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COMPETITION COMMITTEE**

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**SUMMARY RECORD OF THE 94th MEETING OF THE COMPETITION  
COMMITTEE HELD ON 1-2 JUNE 2005**

**-- Executive Summary of the Roundtable Discussion on Competition on the Merits --**

*The attached Executive Summary is an annex to the Summary Record of the meeting held on 1-2 June 2005. It is circulated to Delegates FOR INFORMATION. Delegates are requested to respond with written comments, if any, before 12 December 2005, after which, the proceedings including this Executive Summary will be distributed as a free publication.*

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## EXECUTIVE SUMMARY

*by the Secretariat*

1. Considering the discussion at the roundtable, the delegates' written submissions and the Secretariat's background paper, several key points emerge:

(1) *“Competition on the merits” is a popular but vague term. The principles underlying it and any standards that are based on it need to be clarified.*

2. The concept of “competition on the merits” is supposed to be a helpful point of reference for distinguishing unilateral conduct that is harmful to competition from unilateral conduct that enhances competition. Lawyers, judges and competition law enforcement officials have been using this phrase for many years to explain and justify their arguments and decisions, but there is no consensus on what the term means. The same may be said of terms such as “unreasonable,” “improper,” and “level playing field.” The continued use of these terms despite the absence of precise, generally accepted definitions for them has led to inconsistent interpretations, and therefore to unpredictable results. Consequently, these phrases have not helped to promote a better understanding of the law and policy on abuse of dominance. There is a need for a more principled and consistent basis for determining liability in unilateral conduct cases.

(2) *There is substantial agreement among jurisdictions on the broad goals and methods of enforcing competition laws against abuse of dominance, particularly with respect to studying harm to competition, not competitors, through the use of economics. There is some disagreement, however, over what variables to consider and whether to use a form-based approach or an effects-based approach.*

3. It is widely agreed that the purpose of competition policy is to protect competition, not competitors, but there is less agreement on how to go about doing that. Agencies in many countries use an effects-based approach, focusing on the economic impact that conduct has on consumers and competition. Agencies in a number of other countries, such as Germany and Korea, use a more form-based approach that focuses on how conduct can be categorised. Economic analysis still plays an important role in those jurisdictions, and the form-based approach may provide greater legal certainty and faster resolutions than effects-based methods. Some commentators believe, however, that a critical problem with form-based approaches is that the same type of conduct can be either “normal competition” or “abusive competition,” depending on the circumstances. That would mean that there is no obvious form-based way to assess whether behaviour constitutes competition on the merits, and that attempts to assess potentially abusive conduct in that manner are prone to both false positives and false negatives. Focusing on the conduct's economic effect, they argue, is essential to making an accurate determination of its true nature, and thus it is worthwhile even if it requires more time than a form-based approach. Otherwise, competition law enforcement might not be consistently aligned with competition policy's economic purpose.

4. There is an inherent tension between fostering legal certainty, ease of administration, and accuracy. Form-based systems may provide more certainty and are relatively easy to administer, but also may generate results that are inappropriate, given what the actual market effects are. Case-by-case or effects-based approaches may yield results that are more appropriate given a practice's actual effects, but

having to uncover every detail in every case would be slow, unworkable, and unenforceable. Either approach, driven to excess, produces unattractive results.

(3) *Dissatisfaction with both the ambiguity of some jurisdictions' competition statutes and the lack of clear definitions for terms like competition on the merits has prompted a number of specific tests that aim to detect abusive conduct.*

5. Over the years, scholars searching for more principled ways to sort out pro-competitive conduct from anti-competitive conduct have proposed a number of tests that agencies and courts can apply in abuse of dominance and monopolisation cases. These include the profit sacrifice test, the no economic sense test, the equally efficient firm test, and various consumer welfare balancing tests. There is general agreement that no single test is suitable for every type of case, but there is also some variation with respect to the test that different delegates tend to favour. Each of the four major types of tests has been used by courts and agencies. Other tests, such as the one recently devised by Professor Elhauge, have been proposed from time to time as scholars continue trying to pinpoint what competition on the merits is. Each of the tests has certain strengths and weaknesses.

(4) *The profit sacrifice test states that conduct should be considered unlawful when it involves a profit sacrifice that would be irrational if the conduct did not have a tendency to eliminate or reduce competition.*

6. One form of this test is useful for capturing predatory pricing conduct, but it does not appear to be a good test in other types of cases because it is both over-inclusive and under-inclusive. It is over-inclusive because it can capture certain types of behaviour that increase consumer welfare even though they also exclude competitors. For example, research and development costs for a new drug may be so high that an investment in developing the drug can be profitable only if the drug is so effective that it excludes competitors and gives the innovating firm market power. But is it sound policy to discourage such investments? On the other hand, some conduct may entail no short run profit sacrifice at all yet still be harmful to competition. In addition, the profit sacrifice test is not well-suited to difficult cases in which the conduct at issue can be both beneficial and harmful.

(5) *The no economic sense test states that conduct should be unlawful if it would make no economic sense without a tendency to eliminate or lessen competition.*

7. This test avoids under-inclusiveness because it does not require profit sacrifice. The test can be used offensively, *i.e.*, to argue that conduct was exclusionary because it made no economic sense, and defensively, *i.e.*, to demonstrate that conduct should not be condemned because it did make economic sense. It seems, however, that over-inclusiveness and an inability to deal well with conduct that has mixed effects are characteristic of this test, too.

(6) *The equally efficient firm test states that conduct should be unlawful if it would be likely to exclude a rival that is at least as efficient as the dominant firm is.*

8. The equally efficient firm test (which is also known as the as efficient competitor test) is geared toward distinguishing harm to competition from harm to competitors, and it relies on the fact that without "bad" conduct by a dominant firm, equally efficient rivals cannot be eliminated. The test may be too lenient, though, if it is interpreted as allowing the elimination of new firms that are currently less efficient but that would eventually become equally or more efficient than the incumbent if they are able to survive long enough. Furthermore, an equally efficient firm might be able to enter a market and survive, but that does not always mean it would be able to exert competitive pressure. The mere fact that it could survive, therefore, is not necessarily enough to preserve competition.

(7) *Consumer welfare balancing tests determine whether conduct should be unlawful by requiring decision-makers to weigh the positive and negative effects that the conduct has on consumer welfare.*

9. There are several varieties of consumer welfare tests. They all have a certain amount of appeal because they attempt to use consumer welfare effects themselves, rather than indirect factors such as profit sacrifice, as the gauge of dominant firm conduct. Unfortunately, although it may be possible to determine whether conduct enhances or reduces consumer welfare in some cases, it can be quite challenging, if not impossible, to measure the magnitude of those changes. Yet when conduct has both positive and negative effects on consumer welfare, a balancing step is necessary to determine which effect is stronger. It is therefore difficult to have confidence that balancing tests can be applied accurately, objectively, and consistently. Furthermore, it is not clear what the appropriate time horizon should be when applying this test, but that choice has very important implications for dynamic strategies such as predatory pricing.

(8) *It is desirable to make the reasoning in competition agencies' decisions more transparent because doing so will clarify how competition laws are being interpreted and enforced.*

10. Although it is useful to discuss and apply specific tests, the overall method that courts and agencies ultimately use to identify abusive conduct is going to be based on the precedents set by reasoned decisions. There are opportunities to draw lessons both from matters in which proceedings were not brought and from those in which action was taken. Some agencies, however, do not routinely issue written statements of their reasoning in no-action cases. It could be quite helpful to themselves and to the public if they would start doing so because it would lead to a greater understanding of how any similar matters that arise in the future are likely to be analysed. Furthermore, making the reasoning in all agency decisions transparent can spark debate and lead to refinements in both the competition laws and the enforcement of those laws. . Ireland's competition authority, for example, publishes its no-action decisions with an accompanying analysis, and the U.S. Federal Trade Commission aims to explain its no-action decisions, as well.

11. Several delegates expressed the view that decisions regarding unilateral conduct should offer both legal certainty and clear, structured analysis of market facts in an economic effects-oriented way. More key facts can be brought into play in decisions to take action, even if form-based approaches might not require it. No-action decisions need to be very clear in explaining why conduct that might appear to be superficially unlawful is actually competition on the merits when looked at soberly in the light of market facts.