number of contracts that have to be made under Article 82(c). In particular, the issue arises whether the conditions for discrimination under Article 82(c) are sufficient for a subsequent contract or whether it also needs to be shown that the input in question is essential for the requesting party. Section 8.5. explains the principles applied in this regard and concludes that the conditions for the award of subsequent contracts to customers under Article 82(c) are similar to those governing first and subsequent contracts with rivals under Article 82(b).

A sub-set of this category concerns situation of distribution and resale. The essential facility doctrine does not generally apply in this context, since there is no meaningful scope for value-added competition between a dominant firm and its distributors or resellers. The essential facility doctrine concerns inputs supplied by the dominant firm for transformation into a final product made by downstream firms. A small number of decisions nonetheless suggest that the dominant firm may have a duty to deal with distributors or resellers in certain circumstances. These cases in essence concern situations in which the dominant firm punishes distributors or resellers for dealing in competing products and are therefore most accurately characterised as situations of *indirect* harm to a rival by denying it essential distribution space. Section 8.5 also discusses this category of refusal to deal.

<sup>53</sup> The Community Courts have expressly confirmed that Article 82(b) is the legal basis of the refusal to grant a first licence or contract in a number of cases. See, e.g., Case 311/84, *Telemarketing CBEM* [1985] ECR 3261, para. 26; Case 53/87, *CICRA and Maxicar v. Renault* [1988] ECR 6039; Case 238/87, *Volvo v. Veng* [1988] ECR 6211; Joined cases C-241/91P, *RTE and ITP v Commission* [1995] ECR I-743, para. 54; and Case COMP/38/096, *Clearstream (Clearing and settlement)*, decision of June 4, 2004, not yet published, available at <http://europa.eu.int/comm/competition/antitrust/cases/decisions/38096/en.pdf> (hereafter, “Clearstream”), para. 222.

<sup>54</sup> This was confirmed by the Court of First Instance in *Ladbroke*. *Ladbroke* sought access to broadcasts of French horse races for transmission in its betting shops in Belgium. The Court of First Instance held that no duty to deal arose, since the owners of the broadcasts were not present on the relevant downstream Belgian market (betting shops) and *Ladbroke* was already the leading competitor on this market. See Case T-504/93 *Tiercé Ladbroke SA v. Commission* [1997] ECR II-923, para. 130. For a commentary on the judgment, see Korah “The *Ladbroke* Saga” [1998] *European Competition Law Review*, pp.169-176.

**A duty to deal as a remedy for another abuse.** The final duty to deal that may be appropriate under Article 82 EC concerns situations in which the substantive violation is not a refusal to deal, but another abuse for which a duty to deal is the most effective *remedy*. The usual remedy for the other abuse will be a cease and desist order in respect of the specific conduct at issue. A cease and desist order may, however, be ineffective in certain circumstances to prevent the abuse continuing or to restore competitive conditions. In this situation, a duty to deal may be a necessary and proportionate remedy for the other abuse. This final category is discussed in Section 8.6.

## 8.4. THE DUTY TO DEAL WITH COMPETITORS

### 8.4.1. Evolution Of The Decisional Practice And Case Law

**Physical property.** The duty of a dominant firm to grant access to essential physical property was first developed by the Commission in a series of cases in the late 1980s and early 1990s concerning physical infrastructure and networks. A number of earlier cases arose concerning essential infrastructure and services in the airline sector. Interestingly, most of the access obligations contained in the early Commission decisions have resulted in legislation creating general duties to share the facilities in question.<sup>55</sup> A series of cases involving ports and related facilities then elaborated on the duty to deal, including by specifically mentioning for the first time the term “essential facility.” Finally, the Court of Justice in *Bronner* cut back the scope of the duty to deal by laying down strict conditions for such a duty to arise.

*a. Commercial Solvents.*<sup>56</sup> *Commercial Solvents* is generally regarded as the pre-cursor to the modern case law on refusal to deal. The Court of Justice held that Commercial Solvents abused its dominant position by refusing to continue supply aminobutanol and nitropropane, raw materials for the production of ethambutol (and for which Commercial Solvents held unique know-how in Europe) to Zoja. The basis for the refusal to supply was that Commercial Solvents was planning to vertically integrate into competition with Zoja in the downstream market for the supply of the derived product, ethambutol. Commercial Solvents’ actions were thus intended to exclude Zoja from the downstream market by cutting off essential raw materials. The Court noted that Commercial Solvents had supplied Zoja with aminobutanol for some years and only terminated supplies when Zoja started competing directly with it. In these circumstances, the Court held that there was an abuse.<sup>57</sup>

*b. Cases on airport and airline infrastructure.* The earliest case creating a duty to supply infrastructure access to competitors involve airline computer reservation systems. In *London European/Sabena*,<sup>58</sup> Sabena refused to grant its competitor airline, London European, access to the Saphir computer reservation system (which was managed by Sabena). London European claimed that Sabena refused to grant it access to the Saphir system on the grounds that: (1) London European’s fares were too low; and (2) London European had entrusted the handling of its aircraft to a company

<sup>55</sup> See sources collected at notes 9-10 above.

<sup>56</sup> Joined Cases 6/73 and 7/73, *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v Commission* [1974] ECR 223.

<sup>57</sup> A similar conclusion was reached in *Telemarketing*, where RTL, a dominant broadcaster, committed an abuse by refusing to sell advertising space to CBEM, a telemarketing operator. CBEM had concluded a one-year agreement with RTL allowing it to conduct telemarketing operations on RTL’s broadcasts through CBEM’s own telephone number. After this agreement had expired, RTL indicated that it would no longer accept advertising spots unless the telephone number used was that of its own advertising subsidiary. The Court of Justice found that this amounted to an abuse, since RTL was using its statutory broadcasting monopoly to reserve the activity of telemarketing services to its own subsidiary, thereby eliminating competition from CBEM. See Case 311/84 *Centre Belge D’études De Marché Télémarketing v SA Compagnie Luxembourgeoise De Télédiffusion & others* [1985] ECR 3261. See also *Hugin/Liptons* (OJ 1978 L 22/23), where the Commission found that the refusal to continue to supply a customer with spare parts on the ground that the customer had established a business in servicing and the supply of spare parts in competition with the dominant supplier was abusive.

<sup>58</sup> *London European/Sabena*, OJ 1988 L 317/47. See also *Amadeus Sabre*, Twenty-first Competition Policy Report (1991) p. 73-74 (similar non-discrimination duty imposed on the second other large European computer reservation system owners).

other than Sabena (i.e., tying). The Commission found that this amounted to an abuse, since it would result in the risk of the elimination of London European as a competitor on the relevant routes.

A similar conclusion was reached in *British Midland/Aer Lingus*,<sup>59</sup> which concerned access to interlining facilities, i.e., where airlines are authorised to sell each other's services. Aer Lingus had long cooperated with British Midland within the framework of an international multilateral agreement on interlining services. However, once British Midland commenced a competing route from London-Dublin, Aer Lingus terminated its past cooperation and refused to accept interchangeability of British Midland's tickets on the London-Dublin route. This contrasted with the conduct of British Airways – the other competitor on the route – which continued to interline with British Midland. Aer Lingus also continued its interlining agreement with British Airways, while refusing to deal with British Midland. The Commission found that Aer Lingus' refusal to interline constituted an abuse. This was based, *inter alia*, on the importance of interlining services for a viable operation and the risk that British Midland would be eliminated as a competitor absent access. The Commission reasoned as follows:

“Both a refusal to grant new interline facilities and the withdrawal of existing interline facilities may, depending on the circumstances, hinder the maintenance or development of competition. Whether a duty to interline arises depends on the effects on competition of the refusal to interline; it would exist in particular when the refusal or withdrawal of interline facilities by a dominant airline is objectively likely to have a significant impact on the other airline's ability to start a new service or sustain an existing service on account of its effects on the other airline's costs and revenue in respect of the service in question, and when the dominant airline cannot give any objective commercial reason for its refusal (such as concerns about creditworthiness) other than its wish to avoid helping this particular competitor. It is unlikely that there is such justification when the dominant airline singles out an airline with which it previously interlined, after that airline starts competing on an important route, but continues to interline with other competitors.”

c. *Expansion of the duty to share in the port cases.* The first case specifically mentioning the term “essential facilities” was the Commission's interim decision in *Sea Containers*.<sup>60</sup> Sea Containers wished to introduce a new fast ferry service to the Holyhead-Dun Laoghaire route, using a wave-piercing catamaran technology. To do this, it had to rely on upstream port facilities provided by Sealink, which was also vertically-integrated in the supply of passenger ferry services. Port services available at the port of Holyhead were found by the Commission to be an essential facility for the provision of such services: facilities available at other ports in the same catchment area were not effective substitutes. The Commission found that, in contrast to the establishment of its own fast ferry service, Sealink consistently delayed and raised difficulties concerning Sea Containers' possible use of existing facilities in the port, thereby discriminating against Sea Containers. In the interim, however, Sealink had offered Sea Containers access on non-discriminatory terms, which made the interim relief sought by Sea Containers unnecessary. The Commission followed this precedent in a series of subsequent decisions regarding ports and related infrastructure in other Member States.<sup>61</sup>

d. *Narrowing of the scope of the duty to deal in Bronner.* Despite various Commission decisions granting of access to physical infrastructure, the legal conditions under which access could be ordered were not clarified in any judgment of the Community Courts. This opportunity arose in *Bronner*, a preliminary reference from an Austrian court. The Court of Justice was asked to establish the circumstances under which a newspaper group, Mediaprint, with a substantial share of the market for daily newspaper refusing access to its home-delivery network would engage in abusive conduct. Mediaprint, the owner of the delivery scheme, provided a series of services to an independent

<sup>59</sup> *British Midland/Aer Lingus*, OJ 1992 L 96/34. See also *FAG-Flughafen Frankfurt/Main AG*, OJ 1998 L 72/30 (access to airport ground handling services).

<sup>60</sup> *Sea Containers v. Stena Sealink* (Interim measures), OJ 1994 L 15/8.

<sup>61</sup> See, e.g., *Port of Rødby*, OJ 1994 L 55/52 (refusal by Danish Government to allow EuroPort A/S to build a new port in the immediate vicinity of the port of Rødby or to operate from the existing port facilities at Rødby found abusive); *Port of Elsinore*, Commission Press Release, IP/96/456 (refusal by Danish government to grant access to Elsinore port to the shipping line Mercandia for routes between Elsinore and Helsingborg found abusive); and *Irish Continental Group CCI Morlaix-Port of Roscoff*, XXVth Competition Policy Report (1995), para. 43 (refusal by CCI Morlaix to grant access to Irish Continental to Roscoff port for services between Ireland and France found abusive).

publisher, including home delivery of one of its daily newspapers. The home-delivery scheme did not appear to have been sold independently, but formed part of a package including the printing and sale in kiosks of the daily newspaper in question.

The Court of Justice strongly suggested that Mediaprint had no duty to grant Bronner access to its home-delivery service. In so doing, it confirmed a number of important points in respect of the duty to deal. First, the Court confirmed that the indispensability of the requested product for competitors is a critical element of any duty to deal. It held that “it would still be necessary...in order to plead the existence of an abuse within the meaning of Article 8[2]...not only that the refusal of the service comprised in home delivery be likely to eliminate all competition in the daily newspaper market on the part of the person requesting the service and that such refusal be incapable of being objectively justified, but also that the service in itself be indispensable to carrying on that person’s business, inasmuch as there is no actual or potential substitute in existence for that home-delivery scheme.”<sup>62</sup> Second, in assessing “indispensability,” the question was whether there were “technical, legal or even economic obstacles” to making an alternative facility, indicating that a strict test applied.<sup>63</sup>

Finally, when assessing the ability of competitors to develop their own facilities, the standard was not whether the requesting party could develop another facility, but whether a company operating on the same scale as the dominant firm could do so, i.e., an objective standard based on an equally-efficient entrant.<sup>64</sup> Taken together, the Court’s judgment and the opinion of the Advocate General advocate a less interventionist approach to refusals to deal under Article 82 EC and display a greater recognition of the underlying policy and welfare considerations.<sup>65</sup>

**IP rights.** The evolution of the law on compulsory licensing of IP rights under Article 82 EC has tracked a similar path to that of physical property. At the outset, the judgment of the Court of Justice in *Volvo/Renault* signalled a cautious approach to the duty to grant a licence under Article 82 EC.<sup>66</sup> Shortly thereafter, however, an extreme case arose in *Magill* where the Community institutions treated the duty to licence IP rights as a sub-set of the essential facility analogue developed for physical property.<sup>67</sup> This culminated in the expansion of the duty to share in a controversial Commission interim decision in *IMS Health*,<sup>68</sup> followed later by *Microsoft*.<sup>69</sup> The most recent development – the judgment of the Court of Justice in *IMS/NDC*<sup>70</sup> – signals a return to a more orthodox position.

<sup>62</sup> Judgment of the Court of Justice in *Bronner*, above note 3, para. 41.

<sup>63</sup> *Ibid.*, para. 43.

<sup>64</sup> *Ibid.*, paras. 44-45.

<sup>65</sup> For commentary on *Bronner*, see Treacy, “Essential facilities: is the tide turning?” [1998] *European Competition Law Review* p.501-505, Hancher “A Review of Bronner” [1999] *Common Market Law Review* p.1289-1307, and Temple Lang, “The Principles of Essential Facilities in European Community Competition Law – The Position Since Bronner,” *J. of Network Industries* 375 (2000).

<sup>66</sup> See, e.g., Case 238/87 *AB Volvo v. Erik Veng (UK) Ltd* [1988] ECR 6211 (*Volvo* hereinafter). See also Case 53/87 *Consorzio italiano della componentistica di ricambio per autoveicoli and others v. Renault* [1988] ECR 6039 (“*Renault*” hereinafter), which was decided on the same day as *Volvo* on substantially the same grounds.

<sup>67</sup> Case IV/31.851 *Magill TV Guide/ITP, BBC and RTE* OJ [1989] L 78/43; Case T-69/89 *Radio Telefis Eireann (RTE) v. Commission* [1991] ECR II-485, Case 70/89 *The British Broadcasting Corporation and BBC Enterprises Ltd. (BBC) v. Commission* [1991] ECR II-535, and Case T-76/89 *Independent Television Publications Limited (ITP) v. Commission* [1991] ECR II-575 (together, “*Magill* CFI judgment”); affirmed on appeal in Joined Cases C-241/91 P and C-242/91 P *Radio Telefis Eireann and Independent Television Publications Limited (RTE & ITP) v. Commission* [1995] ECR I-743 (hereafter “*Magill* ECJ judgment”).

<sup>68</sup> *IMS Health/NDC*, OJ 2002 L 59/18 (interim measures) (*IMS Interim Decision* hereinafter).

<sup>69</sup> Case COMP C-3/37.792 *Microsoft*, Commission decision of March 24, 2004, not yet published (*Microsoft* hereinafter).

<sup>70</sup> Case C-418/01, *IMS Health v. NDC Health*, judgment of April 29, 2004, not yet reported (*IMS preliminary ruling* hereinafter)

a. *Volvo/Renault*. The first Court of Justice judgments concerning compulsory licensing under Article 82 EC were *Volvo* and *Renault*. The cases concerned the ability of an after-sales service provider to obtain registered design rights for particular car models from the manufacturer. The Court of Justice ruled that the freedom to refuse to license and IP right was at the core of the subject matter of the exclusive right and concluded that the refusal to license a protected design, even in return for a reasonable royalty, was not in itself abusive. However, the Court did not adopt a *per se* legality standard. It made clear that the exercise of an exclusive IP right could be in breach of competition law if it involved “additional abusive conduct,”<sup>71</sup> such as the arbitrary refusal to supply spare parts to independent repairers, the fixing of prices at an unfair level, or the decision to cease producing spare parts for a particular car model, even though many cars of that model were still in circulation.

b. *Magill*.<sup>72</sup> The only case in which the Community Courts have upheld a duty to licence an IP right is *Magill*. Broadcasters in the United Kingdom and Ireland – the BBC, RTE and ITP – each published weekly television guides containing details of their own TV programmes. These listings were a by-product of their main activity as broadcasters and did not require any specific investment or embody any literary or artistic value. Magill wanted to publish a comprehensive weekly TV guide with all broadcasters’ listings – a product for which there was unsatisfied consumer demand – and requested the TV listing information from the three broadcasters. The broadcasters claimed their TV listings were protected by copyright and refused to make the information available. The Commission ordered the three broadcasters to provide Magill with the information it had requested. The Court of First Instance upheld the Commission’s decision that the three broadcasters had abused the dominant position which they held on the markets for their television programme schedules, which was further upheld by the Court of Justice.

The Court of Justice established that the refusal to licence an IP right was not in itself an abuse by a dominant firm, but could be regarded as such in “exceptional circumstances.”<sup>73</sup> The Court regarded three circumstances in *Magill* as exceptional. First, “the information was indispensable for the production of a comprehensive TV program guide covering all the TV channels, a new type of product for which there was a clear and unsatisfied consumer demand.”<sup>74</sup> Second, “the TV companies, by refusing to provide essential information, were monopolising the separate market for TV program magazines.”<sup>75</sup> And third, “there was no objective justification for the refusal.”<sup>76</sup>

c. *Ladbroke*.<sup>77</sup> Ladbroke, an operator of betting shops in Belgium, complained to the Commission that its French competitor, Paul Mutuel International (PMI), should be required to grant a license of its copyright for televised pictures and sound commentaries on French horse races. On appeal following the rejection of Ladbroke’s complaint by the Commission, the Court held that the *Magill* principles did not apply to a refusal by certain French race course operators to allow Ladbroke’s betting shops in Belgium access to the live broadcasts of French horse races to which the French operators held the IP rights. This was because Ladbroke was not only already present on the Belgian market in question, but was in fact the leading betting operator. In other words, access to French race broadcasts could not, in fact, have been essential for Ladbroke’s activities in Belgium.

<sup>71</sup> *Renault*, above note 53, paras 15-16 (“The mere fact of securing the benefit of an exclusive right granted by law, the effect of which is to enable the manufacture and sale of protected products by unauthorised third parties to be prevented, cannot be regarded as an abusive method of eliminating competition. Exercise of the exclusive right may be prohibited by Article 8[2] if it gives rise to certain abusive conduct on the part of an undertaking occupying a dominant position.”).

<sup>72</sup> See sources collected at note 67 above.

<sup>73</sup> *Magill* ECJ judgment, at para. 50.

<sup>74</sup> *Ibid.*, paras. 53-54.

<sup>75</sup> *Ibid.*, para. 56.

<sup>76</sup> *Ibid.*, para. 55.

<sup>77</sup> Above note 54. For a detailed commentary on the judgment, see Korah “The Ladbroke Saga” [1998] *European Competition Law Review*, pp.169-176.

*d. IMS Interim Decision.* In 2001, the principles established for abusive refusals to licence culminated in controversy in the *IMS Interim Decision*. The case concerned a copyright-protected data analysis structure in Germany, referred to as the “1860 brick structure,” which divides the German territory into 1,860 geographic units or “bricks.” These bricks are designed to group doctors, patients, and pharmacies so as to allow the reporting of pharmaceutical sales data in a way that is useful for calculating the compensation of pharmaceutical company sales representatives. This aggregation of territories is also necessary for reasons of German data protection law, which prevents disaggregation of data to a level lower than three pharmacies. The bricks – which were designed by IMS with certain input from pharmaceutical company users – were mainly comprised of groupings of postcode areas. Crucially, however, these groupings were not predetermined, but required some segmentation by IMS.<sup>78</sup>

In 2000, two companies established in Germany by former IMS personnel, NDC Health GmbH (NDC) and Azyx Deutschland GmbH (Azyx), entered the German market. (Their parent companies were direct competitors of IMS in the EU and elsewhere.) It then became apparent to IMS that the brick structures used by these companies’ data services offerings infringed IMS’s copyright in the 1860 brick structure. To prevent NDC and Azyx from further using its copyright, IMS obtained injunctions against these companies from the German courts. On December 19, 2000, NDC complained to the Commission that IMS should be forced to license the 1860 brick structure to its competitors so that they could continue to use it to offer data services that competed with IMS’s.

On July 3, 2001, the Commission adopted an interim decision, which found that customers gave input in the development of the 1860 brick structure, and that that structure had become a *de facto* industry standard for wholesaler pharmaceutical data presentation in Germany. These factors made the 1860 brick structure an “essential facility” that had to be made available, on “reasonable terms,” for incorporation in competing NDC and Azyx services. The interim decision seemed to apply two different legal tests, without explaining the relationship between them. First, the Commission applied the *Bronner* criteria to IP rights, without referring to the additional criteria for compulsory licensing of IP rights established in *Magill*.<sup>79</sup> Later in the decision, the Commission suggested that the *Magill* “exceptional circumstances” were present in the IMS case, but did not refer to any of the circumstances cited in *Magill*. Instead, the Commission relied on the following considerations: (1) IMS had created, in collaboration with the pharmaceutical industry over a long period of time, a brick structure which has become the *de facto* industry standard for the presentation of regional data services; and (2) IMS was excluding all competition from the market for regional data services by refusing, without objective justification, to licence this structure to competitors.<sup>80</sup> Importantly, the Commission found that, contrary to what was suggested in *Magill*, there was no requirement for a refusal to supply to prevent the emergence of a “new product” in order to be abusive.<sup>81</sup>

<sup>78</sup> The following emerged from litigation in the German courts concerning the copyright. In the first place, one third of bricks in the 1860 Brick Structure do not correspond to postcode areas at all. Further, the vast majority of bricks contain two or more postcode areas (and, in some cases, up to 28 postcode areas). As there are approximately 8,200 postcode areas in Germany, there was a very large number of permutations and combinations for each brick in terms of the postcode area configuration that it ultimately contained. the design of the brick structure was not therefore objectively predetermined or unavoidable. See judgment of the *Landgericht Frankfurt* of November 16, 2000 in *IMS/Pharma Intranet* (“The [1860 Brick Structure] is a collective work within the meaning of sec. 4 Intellectual Property Rights Act. This is because *the organisation of the pharmaceutical data and, indeed, especially that data’s allocation within a particular area structure constitutes a personal intellectual creation...* Objective criteria do not require dividing the area of the Federal Republic into 1,860...market segments. It is much rather the case that choosing the size of the individual segments is the result of a subjective process of weighing and balancing. *The underlying basis for the market segmentation is only partially such generally accessible data as the municipality directory of the German Federal Post Office and cartographic materials. It is undisputed that a multitude of additional criteria are involved in segmenting.*”) (translation from German original) (emphasis added).

<sup>79</sup> *IMS Interim Decision*, above note 68, para. 70.

<sup>80</sup> *Ibid.*, para. 180.

<sup>81</sup> *Ibid.*

Following an appeal by IMS, the President of the Court of First Instance granted a stay of the Commission's interim decision.<sup>82</sup> Unusually for an interim measures application, the President was critical of the Commission's substantive analysis, finding that there were "strong prima facie grounds" to doubt the correctness of the legal analysis.<sup>83</sup> In particular, the President noted that the "exceptional circumstances" of the *Magill* case were potentially very different from *IMS*. The President noted that there were, at first sight, "a number of potentially important differences" between *Magill* and the *IMS* case: the requesting parties in the *IMS* case did not wish to offer any new product on a separate market, but wished to compete with *IMS* on the same market by offering essentially the same services. The President concluded that this interpretation of the exceptional circumstances in *Magill* "constitutes, at first sight, an extensive interpretation of that notion" and that there were serious grounds to doubt the correctness of the Commission's view.<sup>84</sup>

*e. IMS preliminary ruling.*<sup>85</sup> Shortly after the Commission's interim decision in *IMS*, a German court hearing the copyright infringement dispute between *IMS* and its competitors sought a preliminary ruling from the Court of Justice on the legal conditions for a compulsory license under Article 82 EC. Although the wording of the questions was somewhat obscure, the reference in essence sought to clarify a number of the Commission's findings in the interim decision adopted against *IMS*.

The Court of Justice made a number of important findings regarding the scope of the duty to licence under Article 82 EC. It first confirmed the long-established principle that the mere refusal to license an IP is not in itself an abuse, but that, in exceptional circumstances, the exercise of an exclusive right by the IP owner may be linked to abusive conduct. Second, the Court held that, for the refusal by a dominant IP owner to give access to a product or service indispensable for carrying on a business to be abusive, three cumulative conditions must be satisfied: (1) the refusal prevents the emergence of a new product for which there is a potential and unsatisfied consumer demand; (2) the refusal is unjustified; and (3) the refusal excludes competition on the secondary market.

The Court then elaborated on these conditions in several respects. First, with respect to the issue of whether the existence of two markets – that is an upstream market for the supply of the IP and a downstream market where the IP is used for the production of another product or service – is a necessary condition for a compulsory license of an IP, it noted that it is enough in this regard to identify a "potential" or "hypothetical" upstream market.<sup>86</sup> Thus, "it is determinative that two different stages of production may be identified and that they are interconnected, the upstream product is indispensable in as much as for supply of the downstream product."<sup>87</sup>

As regards the emergence of a new product, the Court concluded that for a refusal to license to be abusive:<sup>88</sup>

"[T]he undertaking which requested the license does not intend to limit itself essentially to duplicating the goods or services already offered on the secondary market by the owner of the copyright, but intends to

<sup>82</sup> Case T-184/01 R, *IMS Health Inc. v. Commission*, [2001] ECR II-3193, para. 102. The President's Order was confirmed on appeal by the President of the Court of Justice in Case C-481/01P(R) *NDC Health v IMS Health* [2002] ECR I-3401. *IMS*'s appeal was discontinued following the withdrawal of the interim decision by the Commission in 2003 on the grounds that, following the withdrawal, the appeal had no further object. See Order of the Court of First Instance in Case T-184/01 *IMS Health Inc. v Commission*, March 10, 2005, not yet reported. The national case that led to the preliminary ruling of the Court of Justice in principle continues in Germany, although it is not clear what practical impact it could have in circumstances where, as the Court of First Instance has now confirmed, none of the Commission's findings produce legal effects today.

<sup>83</sup> *Ibid.*, para. 106.

<sup>84</sup> *Ibid.*

<sup>85</sup> Case C-418/01, *IMS Health GmbH & Co. OHG and NDC Health GmbH & Co. KG*, judgment of April 29, 2004, not yet reported.

<sup>86</sup> *Ibid.*, para. 44.

<sup>87</sup> *Ibid.*, para. 45.

<sup>88</sup> *Ibid.*, para. 49.

---

produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand.”

Finally, on objective justification, the Court noted that the assessment of potential justifications must be conducted by national courts on a case-by-case basis.

*f. Microsoft.* In March 2004, the Commission issued an infringement decision against Microsoft, following a lengthy investigation. It found that Microsoft had a virtual monopoly in personal computer (PC) operating system software through its various Windows products. PC operating systems are frequently connected to a more powerful multi-user computer or “server,” which allows several PC users to share multiple file, print, and group and user administration services. Microsoft is also active in supplying workgroup server operating systems, where it faces competition from a range of other vendors with their own proprietary technologies. Microsoft’s PC operating system near-monopoly gives it control over the proprietary protocol specifications that allow a PC to interoperate effectively with a server operating system.

The Commission’s case is that Microsoft has refused to supply the protocol specifications contained in its PC operating systems to competing stand-alone vendors of server operating systems or has done so on discriminatory terms, thereby reducing the interoperability of competitors’ products with its dominant Windows PC operating system product. It considers that Microsoft’s advantages over competitors in this regard are not only due to the inherent superiority of its server operating system products over rival products, but because of the unfair handicap faced by rivals who lack full interoperability with the Windows PC operating system product. Over time, the Commission considers that, if this situation persisted, there is a risk that competing vendors would be eliminated from the market. The Commission therefore required, as a remedy, that Microsoft should draw up detailed lists of protocol specifications to enable third parties to interconnect with Microsoft Windows client and server operating systems so that a non-Microsoft operating system could replace a Windows server without loss of functionality. The objective of the remedy is therefore to allow competing workgroup server operating system vendors to have the same level of interoperability as Microsoft achieves between its PC and server operating system products.<sup>89</sup>

The Commission’s legal analysis is something of a hybrid. On the one hand, it recalls the traditional criteria for a duty to licence as established in *Volvo, Magill, Ladbroke* and other cases.<sup>90</sup> On the other hand, the Commission also indicated that the criteria for a duty to licence established in these cases were not necessarily exhaustive and that a duty may also be appropriate in other circumstances.<sup>91</sup> In the case at hand, the Commission relied on a series of factors to justify a duty to licence: (1) Microsoft’s conduct was part of a general pattern of conduct, including another abuse (tying);<sup>92</sup> (2) Microsoft discriminated by supplying certain vendors but not others;<sup>93</sup> (3) Microsoft terminated past voluntary disclosures of interoperability information;<sup>94</sup> (4) there was a risk of elimination of competition on the server operating system because interoperability information was of “significant competitive importance”<sup>95</sup> and there are no substitutes for Microsoft providing this information;<sup>96</sup>

---

<sup>89</sup> On June 7, 2004, Microsoft appealed the Commission’s Decision before the Court of First Instance. Suspension of the Decision was refused by the Order of the President of the Court of First Instance in Case T-201/04 R, *Microsoft Corporation v Commission*, December 22, 2004, not yet reported. The Order does not enter into detail on the merits of the Commission’s substantive analysis, since the parties agreed in advance, for purposes of the interim measures stage, that Microsoft had a *prima facie* case on the merits, i.e., an arguable case.

<sup>90</sup> *Microsoft, ibid.*, paras. 548-554.

<sup>91</sup> *Ibid.*, para. 555. The Commission also refers to the judgment in the Case T-198/98 *Micro Leader Business v. Commission* [1999] ECR II-3989 to conclude that “the factual situations where the exercise of an exclusive right by an intellectual property right holder may constitute an abuse cannot be restricted to *one* particular set of circumstances.” (para. 557) (Emphasis in original.).

<sup>92</sup> *Ibid.*, Section 5.3.1.1.3.1.

<sup>93</sup> *Ibid.*, paras. 574 et seq.

<sup>94</sup> *Ibid.*, paras. 578 et seq.

<sup>95</sup> *Ibid.*, para. 586.

(5) Microsoft's refusal adversely impacted on technical development and consumer welfare;<sup>97</sup> (6) a duty to disclose the specifications did not affect Microsoft's incentives to innovate: source code information – which might allow competitors to develop clone products – would not be disclosed;<sup>98</sup> (7) interoperability information disclosure was common in the software industry;<sup>99</sup> and (8) disclosure was consistent with EU legislation on the protection of software programs.<sup>100</sup>

#### 8.4.2. The Legal Conditions For A Duty To Deal With Rivals Under Article 82 EC

**Summary of the relevant conditions.** From the decisional practice and case law, the following minimum conditions apply to a refusal to deal under Article 82 EC: (1) there is a refusal to deal; (2) the requested party is dominant on an upstream “market” for the supply of the input and the anti-competitive effects of the refusal arise on a second downstream “market;” (3) the input in question is essential for competition on the second market, in the sense that it cannot be duplicated or can only be duplicated at an uneconomic cost; (4) the refusal to deal would eliminate competition on the second market; (5) at least in the case of IP rights, the refusal to deal prevents the emergence of a new product for which there is consumer demand; and (6) no objective considerations justify the refusal to deal. Each of these conditions is examined in detail below.

**Condition #1: a refusal to deal.** The Community institutions have applied an expansive interpretation to the criterion that the dominant firm must have engaged in a refusal to deal. In *Deutsche Post*, the Commission made clear that “the concept of refusal to supply covers not only outright refusal but also situations where dominant firms make supply subject to objectively unreasonable terms.”<sup>101</sup> The Commission has not explained in detail what amounts to “objectively unreasonable terms.” One approach is to say that there is a constructive refusal to deal where the dominant firm insists on a price that is “excessive.” “Excessive” in this context does not mean exploitative within the meaning of Article 82(a), but implies a price at which an equally efficient downstream operator would not be profitable. This raises similar issues to the price squeeze principle, discussed in Chapter Seven. In simple terms, a price squeeze arises where the terms upon which the dominant firm sells an upstream input would cause the dominant firm's own downstream operation to lose money if it had to pay the same upstream input price as rivals. Thus, if the input price offered by the dominant firm would render its own downstream operations unprofitable if they had to pay it, the price demanded by the dominant firm would generally amount to a constructive refusal to deal.<sup>102</sup>

The Commission has also considered dilatory tactics by a dominant firm as tantamount to a refusal to deal. For example, in the *Holyhead harbour* case, the Commission made extensive reference to what it categorised as a dilatory or bad faith attitude by the dominant harbour operator, Sealink, towards the requesting party, Sea Containers. The Commission noted that Sealink:<sup>103</sup> (1) consistently delayed and raised difficulties concerning Sea Containers' possible use of existing facilities on the west side of the

<sup>96</sup> *Ibid.*, paras. 666 et seq.

<sup>97</sup> *Ibid.*, Section 5.3.1.3.

<sup>98</sup> *Ibid.*, para. 714.

<sup>99</sup> *Ibid.*, paras. 730 et seq.

<sup>100</sup> *Ibid.*, paras. 743 et seq.

<sup>101</sup> *Deutsche Post AG*, OJ [2001] L 331/40, para. 103.

<sup>102</sup> This is not necessarily decisive in all cases, however. As discussed in Chapter Five, there may be circumstances in which the dominant firm's downstream operations can support lower returns on one product where other, differentiated products yield higher returns. The main reason for this is the presence of common costs for the dominant firm and different consumer preferences over the final products. In these circumstances, a stand-alone provider of one product might not be able to compete on the basis of the dominant firm's prices in one market, without implying that the dominant firm's prices are anti-competitive. But the point made in the text is valid as a general matter.

<sup>103</sup> See *Sealink/Sea Containers*, above note 6, paras. 70-74.

port; (2) delayed in making known its willingness to permit Sea Containers to operate from temporary facilities, at its own expense, on the eastern side on the port, until such time as the redevelopment works required them to be moved; (3) did not conduct its negotiations with Sea Containers by proposing or seeking solutions to the problems it was raising and that its rejection of all of Sea Containers' proposals without making any counter offer or attempting to negotiate; and (4) gave itself rapid approval for its own fast ferry service. The Commission concluded that this attitude was "entirely negative and consisted of raising difficulties" and was not consistent with the obligations on an undertaking which enjoys a dominant position in relation to an essential facility. A similar approach was taken in *Clearstream*, where the Commission contrasted a cooperative attitude towards one customer with a dilatory attitude towards another, Euroclear.<sup>104</sup>

**Condition #2: two "markets."** It has always been understood that the duty to deal under the "essential facility" principle and Article 82 EC only applied in vertical situations, that is an upstream market for the input in question and a downstream market in which that input is essential. As the leading treatise on U.S. antitrust law – where the duty to deal was first developed – states, "it should be clear from the outset that the essential facility doctrine concerns vertical integration."<sup>105</sup> The same view has been taken in a wide range of articles, commentaries, and other sources of reference on the duty to deal.<sup>106</sup>

*a. Basic rationale.* The rationale for the two market requirement has not been clearly articulated in any decision or case under Article 82 EC. But it seems to reflect the principle that monopoly power which results from a legitimately-acquired property right cannot be objected to in a single market context (except, perhaps, where there is excessive pricing). It is generally pro-competitive to allow a firm to keep these advantages for itself in one market and to expect rivals to develop their own products.<sup>107</sup> The same does not hold good where a dominant firm seeks to use its

<sup>104</sup> *Clearstream*, above note 53, paras. 293 et seq. See also *IMS Interim Decision*, above note 68, para. 174. IMS had obtained preliminary injunctions against two competitors, NDC and Azyx, to stop suspected copyright infringements. After these injunctions had been obtained, NDC and Azyx requested a licence from IMS, offering sums of 10,000 DM and 100,000 DM, respectively. IMS refused these requests on the grounds, *inter alia*, that the proposed licence fees were insufficient. The Commission rejected this argument and suggested that, even if the initial offers were considered too low by IMS, it should have made a counter offer or indicated what a reasonable fee would have been.

<sup>105</sup> See Areeda & Hovenkamp, *Antitrust Law*, 1996, Vol. IIIA, ¶ 771.a. See also Faull & Nikpay, *The EC Law of Competition* (1999) 625-626.

<sup>106</sup> See, e.g., Temple Lang, "Defining Legitimate Competition: companies' duties to supply competitors and access to essential facilities," 18 *Fordham International L. Jour.*, (1994) 437, at 488 ("A vertically integrated company is not necessarily obliged to provide access to a facility that other companies wish to use if it is not providing them to any independent users. The key test seems to be whether its upstream operations are merely part of the same business, or separate in nature"); also in Hawk (ed.), 1994 *Fordham Corporate Law Institute* (1995) 245-313; Temple Lang, "The principle of essential facilities and its consequences in European Community competition law," 1996, Oxford, Regulatory Policy Institute, 19-46; Temple Lang, "The principle of essential facilities in European Community competition law – the position since Bronner," *Journal of Network Industries* (2000), 375-405; Doherty, "Just what are essential facilities?" 38 *Common Market Law Rev.* (2001) 397-436; Owen, "Determining optimal access to regulated essential facilities," 58 *Antitrust L. Jour.*, 887, at 888 ("Access problems arise generally when the bottleneck monopolist is partially vertically integrated"); Bishop and Overd, "Essential Facilities: The rising tide," [1998] *European Competition Law Review*, 183 ("The argument for such a requirement is that it might increase competition in a downstream market to the benefit of consumers"); Bergman, "The Bronner Case - a turning point for the essential facilities doctrine?" [2000] *European Competition Law Review*, 59 ("The most important of these are that the facility must be necessary for a firm to compete in a related market and that the competing firm must lack the ability to duplicate the facility"). See also Advocate General Jacobs in *Oscar Bronne*, above note 3, para. 61: "[W]here access to a facility is a precondition for competition on a related market for goods or services for which there is a limited degree of interchangeability" (Emphasis added). For U.S. case law, see *Alaska Airlines v. United Airlines*, 948 F.2d 536, 544 (9<sup>th</sup> Cir. 1991), cert. Denied, 503 U.S. 977 (1992) ("When a firm's power to exclude rivals from a facility gives the firm the power to eliminate competition in a market downstream from the facility, and the firm excludes at least some of its competitors...").

<sup>107</sup> The point was well put by Advocate General Jacobs in *Bronner*, above note 3, para. 57 ("In the long term it is generally pro-competitive and in the interest of consumers to allow a company to retain for its own use

control over an input in one market to restrict competition in another market where that input is essential for competition. This might loosely be described as anti-competitive leveraging, which is sometimes regarded as unlawful under competition law. Competition law tolerates a monopoly in one market – the incentives that drive innovation are generally beneficial to consumer welfare in the long run in a single market context – but does not allow a firm to use its control over an input that is essential for competition to create a monopoly in the second market. Put differently, an input that allows a firm to enjoy a monopoly in one market is considered a legitimate competitive advantage, whereas using control over that input to monopolise other markets is not regarded as competition on the merits.

The need for two markets also has a strong rationale in IP cases because the owner has certain core moral rights in the protected matter. These core rights are sometimes referred to by the Community Courts as the “essential function.”<sup>108</sup> For purposes of Community law, the “essential function” of an IP right protects the moral rights of the author in the work and ensures incentives and rewards for creative efforts by granting the owner the exclusive rights of reproduction and commercial exploitation of the protected work.<sup>109</sup> It is only when the intellectual property right holder uses the rights for a purpose which goes beyond their essential function, and seeks exclusivity in a market separate from that to which the intellectual property relates, that anti-competitive conduct can be alleged, and the essential facility doctrine can apply.<sup>110</sup> In other words, the “exclusion” caused by IP in the market to which it relates is the key component of the owner’s core moral rights.

These principles have been consistently reflected in the case law on IP rights. In *Volvo/Renault*, the Court of Justice held that it was not abusive in itself for car manufacturers to refuse to licence third parties that wished to compete in the manufacture and sale of the protected body panels. The reason for this conclusion was that a contrary interpretation would deprive the IP owner of the exclusive rights granted by national IP laws and recognised under Community law.<sup>111</sup> The Community Courts adopted a similar approach in *Magill*. In that case, various TV companies were found to have abused their dominant position on the separate markets for TV programs and the magazines in which they were published by relying on national copyright in their program schedules to prevent the publication by a third party of a new comprehensive guide to their weekly program listings. The Court of First Instance found that the broadcasters’ conduct went far beyond the “essential function” of their copyright:

---

facilities which it has developed for the purpose of its business. For example, if access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request, able to share the benefits. Thus the mere fact that by retaining a facility for its own use a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it.”).

<sup>108</sup> *RTE & ITP v. Commission*, ECJ judgment, above note 67, para. 50; *RTE v. Commission*, CFI judgment, above note 67, para. 70. For national cases, see e.g. *Philips Electronics NV v. Ingman Ltd* [1998] 2 CMLR 839, 853; *Sandvik AB v. KR Pffiffner (UK) Ltd* [1999] EuLR 755, 787; and *HMSO v. Automobile Association* [2001] ECC 272, 278.

<sup>109</sup> See Cases 55/80 and 57/80 *Musik-Vertrieb membran GmbH et K-tel International v. GEMA* [1981] ECR 147, paras. 12-13; and Case 158/86 *Warner Brothers and others v. Christiansen* [1988] ECR 2605: “The two essential rights of the author, namely the exclusive right of performance and the exclusive right of reproduction, are not called in question by the rules of the Treaty,” (para. 13).

<sup>110</sup> See, e.g., *Renault*, above note 53, paras. 15-16 (“...the mere fact of securing the benefit of an exclusive right granted by law, the effect of which is to enable the manufacture and sale of protected products by unauthorized third parties to be prevented, cannot be regarded as an abusive method of eliminating competition. Exercise of the exclusive right may be prohibited by Article 8[2] if it gives rise to certain abusive conduct on the part of an undertaking occupying a dominant position.”).

<sup>111</sup> *Volvo*, above note 3, para. 8. See *Renault, ibid.*, para. 15.

---

“Conduct of that type - characterised by preventing the production and marketing of a new product, for which there is potential consumer demand, on the ancillary market of TV magazines and thereby excluding all competition from that market solely in order to secure the applicant’s monopoly - clearly goes beyond what is necessary to fulfil the essential function of the copyright as permitted in Community law.”<sup>112</sup>

b. *Treatment of the two markets requirement in the decisional practice and case law.* A clear vertical separation between the upstream market in which the dominant firm controls an input and the downstream market in which that input is essential for competition is present in refusal to deal cases under Article 82 EC.<sup>113</sup> For example, in the various cases in which access to port facilities has been required by the Commission, third parties would not have been entitled to set themselves up as co-providers of port facilities: the duty to give access was strictly limited to the right to use the port for activities on the downstream passenger ferry market. In *Magill*, there would have been no suggestion that a requesting party could insist on the right to use the television companies’ broadcasting equipment: the duty was limited to the downstream market for television magazines. Other situations could also be envisaged. Suppose that a manufacturer developed a production process that gave it an unbeatable cost advantage over rivals. That process could render rivals’ activities uneconomic and eliminate all competition on the relevant market, but it could never be suggested that the firm with the unbeatable advantage should share its factory with rivals.

While the element of vertical integration has been clearly acknowledged in the decisional practice and case law, the precise definition of the upstream and downstream markets was not articulated until the Court of Justice’s judgment in *IMS*. It will be recalled that, in the *IMS Interim Decision*, the Commission considered that two markets were not necessary for a duty to deal to arise. In that case, there was only one market – regional wholesaler data – and the IP right was specifically developed for that market and had no other independent use or existence. However, no reasons were advanced for the conclusion that two markets were not necessary: the Commission simply made the elliptic statement that the fact that the Community Courts’ case law on refusal to deal involved two markets “does not preclude the possibility that a refusal to licence an intellectual property right can be contrary to Article 82.”<sup>114</sup>

In the preliminary ruling in *IMS*, the Court of Justice confirmed that two markets are a necessary condition for a compulsory license of an IP, but that it is enough in this regard to identify a “potential” or “hypothetical” upstream market.<sup>115</sup> The Court expanded on this by adding that “it is determinative that two different stages of production may be identified and that they are interconnected, the

---

<sup>112</sup> *RTE v. Commission*, CFI judgment, above note 67, para. 73. See also *DSD*, OJ 2001 L 166/1, para. 144 (“[A]ccording to the case law of the Court of Justice and Court of First Instance, exercise of an exclusive [intellectual property] right may be prohibited by Article 82... if it gives rise to certain abusive conduct on the part of the undertaking occupying the dominant position. The crucial point is whether the conduct in question goes beyond what is necessary to fulfil the essential function of the exclusive right as permitted in Community law.”).

<sup>113</sup> See, e.g., *Commercial Solvents* ((1) raw material; (2) derivative products of the raw material); Case 311/84 *Télémarketing (CBEM) v. SA Compagnie luxembourgeoise de télédiffusion (CLT) and Information publicité Benelux (IPB)* [1985] ECR 3261 ((1) television broadcasting; (2) telemarketing); Case C-18/88 *Régie des télégraphes et des téléphones v. GB-Inno-BM SA* [1991] ECR I-5941 ((1) Establishment and operation of the public telecommunications network; (2) importation, marketing, and maintenance of equipment for connection to the network) (“an abuse...is committed where, without any objective necessity, an undertaking holding a dominant position on a particular market reserves to itself an ancillary activity which might be carried out by another undertaking as part of its activities on a neighbouring but separate market, with the possibility of eliminating all competition from such undertaking” para. 18); *Frankfurt Airport* ((1) provision of airport facilities for the landing and take-off of aircraft; (2) ramp-handling services; *Magill* ((1) broadcasting; (2) television program guides); *Sea Containers v. Stena Sealink* ((1) port services; (2) passenger ferry services; *Ladbroke* ((1) broadcast coverage of horse races; (2) operation of betting shops; *Bronner* (1) distribution of newspapers; (2) publication and sale of newspapers; and *Microsoft* ((1) PC operating systems; (2) work group server operating systems).

<sup>114</sup> *IMS Interim Decision*, above note 68, para. 184.

<sup>115</sup> *IMS Preliminary Ruling*, above note 85, para. 44.

upstream product is indispensable in as much as for supply of the downstream product [sic].”<sup>116</sup> The Court therefore suggests that it does not matter that the upstream input was never independently marketed before and is only used as a key component in the production of a final product. It is sufficient that there is “the possibility of identifying a separate market” even if none yet exists.<sup>117</sup>

c. *The meaning of a “potential market.”* The Court of Justice’s interpretation of the two market requirement raises a number of issues. Left unqualified, the view that a “potential market” is enough could lead to the definition of separate product markets for many IP rights that are just used as inputs – often critical ones – in products or services that are commercialised successfully. As one commentator notes, under this standard “any intellectual property right could ‘hypothetically’ be marketed as a stand-alone item,” and hence potentially subject to an obligation to licence, which “would represent a huge disincentive for dominant firms to invest in new production processes that would allow them to gain a competitive advantage vis-à-vis competitors ...”<sup>118</sup> For example, in *IMS*, copyright in the 1860 brick structure was the key competitive advantage of *IMS*’s downstream data service. It was developed specifically for that service and had no other commercial or independent use.

The Court’s qualification that the potential market must correspond to a “stage of production” does not necessarily clarify matters either. It is not clear whether the Court regards the mere existence of a request from a third party as sufficient to create a “potential” or “hypothetical” upstream market or whether each “stage of production” must mean something identifiably distinct, either in the literal sense of there being an intermediate product (even one which has never been sold separately), or in the sense of a separate input such as a catalyst. The issue is of some practical importance, since a broad construction of the term “potential” market is likely to lead to a greater number of compulsory licensing cases.

The latter interpretation is preferable. A “stage of production” that does not correspond to a market – in the sense that it gives rise to a product or service which is sold or licensed – should not be enough in itself to entitle a competitor to demand it. A production chain cannot be divided into a series of severable stages at the request of any competitor who wishes to have access to key competitive advantages. A “stage of production” must mean something more akin to an actual market in the sense that it something that is inherently capable of being sold or licensed to third parties (and even if the dominant firm has not yet done so). A stage of production of that nobody had ever sold or licensed, or that it would never be rational to sell or licence, can only be a competitive advantage. It cannot be assumed that the Court had in mind that all competitive advantages, if valuable enough, should be shared.

*Bronner* supports the notion that the upstream “market” should be an actual market or something that is capable of being regarded as such. In deciding whether a duty to deal was appropriate, the Court of Justice noted that it should be first established whether Mediaprint was dominant on the relevant upstream market, which the Court held should be defined according to traditional market definition principles.<sup>119</sup> The national court was therefore required to establish whether home-delivery schemes constitute a separate market, or whether other methods of distributing daily newspapers, such as sale in shops or at kiosks or delivery by post, are sufficiently interchangeable. In other words, the Court had in mind a number of established *actual* methods of distributing products rather than hypothetical possibilities or severable parts of existing methods.

Admittedly, the Court later stated in *IMS* that the fact that the home-delivery service in *Bronner* was not marketed separately did not preclude the possibility of identifying a separate market.<sup>120</sup> But it is

<sup>116</sup> *Ibid.*, para. 45.

<sup>117</sup> *Ibid.*

<sup>118</sup> See Geradin, “Limiting the Scope of Article 82 EC: What Can The EU Learn From the U.S. Supreme Court’s Judgment in *Trinko*, in the Wake of *Microsoft*, *IMS*, and *Deutsche Telekom*?”, 41 *Common Market Law Review* 1519 (2004), at page 1523.

<sup>119</sup> *Bronner*, above note 3, para. 34.

<sup>120</sup> *IMS Preliminary Ruling*, above note 85, para. 43.

not clear that this interpretation is correct as a matter of fact, since Mediaprint did offer home delivery services to a rival firm. (The Advocate General in *IMS* indicated that this was irrelevant, since the services were offered as part of a package, but it is not clear why this made any difference.) Moreover, the point is not whether Mediaprint in fact marketed its home delivery service separately, but whether home delivery is something that could rationally be offered to other firms on the market. Given the low marginal cost of delivering additional products once a home delivery service had been created, and the possibility that adding new products would increase economies of scale and scope, the upstream market in *Bronner* was clearly either an actual market or something that could rationally be regarded as such. The same cannot be said of a “potential” market made up of an input that is only used as an essential component in one market.

**Condition #3: indispensability of the input for competition.** The Court of Justice has clearly explained the type of economic evidence that is required for establishing indispensability. First, the product or service to which access is requested must be essential for the exercise of the activity in question.<sup>121</sup> Second, “it must be determined whether there are products or services which constitute alternative solutions, even if they are less advantageous.”<sup>122</sup> Furthermore, “it must be established, at the very least, that the creation of those products or services is not economically viable for production on a scale comparable to that of the undertaking which controls the existing product or service,”<sup>123</sup> including the time reasonably required to produce them.<sup>124</sup> Thus, it must be shown that the cost of duplicating the allegedly essential facility constitutes a barrier to entry such that “it deters any prudent undertaking from entering the market.”<sup>125</sup> In short, there must be no actual or potential “viable alternatives” to the dominant firm’s input<sup>126</sup> or the cost of such alternatives is “prohibitively expensive and would not make any commercial sense.”<sup>127</sup>

The key economic question is, therefore, whether the investments required for duplicating the facility to which access is requested would render entry by a reasonably efficient competitor, or a group of competitors making a joint investment, uneconomic. Of course, the impact on entry depends on the entrant’s expectations about its sales and prices post entry.<sup>128</sup> *Bronner*, for example, argued that it could not afford replicating the home-delivery system of Mediaprint because of its small distribution. However, *Bronner*’s calculation was incorrect because it relied on an unreasonable assumption regarding its distribution after the introduction of the new home-delivery system. In this respect, the Court clarified that:<sup>129</sup>

“For such access to be capable of being regarded as indispensable, it would be necessary at the very least to establish ... that it is not economically viable to create a second home-delivery scheme for the distribution of daily newspapers with a circulation comparable to that of the daily newspapers distributed by the existing scheme.”

Similarly, in *European Night Services*, the Court of First Instance refused to consider railway infrastructure supplied by the parents of a joint venture to the joint venture as an essential facility.

<sup>121</sup> See *Ladbroke*, *supra* note 54 (live pictures of French races not indispensable to compete in the relevant Belgian market).

<sup>122</sup> *IMS Preliminary Ruling*, above note 85, para. 28 (citing *Bronner* at paras. 43 and 44).

<sup>123</sup> *IMS Preliminary Ruling*, para. 28 (citing *Bronner* at para. 46).

<sup>124</sup> See Case T-374/94 *European Night Services* [1998] ECR II-3141, para. 209, footnote 34

<sup>125</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, paras. 66 and 68.

<sup>126</sup> See *European Night Services* above note 124, para. 209; *Clearstream*, above note 56, para. 227 (Clearstream a *de facto* monopolist and unavoidable trading party for primary clearing and settlement services in Germany).

<sup>127</sup> See *GVG/FS*, OJ [2004] L 11/17, paras. 109, 120, 148.

<sup>128</sup> See Mats Bergman, “The Role of the Essential Facilities Doctrine”, *Antitrust Bulletin*, 2001 and Mats Bergman, “When Should an Incumbent Be Obligated to Share its Infrastructure with an Entrant under the General Competition Rules?”, Uppsala University, 2003.

<sup>129</sup> *Bronner*, above note 3, at para. 46.

There was no evidence that third parties could not obtain locomotives either directly from manufacturers or indirectly by renting them from other undertakings. Nor were there any exclusivity restrictions in the supply contracts for the joint venture, which meant that suppliers to the joint venture were free to sell to other willing buyers. The Court also indicated that a high standard of proof on the party seeking to assert a duty to deal: it was not enough to merely assert that the joint venture was the first to acquire the locomotives in question on the market; there had to be evidence that they were alone in being able to do so.<sup>130</sup> The fact that the requesting party has continued to carry out its operations for a material period of time despite the refusal, or where it uses alternative solutions, creates a strong inference that access is not essential.<sup>131</sup>

Evidence of lack of competition is a necessary, but not sufficient, condition for a finding of indispensability. As one commentator notes, the analysis should focus on whether it is possible for a second, substitute facility to be created, and not on whether competitors will in fact make the investment.<sup>132</sup> There may be no competition even when competitors have access to the inputs required to compete if: (1) their products are regarded as less desirable by consumers; or (2) they are less efficient in production. A duty to deal cannot be imposed to overcome competitors' lack of efficiency relative to the dominant firm or to compensate them for the fact that consumers prefer the dominant firm's products.

In principle, all relevant evidence pointing to indispensability should be considered. For example, in *IMS*, one issue was whether input given by certain users into the development of the facility is a relevant barrier to entry for the production of alternative facilities. The Court of Justice suggested that a high level of participation by users in the development of the facility, on the supposition that it was proven, could create a dependency by users, particularly at a technical level. In such circumstances, the Court considered it unlikely that users would make exceptional organisational and financial efforts in order to acquire products based on other inputs. Rivals might therefore be obliged to offer terms which rule out any economic viability of business on a scale comparable to that of the undertaking which controls the protected structure.<sup>133</sup>

Consumer preferences for a facility cannot, however, make it essential. If rivals can economically offer alternative facilities, the fact that some or all consumers prefer the dominant firm's facility is irrelevant. In the absence of any agreement between the dominant company and its customers that they will buy exclusively from it, the way that customers exercise their right to choose which products to buy is simply the result of the legitimate interplay of competition. Users of a product may be influenced by many reasons, none of which require the seller of the product to share its advantages. Users might be influenced by the fact that they have become accustomed to the dominant company's product, or that they have trained all their employees to use it, or that the cost or inconvenience of changing is greater than the possible benefits to be obtained. The fact that users are primarily influenced by their own business reasons rather than by the relative merits of the competing products does not make a good product or a competitive advantage into an essential facility. In addition, since customer preferences are subjective, can change, may be ill-considered or even ill-informed, they could not be the basis for the test of an essential facility. The test for an essential facility is whether competitors are *objectively* able to develop and offer their own products or services for sale, not whether buyers are willing to buy them.<sup>134</sup>

**Condition #4: elimination of competition.** The key legal condition for a duty to deal is that the refusal to share the indispensable input entails the "elimination or substantial reduction of competition to the detriment of consumers in both the short and the long term."<sup>135</sup> This condition is the corollary

<sup>130</sup> *European Night Services*, above note 124, paras. 215-216.

<sup>131</sup> See Case T-52/00 *Coe Clerici Logistics SpA v Commission* [2003] ECR II-2123, para. 25.

<sup>132</sup> See Temple Lang, "The Principle of Essential Facilities in EC Competition Law – the Position since *Bronner*," *Journal of Network Industries* 375, 382 (2000).

<sup>133</sup> *IMS preliminary ruling*, above note 85, para. 29.

<sup>134</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, para. 51.

<sup>135</sup> *Ibid.*, para. 61.

of the condition that the dominant firm's input is indispensable for competition: if the input is not indispensable, it is difficult to see how the refusal to share it could have substantial effects on competition. Conversely, if an input is truly essential for competition, it would, ultimately, allow the firm or firms that own or control it to exclude all competition on the relevant downstream market in which the input is used. The Commission has explained this underlying policy rationale for imposing a duty to deal in the following terms:<sup>136</sup>

“The duty to provide access to a facility arises if the effect of the refusal to supply on competition is objectively serious enough: if without access there is, in practice, an insuperable barrier to entry for competitors of the dominant company, or if without access competitors would be subject to a serious, permanent and inescapable competitive handicap which would make their activities uneconomic. Hence, access to a facility is ‘essential’ when refusal to supply would exclude all or most competitors from the market.”

A strict interpretation of the criterion that the refusal to deal should have a significant, adverse effect on competition is important if the duty to deal under Article 82 EC is to have any sensible rationale. If the downstream market is already competitive, or would become so in the near future through competitors introducing their own products, no useful purpose would be served in imposing a duty to deal, even if the dominant firm's input is essential for competition from certain (presumably less efficient) undertakings. In economic terms, the only plausible justification for a duty to deal is that the welfare loss to consumers is very large due to the dominant firm's “genuine stranglehold” over the market.<sup>137</sup> Absent this condition, the usefulness of a duty to deal evaporates and the negative effects on *ex ante* investment decision making become even greater.

Surprisingly, the standard of foreclosure required for a duty to deal to arise is not entirely clear from the decisional practice and case law. In *Bronner*, the Court of Justice seemed to suggest a range of different standards. It first cited *Magill* as support for the view that a duty to deal was appropriate because it was likely to “exclude *all competition* in the secondary market of television guides,”<sup>138</sup> thereby suggesting a total foreclosure standard. But it later added that, in the case at hand, it would be necessary to show that the refusal was “likely to eliminate all competition in the daily newspaper market *on the part of the person requesting the service*,” thereby suggesting a lower standard. In *IMS*, the Court of Justice again repeated its formulation in *Magill* and *Bronner*, that the refusal is “such as to exclude *any competition* on a secondary market.”<sup>139</sup>

In *Microsoft*, the Commission appeared to advocate a different standard of foreclosure again,<sup>140</sup> namely one where licensing is mandated if: (1) the requested IP is “necessary” for a competitor to “viable stay in the market,” (2) the refusal represents a reduction in “the level of disclosures;” (3) “there is a risk of elimination of competition” in the secondary market; (4) the refusal to supply “has the consequence of stifling innovation in the impacted market;” and (5) the refusal is not objectively justified because “on balance” the possible negative impact of an order to supply on the dominant firm's incentives to innovate is outweighed by its positive impact on the level of innovation of the whole industry.<sup>141</sup> This is said to represent “an altogether more open-ended approach in which [the Commission] reserves the right to consider the costs and benefits of mandating access, given the facts surrounding the case.”<sup>142</sup>

<sup>136</sup> See Commission submission in “*The Essential Facility Concept*,” Organisation for Economic Cooperation and Development (1996), p. 94 (document available at <http://www.oecd.org/dataoecd/34/20/1920021.pdf>) (hereafter “OECD Paper”).

<sup>137</sup> *Ibid.*, para 65.

<sup>138</sup> *Bronner*, above note 3, para. 40 (emphasis added).

<sup>139</sup> *IMS Preliminary Ruling*, above note 85, para. 38 (emphasis added).

<sup>140</sup> See, e.g., Ridyard, “Compulsory Access Under EC Competition Law – A New Doctrine of ‘Convenient Facilities’ and the Case for Price Regulation,” *European Competition Law Review*, (2004) 670; Geradin, above note 118, at 1523; and Ahlborn, Evans, and Padilla, above note [ ], at [ ].

<sup>141</sup> *Microsoft*, above note 89, at paras. 779-784.

<sup>142</sup> See Ridyard, above note 140, at 143.

Whatever the merits of Microsoft's appeal on this issue, a number of principles seem clear. First, the test cannot be based on whether the requesting party would be eliminated from the relevant market. The legal test is not harm to a competitor, but harm to competition. A test based on competitor exit would also be open to abuse, since a particularly small or inefficient competitor could insist on a licence, with no net gain to competition. Thus, as the Advocate General stated in *Bronner*, "a particular competitor cannot plead that it is particularly vulnerable."<sup>143</sup> Foreclosure must therefore concern competitors in general and, presumably, competitors who are at least as efficient as the dominant firm.

Second, it is hard to see the justification for a general requirement that an unlawful refusal to deal should eliminate *all* competition in the sense that a 100% market share should be proved in each case. A duopoly is often uncompetitive, in particular where two companies share the same facility. The wording of Article 82(b) also requires "limiting production" to the "prejudice of consumers" and not a total absence of any competition. Moreover, a requirement of total monopolisation would be open to abuse. A dominant firm could always decide to deal with, or tolerate, a particularly small, inefficient, or friendly competitor and argue that not all competition had been eliminated.

Of course, if a facility is truly essential for downstream competition, the dominant firm will either already have or could create a monopoly on the downstream market by denying rivals that input. Thus, the logic of a duty to deal is that the upstream monopoly could *ultimately* lead to a downstream monopoly, even if this has not already occurred. This means that the debate about the standard or foreclosure might more aptly be characterised as concerning the stage at which intervention occurs. If intervention occurs at an early stage, competition may not yet be eliminated, without implying that the market would remain competitive in the future. In contrast, if intervention occurs at a late stage, the dominant firm is likely to have excluded all or most competition through its control over the essential input.

Third, there may be one situation in which a criterion based on the elimination of all competition has a certain logic. In the case of IP rights at least, there is an additional requirement that the refusal should prevent the emergence of a new kind of product. If the refusal to deal prevents the emergence of new products that compete with the dominant firm's products, then, by definition, all competition on the market would be eliminated by the refusal to licence. There is also, in that instance, consumer prejudice, since consumers are denied something new that they value.

Finally, the Community institutions' practice has been to impose a duty to licence only where it is clear that the refusal to deal results in the substantial elimination of competition. In *Magill*, there were no other undertakings present on the relevant downstream market other than the broadcasters themselves. In *IMS*, there was a monopoly until the two new entrants became active on the market. All of the port cases involved situations in which there was either a monopoly or a duopoly. What qualifies as a "substantial" effect on competition may vary from case to case, but it should *at least* mean the absence of effective competition on the market, i.e., dominance on the relevant downstream market. Thus, the issue seems to be whether dominance in the upstream market would also lead to dominance in the downstream market, regardless of whether this has already occurred or not. In most cases, however, a small number of reasonably efficient rivals should be enough to make the market reasonably competitive.

**Condition #5: new product.** A corollary of the Community Courts' consistent holding that, in the case of IP rights, a refusal to deal is not in itself unlawful is that there must be some "additional element" which justifies treating a refusal to deal as abusive. And it is also clear following the *IMS Preliminary Ruling*, that that "additional element" cannot be the fact that the IP would lead to an economic monopoly if it is not shared with rivals. Some additional impropriety or abuse that adversely affects consumer welfare is required. In *Magill*, that additional element was that the refusal prevented the emergence of a "new product" for which there was consumer demand.

The rationale for the new product condition is two-fold. First, there is no general justification for ordering a licence that would allow the production of copies of the dominant firm's products, since this would deprive the IP owner of the reward for his creative efforts.<sup>144</sup> The second reason is that a

<sup>143</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, para. 51.

<sup>144</sup> Advocate General Gulmann put the matter as follows in *Magill*: "Where the product is one that largely meets the same needs of consumers as the protected product, the interests of the copyright owner carry great weight.

duty to deal is only appropriate where there is a clear benefit to competition in ordering access, or, put differently, “prejudice to consumers” under Article 82(b) if a licence is not granted. If consumers receive a market option that did not exist previously and for which there is demand, there is a clear benefit to consumer welfare. Where the requesting party wishes to supply essentially the same product or service, the benefits to competition are far from guaranteed. In that case, the principal benefit of ordering access would be increased price competition, but this will be a direct function of the access charges that the requesting party pays the dominant firm. Depending on what those terms are, the scope for increased price competition may in fact be quite limited.<sup>145</sup> The new product requirement therefore serves the important function that access should only be ordered where there is some clear, identifiable benefit to competition.

*a. A necessary or alternative criterion?* One issue that remained unclear to some extent following *Magill* was whether the additional element of a new product was a necessary part of the legal test for a duty to deal, i.e., whether the *Magill* criteria were cumulative or alternative. The Commission initially suggested that the criteria were cumulative in *Lederle-Praxis Biologicals*,<sup>146</sup> as well as its interpretation of *Magill* advanced in *Ladbroke*.<sup>147</sup> In contrast, the Court of First Instance in *Ladbroke* used language that, on a literal reading, seemed to suggest that the new product requirement was an alternative and not a cumulative requirement,<sup>148</sup> without, however, entering into any discussion of whether this interpretation was justified as a matter of law or policy. (The Court’s comments were in any event *obiter*, since no duty to deal arose as a matter of fact in *Ladbroke*.)

The issue was raised squarely in the various *IMS* proceedings. The Commission took the view, in the interim decision, that a new product was not a necessary requirement.<sup>149</sup> This conclusion was considered highly controversial because, in the absence of a new product requirement, the interim decision treated as abusive the simple exercise by the IP owner of its core moral rights – the exclusive right to reproduce the protected matter – as abusive where the IP right is “essential” for competitors.<sup>150</sup>

---

Even if the market is limited to the prejudice of consumers, the right to refuse licences in that situation must be regarded as necessary in order to guarantee the copyright owner the reward for his creative effort.” See Opinion of Advocate General Gulmann in *RTE & ITP v. Commission*, ECJ judgment, above note 67, para. 97.

<sup>145</sup> For the terms on which access should be ordered, see Chapter Twelve on remedies.

<sup>146</sup> *Ladbroke*, above note 54, para. 22 (“[W]hat was the decisive factor in the *Magill* case was that the abusive conduct of the television channels concerned consisted in preventing the marketing of a new product to the detriment of consumers’ interests.”).

<sup>147</sup> See Complaint by Lederle-Praxis Biologicals, *XXIVth Annual Competition Report*, (1993) at p. 353. Lederle-Praxis Biologicals alleged that Pasteur-Merieux, Merck, and SmithKlineBeecham were abusing their dominant positions in various Member States by not supplying and licensing the registration documents of Hepatitis B vaccine to Lederle for inclusion in multivalents to be developed by it. The Commission rejected this complaint and concluded that Community law does not allow compulsory licensing of IPRs to competitors that wish to use those rights to offer the same products as the IPR owner: “The Commission concluded that, at the current stage of EC competition law, it is highly doubtful whether one could impose an obligation upon a dominant firm... (in an eventual EC bulk intermediate Hep B market), as a remedy to ensure the maintenance of effective competition in the national Hep B markets, to share its intellectual property rights with third parties to allow them to develop, produce and market the same products (i.e. multivalents containing the Hep B antigen) which the alleged dominant firm was also seeking to develop, produce and market.” (emphasis added). See also the explanation of *Magill* in the Opinion of Advocate General Jacobs in *Bronner*, above note [ ], para. 63 (“[T]he existing products, namely individual weekly guides for each station, were inadequate, particularly when compared with the guides available to viewers in other countries. The exercise of the copyright therefore prevented a much needed new product from coming on to the market.”).

<sup>148</sup> *Ladbroke*, above note 54, para. 131

<sup>149</sup> See *IMS Interim Decision*, above note 68, para. 180.

<sup>150</sup> See, e.g., Korah, “The Interface between Intellectual Property and Antitrust: The European Experience,” 69 *Antitrust L.J.* 8011; Baches Opi, “The application of the essential facilities doctrine to intellectual property licensing in the European Union and the United States: Are intellectual property rights still sacrosanct?” 11 *Fordham Intellectual Property, Media and Entertainment Law Journal* (2001) 409-506; Hull, Atwood &

Whatever the reasons or features of a market that lead to an IP owner obtaining a temporary or lasting economic monopoly, these only concern the issue of dominance and do not in themselves amount to abusive conduct.<sup>151</sup> The Commission's core thesis was also perverse as a general matter – the more brilliant the invention, the greater the duty to share – and risked rendering the moral rights of the IP owner nugatory. Its conclusion was also contrary to the Community Courts' consistent findings that a refusal to licence an IP right is not, in itself, an abuse.<sup>152</sup> The interim decision was therefore widely regarded by most commentators as wrong because it struck at the core of the basic system of IP protection, rather than allowing a very limited exception of the kind intended under the essential facility analogue.

That the "essential" nature of IP is not a reason in itself to compel sharing is confirmed by *Volvo* and *Magill*. In *Volvo*, it was clear that a body panel based on a shape other than Volvo's registered design would not fit the relevant car model. Similarly, in *Magill*, the broadcasters were the only source of the listings information, since no one could predict listings in advance. And yet, in both cases, the "essential" nature of the protected matter was not a sufficient reason in itself to compel sharing it with rivals. Additional factors or conduct were necessary.

For example, in *Volvo/Renault*, the Court stated that the following were examples of abusive behaviour that needed to be coupled with a refusal to licence: (1) an arbitrary refusal to supply spare parts to independent retailers; (2) the fixing of the prices for spare parts at an unfair level; or (3) a decision no longer to produce spare parts for a product still in use. In the first two examples, the dominant company has carried out other acts, apart from refusing to grant licences, which do not relate to the intellectual property right and which are themselves an abuse (i.e., discriminatory conduct and abusive behaviour aimed at distorting competition on a separate market, and conduct or behaviour aimed at excessive pricing). In the third situation, the dominant company can force consumers to buy new products that they do not need. Likewise, in *Magill* there was not merely a refusal to licence to licence an essential input, but also behaviour aimed at preventing the emergence, on a separate market, of a new product for which there was consumer demand, thereby monopolising that ancillary market.

In the preliminary ruling in *IMS*, the Court of Justice disagreed with the Commission's interpretation and held that the new product criterion is a necessary part of the legal test for a compulsory licence. It is now clear therefore that, contrary to the Commission's finding in the *IMS Interim Decision*, a refusal to licence an IP right must prevent the emergence of a new product for which there is potential

---

Perrine, "Compulsory Licensing," *European Antitrust Review* (2002) 36-39; Gitter, "The conflict in the European Community between competition law and intellectual property rights: a call for legislative clarification of the essential facility doctrine," 40 *American Business Law Journal* (2003) 217-300; Aitman & Jones, "Competition law and copyright: Has the copyright owner lost the ability to control his copyright?" [2004] *European Intellectual Property Review* 137-147; Conde and Riziotis, "Comment, International review of intellectual property and competition law," No. 5 (2004) pp. 564-573, and Temple Lang, "Compulsory licensing of intellectual property in European Community antitrust," testimony to the Department of Justice/Federal Trade Commission Intellectual Property hearings (2000), available at <http://www.ftc.gov/opp/intellect/020522langdoc.pdf>.

<sup>151</sup> The "exceptional circumstances" relied upon by the Commission in the interim decision – user input from IMS's customers and the characterisation of the 1860 brick structure a "*de facto* standard" – added nothing of substance to the Commission's core case, i.e., that IMS's IP was essential for competitors. They also seemed inconclusive. For example, user input is normal and pro-competitive in many industries (e.g., beta testing of software). The relevant legal point was that there was no restriction on IMS's competitors enlisting users' help for any purpose that they saw fit. Standards issues did not seem to arise absent an agreement between IMS and its customers that they would adopt the 1860 brick structure as a standard. No issues of interoperability arose either, since customers did not exchange data *inter se*. All the Commission's "exceptional circumstances" amounted to therefore was that the majority of consumers considered it essential to use a certain technical solution, i.e., that IMS's IP was essential for competitors.

<sup>152</sup> See *Volvo*, above note 53, paras. 8-10; *Renault*, above note 53, paras. 15-16; and *RTE v. Commission (Magill)* above note 85, paras. 73-75.

and unsatisfied consumer demand. This requirement is not satisfied where the requesting party wishes to offer goods or services already offered by the dominant firm.<sup>153</sup>

*b. The meaning of a “new product.”* The practical application of the new product criterion has not raised difficulties in the limited case law to date. In *Magill*, it seemed obvious that a single, composite television guide was a new *kind* of product when compared to the existing guides based on each broadcaster’s own listings. It was also clear that there was demand for the new kind of product and that consumer welfare would be enhanced by a duty to deal. A consumer planning a week’s viewing could rely on a single, convenient guide rather than having to purchase multiple guides and cross reference them for viewing purposes.

In *IMS*, it also seemed clear that the requesting parties’ services were not new when compared to IMS’s existing services. They argued in the interim proceedings before the Court of First Instance that their data services were different to IMS’s because they included certain data not contained in IMS’s offering (e.g., products returned by wholesalers) and allowed for more frequent data delivery. In his Order, the President rejected this argument, noting that their services were “differing only as to detail from the services offered by [IMS] and that they were “at most, new variations of the same services and on the same market as [IMS].”<sup>154</sup> There was limited scope for added-value competition in circumstances where IMS and its competitors would be reporting the same underlying raw data in the same presentation format.

The new product criterion has been criticised by certain commentators as “problematic,”<sup>155</sup> leading to “undesirable consequences,”<sup>156</sup> or “lacking solid economic foundation.”<sup>157</sup> This is only true, however, if the assessment of this criterion is reduced to a fruitless debate about degrees of novelty. For example, the law would descend into nonsense if the debate in *Magill* turned on whether presenting listings in a new colour or format was sufficiently “new.” Although these “improvements” in the television listings would result in product variants that did not exist before, a test based on trivial changes would be meaningless and would lack any useful limiting principle. In any given case, there will always be a large number of changes that could be made to a product to improve it in minor ways and it will usually be possible to find some consumer somewhere who attaches nominal value to such improvements.

An intelligent application of the new product criterion should be based on a number of considerations. In the first place, it should be for the party asserting a duty to deal to put forward evidence of its plans to produce a new product, since that information will not be in the possession of the dominant firm. Second, the product should not merely be new in the sense that it represents some incremental or minor improvement on existing products. Rather, the product should be a *new kind of product* in the sense that it creates a new type of market option that did not previously exist. For example, in *Magill*, a composite magazine was clearly a new kind of product, whereas simply changing the format of the existing products, while adding some novelty, would not be. Similarly, the high speed ferry service that the requesting party wished to launch in *Sea Containers-Stena Sealink* represented a vast improvement on existing services, cutting journey times by less than half. A final principle, grounded in economics, is that a new product is one which satisfies potential demand by meeting the needs of consumers in ways that existing products do not. That is, a new product *expands* the market by bringing in consumers who were not satisfied before. It is in this sense that the new product creates a new option, not just variations of the same product as supplied by the IP holder.

<sup>153</sup> This formulation is preferable to that used by the Advocate General in *IMS*, who stated that a product is “new” where the requesting party intends to offer goods or services of a “different nature” which answer specific consumer requirements not satisfied by existing goods or services. See Opinion of Advocate General Tizzano in the *IMS Preliminary Ruling*, above note 85, para. 62.

<sup>154</sup> See Case T-184/01 R, *IMS Health Inc. v. Commission*, [2001] ECR II-3193, para. 102.

<sup>155</sup> See, e.g., Geradin, above note 118, at 1523.

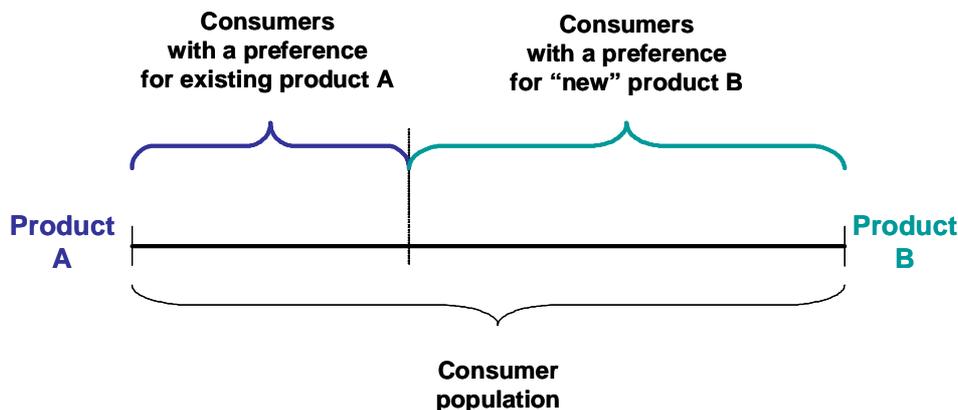
<sup>156</sup> *Ibid.*

<sup>157</sup> See Ridyard, above note 140, at 670.

Suppose there is a market in which products *A*, *B*, *C*, *D* and *E* are sold. Product *F* is a “new product” if it expands the market, so that the total demand for *A-F* exceeds the demand for *A-E*. Product *F* is not a new product if it does not expand the market, so that the total demand for *A-F* is the same as the demand for *A-E*. The new product should therefore be market-expanding rather than simply stealing share from existing products. Thus, in *Magill*, a guide that combined all television listings together expanded demand significantly. That is because a guide that combines all television listings provides convenience to consumers and, hence, attracts new consumers into the market. A guide that is merely a variant of an existing guide is unlikely to expand demand significantly: it will more likely only shift demand from an existing guide.

The degree of expansion should also be considered as a practical matter. Whenever a firm introduces a product it expands the market somewhat. A product is “new,” however, if it expands the market by a “significant” amount. This statement can be illustrated with the help of the following diagram, which is based in what economists denote as Hotelling’s linear city.<sup>158</sup> In Figure 3 below, the new product *B* expands the market by bringing in consumers that were not interested in product *A*. The new product condition is satisfied in this example, but it would not be so if products *A* and *B* were both located at the centre of the linear city competing head-to-head for the same set of consumers.

Figure 3: The “New Product Condition”



c. *The relevant market in which the new product should arise.* Another issue is whether the new product should be in the same relevant market as the dominant firm’s product or whether it should relate to a separate market. Case law seems clear that it should compete with the dominant firm’s own products. First, in *Bronner*, Advocate General Jacobs defined the duty to deal as arising when the refusal “prevents a new product from coming on a neighbouring market in competition with the dominant undertaking’s own product on that market.”<sup>159</sup> Second, in the *IMS* preliminary ruling, Advocate General Tizzano defined a new product as one “in competition with” the dominant firm’s own products.<sup>160</sup> Finally, the Court of Justice in *IMS* emphasised that the new product(s) are to be offered on the same (secondary) market where the IP owner is active.<sup>161</sup>

d. *The new product condition and physical property.* A curious feature of the decisional practice and case law is that the new product criterion does not seem to apply in the case of access to

<sup>158</sup> The following assumptions apply: Consumers are located in the linear city. They have heterogeneous preferences with respect to products *A* and *B*. Consumers preferences with respect to a product are more intense when it is located closer to that product. In the picture, products *A* and *B* compete in the same relevant product market. A price reduction in product *A* is likely to cause a reduction in the sales of product *B*. Yet, at current prices, the addition of product *B* to the market increases consumer welfare by adding an entire class of consumers whose preferences were such that they preferred not to buy to buy product *A*.

<sup>159</sup> Opinion of Advocate General Jacobs in *Bronner*, above note 3, para. 43 (Emphasis added).

<sup>160</sup> Opinion of Advocate General Tizzano in the *IMS Preliminary Ruling*, above note 85, para. 62.

<sup>161</sup> *IMS Preliminary Ruling*, above note 85, para.52.

physical property. It is not entirely clear whether this is a deliberate policy decision on the part of the Community Courts or is the inadvertent result of the narrowly-framed questions to come before them. Certainly, from an economic perspective, the general equivalence of physical and intellectual property strongly suggests that the new product criterion is equally appropriate in the case of physical property. If consumers obtain a new market option that did not exist previously, there is a clear benefit to competition. If they do not, the benefits of forced sharing are far from obvious. This applies equally to IP and physical property. It is also notable that, in a number of cases in which mandatory sharing of physical assets was ordered, the requesting party in fact wished to offer a new product. For example, in *Sealink/Sea Containers*, Sea Containers wished to offer a new high speed ferry service that the dominant firm did not offer at the time.

**Condition #6: objective justification.** The final condition for a duty to deal is that there are no objective reasons that would justify the dominant firm's refusal to deal. While this requirement has been a consistent feature of the decisional practice and case law, the precise scope of this defence has not been clearly articulated in the case law. Indeed, case law to date appears to have taken a strict approach to objective justification. For example, in the *IMS Interim Decision*, IMS argued that it was entitled to refuse to deal with one of the requesting parties, NDC, since senior managers within that undertaking had been subject to a criminal complaint relating to the theft of business secrets from IMS on the relevant market. The Commission rejected this defence on the grounds that, first, the complaint was at a preliminary stage and, second, that the complaint was against individuals and not the company itself. It also stated that, even if none of the above factors were present "it is incumbent on IMS to address any perceived harm it has suffered through alleged criminal behaviour through appropriate lawful means, and not by attempting to eliminate competition in the relevant market."<sup>162</sup> The Commission was also unreceptive to the argument that the requesting parties did not offer insufficient royalties and, as noted above, appeared to suggest that there were affirmative good faith duties on the dominant firm to indicate an acceptable figure.

The range of acceptable justifications for a refusal to deal will vary from case to case depending on the facts. In principle, however, a number of defences should be valid. For example, the Access Notice on telecommunications mentions the following categories of objective justification:<sup>163</sup>

"Relevant justifications in this context could include an overriding difficulty of providing access to the requesting company, or the need for a facility owner which has undertaken investment aimed at the introduction of a new product or service to have sufficient time and opportunity to use the facility in order to place that new product or service on the market."

In the case of physical facilities, the absence of available capacity must also be a relevant defence. Creditworthiness is also a legitimate reason for refusing to deal, or, more generally, that the requesting party would be unsuitable, unreliable, or unsatisfactory as a trading party.<sup>164</sup> There may also be issues concerning quality degradation or security that would justify the refusal to admit new users.<sup>165</sup> Thus, in *DuPont Holographic System*, a refusal to supply a protected hologram system for graphic art purposes was held justified because DuPont wanted to reserve its technology for security purposes, and feared a loss of security if it was licensed for graphics.<sup>166</sup> The fact that, prior to the request for access, the

<sup>162</sup> See *IMS Interim Decision*, above note 85, at para. 173.

<sup>163</sup> See Access Notice, above note 9, para. 91. See also Lugard, "ECJ Upholds Magill: It Sounds Nice In Theory, But How Does It Work In Practice?", [1995] *European Business Law Review*, 231, 233. On objective justification generally, see Temple Lang, "The Principle of Essential Facilities And Its Consequences In European Community Competition Law," *Essays In Regulation (Regulatory Policy Institute)*, No. 7, (1996), 19, at 28.

<sup>164</sup> See Access Notice, *ibid.*, para. 85; *British Midland/Aer Lingus*, above note 59, para. 25.

<sup>165</sup> See, e.g., *Sea Containers-Stena Sealink*, above note 6, para. 74.

<sup>166</sup> See Decision of the Office of Fair Trading in Case CP/1761/02 *E.I. du Pont de Nemours & Company and Op. Graphics (Holography) Limited*, September 9, 2003, para. 34 ("...DuPont has informed the OFT that it has adopted an overall strategy of promoting the security and authentication applications of HPF. Part of this strategy is the large scale supply of unprocessed HPF only to undertakings with experience of and premises already suited to highly secure production. DuPont considers that in order to obtain large scale contracts with these customers it must be able to guarantee complete supply chain security. Du Pont has concerns about its

dominant firm intended to phase out the product in question for use in certain applications is also a defence.<sup>167</sup> Finally, where products are in short supply, it may be reasonable for a dominant firm to prioritise long-standing over occasional customers.<sup>168</sup>

Defences based on capacity limitations, quality degradation, and safety will, however, be scrutinised carefully. In *Frankfurt Airport*,<sup>169</sup> the airport operator argued that its refusal to allow self-handling or additional ramp handling suppliers was justified by a lack of capacity and concerns over safety and quality degradation concerns. An experts report was also submitted by the airport operator to bolster these concerns. The Commission did not accept this report at face value, but set up a group of technical experts consisting of representatives of the airport operator and the complainant and chaired by an independent expert. When the technical group could not reach an unanimous conclusion, the Commission appointed a leading industry expert to compile a detailed independent report. The Commission evaluated the various reports in reaching its conclusion that the airport operator's defences were, for the most part, unjustified.<sup>170</sup>

In the case of IP rights, the dominant firm should also have a defence if it intends to bring to market itself the "new product" that the requesting party wishes to offer. This is important in practice, since many inventions involve improvements or upgrades on existing products. If the dominant firm was not entitled to refuse to licence in these circumstances, competitors would effectively have a right to share in new inventions. This would be unwarranted, since the justification for a compulsory license – that consumers will benefit from a new product that did not exist previously – is lacking if the dominant firm intends to bring that product to market itself. One important limitation in this regard is that the dominant firm must have some reasonable plan in place to develop the "new product" itself at the time when the licence request is made. If not, a dominant firm could always argue *ex post* that it intended to make the same innovation as the requesting party.<sup>171</sup>

A final important issue is whether a refusal to deal can be objectively justified by the fact that the requested input is the result of significant research and development or is extremely valuable for some other reason. In other words, the issue arises whether satisfaction of the preceding criteria for a duty to deal is sufficient justification for access to be ordered or whether the dominant firm is still entitled to refuse to deal because its property represents the result of significant investment or original work.

---

ability to provide this guarantee if it continues to supply HPF to customers for use in graphic arts applications.”).

<sup>167</sup> *Ibid.*, para. 33 (“DuPont has subsequently confirmed that it has now ceased using HPF to produce standard holograms for use in graphic arts applications and that the process of ceasing production of all HPF holograms will be completed by 2004. It therefore appears unlikely that DuPont's refusal to supply unprocessed HPF to OPG is aimed at eliminating competition in any downstream or associated market in which OPG is currently active.”).

<sup>168</sup> See *ABG/Oil Companies*, OJ 1977 L 117/1.

<sup>169</sup> See *FAG-Flughafen Frankfurt/Main AG*, above note 59.

<sup>170</sup> A more controversial aspect of the decision was the Commission's suggestion that the dominant airport operator had a duty to carry out certain adjustments to the existing infrastructure in order to make capacity available (*ibid.*, paras. 86-87). The Commission reasoned that the airport operator could have: (1) added capacity; (2) closed a limited number of stands in order to free up capacity; and (3) relocated certain cargo services. Presumably, the Commission had in mind a number of existing options open to the airport operator at little or no cost rather than suggesting that it should incur additional costs that would ultimately be passed on to the airport users.

<sup>171</sup> This also highlights a practical difficulty with the “new product” requirement: it may require the party requesting a licence to disclose its plans for a new product to the IP owner to prove the justification of its request. This difficulty seems unavoidable given the test as formulated by the Community Courts, but it could lead to conflict over which party first adopted the idea for a new product. On the plus side, it is likely to discourage unmeritorious compulsory licence applications, since only undertakings that genuinely require access to the dominant firm's inputs to develop new kinds of product would have a strong incentive to disclose their plans.

A defence along these lines has been put forward by a number of commentators,<sup>172</sup> and referred to in certain decisions at national and Community level. For example, in *DuPont Holographic System*, the Office of Fair Trading noted that DuPont's holographic film product was the result of original research and development and that the mere fact that it had certain unique advantages over rival products at the time was not a reason in itself to compel a duty to deal:<sup>173</sup>

“Unprocessed HPF is the product of research and development by DuPont. The effect of treating every new product which, at the time of its discovery, had unique properties as an essential facility (if this product was a necessary input into a downstream market), would be to permit an excessive degree of interference with the freedom of undertakings to choose their own trading partners. As stated above, competition law should have this effect only in exceptional circumstances.”

The issue has also been raised squarely in Microsoft's appeal against the Commission's decision ordering it to disclose interoperability information to competitors. At the interim measures stage, the President of the Court of First Instance considered that this ground was at least arguable in principle. He noted that, unlike the IP rights in *Magill* and *IMS*, Microsoft's IP “relates to secret and valuable technology.”<sup>174</sup>

Whatever the merits of Microsoft's arguments on appeal, such a defence should in principle be admitted. A great difficulty with the current legal conditions for a duty to deal is that undue emphasis is placed on the importance of the dominant firm's input to rivals and whether the refusal to share it would eliminate competition on the downstream market in which it is essential. These effects should be counterbalanced against the effects of a duty to share on the dominant firm's incentives to innovate, since, otherwise, there is a risk that a duty to deal would be imposed in cases in which it was least justified. For example, the “exceptional” circumstances for granting access to IP rights will be “normal” in the case of many IP rights that have unique advantages over rival products and so allow a firm to achieve an unassailable market position. Indeed, this type of “reward” for successful innovation is central to the justification for the system of IP protection.

The need to confine a duty to deal to exceptional cases is also rooted in the nature of property rights. Property rights are not held on trust for the public good, or to allow rival firms to develop new products. Owners of property have moral and other ownership rights that have a protected status in law. Such rights cannot in general be reduced to a right for a third party to insist on a contract upon offering reasonable terms, even if the property in question is essential for competition. Otherwise, property rights would in effect be converted into liability rights. The objective justification criterion should therefore recognise that certain property should not be subject to obligations to share, even if they are essential for competition and would result in market foreclosure. In other words, the law must recognise that many forms of “foreclosure” created by property rights are essential to a properly-functioning market economy, including in situations in which such property is essential to rivals.

The Commission attempted to undertake such an analysis in *Microsoft* when it sought to balance the pro-competitive effects of a duty to deal against the adverse effects of a duty to deal on Microsoft's incentives to innovate.<sup>175</sup> But in quantitative terms, there is no reliable way in which such an exercise can be undertaken *ex post*. Once an extremely valuable asset has been created, and so allows a firm to achieve a near-monopoly position, the benefits of sharing it will always look attractive *ex post*. But it is precisely this prospect of large future profits that spurs risky decision-making *ex ante*. There is no

<sup>172</sup> See, e.g., Waelbroeck, “Interface Between Competition And Intellectual Property – Access To Intellectual Property By Third Parties – Magill: Hard Cases Make Bad Law,” *IBC Conference paper*, November 1995 (on file with authors); Zinsmeister and Van Themaat, “Magill: the result of a compulsory application of genetically modified competition law,” *Melanges en hommage a Michel Waelbroeck*, Bruylant, 1999, 1717; and Nikolinakos, “Access Agreements in the Telecommunications Sector – Refusal to Supply and the Essential Facilities Doctrine under EC Competition Law,” *European Competition Law Review* (1999), 399, 406.

<sup>173</sup> *DuPont Holographic System*, above note 166, para. 29.

<sup>174</sup> See the Order of the President of the Court of First Instance in Case T-201/04 R, *Microsoft Corporation v Commission*, above note 89, para. 106.

<sup>175</sup> See *Microsoft*, above note 69, paras. 704 et seq.

effective resolution of this dilemma, but second-best solutions may be employed. For example, there are industries in which empirical evidence shows that the principal parameter of competition is research and development. An obvious case concerns the pharmaceutical industry where valuable patents may allow firms to achieve large net profits. But large profits fund research efforts on other potential products – most of which never lead to commercial products.<sup>176</sup> In these circumstances, it may be questioned whether a general duty to share essential IP – even when limited to the development of new kinds of products – would be appropriate as a matter of public policy. These considerations are by no means unique to the pharmaceutical sector, but would equally apply to any other industry or product where empirical evidence, experience, or logic suggest that general duties to share valuable assets would lead to more harm than good.

**The relevance of a prior course of dealing.** Earlier precedents such as *Commercial Solvents* and *Télémarketing* concerned situations in which the dominant firm terminated past cooperation with a third party. These precedents have generated a great deal of discussion on whether a dominant firm's duty to deal with new trading parties under Article 82 EC is different from its duty in respect of existing trading parties. A number of commentators argue that the case law on new customers is distinct from that concerning existing customers.<sup>177</sup> The principal argument is that there must always be a reason why a dominant firm terminates past, and presumably efficient, cooperation with a rival and that an anti-competitive inference may be appropriate in certain circumstances. Moreover, past terms may offer a useful starting point for determining the terms of a new contract, a problem that is apt to be acute in refusal to deal cases where there was no prior dealing. There is some support for this view in the case law,<sup>178</sup> including in *Microsoft*, where the Commission considered a prior course of dealing between Microsoft and its rivals to be “of interest” in determining whether a duty to deal was appropriate.<sup>179</sup> Most recently, the Commission has gone as far as to suggest that a past course of dealing may give rise to a “legitimate expectation” of future dealings.<sup>180</sup>

Other commentators have rejected the relevance of a prior course of dealing and argue that the case law from *Commercial Solvents* through to *Microsoft* represent a unified set of principles.<sup>181</sup> Several reasons are said to justify this conclusion. First, the facts in *Commercial Solvents* and *Télémarketing* and the language used by the Court of Justice are consistent with its later statements in cases such as *Bronner*. In *Commercial Solvents*, the dominant company was the only source of the raw material in question: the Court specifically rejected claims that other nascent technologies in the trial stage were a

<sup>176</sup> See sources collected at note 24 above.

<sup>177</sup> See, e.g., Hatzopoulos, “Case note on *IMS*,” 41 *Common Market Law Review* 1613 (2004) (*IMS* confirms that there is “a refusal to supply doctrine distinct from the *Commercial Solvents* line of case law”); and Sher, “The Last of the Steam-Powered Trains: Modernising Article 82,” [2004] *European Competition Law Review* 243 (“...one rule for existing customers, another for new customers”).

<sup>178</sup> See Opinion of Advocate General Jacobs in Case C-53/03 *SYFAIT v. Glaxosmithkline*, October 24, 2004, not yet reported, para. 66 (two different rules: one for existing customers and one for new customers under the essential facilities analogue) and *Genzyme*, [2004] CAT 4, para. 571 (UK Competition Appeal Tribunal distinguished between *Bronner* on the one hand and the *Commercial Solvents* and *Télémarketing* judgments on the other).

<sup>179</sup> *Microsoft*, above note 69, para. 556.

<sup>180</sup> See *Clearstream*, above note 53, paras. 242-243. This goes too far, however, if, by this, the Commission implied that a dominant firm had created a legitimate expectation in the sense used under general principles of Community law. A legitimate expectation is only capable of creating a legally enforceable obligation against a Community institution, not a private undertaking.

<sup>181</sup> See, e.g., Subiotto and O'Donoghue, “Defining the Scope of the Duty of Dominant Firms to Deal with Existing Customers under Article 82 EC,” [2003] *European Competition Law Review* 683 (distinction between dominant firms' duties towards new and existing customers “arbitrary;” both new customers and existing customers are subject to the requirement that the requested input or facility be “essential”); and Geradin, above note 118 (implying that *Commercial Solvents* and the essential facility doctrine constitute a single line of case law). A number of US commentators make a similar point: see Elhauge, above note 45 at 313; and Robinson, “On Refusing To Deal With Rivals, 87 *Cornell Law Review*, 1177 (2002), 1203.

substitute for Commercial Solvents' raw materials.<sup>182</sup> The need for an essential input in the case of existing customers was made more express by the Court in *Télémarketing*, where it interpreted *Commercial Solvents* as limited to situations in which an undertaking holds a dominant position on the market in respect of an input that is "indispensable for the activities of another undertaking on another market."<sup>183</sup>

Second, later decisions and judgments on the duties to deal with new customers expressly cite the *Commercial Solvents* line of case law as the basis for the duty to deal with new customers, thereby suggesting that the underlying principles are the same as in the case of existing customers. For example, in *Sea Containers-Stena Sealink* – the first decision expressly mentioning the term "essential facility" – the Commission cited *Commercial Solvents* and *Télémarketing* for the proposition that "an undertaking which occupies a dominant position in the provision of an essential facility and itself uses that facility (i.e., a facility or infrastructure, without access to which competitors cannot provide services to their customers), and which refuses other companies access to that facility without objective justification or grants access to competitors only on terms less favourable than those which it gives its own services, infringes Article 8[2]."<sup>184</sup> Similarly, for IP rights, the Court of Justice has also cited the *Commercial Solvents* line of case law as the legal basis for a duty to deal.<sup>185</sup> Indeed, it is not even clear that a hard and fast distinction can be made between case law involving "new" and "existing" customers: a number of cases associated with the duty to deal with "new" customers in fact involved the termination of past cooperation or discriminatory refusals to deal.<sup>186</sup>

Finally, a legal principle to the effect that the substantive test for a duty to deal would vary depending on whether the trading party was new or an existing customer would be precarious. It would imply that a dominant owner of an input would be able to exploit the property exclusively if it operates in a vertically integrated fashion at all times, but would be compelled to deal if, at any point in time in the past, it considered it more efficient to deal with an independent operator. The law might then be reduced to happenstance and would become less predictable. At the extreme, such a duty might lead to the dominant firm not dealing with any rival, even when it was efficient to do so. A dominant firm is in principle entitled to choose its trading parties and to cease or vary the terms of any past cooperation. What was efficient in the past may not be so today.

On balance, the argument that the duty to deal with an existing trading party is subject to different legal conditions than the duty to deal with a new competitor does not seem correct. But a prior course of dealing is clearly of *some* relevance. Where a dominant firm has been supplying a downstream trading party, and then terminates the relationship, the reason for that termination should be looked at where it has a sufficiently serious effect on competition. (If the termination has no effect on competition – for example where there are sufficient other downstream competitors – there would be no reason to enquire into the reason.) The termination might, for example, be due to the fact that the company terminated was the most aggressive competitor. The dominant firm should therefore be required to offer some legitimate explanation for a decision to terminate an existing relationship. No

<sup>182</sup> *Commercial Solvents*, above note 56, para 13.

<sup>183</sup> *Télémarketing*, above note 57, para 26. Admittedly, there is language in the judgments referring to the fact that the refusal to deal would eliminate all competition on the part of the party requesting access. But this probably amounted to the same thing as saying that the input should be essential for competition on the relevant downstream market: if effective substitutes were available, it is hard to see how all competition from the requesting undertaking would be eliminated. It also bears emphasis that, in both *Commercial Solvents* and *Télémarketing*, only one undertaking in fact requested access. This suggests that the elimination of all competition on the part of the requesting undertaking and the elimination of all competition on the relevant market actually amounted to the same thing in those cases.

<sup>184</sup> *Sea Containers-Stena Sealink*, above note 6, para. 66, footnote 6.

<sup>185</sup> *Magill*, ECJ judgment, above note 68, para. 56.

<sup>186</sup> See, e.g., *British Midland/Aer Lingus*, above note 59 (Aer Lingus refused to continue with British Midland on interlining facilities, while continuing to deal with British Airways); *Magill*, above note 67 (broadcasters provided listings free of charge to overseas publications and newspapers); *Microsoft*, above note 69 (less information provided to Sun Microsystems than other rivals); and *Clearstream* (refusal to deal and discriminatory refusal to deal "two manifestations of the same behaviour" (para. 216)).

presumption should be attached either way to a prior course of dealings: there are many pro-competitive reasons why a dominant firm would stop dealing with a past trading party (e.g., vertical integration). But it may be that an inference of anti-competitive intent would be appropriate in certain circumstances. If an anti-competitive bent is revealed, and the other conditions for a refusal to deal are met, the fact that the dominant firm dealt with rivals in the past may offer a useful indication that a duty to deal can work and what the future terms might be. Of course, what was acceptable in the past may not be in future, but it is much easier to adjust past terms for changes in circumstances than to create new terms for the first time.<sup>187</sup>

**The relevance of the source and perceived value of the property right.** It is sometimes argued that the duty to deal under Article 82 EC should be regarded as an exceptional response to aberrant or questionable property rights.<sup>188</sup> This argument usually has two elements. The first is that a duty to deal in the case of IP rights is justified where a competition authority or court perceives the value of the IP right in question to be weak. Even if competition authorities and courts were well-equipped to distinguish “good” and “bad” IP rights – which is doubtful – this argument is unpersuasive. First, while it may be true to say that there was some doubt surrounding the justification for the IP rights at issue in *Magill* and, to a lesser extent, *IMS*, the same could not be said about other cases in which a duty to deal has been considered appropriate. The most notable examples are *Microsoft* and the *Intel/Via* case before the United Kingdom courts,<sup>189</sup> each of which concerned valuable IP and related rights. Second, it would be *ultra vires* for the Community institutions to question the existence or validity of property rights granted under national law.<sup>190</sup> Third, it would be highly unsatisfactory if

<sup>187</sup> Elhauge, above note 45, argues that, under the case law of the U.S. Supreme Court at least, the relevant point is not a prior course of dealings, but whether the dominant firm’s *present* dealings discriminate between rivals and non-rivals (at 305-314). He explains that all leading U.S. cases on a duty to deal can be explained in terms of discrimination against rivals (at 309). To be clear, discrimination in his sense does not mean forward integration by the dominant firm, or a decision to deal with some rivals but not others. The relevant distinction is whether, at the same time, a dominant firm selects to deal only with non-rivals and to exclude rivals. If anti-rival discrimination in this sense is present, and all of the other conditions for a refusal to deal are met, Elhauge argues that a court or competition authority can be more confident that a duty to deal will not cause much harm to the dominant firm’s *ex ante* incentives to invest. This is because the dominant firm is already dealing with some parties and the present terms of those dealings offer a more reliable indicator of acceptable terms for other contracts than past terms. Some Article 82 EC decisions and case law fit this thesis, but most do not. In *Sea Containers-Stena Sealink*, above note 6, the dominant harbour operator, Sealink, dealt with B&I Line, but refused to deal with Sea Containers when it became aware that Sea Containers wished to launch a new fast ferry service that would have competed with Sealink’s own proposed service. In *Magill*, there was also a suggestion of anti-rival discrimination: the broadcasters supplied the information (sometimes free of charge) to overseas publications and daily newspapers, but would not deal with *Magill* who wished to launch a directly-competing magazine. Finally, in *Microsoft*, the Commission suggested that Microsoft required non-rival licensees not to supply interoperability information to its direct competitors in the workgroup server area, i.e., Microsoft was distinguishing between disclosure to rivals and non-rivals: see *Microsoft*, above note 69, paras. 574, 576.

<sup>188</sup> See, e.g., Forrester, “Compulsory licensing in Europe: a rare cure to aberrant national intellectual property rights?,” testimony to the Department of Justice/Federal Trade Commission Intellectual Property hearings (2002), available at <http://www.ftc.gov/opp/intellect/020522forrester.pdf>. (suggesting that it would be “unimaginable ... that a truly innovative piece of technology (a pharmaceutical patent or novel software code, for example) would be treated in such a manner.”) and Delrahim, “Forcing Firms to Share the Sandbox: Compulsory Licensing of Intellectual Property Rights and Antitrust”, paper presented at the British Institute of International and Comparative Law, London, May 10, 2004 (“United States commentators had another problem with *Magill* and *IMS*: each case involved a weak copyright in what might well have been considered uncopyrightable facts in the U.S. A major part of both decisions seems to have been the concern that the underlying intellectual property was questionable...I believe that the *Magill* and *IMS Health* cases may provide little precedent for a future case that features undisputed software rights, for example, or strong patent rights.”).

<sup>189</sup> *Intel Corporation v Via Technologies Inc. and Elitegroup Computer Systems (UK) Ltd*, [2002] EWCA Civ. 1905, December 22, 2002 (Court of Appeal) (Via’s claims that it was entitled to manufacture and sell chipsets compatible with Intel’s Pentium 4 product considered arguable, for purposes of summary judgment, under Article 82 EC). The case has since resulted in a settlement agreement between the parties.

<sup>190</sup> See sources collected at note 14 above.

the Community institutions did not formally question the existence or validity of property rights, but would informally decide cases by passing unpublished value judgments on the perceived strength of the property rights at issue. Decisions would then be rendered for reasons other than those stated in the text itself and which would be unlawful if they were made express. Finally, if certain property rights are aberrant, the correct remedy is to amend the legislation that creates such aberrant rights. This does not mean that competition has no role to play, but it means that competition law should not, in the first instance, be a means of correcting defects in property laws.

A second argument is that a duty to deal is appropriate where the property in question results from the use of public funds, a former state monopoly, or is a natural monopoly.<sup>191</sup> It is true that EU Member States spend a greater proportion of GDP on public investments in physical facilities than, say, the United States, which may explain why there is a greater incidence of forced sharing in the EU.<sup>192</sup> But it is hard to see why the public source of the funding for the property should lead to a stricter legal standard. First, the wording of Article 82 EC does not allow a distinction to be made between property that results from public and private funding.<sup>193</sup> The wording of Article 295 EC would also preclude discrimination between property rights along these lines. Second, it will not always be easy to say that the source of the funds is unambiguously public in nature. Much of the infrastructure offered to former state monopolies has been the subject of significant improvements following privatisation, with the result that the sources of the funding are now mixed. Third, if certain assets cannot be economically duplicated by private funding, the proper course is to regulate the natural monopoly created by public funds, which the Commission has done in the case of virtually all utility networks.<sup>194</sup> Competition law should not generally be used to plug gaps in regulation. Finally, the Commission itself has rejected this argument. In *Frankfurt Airport*, the airport operator argued that its historical legal monopoly on the provision of ramp-handling services justified a refusal to share. The Commission concluded that the historical character of the monopoly was irrelevant: what mattered was the airport operator's conduct on the market.<sup>195</sup> This suggests that the Commission is indifferent to the historical source or reason for a monopoly once the substantive conditions for a duty to deal are satisfied.

In sum, the perceived weakness of certain property rights, or the public source of their funding, may explain why certain refusal to deal cases are pursued, but it does not offer a useful legal test for determining the legal conditions under which a duty to deal is appropriate. At most, the fact that a facility is a natural monopoly, the result of a former statutory monopoly, or publicly-owned helps explain the type of cases that, as a matter of policy, are thought most likely to confer the greatest benefit to competition in ordering access and the least harm to the property owner. Limiting the use of the doctrine of forced sharing to these situations is therefore a convenient policy argument to place

<sup>191</sup> See Areeda & Hovenkamp, *Antitrust Law*, Vol. III A (1996), at 176 (¶ 771).

<sup>192</sup> See Geradin, "The Opening of State Monopolies to Competition: Main Issues of the Liberalisation Process," in *The Liberalisation Of State Monopolies In The European Union And Beyond*, 181, 183 (2000).

<sup>193</sup> Other provisions of the EC Treaty grant the Commission extensive to deal with anti-competitive actions by the State and public authorities. Articles 81 and 82 only apply to undertakings, but may also be applied, in combination with Articles 3 and 10 of the EC Treaty, to certain forms of government action. As a general rule, the combined application of Articles 81 or 82 and Articles 3 and 10 prevents member states from adopting any measure that would deprive the competition rules of their effectiveness. In Article 10 of the EC Treaty, member states agree to take all appropriate measures to ensure the fulfillment of the obligations arising out of the EC Treaty. One of these obligations, which is codified in Article 3(g) of the EC Treaty, is the maintenance of "open and free competition." Article 86 limits the extent to which member states may intervene in the market through public undertakings. These rules are aimed at ensuring the equal application of the competition rules to all market participants. Article 86 contains three paragraphs: (1) Article 86(1), which prohibits member states from granting competitive advantages to public undertakings and undertakings enjoying special or exclusive rights contrary to Articles 81 and 82; (2) Article 86(2), which provides for a limited exception for certain undertakings; and (3) Article 86(3), which grants the Commission certain powers to ensure compliance with the provisions of Article 86. See generally Bellamy & Child, *Common Market Law of Competition*, Sweet & Maxwell, 5th edition, 2001, Chapter [ ].

<sup>194</sup> See sources collected at note 9 above.

<sup>195</sup> See *FAG-Flughafen Frankfurt/Main AG*, above note 59, paras. 97-98.

general restrictions on the duty to share in order to limit its harmful effects rather than a substantive principle.

### 8.4.3. The Duty To Make Subsequent Contracts With Rivals

**Overview.** The previous section dealt with the circumstances in which a dominant firm active on a downstream market can be compelled to deal with rivals when it has not done so previously, i.e., the duty to make a *first* compulsory contract or licence with rivals. If the dominant firm has already made one contract with a rival, the issue arises whether it can be obliged to offer a second or subsequent contracts to other rivals under Article 82 EC. This assumes, crucially, that the dominant firm is active in the downstream market in which it has already made contracts with rivals and in which further contracts are sought. If it is not, it cannot be obliged to deal with anyone under Article 82(b),<sup>196</sup> although a duty to deal with subsequent customers may arise under Article 82(c) (non-discrimination) if the dominant firm has already made one contract.<sup>197</sup>

The duty of a dominant firm to grant further contracts with rivals raises two principal issues, each of which is discussed below. First, if a dominant firm has already made one compulsory contract with a rival, in what circumstances can it be obliged to deal with other rivals? Second, there may be situations in which a dominant firm may have a non-discrimination duty towards rivals, most notably in the case of multi-firm combinations that meet the legal conditions for a duty to deal.

**The number of compulsory subsequent contracts with rivals that must be concluded by the dominant firm.** The number of contracts that the dominant firm must make with rivals once a duty to grant a first contract has been imposed has not been dealt with in the case law. As a practical matter, two comments should be noted from the outset. First, if the dominant firm is already dealing with some rivals and has spare capacity for others, it will usually be rational to deal with further willing buyers. Second, at least in the context of administrative action, the Commission's practice has been to require the dominant firm to deal with all actual or potential competitors on the relevant market at the time the duty to deal is imposed. This most likely reflects the Commission's desire to act in a non-discriminatory manner with respect to the range of potential requesting parties.<sup>198</sup> These important qualifications mean that, in practice, the issue of compulsory subsequent contracts will not arise as much as might be expected.

The issue may nonetheless arise where a dominant firm has made a first contract or licence to a rival and another rival seeks a subsequent contract or licence. How many contracts the dominant firm can be *obliged* to grant rivals may therefore be important in practice. The issue involves the simultaneous application of the principles of foreclosure under Article 82(b) and non-discrimination under Article 82(c). Three different approaches could be taken.

A first approach is to say that, once a first contract or licence is granted – whether voluntary or compulsory – the dominant firm has a duty to deal with any other undertaking that meets the conditions of Article 82(c), i.e., they are similarly situated to the undertaking receiving the first contract or licence, they would suffer a competitive disadvantage through the refusal to licence, and no justification exists for the refusal to grant a subsequent licence.<sup>199</sup> In other words, the only issue is whether the dominant firm is discriminating against subsequent requesting parties. This approach is

<sup>196</sup> See *Ladbroke*, above note 54.

<sup>197</sup> See *infra* Section 8.5

<sup>198</sup> Actual licences have only, however, been granted to a handful of undertakings in each case. In *Magill*, there was a broad duty to licence all downstream operators, but in fact there was only one requesting party, Magill. In *IMS*, the Commission seemed to indicate a broad duty to licence to “all undertakings currently present on the market for German regional sales data services,” but there were in fact only two such undertakings. Finally, in *Microsoft*, while the interoperability remedy applied to any undertaking active in the workgroup server area, licences have only been taken up by a handful of undertakings who were involved as complainants in the administrative procedure. Thus, in practice, it would seem that only those undertakings who made prior licence requests or participated in the administrative procedure as complainants receive licences under Article 82(b).

<sup>199</sup> For detailed treatment of the conditions under Article 82(c) see Chapter Five.

highly questionable. It would be curious if the conditions for the award of a first contract were much more onerous than the conditions for the award of subsequent contracts. Under this approach, subsequent contracting parties would simply need to show that they were in a similar position to the first contracting party and that they would suffer a competitive disadvantage unless they received access to the essential input. These conditions would likely be satisfied in the case of the vast majority of refusals to deal and would mean that, once a dominant firm has offered one contract or licence, it would be obliged, under a non-discrimination principle, to offer contracts to all-comers. The dominant firm would then have a serious disincentive to offer a voluntary first contract. Rivals that did not meet the strict conditions for a first compulsory contract would also be encouraged to simply wait until a duty to deal had been imposed and then insist on another contract on non-discrimination grounds. Another anomaly would be that, in the absence of an express requirement of “consumer prejudice” under Article 82(c), the first licence to a rival under Article 82(b) would clearly be subject to the need to show consumer harm, whereas any subsequent licence under Article 82(c) may not be.<sup>200</sup>

A second approach to the question of how many contracts the dominant firm should be obliged to make is that, once the dominant firm has granted one contract or licence, it can refuse to grant any further contracts or licences on the grounds that not all competition would be eliminated by a subsequent refusal to deal. This approach has some superficial appeal, but would be open to serious abuse in practice. A dominant firm could always avoid effective competition by granting a licence to a small, inefficient, or friendly rival that makes no meaningful contribution to competition on the downstream market. If this were accepted, the entire premise of the duty to deal – that it would bring to an end a serious handicap to effective competition on the downstream market – would be called into question.

This leads to the final, correct principle: a subsequent contract or licence to a rival need only be offered where it meets *all* of the conditions for the grant of the first compulsory contract or licence.<sup>201</sup> The key issue therefore is whether a subsequent contract or licence is necessary to prevent substantial anti-competitive effects on the downstream market (assuming all of the other conditions for a duty to deal are met). This is directly related to the standard of foreclosure required in the case of a first contract or licence. Thus, no additional contracts would be required if the market was already competitive.<sup>202</sup> Another contract would only be justified where the refusal to grant it would result in the market remaining uncompetitive. How many contracts or licences are needed will vary from case to case, depending on how scattered the competitive fringe is, their available capacity, and barriers to entry and exit. But, in general, one or two efficient licensees ought to be enough to generate reasonable competition in most markets, with the result that admitting further rivals would be unnecessary.

**Situations in which non-discrimination duties towards rivals may be appropriate.** There are potential exceptions to the principle that the dominant firm can only be obliged to make a subsequent contract with a rival if the conditions for the first contract are satisfied. Non-discrimination duties towards rivals may be appropriate in at least two situations under Article 82 EC. The first concerns collective refusals to deal. Although the duty to deal under Article 82 EC is usually thought of in connection with single dominant firms, similar issues arise where two or more companies make

---

<sup>200</sup> Chapter Five (Abusive Discrimination) argues that consumer welfare is implicit in Article 82(c), since, otherwise, discrimination that enhances consumer welfare overall would be unlawful. This cannot have been intended under Article 82(c), but the issue remains unresolved under the case law.

<sup>201</sup> See Temple Lang, *Anticompetitive non-pricing abuses under European and national antitrust law*, in Hawk (ed.), 2003 *Fordham Corporate Law Institute* (New York, 2004) 235-340, at 245.

<sup>202</sup> This appears to have been the conclusion reached in *Intel Corporation v Via Technologies Inc. and Elitegroup Computer Systems (UK) Ltd*, [2002] EWHC 1159 (Chancery Division), para. 178 (“[O]ne of the essential elements in the exceptional circumstances requirement is the elimination of all competition in the relevant market. Here the allegedly dominant undertaking has granted licences and is not the only player in the market. It is not sufficient for VIA to say that Intel and its licensees are less innovative than VIA for it to overcome this hurdle.”). The judgment was overturned on appeal, but the correctness of Mr. Justice Collins’ conclusion on this issue was not cast in doubt.

arrangements to establish joint or reciprocal operations. In these circumstances, third parties may find that they cannot do business with the companies involved, or that they can do so only on less favourable terms than those given by the parties to one another or to the joint venture. The question therefore arises whether the parties should be entitled to refuse to do business with third parties, or entitled to give third parties less favourable terms than they give to one another.

This area of law is primarily the province of Article 81 EC, since there will typically be agreements between the joint venture or consortia members. Thus, in granting an individual exemption under Article 81 EC for such arrangements, the Commission has routinely considered whether the joint venture parties should grant competitors non-discriminatory terms when, if they were not so required, the parties would be in a position to eliminate competition in respect of a "substantial" part of the products concerned either by refusing to supply competitors or by supplying them only on substantially less favourable terms.<sup>203</sup> The same general principles applies in respect of standard setting organisations, where the Commission has routinely insisted on equal access to the standardised technology for non-members.<sup>204</sup>

Substantially the same principles apply under Article 82 EC, since the decisions and cases under Article 81 EC are most analogous to situations in which the joint venture owning the essential facility is in a dominant position. The fact that the users are also shareholders does not significantly alter the legal or economic position. Accordingly, the duty of a group of collectively dominant companies that own or control essential infrastructure or assets not to discriminate against non-member rivals is higher than in the case of a single firm owning such a facility.<sup>205</sup> This distinction reflects the fact that a group of competitors acting in concert in such circumstances can achieve a monopoly not by developing better quality products but through the joint acquisition or amalgamation of assets, which is in principle treated much more strictly under competition law. Imposing a duty to deal on a multi-firm combination is also much easier to administer, since the combination will already be admitting several independent undertakings and their terms of access provide a benchmark for additional undertakings. Multi-firm combinations controlling essential facilities are therefore likely to have a non-discrimination duty towards rivals, assuming of course that all other conditions for a duty to deal are satisfied.

The above principles have generally been applied by the Community institutions in the case of jointly-owned facilities. This was in essence the rationale behind the *European Night Services* case, although, on the facts, the Court of First Instance overturned the Commission's conclusion that a non-discrimination duty should apply,<sup>206</sup> since the infrastructure in question was not an essential facility.<sup>207</sup> Similarly, in the cases involving airline computer reservation systems, the two major systems were jointly owned by several European airlines.<sup>208</sup> The airlines were also users of both facilities and some of them were dominant in their national markets. In these circumstances, they each had duties not to discriminate in favour of the system in which they were shareholders.

<sup>203</sup> See, e.g., *IGR Stereo Television-Salora*, XIth Competition Policy Report (1981) p 63 ; *DHL International*, XXIst Report on Competition Policy (1991), para. 88, *Eirpage*, OJ [1993] L 306/22, para. 20; *Infonet*, XXIInd Report on Competition Policy (1993), p.416, *EBU-Eurovision*, OJ [1993] L 179/23, Art. 2; *BT-MCI*, OJ [1994] L 223/36, para. 57; *ACI*, OJ [1994] L 224/28, Art. 2; *European Night Services*, OJ [1994] L 259/20, Art. 2; *Gas Interconnector*, XXVth Competition Policy Report (1996), para. 82, *Atlas-Phoenix-Global One*, OJ [1996] L 239/23; *Unisource-Uniworld*, OJ [1997] L 318/1; and *British Interactive Broadcasting*, OJ [1999] L 312/1.

<sup>204</sup> See Dolmans, "Standards For Standards," 26 *Fordham International Law Journal* 163 (2002), 163, 171-174 (Commission generally insists on open and non-discriminatory access for non-members as a condition for exemption under Article 81(3) EC).

<sup>205</sup> See Areeda, "Essential Facilities: An Epithet In Need Of Limiting Principles," 58 *Antitrust L. Jour.*, 841, at 843.

<sup>206</sup> See *Night Services*, OJ [1994] L 259/20, Article 2.

<sup>207</sup> See *European Night Services*, above note 3, para. 207.

<sup>208</sup> See *London European/Sabena* and *Amadeus Sabre*, above note 58.

A second possible exception concerns the abusive refusal to supply essential interoperability information or other abuses that rest on a similar non-discrimination theory. In *Microsoft*, the duty to deal with all comers appears to have been motivated by the Commission's conclusion that the refusal to share interoperability information discriminated against rivals and denied work group server operators the ability to compete on an equal playing field. In this circumstance, the basis for the remedy was itself a discriminatory refusal to deal and the Commission may have felt that consumer welfare was best served by ending the discrimination and allowing the market to decide which products they prefer on the basis of quality and price rather than arbitrarily selecting *ex ante* which licensees would contribute most to the competitive process. This implies that a duty to deal with all comers is only justified where the constituent element of the refusal to deal involves discrimination against rivals and unfairly impairing the quality of their products.

## **8.5. THE DOMINANT FIRM'S DUTY TO DEAL WITH CUSTOMERS UNDER ARTICLE 82 EC**

**Overview.** The preceding sections dealt with the circumstances in which a dominant firm competes with downstream rivals and refuses to make first or subsequent contracts with those rivals. In exceptional circumstances, such conduct may violate Article 82(b), the clause dealing with unlawful foreclosure under Article 82 EC. Somewhat different considerations apply where the dominant firm is not present on the downstream market but is simply active in the supply of inputs or final products to customers. In this situation, a duty to deal can only arise under Article 82(c), which prevents a dominant firm from applying dissimilar conditions to equivalent transactions absent objective justification.

A number of legal issues arise. The first is whether and in what circumstances the non-discrimination clause in Article 82(c) obliges a dominant firm to deal with a subsequent customer in circumstances in which it has already granted a first contract to one customer. (If there is no first contract, there can be no discrimination.) The second concerns situations in which the product supplied by the dominant firm is not an input used for transformation, but is a final product for distribution or resale. Case law indicates that it may be an abuse to terminate dealings with distributors or resellers, but the precise rationale for this conclusion has not been clearly articulated. The final situation concerns the special case of parallel trade and whether unilateral output restrictions by a dominant firm of the quantities supplied to parallel traders constitutes an abuse. Each of these situations involving potential duties to deal with downstream trading parties is considered below.

### **8.5.1 The Duty To Grant Subsequent Contracts Under Article 82(c)**

**Duty to deal with customers analogous to the duty to deal with rivals.** Section 8.4.3. clarified that a dominant firm cannot be obliged to grant a subsequent contract to a competitor under Article 82(b) merely because, in denying a licence, it would be discriminating against the rival under Article 82(c). The correct principle is that a subsequent licence to a rival should only be granted where the conditions for the first licence are satisfied. In effect, therefore, discrimination against rivals in this instance falls to be assessed as an issue of foreclosure under Article 82(b) rather than an issue of discrimination as such. Discrimination under Article 82(c) is, however, relevant where the dominant firm is not active in the downstream market, but has already granted one contract to a downstream customer and another customer insists on a subsequent contract. In other words, the legal issue arises whether and under what conditions a dominant firm can be obliged to grant a subsequent contract to undertakings with whom it does not compete in circumstances where it has already granted one contract.

The application of Article 82(c) in this situation is subject to a number of pre-conditions. In the first place, only Article 82(c) applies where the dominant firm is not active in the downstream market in which the input is said to be essential for competition. If the dominant firm is active, its customers are also its rivals and the principles of unlawful foreclosure under Article 82(b) apply. Further, if the dominant firm is not active in the downstream market, it cannot be obliged to grant a first contract to any undertaking. This was the conclusion reached in *Ladbroke*, where the absence of the dominant firm from the downstream market justified the refusal to deal. It follows from this that the duty to deal under Article 82(c) only arises where the dominant firm has already granted a first voluntary

---

contract. The real issue, therefore, is how many further contracts the dominant firm can be obliged to grant to customers under Article 82(c).

The number of contracts that a dominant firm may be required to grant to customers under Article 82(c) has not formally arisen in the decisional practice and case law. A number of principles nonetheless seem reasonably clear.<sup>209</sup> First, the conditions of Article 82(c) must obviously be satisfied. These are discussed in detail in Chapter Five (Abusive Discrimination), but, may be briefly summarised as follows. The situation of the first and subsequent customers must be “equivalent” from the perspective of the dominant firm and the customers. There must also be discrimination, either in the sense that the dominant firm refuses to deal outright with further customers or deals on discriminatory terms that in effect amount to a refusal to deal. Finally, and crucially, the second or subsequent customers must suffer a competitive disadvantage in relation to the first customer, which requires that the customers compete with each other. Unless all of these cumulative conditions are present, Article 82(c) cannot apply.

Second, the fact that the dominant firm has concluded one contract with a customer should not lead to a duty to deal with any subsequent party that makes a request. Otherwise, the dominant firm would be seriously discouraged from making a first contract. The value of any first contract might also need to be renegotiated if the decision to grant one contract would oblige the dominant firm to make others, which would increase transaction costs. These considerations apply *a fortiori* in the case of IP rights, since the value of a first licence would be directly affected by any subsequent licences. The dominant firm remains entitled, as a general matter, to exercise the prerogatives of any property owner and to organise its dealings with downstream trading parties in the manner that it considers most useful. It is true that the objections to a duty to deal with additional downstream customers in circumstances where the dominant firm already deals with at least one customer are less strong than in the case in which a dominant firm is obliged to deal with a direct rival. But this should not at the same time mean that the dominant firm’s property rights cease to have any meaningful content.

Finally, the key issue in refusal to deal involving customers concerns the objective justification for the refusal to deal with further customers. A dominant firm must always have some reason to refuse to make a profitable deal. In the case of refusal to deal with customers, the self-interest of the dominant firm to avoid direct competition is not present to the same extent or at all as it is in the case of refusals to deal with rivals. At a minimum, the categories of objective justification available in the case of refusal to deal with rivals should also be open to the dominant firm in the case of refusal to deal with additional customers. In addition, there will be specific defence available to the dominant firm in the case of refusal to deal with customers. The most obvious additional defence is that the dominant firm has made an exclusive contract with the first customer and does not wish to undermine the value of that contract and any efficiencies that justified it by making further contracts. In other words, if the dominant firm could lawfully make the contract with the first customer exclusive, the refusal to deal with further customers must be lawful too.

One unresolved issue is whether a duty to grant a subsequent contract to a customer is also subject to the condition that the product in question is essential for competition or whether the mere fact of discrimination suffices. The former interpretation is preferable. After all, the only real difference between the situations involving a duty to deal with rivals under Article 82(b) and a duty to deal with customers under Article 82(c) is that, in the latter case, the dominant firm considers it more efficient to operate through independent undertakings than to partially integrate. If the inputs that the dominant firm owns or controls are essential for downstream competition, and the other additional elements for an abusive refusal to deal are present, the effect of a refusal on the downstream market is likely to be similar in each case. This implies that the legal principles for ordering access should be similar too. A second or subsequent customer would therefore need to show an abuse capable of justifying the grant of a compulsory contract; in other words, that the conditions for a compulsory first contract are met and that a further contract is still needed to prevent serious anti-competitive effects on the downstream market in which the dominant firm’s input is essential for competition. The fact that one

---

<sup>209</sup> See generally Temple Lang, “Anticompetitive Abuses Under Article 82 EC Involving Intellectual Property Rights,” in Ehlermann & Atanasiu (eds.) *European Competition Law Annual 2003: What Is an Abuse of Dominant Position?* (Hart Publishing Oxford (2005)).

contract had already been concluded by the dominant firm would also mean that subsequent contracting parties face a higher hurdle: they would need to show that the downstream market remains uncompetitive following the grant of a first contract, as well as satisfying all the other conditions for the award of a first contract. The mere fact of discrimination would not suffice.

There is some support for the above interpretation in the recent *Clearstream* decision. Clearstream, a dominant supplier of so-called primary clearing and settlement services for securities issued under German law, was found to have unlawfully refused to supply such services to Euroclear, an intermediary for so-called secondary clearing and settlement services. The primary and secondary clearing and settlement services at issue in the decision were different activities, with the result that Euroclear was a customer of Clearstream's, not a direct competitor. The Commission found that the primary clearing and settlement services offered by Clearstream were an essential facility, since they could not be practically or economically replicated by Euroclear, and that Clearstream, as a *de facto* monopoly provider of the relevant services, had a duty to make them available to Euroclear. The Commission also found that Clearstream had discriminated against Euroclear, contrary to Article 82(c), by supplying access to the relevant services to other customers immediately upon request. Importantly, however, the Commission did not treat the issue of discrimination as a stand-alone infringement, but concluded that it was part of the overall refusal to supply the essential facility clearing services.<sup>210</sup> This suggests that the legal duty to deal with subsequent customers has been assimilated with the principles regarding first contracts, i.e., essential facilities. This interpretation makes sense, since the law on refusal to deal would then be subject to a single, unified set of principles.

### 8.5.2 Refusals To Deal Arising At The Level Of Distribution Or Resale

**Essential facility principles generally inapplicable.** The previous sections concerned the duty of a dominant firm controlling an essential upstream input to deal with undertakings that transform the input into a final product sold on a downstream market. Different principles apply where the refusal to deal does not concern an upstream input that is transformed by rivals or customers, but where the product in question is used only for distribution or resale. The essential facilities analogue outlined in the preceding sections does not generally apply in the case of refusals to deal arising at the level of distribution or resale.<sup>211</sup> This is because the essential facility principles only apply where there is scope for value-added competition,<sup>212</sup> which is usually only possible in the case of inputs used for transformation into a final product. In the case of physical property, the requesting party uses the essential input to offer a final product or service downstream. In the case of IP, the input is essential to offer a new kind of product. The essential facility principle therefore assumes that firms can increase competition by adding value to the input or by offering differentiated products.

The same rationale does not apply in the context of a distribution or resale, since downstream trading parties are merely reselling the dominant firm's product. There is no scope for meaningful competition between a dominant supplier and its distributors/retailers where the latter merely engage in resale or distribution. If companies, all of which are using the same facility, can do little more than sell the result to consumers with substantially the same format and price (which will be governed by the access charges that competitors pay to the owner of the facility). Put differently, if there is no meaningful competition worth protecting between a dominant firm and its distributors and/or resellers, there is no harm under competition law resulting from a refusal to deal.

Another reason why the essential facility principles do not apply in the context of distribution and resale is that the injury to competition through a refusal to deal can be no greater than if the dominant firm forward integrates. The only "harm" therefore is one integrated firm supplies the same quantity

<sup>210</sup> See *Clearstream*, above note 53, para. 222.

<sup>211</sup> See, e.g., Commission submission in the OECD Paper, above note 136, p 98 ("[T]he rules about the duty to supply downstream competitors do not apply to distributors since a refusal to supply a particular distributor does not have a significant effect on competition.").

<sup>212</sup> See Temple Lang, above note 65 at 375 ("[A] condition of the essential facilities principle is that the downstream activities must constitute a real market involving added value services: if it is merely distribution or resale of products produced upstream, there is not enough competition to protect....").

of products that were previously supplied by two independent firms. Such “harm” has no necessary connection with harm to competition. This principle was confirmed by *Filtrona/Tabacalera*.<sup>213</sup> *Filtrona* argued that *Tabacalera* had abused its dominant position as a purchaser of cigarette filters in the Spanish cigarette market by increasing its own production of ordinary cigarette filters from 44% to 100% of its own requirements, thereby discontinuing its purchases from *Filtrona*. The Commission held that: (1) a company’s production of its own requirements is not in itself an abnormal act of competition (production by cigarette manufacturers of their own filters is common practice in the industry); (2) *Tabacalera*’s decision was justified on economic grounds, in particular because it enabled it to achieve economies of scale and generally to reduce production costs; and (3) no special circumstances suggested that *Tabacalera*’s decision was part of an abusive behaviour or strategy. The case thus confirms that vertical integration without anti-competitive purpose is not abusive even if the effect is that a dominant firm ends a previous course of dealings with an existing customer.

**The rationale for the decisional practice and case law requiring a duty to deal in the context of distribution or resale.** A small number of decisions under Article 82 EC have found that it may be an abuse for a dominant firm to refuse to deal with downstream distributors or resellers. The first case *United Brands*.<sup>214</sup> The Court of Justice held that it was abusive for a dominant supplier to terminate supplies to a distributor, *Oelsen*, on the grounds that the distributor had participated in an advertising campaign for a competitor of the supplier. The Court seemed to elaborate a more general principle to the effect that a dominant firm “cannot stop supplying a long standing customer who abides by regular commercial practice, if the orders placed by that customer are in no way out of the ordinary.”<sup>215</sup> However, it later tempered that statement by stating that the refusal should have a possible consequence that “it might in the end eliminate a trading party from the relevant market” and that the dominant firm can always take reasonable steps to protect its commercial interests.<sup>216</sup>

Later, in *Boosey & Hawkes*,<sup>217</sup> the Commission clarified further the circumstances in which a dominant firm is entitled to refuse to continue to deal with existing customers. *Boosey & Hawkes* refused all further supplies to a customer who had transferred its central activity to the promotion of a competing brand of musical instruments. An important evidentiary point in this connection was that *Boosey & Hawkes* had embarked on a plan to exclude the competitive threat from that rival and that the refusal to supply the customer was part of that plan.<sup>218</sup> While the Commission found that the sudden and complete termination of supplies was, on the facts, disproportionate, it confirmed that a dominant firm can lawfully terminate relations with reasonable notice and that there is no obligation on a dominant firm to subsidize competition to itself.<sup>219</sup>

“There is no obligation placed on a dominant producer to subsidise competition to itself. In the case where a customer transfers its central activity to the promotion of a competing brand it may be that even a dominant producer is entitled to review its commercial relations with that customer and on giving adequate notice terminate any special relationship.”

Although it seems reasonably clear that the essential facility analogue under Article 82 EC does not apply in the case of mere distribution or resale, the rationale for the above decisions and case law remains unclear. A number of different approaches might be considered. The first approach is to argue that the dominant firm has a duty to deal where the refusal to do so would eliminate the trading party from the market. This is not, however, a useful legal principle. The mere fact that a trading party exits the market has no necessary connection with effects on competition. If this were accepted, a dominant firm would commit an abuse each time that it forward integrated, which the Commission has rejected in *Filtrona/Tabacalera*. The law would also be reduced to happenstance in this

<sup>213</sup> XVIVth Report on Competition Policy (1989), point 61.

<sup>214</sup> Case 27/76 *United Brands* [1978] ECR 207.

<sup>215</sup> *Ibid.*, para. 182.

<sup>216</sup> *Ibid.*, para. 183, 189.

<sup>217</sup> *BBI/Boosey & Hawkes*, OJ 1987 L 286/36.

<sup>218</sup> *Ibid.*, para. 19.

<sup>219</sup> *Ibid.*

circumstance, since abuses could be found if the distributor or retailer was particularly small or inefficient. This approach also ignores the many situations under EC competition law in which a firm is entitled to limit the number of its trading parties through exclusive or selective distribution arrangements.

A second approach is to argue that the dominant firm must behave in a proportionate manner and should not suddenly terminate a trading party that has established a long-standing relationship or some other form of dependence on it. But this principle fares no better than the first. It would have the perverse consequence that a dominant firm could never safely terminate an exclusive distribution arrangement. Issues of dependence are better dealt with under contract law or national laws that protect situations of “economic dependence” in distribution arrangements. The fact that Council Regulation 1/2003 expressly permits national laws to adopt stricter or different standards to Article 82 EC further bolsters this argument. If a particular category of trading party is considered to be vulnerable by the Community institutions, the proper course would be to adopt legislation requiring certain minimum obligations upon termination, as occurred in the case of commercial agents.<sup>220</sup> The use of general competition laws to protect categories of distributors or retailers considered to be dependent on large manufacturers should be avoided.

The final and correct approach is to treat decisions such as *United Brands* and *Boosey & Hawkes* as situations in which the dominant firm is trying to impair rivals’ competitiveness by denying them access to distribution: the refusal to supply *indirectly* has the object or effect of foreclosing a rival of the dominant firm.<sup>221</sup> In both *United Brands* and *Boosey & Hawkes*, the dominant firm only refused to deal because the customer had either started selling a competing brand (*Boosey & Hawkes*) or was engaged in promotional activities for a competitor (*United Brands*). Although the contract between the dominant firm and the customer was not exclusive in nature, the dominant firm could, in effect, insist on exclusivity by threatening the withdrawal of supplies in the event that the customer dealt with a competitor. Thus, by insisting that customers should only deal with the dominant firm, this “might in the end eliminate a [competitor] from the relevant market.”<sup>222</sup>

Under this approach, it is only access to distribution that could be regarded as “essential,” and not the products supplied by the dominant firm for resale. The most appropriate analogy therefore would be the distribution network at issue in *Bronner*. Whether an abuse arises would involve consideration of a number of factors. As a preliminary matter, it should be determined whether there is dominance at the level of distribution in the sense that the dominant firm controls the majority of actual or potential distribution outlets. The range of distribution options available to rivals would need to be assessed, including self-distribution. Second, it would need to be determined whether the denial of distribution outlets to rivals was likely to have a material effect on competition in the relevant final product market.<sup>223</sup> If the downstream market is reasonably competitive, there may be no reason to order the dominant firm to allow its distributors to deal with rival products. Finally, the issue of objective justification should be considered. In particular, the Commission has confirmed in *Boosey & Hawkes*, that it may, with reasonable notice, be legitimate for the dominant firm to terminate relations with a customer who transfers its main activity to dealing in competing products. A genuine conflict of interest should always be a defence.

### 8.5.3 Refusal to deal and parallel trade

**No presumption of abuse.** Although no general duty to deal arises in the context of distribution and resale, the overriding importance of the integration of the single market under the EC Treaty raises the

<sup>220</sup> See Council Directive of 18 December 1986 on the coordination of the laws of the Member State relating to self-employed commercial agents, OJ [1986] L382/17.

<sup>221</sup> See Subiotto & O’Donoghue, above note 181, at 688.

<sup>222</sup> *United Brands*, above note 214, para. 183.

<sup>223</sup> See, e.g., Case T-65/98, *Van den Bergh Foods Ltd v Commission*, [2003] ECR II-000 (control over approximately 40% of available distribution outlets was considered, on the facts, to have a material adverse effect on the downstream market). For a discussion of the treatment of exclusivity requirements under Article 82 EC, see Chapter Seven

legal issue whether a refusal to deal by a dominant firm with undertakings engaged in arbitrage (or parallel trade) within the EU can be considered an abuse. It is well established that an agreement between two or more undertakings with the object or effect of limiting parallel trade within the EU constitutes a restriction of competition.<sup>224</sup> Agreements that limit parallel trade from non-Member States to the EU may also, in certain circumstances, violate Article 81 EC.<sup>225</sup>

No such general principle applies, however, in respect of unilateral action under Article 82 EC, even if such action results in a reduction of the volume of products sold for parallel trade. In the first place, an agreement between two independent undertakings to act in concert in respect of limiting parallel trade is different in nature from the unilateral decision by a firm, including a dominant firm, to decide with whom it will deal and for which quantities. The fact that, in some general sense, the practical effect of the refusal to supply *resembles* a violation of Article 81 EC does not automatically mean that there has been a violation of Article 82 EC.<sup>226</sup> Similarly, the fact that a dominant firm's unilateral decisions produce effects that it could not bring about by agreements, and which might be contrary to Article 81 EC if they were agreed between two undertakings, should not render its conduct abusive.

Second, a dominant firm's freedom of contract, its right to dispose of its property in the manner it sees fit, and the right to optimise its commercial interests carry great weight.<sup>227</sup> In the most extreme case, a dominant firm could withdraw its products entirely from a market where its profits were eroded by parallel trade, which the Community Courts have held would be lawful, even if it would, obviously, eliminate the scope for parallel trade.<sup>228</sup> A dominant firm is *a fortiori* entitled to take other reasonable measures to protect its profitability and that of its distributors in the importing Member State. Finally, there is no general duty under Article 82 EC to deal. As with any duty of forced dealing, it can only be imposed "only after a close scrutiny of the factual and economic context, and even then only within somewhat narrow limits."<sup>229</sup>

A refusal to deal in the context of parallel trade may, however, be abusive in certain circumstances. In particular, an intention to limit parallel trade may render abusive a refusal of supply by a dominant undertaking, since it is normally aimed at removing a source of competition from the dominant undertaking on the market in the Member State of import, i.e., competition from arbitrage. For example, a refusal to deal with parallel traders that was discriminatory and resulted in the imposition of excessive prices by the dominant firm in the Member State of destination of the imported products may be an abuse.<sup>230</sup> Even assuming that a sufficient effect on competition could not in all cases be shown, an additional argument can be made in support of such a conclusion on the basis of the

<sup>224</sup> See, e.g., Case C-279/87 *Tipp-Ex v Commission* [1990] ECR I-261, para. 22 and Case 19/77 *Miller v Commission* [1978] ECR 131, para. 7.

<sup>225</sup> See, e.g., Case C-306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA* [1998] ECR-I-1983.

<sup>226</sup> See Opinion of Advocate General Jacobs in *SYFAIT*, above note [ ], para. 53. See also Joined Cases C-2/01 P and C-3/01 P *Bundesverband der Arzneimittel-Importeure eV and Commission v Bayer*, [2004] ECR I-nyr, para. 87 ("[T]he mere fact that the unilateral policy of quotas implemented by Bayer, combined with the national requirements on the wholesalers to offer a full product range, produces the same effect as an export ban does not mean that the manufacturer imposed such a ban or that there was an agreement prohibited by Article 81(1) of the EC Treaty."). *A contrario*, the mere fact that unilateral conduct has effects similar to an Article 81 violation does not prove an abuse.

<sup>227</sup> *SYFAIT*, above note 118, para. 67.

<sup>228</sup> See Case C-249/88 *Commission v. Belgium* [1991] ECR I-1275, para. 20 ("As the Belgian Government rightly observes, differences in the price of the same product, from one Member State to another, may be accounted for by the commercial strategy of the manufacturing undertaking, and a hindrance to imports may not be inferred from the mere fact that an undertaking abandons the marketing of a given product on the market of a Member State on the ground that the maximum price imposed on it is inadequate. It may be observed, for example, that, in order to avoid parallel exports, an undertaking may have an interest in not marketing its products in a Member State at a price which it considers to be insufficient").

<sup>229</sup> *SYFAIT*, above note 118.

<sup>230</sup> See Case T-198/98 *Micro Leader Business v Commission* [1999] ECR II-3989.

market-partitioning object of the conduct at issue.<sup>231</sup> The Commission has relied in the past on clear evidence of threats to terminate distributors as punishment for export activity and, in some cases, on actual implementation of threats.<sup>232</sup> Contractual restrictions that seek to limit or prevent the scope for arbitrage may also be abusive. In *United Brands*, a key feature of the abuse was that the dominant firm prevented trade in bananas by prohibiting the sale of green bananas (yellow bananas would deteriorate too quickly to allow transportation to other Member States). It is one thing for a dominant firm to unilaterally decide that it will not sell to undertakings engaged in parallel trade, but quite another to agree a contractual restriction with another party specifically intended to prevent all parallel trade.

**The special case of pharmaceuticals.** Refusal to deal in the context of parallel trade has arisen most frequently in the pharmaceutical sector. Several characteristics of this industry create scope for parallel trade.<sup>233</sup> First, most Member States control prices of prescription medicines through extensive national regulation. Different mechanisms are used to set and control prices, including direct price controls, profit caps, negotiated prices, agreed reimbursement rates, and reference pricing, i.e., when prices are set by reference to prices in other Member States and internal reference pricing where the price would be based on groupings of supposedly similar products in that Member State. Large disparities in the prices of medicinal products in the Member States are engendered by the differences existing between the state mechanisms for fixing prices and the rules for reimbursement.<sup>234</sup>

Second, even where pharmaceutical manufacturers retain some residual discretion in setting launch prices, differences in national wealth and health budgets between Member States may require manufacturers to engage in price discrimination.<sup>235</sup> As a result, price differentials for the same product between Member States may be as high as 70% in some cases.<sup>236</sup> Price discrimination is generally efficient when it leads to higher output than would occur if the seller charged a uniform price to all buyers.<sup>237</sup> Efficiencies result primarily from the fact that buyers willing to pay less than the uniform price would still receive the product, whereas, in the case of a uniform price, they would not.

Finally, pharmaceutical wholesalers must hold an adequate range of products to meet the requirements of a specific area. They must also be able to deliver requested supplies within a short time.<sup>238</sup> Member States may specify certain minimum obligations in this connection on holders of distribution licenses. This creates certain obligations on manufacturers to supply wholesalers with minimum

<sup>231</sup> *SYFAIT*, above note 118, para. 70.

<sup>232</sup> See, e.g., *Tipp-Ex* (OJ 1987 L 222/1 – evidence and implementation of threats); *John Deere* (OJ 1985 L 35/38 – evidence of threats); *Sperry New Holland* (OJ 1985 L 376/21 – reduction and termination of supplies); *Konica* (OJ 1988 L 78/34 – evidence of threats); and *Johnson and Johnson* (OJ 1980 L 377/16 – evidence of threats).

<sup>233</sup> See OECD report on *Competition And Regulation Issues In The Pharmaceutical Sector* (2000), available at <http://www.oecd.org/dataoecd/35/35/1920540.pdf>.

<sup>234</sup> *SYFAIT*, above note 118, paras 77-79.

<sup>235</sup> Economic conditions between the former 15 EC Member States and recently-acceded Member States vary significantly. The acceding countries account for approximately 8.5 per cent of the GDP generated by the EU 15, with a GDP per capita ranging between 69% (Slovenia) and 42% (Estonia). See *Eurostat Yearbook 2002* (Chs 3 and 6) and the Commission's Strategy Paper *Towards the Enlarged Union*, COM (2002) 700 final.

<sup>236</sup> See Towse, *What are the short and long run implications for the UK of parallel trade in pharmaceuticals?*, Working Paper, London, Office of Health Economics, 1-20.

<sup>237</sup> See Chapter Seven for a review of the economics of price discrimination. See generally Schmalensee, "Output and welfare implications of monopolistic third-degree price discrimination," (1981) *American Economic Review*, vol. 71, pp. 242-247; Schwartz, "Third-degree price discrimination and output: Generalizing a welfare result," *American Economic Review*, (1990) vol. 80, pp. 1259-1262; and Varian, "Price discrimination and social welfare," (1985) *American Economic Review*, vol. 75, pp. 870-875.

<sup>238</sup> See Council Directive 2001/83 on the Community code relating to medicinal products for human use (OJ 2001 L 311/67 (as amended by Directive 2004/27 of the European Parliament and of the Council (OJ 2004 L 136/34) (together, "Directive 2001/83")), Article 1(18).

stocks of medicines for the domestic market.

The above factors create an environment which offers scope for profitable arbitrage between Member States. Large disparities in price caused by national price legislation and price discrimination are relied upon wholesaler arbitragers who export pharmaceutical products from lower price countries to higher price countries, leading to a considerable growth in parallel trade in pharmaceutical products.<sup>239</sup> The impact of parallel trade on consumer welfare varies between the short and long term. In the short term, there is obviously some net gain to consumers in the form of lower prices from increased intra-brand and inter-brand competition. For this reason, a number of Member States stipulate the use of a certain minimum percentage of parallel trade products by prescribing doctors where available. Because of reimbursement schemes for most medicines, however, the parallel trader has little incentive to pass the full benefit of the lower-priced product onto the final consumer. The most likely outcome therefore is that parallel traders, not consumers, benefit most from parallel trade.<sup>240</sup>

In the long term, pharmaceutical manufacturers argue that consumers suffer a significant net loss through parallel trade.<sup>241</sup> They say that parallel trade from low-priced to high-priced countries forces average prices down towards marginal cost and that pricing at or near marginal cost in a handful of countries can suffice to make average prices worldwide inadequate to cover the fixed cost of research and development. In the long run, a manufacturer faced with such a scenario might decide to reduce certain research and development on future products. This is exacerbated by the existence of national price controls, since one effect of parallel trade is to export the price regulation of the low-priced country to the high-priced country, which, again, may confiscate research and development expenditure from the manufacturer.<sup>242</sup>

Decisions at national and EU level have sought to grapple with these competing considerations, with mixed results.<sup>243</sup> The issue has now been determined in *SYFAIT*, which concerned the reduction by a pharmaceutical manufacturer operating in Greece of quantities supplied for parallel trade by Greek wholesalers. The Advocate General was sympathetic to the view that the pharmaceutical industry's specific characteristics justified the refusal by a dominant manufacturer to supply products for parallel trade. Among the factors mentioned by the Advocate General were: (1) that parallel trade is mainly the result of disparities in national price regulation; (2) that consumers may not always benefit from parallel trade; and (3) the need for manufacturers to recover their high fixed costs for research and development. These special features offered were considered by the Advocate General to constitute objective justification for a refusal to deal with parallel traders and, moreover, he considered it "highly unlikely" that the same features would be present in any other industry.<sup>244</sup>

---

<sup>239</sup> By 2004, before any possible impact from EU accession, parallel imports accounted for 5% or more of total EU sales of pharmaceuticals (20% in the UK) and, for some products, parallel trade represented more than half of sales in major markets. See Kanavos, Costa-i-Font, Merkur, & Gemmill, "The economic impact of pharmaceutical parallel trade in European Union Member States: A stakeholder analysis," Special Research Paper (2004), *LSE Health & Social Care*.

<sup>240</sup> In 1998, the Commission stated that "parallel trade creates inefficiencies because most, if not all, of the financial benefit accrues to the parallel trader rather than to the health care system or patient." See Commission Communication on the Single Market in Pharmaceuticals, COM (1998) 588.

<sup>241</sup> See, e.g., Danzon & Towse, *Differential Pricing for Pharmaceuticals: Reconciling Access, R&D and Patents*, AEI-Brookings Joint Center Working Paper No. 03-7 (July 2003), at 13-14 ("Although consumers in the initially high price country may appear to benefit from lower prices under a uniform price policy, in the long run these consumers are worse off if these low prices result in lower expected returns to R&D and hence fewer new medicines than they would have been willing to pay for, had differential pricing been feasible.").

<sup>242</sup> See Venit & Rey, "Parallel Trade and Pharmaceuticals: A Policy in Search of Itself," *European Law Review*, 153 (2004).

<sup>243</sup> For a detailed review of national decisions and judgments on refusal to deal and parallel trade in pharmaceuticals, see European Federation of Pharmaceutical Industries and Associations (EFPIA), *Article 82 EC: Can It Be Applied To Control Sales By Pharmaceutical Manufacturers To Wholesalers?*, Research Paper, November 2004, available at [http://www.efpia.org/6\\_publ/default.htm](http://www.efpia.org/6_publ/default.htm).

<sup>244</sup> See Opinion of Advocate General Jacobs in *SYFAIT*, above note 118, para. 53.

It is not clear, however, why the considerations relied upon by the Advocate General render the pharmaceutical industry unique in comparison to other industries. The first reason – the existence of national price regulation – has generally been found to be irrelevant by the Community Courts.<sup>245</sup> A number of other government measures may have a similar determinative influence on the scope for arbitrage. For example, the majority of the cost to consumers for motor fuel and motor vehicles is comprised of government taxes. Variations in these taxes may have a decisive influence on whether arbitrage is possible.

The second reason – that consumers in the importing state do not necessarily receive the benefit of the lower price – also seems inconclusive. A violation of Article 82 EC cannot depend on estimates of how much money the dominant firm would lose if it had to supply a given extra quantity, or even by comparing that amount with the benefit to consumers in the importing Member State. The concept of an abuse is objective: it does not depend on an assessment of whether a particular seller would make more or less money in its unilateral decisions to sell to third parties. Furthermore, it would be unsatisfactory if intervention under competition law depended on whether conduct would result in increased consumer welfare more than it reduces the seller's profits. Such a rule could not easily be applied by the dominant firm at the time it formulates its supply decisions, since much of the information that affects the net benefit to consumers will depend on supervening events (e.g., government decisions on prices and reimbursement rates, exchange rates etc.).

Finally, the cost structure of the pharmaceutical industry is far from unique in comparison to other industries that require large, risky capital costs (e.g., telecommunications). In other words, while the Advocate General's conclusion in respect of the pharmaceutical industry was clearly correct, his opinion should not preclude *a priori* a similar analysis in other industries that have some or all of the features relied upon by the Advocate General.

**Problems with administering a duty to deal in the case of all parallel trade.** One factor not mentioned by the Advocate General, but which arguably justifies treating virtually all straightforward refusals to deal in the context of parallel trade as lawful, concerns the difficulties of administering a rule that treats a unilateral refusal to deal as unlawful in certain circumstances.<sup>246</sup> Any principle of law which says that it would be abusive for a dominant firm to refuse to supply customers with additional quantities, or to reduce existing quantities supplied, on the basis that the customer intended to export them could raise significant implementation difficulties and produce surprising results. The effect may be that the legality of the same act would depend on whether the customer intended to export or not. A rule of law based on such a statement of intention would likely be precarious. All customers could declare an intention to export, regardless of their true intention, so as to have a claim to all quantities ordered. The fulfilment of their declaration could not be guaranteed. Customers having failed to express such an intention would open themselves to the possibility of not receiving all the quantities ordered. In short, it is questionable whether such a rule would be compatible with principles of legal certainty.

## 8.6 A DUTY TO DEAL AS A REMEDY FOR OTHER ABUSIVE CONDUCT

**The remedy principle.** The preceding sections deal with the limited circumstances in which the refusal by a dominant firm to deal constitutes a substantive violation of Article 82 EC. A related, but different set of principles concern the circumstances in which a duty to deal is a necessary and proportionate *remedy* for another abuse.<sup>247</sup> Under the EC Merger Regulation, the Commission has

<sup>245</sup> See, e.g., Joined Cases C-267/95 and C-268/95 *Merck v Primecrown* [1996] ECR I-6285, para. 47 (“It is a matter of no significance that there exist, as between the exporting and importing Member State, price differences resulting from governmental measures adopted in the exporting state with a view to controlling the price of the product.”). See also Case C-436/93 *Bristol Myers Squibb v Paranova A/S* [1996] ECR I-3457, para. 46, and Case 16/74 *Centrafarm BV and De Peijper v Winthrop BV* [1974] ECR 1183, paras. 15-17.

<sup>246</sup> See Subiotto & O'Donoghue, above note 181, at 692.

<sup>247</sup> See Temple Lang, “Mandating Access: The Principles And The Problems In Intellectual Property Law And Competition Policy,” [2004] *European Business Law Review*, 1089, 1103.

routinely accepted licensing remedies under the EC as an alternative to divestiture or the outright prohibition of the merger.<sup>248</sup> That possibility also exists under Article 82 EC. The power to impose a duty to deal as a remedy for another abuse is consistent with Article 7(1) of Council Regulation 1/2003, which allows the Commission to take any necessary behavioural or structural remedies to bring an infringement to an end. Indeed, in the first leading case on compulsory licensing, *Volvo*, the Court of Justice made clear that a compulsory licence might be a proportionate remedy where the abuse concerns excessive price charged by the IP owner for the protected product.<sup>249</sup>

The detailed application of the general principles on remedies is discussed in Chapter Fourteen, but a number of points may be noted here. In the first place, a duty to deal as a remedy for another abuse will be comparatively rare. In most cases, the primary remedy will be a cease and desist order in respect of the specific conduct at issue. It is only when an obligation to cease and desist would be less effective to prevent the abuse continuing or to restore competitive conditions that a duty to deal is a necessary and proportionate remedy. For example, in excessive pricing cases, the usual remedy is to lower the price by the amount considered to be excessive. In exceptional cases, it may be that excessive pricing would persist, or would be very difficult to detect and monitor, unless accompanied by an obligation to share the input that facilitates the anti-competitive pricing. The abuse remains the unfair pricing, but the remedy is the duty to share.

A related principle is that a duty to deal is mainly appropriate where there is evidence of an extraordinary level of market dominance, a history of past anti-competitive conduct, and persistent market resistance to change. A duty to deal as a remedy therefore suggests that the reasons that justify many of the objections to a compulsory licence no longer exist. Thus, there would need to be evidence that monitoring the dominant firm's behaviour through other remedies has been problematic in the past and that harm to consumer welfare or innovation has already occurred. In this circumstance, a court or competition authority can be more confident that any on-going harm will outweigh the alleged harm to the dominant firm's innovation incentives.

**Examples of a duty to deal as a proportionate remedy under Article 82 EC.** A duty to deal as a remedy for another abuse has arisen in relatively few cases under Article 82 EC. The decisional practice and case law seem to contemplate a number of different types of scenarios in which such a duty may be appropriate. The first situation is where there is no necessary connection between the abusive conduct and a refusal to deal, such as in the case of excessive pricing. The duty to deal is simply the most effective and proportionate remedy in this circumstance. This was in essence the situation envisaged in *Volvo*.

A second scenario is where the refusal to deal *facilitates* or makes worse other abusive conduct. An example of this is provided by *Micro Leader*.<sup>250</sup> Microsoft prohibited the importation of certain French-language software from Canada (where prices were said to be low) to Europe (where prices were said to be higher). A number of European wholesalers complained to the Commission, which found that Microsoft's actions fell within the lawful enforcement of its copyright and that there was no evidence of the wrongful exercise of that right. The Commission added, however, that an abuse might arise in circumstances where Microsoft charged lower prices on the Canadian market than on the European market for equivalent transactions, if European prices were, in addition, excessive

---

<sup>248</sup> For the treatment of licensing as a remedy under the EC Merger Regulation, see Levy, *European Merger Control Law: A Guide to the Merger Regulation* (2003) (LexisNexis) Chapter 18, at 18-06; and Drauz, "Remedies under the Merger Regulation," (1996) *Fordham Corp. L. Inst.*, 221 (Barry E. Hawk, ed., 1997), 225 ("In situations where licenses for technology are proposed as commitments, it is important to ensure that: "(a) the license would allow the licensee to overcome the major barriers or impediments to entry into the market; (b) the licensor could not undermine the license, such as by holding back technical support; (c) the licence would not facilitate collusion between the licensor and licensee, through ongoing information exchange or otherwise; (d) there would be no royalty, or a sufficiently small royalty, that it would not restrict output; and (e) the licence would not put the Commission in an overly regulatory role, such as requiring the Commission to decide the fairness of certain transactions).").

<sup>249</sup> See *Volvo*, above note 53, para. 9.

<sup>250</sup> *Micro Leader*, above note 91.

within the meaning of Article 82(a). In other words, a duty to deal might be an appropriate remedy in this instance, since the refusal to deal would in effect facilitate discrimination and excessive pricing.

A final scenario is where a refusal to deal arises in the context of an overall pattern of abusive conduct and where merely ending that pattern of conduct would not fully eliminate its on-going exclusionary effects. This is one interpretation of the compulsory licences imposed on Microsoft in the EU and the United States. In the EU, the Commission argued that Microsoft's conduct in respect of interoperability was not merely an outright refusal to deal, but concerned a "pattern of conduct" that included: (1) disclosing certain interoperability information, but not all requested information; (2) dealing with certain competitors, but not others; (3) requiring other trading parties not to deal with its workgroup server competitors; and (4) terminating past voluntary disclosures.<sup>251</sup> The consent decrees in *United States v. Microsoft Corporation* rested on a similar theory.<sup>252</sup> The District Court held that the compulsory licence was "closely connected with the theory of liability in this case and [will] further efforts to ensure that there remain no practices likely to result in monopolisation in the future."

---

<sup>251</sup> See *Microsoft*, above note 69, paras. 574-577 and paras. 578-584.

<sup>252</sup> Consent decrees available at <http://www.usdoj.gov/atr/cases/f200400/200457.pdf>. See *United States v. Microsoft Corporation* 16. 231 F. Supp.2d 144, 190 (D.D.C. 2002) (decision conditionally approving the consent decree).