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Changing Views of Competition and EC Antitrust Law

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## **Abstract**

During the last few years the application of EC antitrust law has been subject to a number of changes, aiming at giving a greater role to economic analysis. This is leading to the abandonment of the traditional ordoliberal inspiration of EC competition law. This paper explores how justified is this change. In particular it argues that economic analysis provides different views of how competition works and that it may affect the application of antitrust at different stages. From this point of view a more economic approach is not necessarily incompatible with a reformed ordoliberal paradigm. What appears incompatible is an approach which substitutes efficiency for competition. Such an approach has gained a role in the US antitrust, but its extension to the EC legal context is bound to produce a number of problems, and to lead to results different from the desired ones.

**JEL classification:** A12; K21; L40; L41.

**Keywords:** models of competition, EC competition law, antitrust, ordoliberal paradigm.

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## **1 Introduction**

During the last decades the criteria governing the application of EC Antitrust Law have been subjected to substantial changes. These changes reflect developments in the views about the role of competition law in the economic and legal system, which have taken place in the US and Europe, as a result of a wide ranging intellectual debate. The objective of this paper is to illustrate the developments in the application of EC antitrust law in light of this debate.

The changes in EC Antitrust have concerned a number of aspects: procedure, through the enactment of Regulation 1/2003, the “Modernization Regulation”; and substance, through a wider recourse to economic analysis. As a result of this process, the same basic aims of competition law have been questioned. While in the past EC competition law was seen as squarely directed to the protection of the competitive process, there is now growing consensus that the protection of competition is an instrument in order to achieve consumer welfare and economic efficiency. Lately, in the context of reform of the EU Treaties undertaken by the Lisbon Intergovernmental Conference, the same role of competition law in the EU legal system seems to have been put in question.

At the outset it is appropriate to specify that we limit our analysis to EC antitrust law, i.e. the provisions of the Treaty concerning restrictive practices carried out by private undertakings, namely Article 81, (concerning restrictive agreements) and Article 82, (concerning abuses of dominant position) and related Community legislation. We do not discuss merger control, except for some brief references. Most importantly, we do not discuss the wider subject of competition policy, i.e., the set of instruments and actions aiming at insuring the establishment of competitive markets in the economy. This set includes competition law, but extends to all policy measures aiming at fostering the degree of competition in the economy: state-aid control, privatization, liberalization of previously regulated sectors and pro-competitive regulation of still subject to regulation sectors<sup>1</sup>. What distinguishes competition law from the other measures is that the former consists of rules governing the behaviour of firms in the market, which are applied in a general

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<sup>1</sup>For an exposition of the achievements of the competition policy of the EC see Anderson-Heimler (2007); see also Slot (2004).

and non-discretionary way<sup>2</sup>.

This distinction is particularly relevant in the EC context, because of the double role played by the Commission in the field of competition. On the one hand, the Commission is the executive branch of the Union, thus enjoying powers of legislative initiative. Therefore it is a central actor in the shaping of EC competition *policies*. On the other hand the Commission is in charge of applying EC competition *law*, (under the review of the European Courts), and plays an extremely important role in this respect, through its decisional practice and the enactment of interpretative principles under the form of Guidelines. While in its first role the Commission is in fact a policy agent, in the second one it should just be guided by the criteria set by legislation and by the European Courts of Justice through which competition law should be interpreted<sup>3</sup>.

The paper is organized as follows: in Section I we summarize how economic views of competition have evolved over time. We note that different views of competition imply a different role for antitrust law, which in turn affects the criteria according to which the law is applied. In Section II we review the developments in the application of EC competition law in the past decades. First, we examine how a specific view of the role of competition in the legal order has influenced the shape and the application of EC competition law; we then review the changes that over time have taken place in such an application, aiming at introducing an economic and effect-based approach. Finally, we analyze the new approach adopted by the Commission, based on the effects on consumer welfare and efficiency, and discuss its implications for the debate on the role of competition in the EU legal order which has been opened by the Lisbon Intergovernmental Conference.

## 1.1 Changing views on competition

Since the appearance of *An Inquiry into the Nature and Causes of the Wealth of Nations*, the seminal work by economist and philosopher Adam Smith, competitive markets are seen as a desirable framework for fostering welfare

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<sup>2</sup>The tendency to confuse competition *law* with competition *policy* has been noted by Grillo (2006).

<sup>3</sup>In fact this two-headed role of the Commission has been at times criticized, as antitrust decisions risked being influenced by considerations of policy. Therefore it was sometimes suggested that decisions in antitrust cases were attributed to an independent European Competition Authority.

and growth. According to Smith, it is not from the benevolence of the grocer that we can expect the satisfaction of our needs, but from his greed. Greed will induce him to find and provide the goods we need. And competition among greedy grocers would insure that there are plenty of goods supplied at the best prices. From Adam Smith onwards, it has been generally maintained that competition leads to desirable results in terms of productive efficiency, low prices, incentives to innovation and discovery of new areas for market activity. Therefore a market system where economic agents compete among one another guided by a certain degree of rivalry leads to efficient production and allocation of resources to the benefit of the consumers.

Adam Smith also argued that public policies should be directed to guarantee that markets work effectively, to the benefit of the general public (this was in fact the subject of his most famous book). While he thought that most restraints to the functioning of a free market came from public policies, he also warned that restraints to trade could well come from private actions. He noted that seldom people from the same trade gather without conspiring for practicing higher prices or for monopolizing the markets. Modern antitrust law in a sense derives from this remark, and it is interpreted as a public intervention aimed at protecting the “social mechanism” that allows the market to be conformed by competition guided by rivalry. The way this is done is to impose rules that prevent conducts, which unduly restrict or eliminate competition.

## **1.2 The character of competition law**

Antitrust rules concern agreements and unilateral practices by firms with a substantial market power which restrict competition. In the European Community, Article 81 of the EC Treaty forbids agreements which restrict competition and Article 82 forbids abuses of a dominant position. Similar provisions exist in the US, where Section 1 of the Sherman Act, (the world first modern antitrust law, enacted in 1890), prohibits conspiracies among firms to restrict competition and Section 2 prohibits monopolization, and in most other countries<sup>4</sup>.

Competition rules have a peculiar character. First, antitrust law is based

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<sup>4</sup>The diffusion of antitrust laws has accelerated since the late 1990s, with the abandonment of the command economy in the former socialist countries. Now more than 120 countries have an antitrust law.

on the idea that the desirable results of competition will be obtained spontaneously on the market, once the conditions for its competitive working are guaranteed<sup>5</sup>. Because antitrust law is directed at protecting a competitive mechanism based on rivalry, it is directed at removing the obstacles to the competitive working of the market deriving from private behaviour, but it should not aim at attaining a particular result. Secondly, competition rules concern a subject, which has profound social and political implications: the functioning of the market, the institution, which allows voluntary exchange among equals pursuant to the law. As the early economists pointed out, the proper functioning of the competitive market is based on some of the basic tenets of a liberal society, such as freedom of contracting and property right, and on rules and institutions which guarantee that the process of exchange takes place undistorted by coercion arising from the use of market power, so as to give rise to a selection mechanism based on merit<sup>6</sup>. These rules may be determined either endogenously by the trading subjects, or exogenously by laws based on the recognized “social value” of the market. As a leading law and economic scholar notes “a market is not competitive by assumption or by construction, a market *becomes* competitive, and competitive rules *come to be* established, institutions emerge to place limits on individual behaviour patterns”<sup>7</sup>.

As antitrust rules are related to the basic tenets of a liberal economic society, it is not surprising that competition law has represented the legal framework of reference for the economic system of a free society. In the US, the Sherman Act has long assumed a nearly constitutional character, as the basic charter of the freedom of initiative<sup>8</sup>. In Europe, as we will see, competition rules were born from a vision which gave them a central role in the legal order of a free economic society<sup>9</sup>.

However, this central role has contributed to charge antitrust rules of other objectives which are generally related to the correct functioning of a market system: in particular, freedom of individual and business initiative,

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<sup>5</sup>This characteristic distinguish antitrust from economic regulation, for instance through the fixing of prices or other conditions of supply.

<sup>6</sup>For a discussion see Amato (1997); Grillo (2006).

<sup>7</sup>Buchanan (1964).

<sup>8</sup>Peritz (1996) provides a comprehensive discussion of the role of antitrust law in the U.S. See also Hovenkamp (2005).

<sup>9</sup>Gerber (1998) discusses the role that the ordoliberal vision had the shaping of EC competition law. On this see below. See also Amato (1997).

broadening of economic opportunities, a certain dispersion of wealth, freedom of choice by the consumers<sup>10</sup>. While, in general, protection of competition would also lead to the attainment of these objectives, at times the weighing of some of them in the context of competition policy appears to have led to an application of antitrust law guided by the criteria of “fairness” or by distributional considerations, therefore subject to the political climate of the day<sup>11</sup>.

In particular, in the early years, recourse to antitrust law has often been seen as a more desirable alternative in comparison with more direct forms of intervention in the market, like administrative price controls or governmental control over the industry, in connection with the rising of economic tensions which hampered the confidence of the market system: for instance, when inflationary pressures appeared to reduce consumers’ buying power; or when industry consolidation processes threatened the survival of certain types of enterprises<sup>12</sup>. This obviously affected the way in which the law was applied. However, as Baker<sup>13</sup> notes, at a certain point competition law seems to have represented a political bargain between both producers, who are guaranteed protection from more direct forms of intervention, and consumers, who are guaranteed that a certain level of competition will prevail in the market. Such a political bargain would help explaining the bipartisan role that antitrust law has assumed after World War Two and the systematic recourse to objective criteria based on economic analysis.

### **1.3 Competition law and economic analysis**

Another peculiar character of antitrust laws is that they directly concern an economic concept: competition in the market. Therefore, more than any other kind of rules, they raise the issue of the relations between legal principles and economics.

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<sup>10</sup>See Fox (2003); Pitofsky (2003). Peritz (1996) describes the cycles in the application of US antitrust law in its first century of application.

<sup>11</sup>Peritz (1996) describes the cycles in the application of US antitrust law in its first century of application.

<sup>12</sup>For the U.S. see Peritz (1996); Gerber (1998) gives an illustration of the debate on competition and direct intervention in Europe at the turn of the XIX century. For Europe see also Pace (2005).

<sup>13</sup>

J. Baker (2006).

Economics contributes to the interpretation of the law at different levels: first it provides a framework of analysis of competition and of its essential features; secondly it plays an important role in the development of rules of decision from which it is possible to evaluate whether the conducts under examination must be considered illegal.

*a) Different views of competition*

While on the basis of the early analysis of Smith we may define a competitive market as one where firms compete for demand guided by rivalry, economists have not always been in agreement about the conditions necessary for a competitive market system to be established and fully working; this because the analysis of competition may be made from different points of view. In his famous exposition Smith singled out the three elements which have since characterized the analyses of competition: incentives for the economic agents to appropriate the benefits from the gain from trade; a competition for demand guided by rivalry; and the efficient end-result arising from the process, represented by the supply of plenty of goods at the lowest possible cost. Subsequent economic analysis has drawn attention on one or another of these aspects.

In particular, the marginalist economists of the late XIX century focused their analysis on the conditions under which a system of exchange could lead to the desirable results in term of productive and allocative efficiency<sup>14</sup>. They elaborated the model of *perfect competition*, where individual agents responded passively to incentives given by prices, which in turn were determined by equilibrium between total demand and supply. Such a system leads to the desired conditions of minimizing costs (productive efficiency) and to prices equal to marginal cost (allocative efficiency): therefore the benefits for the consumer are maximized. This happens on condition that firms do not have any market power so that profits are zero in the long run, because competition to get any extra profit leads to the adoption by all firms of the most efficient techniques. Since agents are price takers and not price makers, each of them is very small with respect to the size of the market. This model had a fundamental role as a reference point in the analysis of markets throughout the XX century.

Another stream of thought argues that the model of perfect competition

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<sup>14</sup>The most sophisticated illustration of the early marginalist approach is the *Eléments d'Economie Politique Pure*, the 1874 work by the French economist Léon Walras, the founder of the general equilibrium analysis.

is a static model, and it does not catch the dynamic features exemplified by Smith, that is the search of the profit opportunities by grocers and their like. The economists supporting such an approach have centred their analysis on the role of the grocer, i.e. the entrepreneur, in identifying new opportunities of appropriating benefits from trade, and on the role of incentives in inducing him to action<sup>15</sup>. This implies striving for introducing innovations in the characteristics of the market or in technology, and for identifying new needs and new markets.

This view is also associated with a specific vision of the role of the market, which is perceived not only as the place where exchange takes place, but also as the institution which allows the gathering and exchanging of widespread information, and in which the agents' actions are guided by the discovery and expectation of new opportunities. Competition is then seen as a discovery process<sup>16</sup>.

The suggestions concerning the obstacles to competition deriving from the two approaches we have surveyed are rather different. Obviously, whatever scheme we take, cartels among competitors to restrict prices or control market shares are undesirable: they raise prices above marginal costs and reduce the incentives to search for new profit opportunities. However, the two approaches lead to different conclusions concerning a number of other situations, which are relevant for antitrust. Traditional analysis concentrates on the lack of market power of independent economic agents, which requires them to take prices as given. Therefore, any arrangements, which reduce the autonomy of the agents, like any form of agreement between firms which operate on the same market (*horizontal* restraint) or at different stages of the productive and distribution system (*vertical* restraint), may affect the efficiency results of competition. In the same vein, any form of market power is considered undesirable, because it implies departure from allocative efficiency. Therefore the traditional analysis would suggest intervention when there are important deviations from the paradigm of perfect competition. From this point of view, since the 1930s a stream of economic thought has

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<sup>15</sup>This view is generally attributed to Schumpeter (1948) and to the Austrian economists. However, it may be found in Chicago economist F. Knight and in the works of Nobel laureate J. Buchanan, the leading Public Choice scholar. A recent re-elaboration in modern terms, compatible with general equilibrium analysis, is in Makovsky-Ostroy (2001), who also give a comprehensive view of the various approaches to competition.

<sup>16</sup>This is one of the seminal contributions of F. Hayek (1948).

argued that a state akin to perfect competition is unlikely to prevail in the market, because information asymmetry and promises to entry allow firms to have a certain degree of market power<sup>17</sup>. Obviously this suggests a more widespread intervention in the markets.

The alternative approach looks at the market economy as an institution which is built by the same agents in the market, as they endeavour to discover opportunities to trade so to benefit from them. Freedom of contract in a market context allows agents to fashion their relations in the way which is most appropriate to reach this result: therefore contractual arrangements reducing the autonomy of the parties may still aim at making exchange more efficient. The existence of profits and (apparent) market power is not necessarily proof of the absence or restriction of competition: they may as well indicate that the firm is innovating quickly and has an advantage over its competitors. Exploitation of the consumers by dominant firms through market power could represent powerful incentives for other firms to enter the market. Furthermore, dominant enterprises have usually achieved this position through a superior performance in the market, and it would be against the very meaning of competition to punish a company for its success.

From the point of view of this approach, there is some ambiguity in antitrust rules, because their intervention to limit the abuse of market power inevitably leads to limits to freedom of contract and the use of property rights, the same elements on which the institution of the market is based<sup>18</sup>. Therefore, antitrust rules should be applied parsimoniously, and the limits set by competition law to these basic rights should be only those strictly necessary to eliminate anticompetitive restrictions. Then antitrust should be basically a marginal kind of intervention, which is relatively rare, and generally concerns large distortions of competition.<sup>19</sup>

*b) Decision rules and economic analysis*

A second way in which economic analysis has a particular role in the application of antitrust law concerns its role in devising decisional rules. In particular, Courts and Administrative Authorities applying antitrust law have early developed a decisional practice whereby certain practices, which

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<sup>17</sup>The seminal works on imperfect competition are the ones of Chamberlin (1933), who opened the Harvard tradition in industrial economics, and J. Robinson (1933).

<sup>18</sup>This is the “paradox” on which R.Bork built his criticism of US antitrust practice. See Bork (1978).

<sup>19</sup>This is the suggestion of Hovenkamp (2005).

are presumed to restrict competition, are prohibited *per se*. In such a case, once it is proven that a certain practice is actually in place, the firms involved in it are considered to be infringing the law, without any need to ascertain whether the practice actually had competitive effects. Other practices, instead, cannot be presumed to be immediately restrictive, and a finding of illegality may derive only from an evaluation of their effects on competition, through the application of the *rule of reason*. This implies evaluating the restrictive characteristics of the practice and balancing them out with its pro-competitive effects.

Whether a practice is considered prohibited *per se* or should be evaluated under the “rule of reason” is a question of presumptions: if a practice is forbidden *per se*, it means that its analysis under a legal and economic point of view has shown that in the generality of cases it restricts competition (typically this is the case of cartels fixing prices or sharing markets).<sup>20</sup> When a practice is not seen as immediately anticompetitive, economic analysis can help.

In this context, economic analysis helps the decisional process also by defining whether we should start from a presumption of legality or illegality, which in turn depends on whether we should expect that it has or does not have anticompetitive effects, and by defining the criteria on the basis of which we may evaluate whether it is restrictive<sup>21</sup>. This obviously depends on the paradigm of analysis of competition that is followed. The paradigm based on perfect competition would tend to consider structural aspects of the market in order to evaluate whether it deviates from its desirable outcome. The paradigm based on incentives would rather look at the actual or presumed effects that the practice would end up having on the market.

The relevance of presumptions in the decisional process suggests that there is a risk that decisions may be wrong. From this point of view two kinds of errors are possible: 1) practices, which restrict competition, may be considered harmless; or 2) practices, which are harmless, may be considered restrictive<sup>22</sup>. While legal and economic analysis have at length discussed the relative undesirability of the approaches leading to one or the other of the two

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<sup>20</sup>For the interpretation of the *per se* rule from the point of view of presumptions, see Kovacic (2003); Wood (2004).

<sup>21</sup>For a discussion of the role of economic presumption in the application of the rule of reason see Alhorn-Padilla (2007).

<sup>22</sup>For a discussion of decision rules in relation to the risk of errors see Evans-Padilla (2005).

kinds of errors, which one ends up prevailing depends on the criteria on the basis of which we evaluate whether competition has been restricted. This in turn depends on the way in which we think competition works in the market, i.e. on economic analysis. From our previous discussion, it appears that the traditional paradigm would suggest the adoption of criteria for evaluation, which prevent “type 1” errors, while the paradigm based on incentives would rather suggest that the criteria of intervention be aimed at preventing “type 2” errors.

*c) Structuralism and the US experience*

Given the different approaches to competition, it is not surprising that economic analysis of how a competitive market system works has been evolving over time. And the interpretation of the law has been evolving with it. At different times, a different degree of attention has been given to different determinants of competitive behaviour. Therefore the criteria according to which to evaluate how different practices may harm competition have changed over time. To show this it is useful to examine the US experience<sup>23</sup>.

Until the 1970’s the application of the antitrust law in the United States was guided by the structuralise analysis of the market which dominated industrial organization analysis in the ‘50s and ‘60s. Inspired by the traditional scheme of perfect competition, structuralists argued that attitude towards rivalry, and therefore competition, depended on the number of firms on the market, which in turn depended on exogenous factors like barriers to entry and economies of scale<sup>24</sup>.

Since at the basis of the traditional scheme was price taking and lack of market power, structuralist analysis tended to consider harmful to com-

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<sup>23</sup>A summary in US experience is in Kovacic and Shapiro (2000). A comparison with the EC experience is in Pera-Auricchio (2005). Despite European antitrust has a specific tradition, rooted in economic debates and legislative experiments dating back to the end of XIX century, as discussed by Gerber (1998), the experience in the interpretation of antitrust law in Europe shares much with the one in the US, where a systematic application of modern antitrust law started more than sixty years earlier. This not surprising. Legal thinking in antitrust has been influenced by economic analysis, and in this field there have always been close contacts between the two sides of the Atlantic. Furthermore, since the early development of EC competition law there have been continuous discussions on antitrust foundations and methods between European and American lawyers and economists, which have lead to common ways of understanding the core issues and a common general approach.

<sup>24</sup>Earlier developers of structuralist analysis were E. Mason, with his studies in administered prices, and Bain (1956), who first introduced the concept of barriers to entry.

petition arrangements which could reduce the autonomy of the firm in the market. Furthermore, influenced by the imperfect competition theories of the previous decades, they were sceptical about the automatic establishment of competition in the market. As a result, decision rules were focused not on actual or potential effects of practices on competition, but on their characteristics: as long as they led to a reduction in the autonomy of the agents there was a risk that competition was restricted.

Horizontal agreements were considered *per se* illegal independently on whether they were collusive or just of cooperative nature, aiming at allowing a better and more efficient use of resources<sup>25</sup>. Fears that limits to the autonomy of the firms led to the prohibition *per se* also of vertical agreements between firms at different levels of the production and distribution. Therefore, the law was interpreted to protect not only inter-brand competition, i.e. competition among producers trying to place their products on the market through the distribution channels, but also intra-brand competition among distributors of the same products. Retail price maintenance (i.e. the fixing of retail prices by the producers) had been considered a violation *per se* already at the beginning of the century; the same happened for exclusive dealings, which prevented commercialization of competing products through the same distribution channels, and territorial restrictions which prevented competition among outlets<sup>26</sup>.

The primary fear with mergers was that they could reduce the number of competitors on the market, irrespective of whether this led to an effective reduction in competition<sup>27</sup>.

From the point of view of unilateral behaviour, concerning companies in dominant position, US judges decided early on that the law would not apply to exploitative behaviour. Indeed, the law protected the competitive process, therefore a monopolist that had achieved its position by superior performance should be free to practice the conditions he thought appropriate<sup>28</sup>. However, the possession of market power was seen as a limiting factor: legal rules tended to be based on the concept of “competition on the merits”, meaning that the dominant firm should only compete on the basis of “supe-

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<sup>25</sup>See *U.S. vs. Topco Associates.*, 405 US 596 (1972).

<sup>26</sup>See *U.S. vs. Arnold Schwinn and Co.*, 388 US 365 (1967)

<sup>27</sup>See *Brown Shoe Co. vs. U.S.* 370 US 294 (1962).

<sup>28</sup>See Blumenthal (2007).

rior performance and acumen”<sup>29</sup>. Therefore, dominant companies could not use practices depending on their market power in order to restrain competition, for instance through loyalty-enhancing practices. Competitive harm was usually defined on the basis of the obstacles posed to competitors to compete effectively with the dominant firm. In fact this criterion was often applied with little attention to the actual effects of the conduct on the market, so that practices would be considered restrictive as long as they excluded a competitor and generally dominant firms behaviour was not justified if they could get advantages on the market from economies associated with their size<sup>30</sup>

Finally, because the analysis suggested that restraints to competition were pervasive, and great relevance was given to the number of companies in the market, there was a very activist tilt in the enforcement activity, particularly in oligopolistic markets<sup>31</sup>.

This approach was widely criticized, since it led to decisions, which tended to consider restrictive practices, which did not harm competition (“false positives”) and could often lead to efficiency and improvements in consumer welfare. Therefore they ended up protecting existing (inefficient) competitors. From this approach a perception arose that antitrust law was guided more by criteria of “fairness” and the aim to protect small enterprises rather than by the objective of protecting a vigorous free and competitive market<sup>32</sup>.

*c) The Chicago school*

However, since the 1970s reliance of competition law on economic structuralism has been superseded by the evolution in economic thought, which has stressed the role of incentives and efficiencies in determining agent’s behaviour in the market. In particular, what has come to be known as the Chicago School has shown that a number of practices, which according to the structuralist paradigm were considered to be restrictive of competition because they limited the autonomy of economic agents in the market, aimed instead to give rise to more efficient methods of production or commercialization, which in fact allowed the firms to compete more efficiently. In particular,

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<sup>29</sup>This principle was established in *US vs. Grinnell Co.* 384 US 563 (1966).

<sup>30</sup>This seems the conclusion to be drawn from *U.S. vs. Aluminum Corporation of America (Alcoa)* 948F21 (1945).

<sup>31</sup>In the early 1970s the DOJ tried to argue that oligopolistic interdependence among the few producers of cereals in a very concentrated market represented an agreement restricting competition.

<sup>32</sup>This finding was also at the basis of the pervasive criticism developed by Bork (1978).

vertical restraints, i.e. agreements between producers and distributors, could be very well guided by the need to guarantee that the agents appropriate the benefits deriving from specific investments they bear. On this regard, for instance, it is clear that a distributor who is guaranteed an exclusive dealing will devote more efforts and investments to penetrate the market<sup>33</sup>. Also, horizontal cooperation among enterprises not aimed at fixing prices or subdivide markets is often pursued in order to overcome problems of externalities, without restricting competition on the market.

It may be appropriate to see the changes brought forward by the Chicago school in the context of the second of the general streams of thought about the scope and role of competition we have examined earlier. In particular, the Chicago approach should be viewed in the context of a framework of analysis inspired by the seminal works of Coase<sup>34</sup> and Williamson<sup>35</sup>, which views interactions of agents through cooperation as an alternative to the exchange to overcome the obstacles to the achievement of efficiency.

In fact the innovation in the analysis of economic practices corresponds to a change in the view about the way in which competition works: firms structure their productive and commercial arrangements in order to reap the benefits from trade and for competing more efficiently. Profit incentives become a powerful drive for the changes. And the practices cannot be considered restrictive of competition because they are directed at widening the markets and making firms more effective competitors.

This approach suggested profound changes in the legal rules governing application of antitrust law. First, with the exception of a few practices which had a clear anti-competitive aim, like hard-core cartels to fix prices and subdivide markets, which should be presumed illegal *per se*, most practices should be examined on the basis of their effect on competition through an analysis base on the “rule of reason”. It was also argued that certain practices are generally harmless, in so far as they do not restrict competition and are usually beneficial to economic activity, and therefore may be presumed to be *per se legal*, and not worth further investigation<sup>36</sup>.

This paradigm leads to a substantial change in the way in which to evaluate the harm to competition from a certain practice. Because of the presump-

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<sup>33</sup>See Telser (1960).

<sup>34</sup>Coase (1937); Coase (1960).

<sup>35</sup>Williamson (1975).

<sup>36</sup>This is the position taken by Posner on vertical restraints. See Posner (1981).

tion that many market practices were aimed at solving appropriation issues and at achieving efficiency, the legal criterion on the basis of which practices would be evaluated should be based on their effect on the final market. In particular, starting with the seminal contribution of Posner<sup>37</sup>, the Chicago approach argued that the anti-competitiveness of a practice should be evaluated on the basis of its effects on prices and quantities and from the ensuing effect on *consumer welfare*.

This approach has particular implications for the analysis of practices of dominant companies. As we have seen, the structuralist approach analyzed the behaviour of dominant companies performance with nearly exclusive attention to the effects on the structure of the market and the effect on competition. The new approach then suggests that exclusion of competitors should be considered anticompetitive only when it leads to decrease in consumer welfare.

The Chicago analysis has been very successful both from the point of view of methodology and of its impact on the decisional process.

From the first point of view, antitrust analysis is now generally based on the consideration of efficiency and on the effects of practices on the market. Therefore, there is generally agreement that the number of practices forbidden *per se* should be limited to hard-core restrictions, while the others should be either considered *per se* legal or analyzed on the basis of the “rule or reason”<sup>38</sup>. In this context, during the last twenty years various schemes of economic analysis have been implemented, leading to less optimistic conclusions concerning the need for an activist antitrust intervention. These schemes are generally classified as Post-Chicago analysis. While Chicago analysis tends to restrict intervention to hard-core practices like cartels, this more recent economic analysis has introduced new elements into the paradigm, in particular considering the possibility that firms may strategically use information advantages. This would be particularly relevant for the analysis of dominant companies, which could use strategically vertical agreements in order to exclude competitors from the market. Therefore, this line of thought tends to refuse the relevance of *per se* legality and suggests a wider recourse to the

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<sup>37</sup>Posner (1975).

<sup>38</sup>In fact, one can say that there is now very little difference between the Chicago approach and the one of other schools of thought, like Harvard. On this see Kovacic (2005). See also Elhauge (2007).

“rule of reason”<sup>39</sup>.

From the second point of view the Chicago approach has had a decisive impact on the decisional practice of Courts and Competition Authorities. In the U.S. in particular over time most decisions inspired by the structuralist approach of the 1960s and 1970s were reversed. The effect of practices on the consumer has become the standard paradigm for evaluating consumer harm and non hard-core practices are now reviewed under the rule of reason approach based on consumer welfare analysis.<sup>40</sup> In 2007 the *Leegin* decision, reversing a decisional practice nearly a century old, abandoned the *per se* prohibition of retail price maintenance<sup>41</sup>.

From a more general point of view, the US decisional practice appears to have moved towards the adoption of the vision of incentive-based competition. In particular, in some recent decisions the Courts seems to suggest that the constraints to the behaviour of dominant enterprises should be evaluated very carefully and in a limited number of circumstances<sup>42</sup>. In particular, in *Trinko* the Court argued against the imposition of a duty to deal in the case of firms controlling essential facilities, maintaining that limits on monopolists to exploit their position would affect their ability to innovate<sup>43</sup>.

#### 1.4 From the Competitive Process to Efficiency

The Chicago contribution suggests the need for a more objective foundation to the legal analysis of restrictive practices, providing criteria to this effect. The consumer welfare approach may be considered as a way of better understanding when practices may be presumed to be actually directed only at

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<sup>39</sup>For an illustration of the Post Chicago economic theories see Shapiro (1989). For a discussion see Hoovenkamp (2001) and Makovsky-Ostroy (2001).

<sup>40</sup>Among the most relevant decisions are *Sylvania*, [*Continental Inc. vs. GTE Sylvania Inc.* 433 US 36 (1977)] which applied “rule of reason” analysis to vertical restraints; *BMI* [*Broadcast Music Inc. vs. Columbia Broadcasting System, Inc.* 441 US1 (1979)] which applied “rule of reason” analysis to horizontal cooperation; and *Brooks* [*Brooks Group Ltd. vs. Brown & Williamson Tobacco Corporation*, 509 US 209 (1993)] which revised the standard for predatory pricing.

<sup>41</sup>See *Leegin Creative Leather Products vs. PSKS* in 06 US 480 (2007).

<sup>42</sup>As noted by Braun-Ginsborg (2007), during the last decade the Supreme Court has generally been favourable to the defendant, therefore making it difficult for plaintiffs to argue their case.

<sup>43</sup>See *Verizon Communication Inc. vs. Law Offices of Courts v. Trinko, LLP*. 02 US 582 (2004).

restricting competition on the market (through exclusion or coercion), because they do not result in any increase in efficiency and therefore in benefits for the consumer. The same approach proves useful also in assessing whether, instead, such a presumption is not justified because there are other reasons to undertake them rather than for anticompetitive purposes. In particular, if a practice gives rise to a reduction in prices or an increase in output, it may be inferred that there was a good reason, on efficiency grounds, to undertake it, and that there exists on the market sufficient competition to cause the transfer of at least part of the gains from efficiency to the consumer and, therefore, to ensure pressure towards allocative as well as productive efficiency.

In this vein, other approaches have been elaborated with an aim to providing a more objective, economic-based evaluation of restrictions to competition. In recent years a number of economic criteria have been proposed in order to give a more objective content to the concept of “competition on the merits”, so as to take into account that, if the practice is the result of a superior performance by the firm, it may lead to the exclusion of a competitor, but also to an improvement of the conditions of supply and to a better treatment of consumers<sup>44</sup>.

However, the contribution of Chicago to antitrust law goes further than just stressing the importance of a more thorough economic analysis of competition practices. Instead it calls for a profound change in the whole approach to the objectives of antitrust law, by putting at its centre a purely *economic* paradigm. According to the analysis of legal theorists like Bork and Posner, efficiency and consumer welfare are not the criteria on the basis of which to evaluate the conformity of the behaviour of the parties to the pursued aim of competition law, i.e. the preservation of a competitive market; they are the very same *final objectives* of the law. The reason why law protects

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<sup>44</sup>The effect of the exclusionary practice on consumer welfare is one criterion which may help in evaluating whether the exclusion was actually anticompetitive. Other criteria have been proposed in order to try and qualify the behaviour of the dominant company also on the basis of the characteristics of the competitors. These criteria have been labelled as the “profit sacrifice”, the “non economic sense” and the “as efficient competitor” tests. The “profit sacrifice test” examines whether the practice leads to a profit sacrifice which has no justification other than damaging the competitor; the “non economic sense” test argues that a conduct is unlawful if it makes no economic sense other than the elimination of the competitor; lastly, the “as efficient competitor test” considers as restrictive only those practices which could lead to the exclusion of competitors as efficient as the dominant firm. See the contributions in OECD (2005). For a critical discussion see Vickers (2005).

competition is because it is the best way to achieve consumer welfare and efficiency. It follows that competition is not the final objective of the law, but an intermediate one: it is, in fact, an instrument for the achievement of efficiency and for welfare improvement<sup>45</sup>.

This conclusion is not obvious, however. As we have discussed, the Chicago approach is based on a paradigm of competition which gives great relevance to incentives and to their role in a process guided by rivalry. Attention to consumer welfare and efficiency derives from the preoccupation that antitrust enforcement may lead to type 2 errors, and this justifies that a dominant role in the analysis of practices is given to economic criteria. However, this does not imply a shift in the role of competition from being the main objective of the law to a mere instrument.

Nevertheless, the Chicago-efficiency approach has gained wide support among economic and legal experts in the US and in Europe<sup>46</sup>. In fact, it seems to put on more objective grounds the analyses of anticompetitive practices and to eliminate the risk that in the evaluation consideration is given to issues relating to the fairness of the competitive process, or to its social implications.

However, this implies a radical change in perspective. Traditional competition law aimed at, and was based on, the analysis of the interaction among competitors, in order to insure that it was not distorted by the abuse of market power. Efficiency and consumer welfare considerations were helpful in this context, because they provided criteria on the basis of which to evaluate the effects, actual or potential, of the practices at hand. In the new context, the interaction among competitors is no longer important, so long as it leads to improvements in efficiency and consumer welfare.

As a matter of fact, a suggestion stems from the efficiency framework, to examine practices not in terms of their effects on consumer welfare but rather

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<sup>45</sup>See Bork (1978); Posner (1974). R. Bork, one of the earliest critics of decisions based on the structuralist paradigm, argued that the US Sherman Act had been drafted under the explicit and sole purpose of maximizing efficiency to the benefit of the consumers. Therefore, in his view, it was the legislative will which required that courts apply and efficiently orient criteria in the application of the antitrust law. However Bork's analysis of the origin of the law was highly controversial and is not generally shared [see Hoovenkamp (2005); Peritz (1996)].

<sup>46</sup>Among the European contributions supporting an efficiency approach to the application of competition law, see Jenny (1993); Ahlborn-Padilla (2007); Heimler (2007). See also OECD (2005).

in terms of their effects on total welfare and wealth. According to this view, if a practice leads to savings in the use of resources which are larger than the loss of benefits to the consumers, the same should be considered harmless because in any case a transfer of wealth from producers to consumers would lead to a potential increase in consumers' welfare as well, according to the Kaldor-Hicks criterion<sup>47</sup>.

This latter conclusion emphasizes the difference between the Chicago-efficiency paradigm and the traditional one, once a meaningful economic analysis is included in it. For the first paradigm, substantial restriction of competitive pressure or even its elimination are of no significance, as long as the practice gives rise to efficiency gains. This in turn is a consequence of a more general difference: traditional analysis is concerned not only with total welfare maximization, but also with the allocative effects of the competitive process. And, as we noted earlier, recalling the view of competition law as a political bargain, the broad political support for antitrust law derives from the perception that the allocative effects of competition also represent a fair criterion for the distribution of wealth between producers and consumers. The efficiency approach reckons that these allocative effects should not concern the application of competition law.

It is important to note that this conclusion of the efficiency approach derives from a more general view of the relations between legal principles and economic analysis, which finds roots in the positive approach to law developed by Posner, according to which the development of common law and of its criteria of application are guided by the search of efficient solutions to the problems posed to the judges<sup>48</sup>. Therefore, he argues that judges' decisions should be guided by the paradigm of economics, which provides the best indications for achieving efficiency. In our case, this would imply that the application of antitrust law should be based exclusively on welfare maximization.

However, Posner's approach to law and economics is very controversial<sup>49</sup>. His views are obviously incompatible with those conceptions of the law which view legislation as the consequence of the preference of society for certain

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<sup>47</sup>Both Bork (1978) and Posner (1972) argue for such a total welfare approach. In 1975 Posner proposed a consumer welfare approach, considering that the quest for monopoly would produce monopolization costs which would exhaust any producer surplus: therefore changes in consumer welfare would correspond to changes in total welfare.

<sup>48</sup>Posner (1972).

<sup>49</sup>For a survey see Parisi (2005).

interests, which are therefore protected, and therefore see competition law not only from an economic point of view<sup>50</sup>. In fact these analyses appear to be very important in inspiring application of antitrust legislation in many countries<sup>51</sup>.

Criticism has also come from approaches to law and economics which, like the Public Choice school, are sympathetic to a legal analysis based on economic paradigm, and still believe that economic considerations matter not so much in determining the way in which the law is applied in the specific case, but rather in determining the institutional context in which transactions take place, including in particular the system of law. In this context the role of legal rules is to define socially stable reference rules to the use of economic rights<sup>52</sup>. It is very doubtful that a rule based on case-by-case decisions on the grounds of an efficiency criterion would provide such a socially stable reference<sup>53</sup>. In this vein, some authors have argued that drawing a legal theory of competitive harm without having a clear role for competition in the

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<sup>50</sup>These are the conceptions of the Yale Law School. See the seminal article Calabresi-Melamed (1972).

<sup>51</sup>A. Phelps reviews the legitimate objectives which are pursued by competition law in the book edited by Ehlermann-Laudati (2003). See also the other contributions of the same volume.

<sup>52</sup>According to J. Buchanan (1976) “Social order” requires general acceptance of a minimal set of moral standards. Well defined laws of property and freedom of market exchange minimize the necessary scope and extension of such standards, but they by no means eliminate them”.

<sup>53</sup>In explicitly criticizing Posner, Buchanan (1974) distinguishes between “law... (which) is a stabilizing institution providing the necessary framework within which individuals can plan their own affairs predictably and with minimal external interferences.... (and) legislation (which) is partially different in that its very purpose must be one of serving or implementing explicit social or collective objectives”. G. Monti (...), in discussing Article 82 EC Treaty, notes Posner’s position, in Posner (2000) ch. 9, with respect to Section 2 of the Sherman Act, that not only monopolization should be forbidden, but all practices leading to a distortion of competition, independently of the position of the firm on the market. Such an approach is perfectly attuned to the economic paradigm, and seems to have inspired the paper drafted by economic consultants to the EC Commission (EACP, 2005), suggesting that application of Article 82 should take place independently from the finding of a dominant position. However, as Monti notes, this would amount to eliminate the prescription of Article 82 altogether, substituting with a provision forbidding anticompetitive unilateral behaviour. This would be undesirable. In fact, it would have two effects: it would eliminate the special status of dominant firms; but it would extend an obligation of non-anticompetitive behaviour to all firms. The end result would be a much less stable and foreseeable legal context for all firms.

legal system risks opening up the way to policy perspectives which would be incompatible with an economy led by free market initiative<sup>54</sup>. If the objective of the law is to maximise consumer welfare or total wealth, it is well possible to devise ways other than a competitive market system to obtain them, and in such case there would be no reason to prefer one to another<sup>55</sup>.

In fact, the issue whether efficiency represents a socially accepted rule appears to be central to the purely economic interpretation of the Chicago approach. As a matter of fact, even many of those who share the economic approach to antitrust have reservations in accepting total welfare as the application criterion, in so far as they do not share the view that application of the law should be neutral to transfers of wealth damaging the consumer<sup>56</sup>. However, once competition is no longer the objective of the law, and distributional considerations are brought within the efficiency context, the issue may arise which weight they should be given. This could even lead to a “consumerist” tilt in the application of the law.

This approach is suggested by some streams of analysis which look at consumer welfare as the objective of antitrust law, from a distributional “consumeristic” point of view. In such a case, efficient practices may be considered anti-competitive if they do not lead to the maximum transfer of welfare to the consumer in the short run<sup>57</sup>. These “consumerist” considerations could be relevant when examining the EC experience, to which we now turn<sup>58</sup>.

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<sup>54</sup>This position clearly has roots in the vision of Hayek (1978). See Mestmaker (2007); Zywiky-Saunders (2006).

<sup>55</sup>It may be appropriate to recall that one of the high points in the elaboration of the theory of the market as an institution was the debate on the working of a market system under a socialist regime. Under the influence of traditional model of perfect competition socialist economists looked at competition as an efficient way of optimizing the use of resources. Hayek (1935; 1945) argued that the benefit of competition comes from its ability to organize sparse knowledge: therefore it was most desirable regime, aside its efficiency characteristics.

<sup>56</sup>See Salop (2005), who notes that a total welfare approach would consider in a positive way increases in profits obtained by inefficient competitors, at the expense of consumers. See also Pittman (2007).

<sup>57</sup>This is for instance the “consumer choice” approach suggested by Lande (1982) and Averitt-Lande (2007).

<sup>58</sup>Examples of this kind of approach may be found even in the US jurisprudence: for instance in the Supreme Court *Kodak* judgement, despite a small market share in the sale of copiers, Kodak was found to monopolize the aftermarket for spare parts of the copiers it produced, by refusing to supply spare parts to non authorized repairers. The decision

## 2 Competition law in the EU

The above review of the evolution of economic and legal thought about the interpretation and the application of antitrust law may help examining the developments in EC competition law which have taken place in the last decades. In fact, the European approach is grounded on the ordoliberal legal-economic vision, which conceives competition law as a basic tenet of the legal order of a free market economy. This approach puts at the centre of competition law the protection of the competitive process, i.e. the interaction guided by rivalry between the competitors in the market.

Original ordoliberal thinking was substantially influenced by structuralism, and antitrust rules were guided by the idea that the way the competitive process developed would be affected mainly by the structure of the market. This characteristic of the approach and the relevance of market integration in the application of EC competition rules have given rise to an over-formalistic application of the law. Starting in the 1990s, the developments in legal and economic thinking we examined above have started making inroads in the EC approach, and more economic-based criteria have been introduced, including a full-fledged consumer-welfare analysis. Recently, the EC Commission seems to have shifted to a purely economic approach. The consequences of this shift on the role European competition law are however still open to debate.

### 2.1 The ordoliberal view of competition

It is generally recognized that at the basis of the antitrust provisions in the Treaty is the vision about their role in ensuring a free market economy in a free society, characteristic of the ordoliberal tradition. This was at the time of the drafting of the Rome Treaty the driving intellectual force in Germany, the strongest continental European economy and the only one where a modern competition law was in force<sup>59</sup>.

Ordoliberal competition vision shares many characteristics with the classical liberal view of competition. The competitive market system is placed at

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was interpreted as justified by the desire to prevent that purchasers of Kodak machines locked up by the purchase were subject to excessive pricing by the producer [*Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451, 112 S. Ct. 2072 (1992)].

<sup>59</sup>Gerber (1998); Pace (2005); Vanberg (2004); Ahlborn-Padilla (2007). A collection of writings of ordoliberal legal and economic experts is in Peacock-Willgerodt (1989).

the centre of a free political order: in a state of free competition all economic players meet as equals under a legal viewpoint, and voluntary exchanges and contracts are the only means by which economic activity are coordinated. From this point of view a free competitive market has not only an economic but also a social value. What is distinctive of the ordoliberal view is the role of the legal order in ensuring a competitive market. The free market is not one without rules, but is rather characterised by a legal institutional framework in which market transactions take place<sup>60</sup>. This institutional framework requires a (explicit or implicit) constitutional choice, implying that the legal order must be conformed in such a way as to guarantee the development of a free market. Core to such legal order is a competition law system governing the use of private economic power, so as to guarantee that the freedom of contract, which is obviously central to a competitive market economy, is not used for the purpose of restricting or eliminating the freedom of contracting of other parties.

At the basis of the ordoliberal view of competition law was the protection of the competitive process through the prohibition of any form of conduct, which restrained autonomous economic behaviour. Therefore, antitrust prohibitions would apply not only to cartels (which are obviously incompatible with a competitive order) but also to other types of agreements likely to have the effect of restraining competition. As for unilateral conducts, ordoliberals thought the law should forbid practices through which a firm used its market power in order to prevent competition from other firms, or coerced the freedom of choice of consumers.

In particular ordoliberals argued that a situation where a company dominated the market was incompatible with a competitive order, unless the company competed on the merits, i.e. by superior performance. In the view of the ordoliberals this meant that the dominant company should not use practices which would significantly affect the competitive opportunities of rivals *and* which were based on their market power<sup>61</sup>.

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<sup>60</sup>As it may be clear from the preceding discussion, this view is also shared by other liberal writers, like J. Buchanan and F. Hayek.

<sup>61</sup>Kallaugher and Sher (2004) recall Prof. Ullman proposal for identifying abusive conduct: a) the conduct must affect the competition opportunities of rivals; b) the conduct must not be performance based. For instance this meant that fidelity rebates *based* on the market share of the enterprise would not be allowed: but other *kinds* of rebates, available to non dominant enterprises would be allowed. According to them this proposal was at the base of the *Hoffman La Roche* ECJ decision (see below).

From this approach it came that dominant companies should perform “as if” they were in competition<sup>62</sup>: the prescription followed that dominant companies should not indulge in practices to the consumers unavailable to firms in competition: in particular excessive prices and discrimination.

Finally, these predicaments were applied to an economic vision, which gave an important role to the structure of the industry, considered the main factor of a competitive behaviour, and which was little optimistic that a competitive order would be established spontaneously on the market. In particular, influenced by the experience of the German economy between the two wars, ordoliberalists thought that oligopolistic industries would soon evolve into cartels, leading to collective monopoly. From this point of view the “as if” paradigm was also aimed at discouraging collusion: because firms knew that they would not be able to exploit their market power on the consumer, they would have little incentive to collude<sup>63</sup>. Therefore, the ordoliberal scheme was characterized by a certain favour for smaller competitors, as they allowed the market structure to remain competitive.

## 2.2 Ordoliberalism and the shape of EC competition law

Reference to the ordoliberal vision of competition influenced the way in which EC competition law was drafted, and in which it has been applied for decades.

First, a competitive regime was thought to be instrumental with respect to the basic objectives of the Community as represented in Article 2 of the Rome Treaty, i.e. economic integration and a common market. Therefore *a system ensuring that competition in the market is not distorted* was included since the beginning in Article 3.1 among the Principles of the EC Treaty as actions necessary to achieve these objectives. As we shall see later, this inclusion gave substantial strength to the application of the competition provisions in the Treaty.

Second, as for the substantial provisions, in its first paragraph Article 81 (originally Article 85) of the Treaty forbids agreements that restrict competition, incorporating the ordoliberal aversion on cartels<sup>64</sup>. From this point of view a general prohibition of agreement which have as an “object or as effect”

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<sup>62</sup>Gerber (1998); Ahlborn-Padilla (2007)

<sup>63</sup>See Ahlborn-Padilla (2007) quoting Eucken, a leading ordoliberal. See also Vanberg (2004), who notes that ordoliberalists thought that once a competition law was in place, there would be no need for its frequent use.

<sup>64</sup>On the debate leading to the adopted version of Art. 81, see Pace (2005).

the restriction of competition is followed by a list of types of behaviour which are considered restrictive. Article 81 is however structured in such a way that according to its paragraph 3 agreements which restrict competition may be exempted from the prohibition and give rise to substantial improvements in production and distribution, in technical progress (basically efficiency effects) which are passed on to the consumers. However, in line with the ordoliberal vision, they cannot lead to elimination of competition from the market.

Article 82 (the original Article 86) forbids practices by a dominant company which restrict competition. Even in this case a number of practices are listed which exemplify a forbidden behaviour. The list is substantially identical to the one in Article 81 and this shows how the drafters of the provision were influenced by the “as if” paradigm. In fact, the list in Article 82 seems to concern mostly exploitative abuses, i.e. practices, which directly affect consumers. This is in sharp contrast with the provision in the US antitrust law, which does not provide for exploitative abuses.

Therefore EC antitrust law resents the ordoliberal inspiration in many ways. First, it is enshrined as a constitutional rule in the Treaty, and actually it is included in its basic Principles. Secondly, the competitive process is the reference point of the antitrust law, as Article 81(3) allows agreements enhancing efficiency and consumers welfare as long as they do not lead to elimination of competition from the market, while dominant companies are prevented from abusing of their position in order to restrain competition. Thirdly, an “as if” principle is stated in the provision concerning unilateral practices. Finally, while the approach is centred on the protection of a competitive process, and therefore on rivalry, Article 81 and 82 make explicit reference to the expected effects of competition on the consumers: the conditions for exempting restrictions set in Article 81(3) specify that the exempted agreement must in any case lead to transfer of benefits to the consumers. Article 82 specifies that abusive practices be forbidden in so far as they lead to restriction of competition to the detriment of the consumer.

These principles still seem to contribute to the interpretation of the EC competition law. In a recent and very debated case concerning the application of Article 82 to a rebate scheme, the Advocate General argued in its conclusion that “Article 82 EC, like other competition rules of the Treaty, is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect *the structure of the market and thus competition as such (as an institution)*, which has already been weak-

ened by the presence of a dominant undertaking on the market. In this way consumers are also indirectly protected. Because where competition as such is damaged, disadvantages to consumers are also to be feared”.<sup>65</sup> There is a definite ordoliberal influence in this statement, in the reference both to competition as an institution, and to the structure of the market. Furthermore, consumers’ interests are viewed as indirectly protected by the protection of competition, and not as the direct objectives of this protection.

### 2.3 Early application of EC competition rules

Application of articles 81 and 82 by the Commission and the European Courts has been for a long time guided with attention to the formal characteristics of the practices they concerned rather than to the actual effects on the markets.

As for agreements, this formalistic attitude was reinforced by the enactment, in 1962, of Council Regulation No. 17, which established the criteria for application of competition rules. In fact Regulation No. 17 introduced a notification system, whereby Article 81(3) exemptions could be applied only to agreements which had been notified to the EC Commission or which conformed to the criteria set in general exemption regulation (*block exemptions*) issued by the same Commission.

The Commission interpreted the prohibition in Article 81(1) very narrowly, and issued block exemption regulations detailing very closely the clauses of the agreements, distinguishing between clauses which were prohibited in any case (*black list*) and those which were allowed (*white list*). Therefore agreements tended to be structured closely following the allowed clauses.

In the case of “vertical” restraints, the formalistic attitude of the Commission was reinforced by the presumption that agreements between producers and distributors limiting the autonomy of the latter could lead to artificial segmentation of the European market. Therefore, in the early European experience (and until recently) Article 81(1) was applied very restrictively to vertical restraints and a great relevance was given to provisions in the agreements which could limit the distributors’ ability to sell to consumers in different geographical markets.

In the area of unilateral behaviour, we have noted that Article 82 seems

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<sup>65</sup>Opinion of Advocate General Kokott in (C-95/04), *British Airways vs. Commission of the European Communities*, delivered 23 February 2006, par. 86.

to be concerned with the exploitation of the consumers. In fact, there has been a limited application of Article 82 to exploitative abuses.<sup>66</sup>

However in some fundamental decisions the European Court of Justice (ECJ) interpreted the prohibition as aimed at practices which harmed competitors, and established the limits to the behaviour of a dominant company, in order to protect the competitive process. In *Continental Can*, a case in which the Commission tried to prevent the acquisition by an American company producing metal containers of a competitor in the same sector, the ECJ, while voiding the Commission decision, stated that the objective of EC competition law is to protect the competitive process; therefore conducts which weaken the competitive structure of the markets so as to impose damage to the consumers are prohibited<sup>67</sup>. A relevant point is that in order to include acquisitions under the prohibition of Article 82, the Court made reference to the role of competition in the achievement of EC basic objectives, expressly referring to Article 3(1)g and Article 2. The Court recurred to this teleological interpretation in other instances, when it had to argue that some limits to individual rights should be introduced in order to make them compatible with the role of competition in the Treaty: in particular, it used this approach in its first essential facility case, *ICI-Commercial Solvents*<sup>68</sup>.

An aspect of particular interest of the Court's approach to unilateral behaviour has been the characterization of an abuse of dominance as an objective concept: insofar as the behaviour is liable to restrict competition the same is abusive, irrespective of the intent of the firm. This conclusion derives from the already noted approach that a dominant company must compete only on the merits, and therefore it has a "special responsibility" to perform "as if" it were in competition and therefore should not restrict competition<sup>69</sup>.

This approach has led to a stream of decisions which tend to limit the behaviour of dominant suppliers to competition on performance. This has led

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<sup>66</sup>In particular, there has been a number of instances where the Commission has applied Article 82 to cases in which dominant firms were thought to apply excessive prices. For a list and a discussion see Motta-de Stael (2003). While the ECJ has recognized the applicability of Article 82 in these cases, it has generally found unsatisfactory the criteria according to which the price was considered excessive.

<sup>67</sup>See *Europemballage Co. and Continental Can Co v. Commission* C-6/72 (1973).

<sup>68</sup>See *Istituto Chemioterapico Italiano and Commercial Solvents v Commission* C-6&7/73 (1974).

<sup>69</sup>See case C-85/72, *Hoffman Laroche & Co. AG vs. Commission* (1979), par. 91.

to the prohibition of practices which, when adopted by dominant suppliers, could have as effect the exclusion of competitors from the market. Among these are, in particular, exclusive agreements which are deemed to foreclose the market to competitors<sup>70</sup>; discounts which are designed to exclude competition<sup>71</sup>; refusals to deal with the competitors in the provision of input necessary for operating on the market<sup>72</sup>.

These decisions have been criticized for not being based on economic analysis. Basically, the criticisms concerned two aspects. First it seemed that the Commission and the Courts evaluated conducts on the basis of their formal characteristics, and not on the basis of the actual or potential exclusionary effects that they could be expected to have in the specific context. Secondly, the analysis did not examine whether the exclusion leads to undesirable restriction of competition, or rather was justified on efficiency grounds. As a result the application of the law in the field of unilateral practices tended to concern practices, which were in fact beneficial to the consumer and at the sole effect to lead to the protection of inefficient competitors rather than competition.<sup>73</sup>

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<sup>70</sup>For instance *Hoffman Laroche & Co. AG vs. Commission*, above ; *United Brands Company* C- 335/76 (1976); Case T-65/98, *Van den Bergh Foods v. Commission*. T 65/98 (2004)

<sup>71</sup>For instance *Nederlandsche Banden Industrie Michelin v. Commission* C 322/81 (1983) (Michelin I); *British Airways v Commission of the European Communities* quoted above; and *Michelin v Commission of the European Communities*, CaseT-203/01 (2004) (Michelin II).

<sup>72</sup>For instance *ICI- Commercial Solvents* quoted above; *IMS Health GmbH & Co. OHG and NDC Health GmbH & Co. KG.*, Case C-418/01.

<sup>73</sup>For instance, in the case of *ICI*, the company, which was the only producer of aminobutanol, which it used to produce solvents, decided to enter in the market for ethambutol, a pharmaceutical product for which aminobutanol was an input. Therefore it terminated its supply agreement with Zoja. The Commission and the Court made an early application of the essential facility doctrine, and sanctioned the behaviour as refusal to deal. However *ICI* was substituting for Zoja, and there was no change in the competitive situation from the point of view of the consumer. In *United Brands*, the company tried to terminate and then boycott a distributor which had undertaken to distribute bananas also from a competitor. It is doubtful that the termination would have lead to a reduction of supply to the consumer: actually two different distributors of different brands would have competed more effectively. See Fox (1981).

## 2.4 Towards a greater role for economic analysis

During the 1990s substantial changes have taken place in the application of EC competition law, towards a greater reliance of economic analysis. In turn, these changes were the result of several factors.

### a) Factors of change

First, after fifteen years of discussions, in late 1989 Council Regulation 4069/89 introduced a mandatory control for mergers of Community dimensions in the EC. The introduction took place according to Article 308 of the Treaty (at the time Article 235) according to which the Council may introduce new legislation, which is essential for pursuing the objectives of the European Community. Recourse to this Article was therefore based on the fundamental role that competition law was considered to have on the achievement of the basic Community aims on the basis of Article 3(1) and Article 2 of the Treaty.

The introduction of merger control had important consequences on competition law at large because merger analysis is perspective and concerns the expected effects of the merger on competition in the market. Therefore it is mainly based on the analysis of the economic structure and conditions in the market, at a time in which attention to efficiencies had already been put at the centre of antitrust economic analysis. This in turn influenced the formalistic attitude in the analysis under Article 81 and 82 as well.

Secondly, in the 1980s and early 1990s in a number of decisions concerning vertical restraints, the ECJ stated the need for evaluating prohibition under Article 81(1) in their economic and legal context<sup>74</sup>. The issue raised by the ECJ was that, with the exception of hard-core restrictions concerning price fixing or market sharing, vertical and cooperative agreements could not in principle be considered as restrictive by object. They could well pursue a legitimate interest, and therefore would not need to be prohibited (and thus did not need an exemption under Article 81(3)). This analysis was later extended to horizontal cooperation agreements<sup>75</sup>.

It may be relevant to clear that in these judgments the ECJ was not arguing for an application of Article 81(1) on the basis of the “rule of reason”:

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<sup>74</sup>*L. C. Nungesser Kg E Kurt Eisele v. Commission of the European Communities*, Case 258/78, (1982) ; *Pronuptia de Paris v. Schillgallis*, Case 161/84, (1986); *De Limitis v. Henninger Bräu*, Case C-234/89, (1991).

<sup>75</sup>Court of First Instance in Case T-374/94, *European Night Services v. Commission*, (1998).

according to the Court, as later specified in *Metropole*,<sup>76</sup> the balancing of pro and anti-competitive effects of agreements should take place within Article 81(3). Rather, the ECJ was arguing that with the exception of hard-core restrictions, agreements *cannot be presumed* to be restrictive and suggested that attention should be given to the economic context in which practices took place.

Third, at the turn of the 1980s competition legislation was introduced in a number of countries (Ireland, Italy), or was modified in those which already had one (France, Spain). Usually these new laws were structured according to the provision of Article 81 and 82 of the EC Competition Law. However, the way they were applied was often less legalistic and more influenced by modern antitrust doctrine, giving more weight to the role of efficiency in the explanation of practices, and requiring analysis of their effects on consumer welfare. This gave more strength to the opinion of those who thought the application of EC Competition Law would move toward an economic-based approach, oriented by the developments in legal and economic analysis we have examined before<sup>77</sup>.

Finally, also as a result of the above, the Commission decided to move its attention from vertical to horizontal restraints, and in particular to cartel enforcement, channelling its resources toward this task.

*b) Article 81 and vertical restraints*

The treatment of agreements was the area which was first affected by change. In particular, a first step was to question the way in which Article 81 was applied to vertical restraints. In the US, already in the 1970s the *Sylvania* doctrine had excluded a *per se* prohibition of exclusive agreements. The decisions of the ECJ, which we have referred to above, followed the same inspiration<sup>78</sup>. Therefore, it seemed appropriate to revise the EC approach as well. In the then existing framework of Reg. 17/62 the intent was reached through the enactment of a *block exemption* for vertical agreements which exempted agreements undertaken by concerns which had less than 30% of the market, and in the issuance of detailed guidelines which were based on a thorough economic analysis of the effects of the agreements<sup>79</sup>.

<sup>76</sup>See *Métropole Television SA and Others vs Commission* C 75/84 (1996).

<sup>77</sup>Among the early critics see Korah (1990); Pera-Todino (1996); Siragusa (1997).

<sup>78</sup>While these decisions did not argue for the application of the rule of reason, they called for an economic analysis of practices. See Amato (1997).

<sup>79</sup>Regulation on the application of Art.81 par. 3 to certain categories of vertical agreements and concerted practices, Reg 2790, 22.12, 1999 and the Guidelines on Vertical

The regulation extended an exemption to vertical agreements whereby the market share of the parties concerned were below 30%, unless they had as their object retail price maintenance or exclusive territorial restrictions, leaving however the possibility of a prohibition in case an agreement corresponding to a lower market share had a restrictive effect. The Guidelines, issued in 2000, went in detail to specify the criteria according to which the effects of the agreements would be evaluated. It is relevant that in the guidelines the relevance of vertical restraints to the end of achieving efficiency is clearly recognized, and the direct and indirect effect on consumers of agreements according to the criterion set in Article 81(3) becomes the standard according to which to evaluate the degree of restriction.

The same line of thought led the Commission to formulate three set of guidelines on horizontal cooperation (2000), according to which agreements aimed at cooperation in research and development, specialization and transfer of technologies would be automatically exempted under article 81(1), as long as the market shares of the participating enterprises was sufficiently low, and firms were independent in the phase of commercialization.<sup>80</sup>

Altogether, the new approach made less relevant the distinction between Article 81(1) and 81(3) as even agreements which would fall under Article 81(1) would be automatically exempt if they would be covered by the provisions of the guidelines.

*c) Modernization*

However, the introduction of an economic approach has had even more far-reaching consequences: it put in question the same way in which Reg. 17/62 governed the application of Article 81, and in particular the Article 81(3) authorization system. Therefore, even before the vertical regulation was enacted, the Commission issued a White Paper for the modernization of the application of EC competition law<sup>81</sup>. After three years of public discussion, this led to the adoption of a new Council Regulation, Reg. 1/2003, the Modernization Regulation, which completely overhauled the criteria set in Reg. 17/62.

The Modernization Regulation had many aims, among which the increase

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Restrictions O.J.E.C. C 291 of 13.10.2000.

<sup>80</sup>Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, O.J.E.C. C 3 of 6/1/2001.

<sup>81</sup>White Paper on modernization of the rules implementing Articles 85 and 86 of the EC Treaty, OJ C 132, 12.5.1999.

in the investigative power of the Commission, the introduction of new powers and types of decision and the possibility to open sector inquiries. Furthermore the regulation states the prevalence of EC competition provisions over national competition law, so that EC competition law becomes the one and only competition law for practices affecting the common market; and it dictates the criteria for a decentralized application of EC competition law<sup>82</sup>.

However, to our goals, three aspects are really relevant. Firstly, the regulation completely overhauled the previous system of application of Article 81 based on notifications, introducing a “legal exception” system whereby agreements are evaluated *ex post* on the bases of the whole of Article 81. The legal exception system makes explicit that the criteria of application of the “rule of reason” based on economic analysis become the rule for the application of article 81. This may not appear particularly new: we have noted that in *Metropole* the ECJ, while arguing that Article 81(1) was not concerned with the rule of reason but with the inherent characteristics of the restrictions, remarked that the rule of reason analysis should be performed through the application of Article 81(3). However, at the time a widespread application of the rule of reason was prevented by the fact that exemptions could be obtained only through a notification to the Commission. Now, instead, this criterion becomes the rule for the Commission, the national authorities and the national judges.

This wider recourse to the rule of reason obviously gives great importance to the system of legal and economic presumptions concerning the practices under examination. As for legal presumptions, Regulation 1/2003, following previous EC jurisprudence, specifies that the burden of proof of proving restrictions under Article 81(1) is on the plaintiff, be it the Commission, a national authority or a private party in front of a judge, while the burden of proof of the exception under Article 81(3) is on the defendant. Economic presumptions follow from economic analysis, which may provide an *ex-ante* evaluation of the expected effect of the conducts on competition, and may provide the economic criteria according to which the presumptions may be verified.

These legal and economic criteria have been further explained by the Commission, in its 2004 notice on the application of Article 81(3), which gives ample consideration to the possibility that arrangements and practices

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<sup>82</sup>See among the others Gerber-Cassinis (2006).

may result in positive effects on consumer welfare<sup>83</sup>.

That consumer welfare has become the standard for evaluating the competitive harm is shown by the recent decision of the Court of First Instance (CFI) in the case *Glaxo-Smith Kline*<sup>84</sup>. The case concerned an imposition by GSK to its distributors in Spain not to re-export its drugs, which were sold at an administered price set at a much lower level than in other European countries. The Commission had argued that GSK unilateral imposition was equivalent to an agreement. And pretended that the export ban hampered competition. The CFI, while refusing the first argument, argued that there was in fact no restriction of competition in the new markets, because the practice did not reduce consumer welfare: in fact, because drug prices in all the EU countries are administered by law, parallel exports did not lead to any improvement in consumer welfare and rather corresponded to a mere transfer of profits from producers to parallel exporters.

f) *Work in progress: Article 82*

In the field of Article 82, concerning the abuses of dominance, the role of economic analysis appears to have evolved more slowly. A stream of economic analysis according to which the structure of the market was particularly relevant has for a long time guided the Commission and the Courts.

In particular, this approach is reflected in the treatment given to practices such refusal to deal and rebates by dominant companies. Since *ICI*, the Commission has sanctioned refusals to deal by a dominant company, and has elaborated a wide-ranging doctrine of access to essential facilities, which requires a dominant company to guarantee access to an input it controls every time that such an access is necessary to effectively compete in the market and the input cannot be reproduced economically. Such a provision extends to IP rights when the aim of IP rights is necessary to offer a new product.

Despite this doctrine has been given economically reasonable interpretation, guided by economic considerations in *Oscar Bronner*<sup>85</sup>, it appears that in other cases, ranging from *ICI* to the recent *IMS Health*<sup>86</sup>, the Commission and the Court had been mainly guided by the preoccupation to maintain access to the market, even when this was not clearly justified by economic

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<sup>83</sup>Guidelines on the application of Article 81(3) of the Treaty, O.J.E.C. C 101 of 17.4.2004.

<sup>84</sup>*Glaxo Smith Kline Services v. Commission* T 168/01 (2006).

<sup>85</sup>See *Bronner/Mediaprint*, Case C-7/97, (1998).

<sup>86</sup>See *IMS Health* above).

considerations.

Over time, a drive towards a more economically based antitrust analysis emerged also in the context of Article 82 enforcement<sup>87</sup>.

However, a widespread perception exists that the enforcement of Article 82 EC continues to be driven by the consideration of structural aspects<sup>88</sup>.

This attitude may be traced also in cases involving rebates, a particularly delicate subject, as it involves practices which are likely to benefit consumers: even so the Commission has applied a very formalistic analysis, considering that rebates by a dominant company should only be based on cost efficiencies deriving from the level of sales, and they should therefore be proportional to sales. Other kinds of discounts were usually considered restrictive. In particular, in *Michelin II*, in reviewing a Commission decision concerning rebates, the ECJ evaluated that it was not necessary that discounts are proved to have caused exclusion, and that it was enough to argue that they could have the “likely” effects on competitors. Even more remarkably, in *Michelin II* and in another case concerning rebates (*BA-Virgin Atlantic*), the Commission, and later the EC Courts, reached the conclusion that the practice was restrictive despite the fact that the market shares of the dominant company had declined (*Michelin II*) or had not increased. It is notable that in these cases the issue of a pro-competitive justification for the rebates was submitted to the CFI and the ECJ, which however preferred to stay to the settled law<sup>89</sup>.

In 2005 the Commission presented a discussion paper on the application of Article 82 to exclusionary practices, in which it tried to reconsider its approach on the basis of a more sophisticated application of economic analysis<sup>90</sup>. The Commission aims at defining criteria of analysis of unilateral practices based on their effects on competition, rather than on formalistic classifications. To this goal it has adopted a benchmark based on the defi-

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<sup>87</sup>For instance, a refinement of economic analysis has taken place in predatory pricing cases leading to *Akzo*, where the ECJ spelled out the criteria for holding predatory pricing anti-competitive. [*AKZO v. Commission of the European Communities*, Case C-62/86, (1991)] The CFI’s ruling in *Van den Bergh* conveyed a message purporting that a substantial degree of foreclosure must be shown to pursue an article 82 case. See *Van den Berg* above.

<sup>88</sup>Hildebrand (2002); Gyselen (2003); Kaullager-Sher (2004).

<sup>89</sup>See cases *Michelin II* and *British Airway* above.

<sup>90</sup>EC Commission - DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005.

nition of an “as efficient competitor” i.e. a hypothetical competitor, which would have the same cost as the dominant company. Practices leading to the exclusion of less efficient competitors, in fact, cannot be considered anti-competitive because they derive from superior performance. Therefore, this text gives substance to the criteria of “competition on the merits”. Such an approach is also an approximation to the test concerning the effects of a practice on consumer surplus. In fact, even if one argues that the restrictiveness of a practice can only be evaluated by its effects on prices and quantities, and therefore on consumer welfare, it is sometimes difficult to actually estimate what these effects will be. The analyses of the exclusionary effects on the “as-efficient competitor” would then represent an approximation to a test based on the effect on consumer welfare. On this basis, criteria deriving from economic analysis are defined for each kind of practice (predatory pricing, rebates, refusals to deal) which allow distributing the burden of proof between the plaintiff (or the Commission) and the defendant.

In particular, the Commission goes at length discussing various kinds of defences that it is willing to consider before different kinds of restrictive practices. In this context the Commission proposes to consider an “efficiency defence”, whereby unilateral practices might be justified on efficiency grounds, as long as they conform to the criteria set in Article 81(3), i.e. they do not lead to elimination of competition, and give rise to a transfer of benefit to the consumers.

The proposed guidelines represent a substantial move towards an economic analysis of Article 82. Still, they represent a mix of structural and efficiency analysis<sup>91</sup>. In particular, the indication that a dominant position could be defined at market shares as low as 25% (while in the ECJ jurisprudence such a threshold is generally set above 40%) seems inspired by the structuralist analysis. Also, while the program of the proposed guidelines is to offer a paradigm based on effects, in the actual proposals, economic analysis is used to standardize a series of commercial behaviors that *are presumed* to lead to exclusion of an efficient competitor.

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<sup>91</sup>According to Ahlborn-Padilla (2007), the Commission Draft Guidelines represent a rationalization of the traditional approach. G. Monti (2006) shares this view, however noting the lower threshold for dominance could indicate the Commission has in fact shifted to a Substantial Market Power approach, more restrictive than dominance.

## 2.5 Ordoliberal tradition and reform

The previous analysis shows that the process of change in the application of EC competition law was mostly directed at improving legal decision through the application of economic analysis, along the lines suggested by the developments we discussed in Section I. In particular, the framework of assessment used by the Commission relies on economic analysis of the efficiency effects of the practices on competitors as well as on the consumers.

However, one may wonder how much the introduction of economic analysis based on consumer welfare, or on more refined criteria of economic and legal evaluation, is in fact compatible with a paradigm in which the basic objective of competition law was the protection of the competitive process based on rivalry, according to the traditional ordoliberal interpretation. All the more so because, as we shall see, in various occasions the Commission has argued that the aim of competition policy is “to protect competition in the market as a means of enhancing consumer welfare and ensure an efficient allocation of resources”, therefore endorsing an efficiency-based approach to competition law.

From this point of view, however, it is probably appropriate to distinguish between the ordoliberal legal vision and the ordoliberal economic analysis. Only the first one seems essential to the ordoliberal paradigm, and consists of the constitutional role of competition law in the legal order, and therefore of the role of the process of competition as a distinct objective of the law.

However, it is far from clear that such a legal vision must be necessarily connected to the economic analysis which characterized the early ordoliberal thinkers and which was the consequence of both the historical experience of Germany in the 1920s and 1930s and of the inspiration by the structuralist paradigm.

In particular, the development of the criteria for the application of EC competition law took place at a time in which structuralism was the dominant paradigm of analysis. As we have discussed, this paradigm suggested wide use of *per se* prohibitions of agreements aiming at limiting autonomous behaviour. In the US, the *Schwinn* doctrine about vertical agreements prevented exclusive distribution. Cooperative agreements were seen as potential instruments of collusion. And the maintenance of a certain structure of the market was seen as the guiding principle for evaluating unilateral conduct. This framework of analysis was dominant until the early 1970s. In this

context, the approach to vertical agreements in the EC can certainly be considered overzealous, but the application of the EC law may be considered not incompatible with the then prevailing schemes of economic analysis.

If structuralism is disentangled from the ordoliberal paradigm, the issue then becomes whether an approach based on the protection of the competitive process is compatible with the application of modern economic analysis. We have already argued at the end of Section I that an analysis based on the effects of the practices could well be compatible with such an approach, provided that efficiency effects are not considered to justify elimination of competition, or its reduction unrelated to the benefits to the consumers.

One can further note that it is not the attention to the competitive process which led to the excessive formalism in the application of Article 81. As we have argued earlier, this appears in fact to depend on the way in which the Commission tended to interpret Article 81. This in turn depended on its preoccupation with the objective of market integration, and the risk that vertical agreements could lead to geographical segmentation.

A clear indication comes from comparing the practice of the Commission with the decisional practice of the ECJ in the field of agreements. Already in 1966, in *Technique Minière*<sup>92</sup>, in examining a case of exclusive distribution, the ECJ argued that once the practice does not have as an “object” the restriction of competition, i.e. the fixing of prices or the subdivision of the market, the prohibition in Article 81(1) should be evaluated on the basis of the legal and economic context in which the agreement took place. The Court therefore opened the way to an economic interpretation of the law, which could go beyond a formalistic prohibition.

The fact that such path was not followed depended on the prevalence at the time of the preoccupation of market integration: in the *Consten/Grundig* decision, the Commission considered as forbidden by objective a clause of exclusive territorial restriction protecting Consten, which was the exclusive distributor of Grundig in France, despite the parties had argued that the clause aimed to protect its investment in the development of the business. The Court accepted this position<sup>93</sup>. This decision, together with the way in which the Commission interpreted the two-step analysis in Article 81, opened the way to the formalistic approach we have described above.

However, in the above-mentioned Article 81 decisions of the 1980s and

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<sup>92</sup>See *Société La Technique Minière v Maschinenbau Ulm GmbH* C- 56/65 (1966).

<sup>93</sup>See *Consten & Grundig vs. Commission* C 64/556 (1964)

1990s, the ECJ again stated that with the exception of hard-core restrictions, agreements could not be presumed to be restrictive without an economic analysis.

These assessments are important because they were reached by the ECJ within the context of the traditional analytical scheme inspired by the ordoliberal tradition. Therefore they implied that, even in that context, a meaningful economic analysis should be carried out before concluding that a restriction to the autonomy of the contracting parties would have “as an objective or as an effect” a restriction of competition, or rather it was just a way to achieve other legitimate objectives, like a better sharing of risks or the creation of appropriate incentives, without any negative impact on competition in the market.

In the field of unilateral exclusionary practices the evidence is less clear-cut. At various instances both the Commission and the EC Courts have argued that, even within the traditional paradigm of competition on the merits, the evaluation of the exclusionary effects of the practices should be made on the basis of economic analysis, in order not to hamper practices leading to increases in consumer welfare. However in practice even in this case the evaluation has tended to qualify as restrictive certain practices without further inquiry about their effects.

However, it is doubtful that this conclusion derives from the use of the paradigm of competition on the merits, rather than from its actual application. Performance competition is in fact a vague concept, which must be filled with recourse to economic paradigm, which takes into account the significance and implications on the practice at hand, and in particular its effects on the market. If the practice is the result of a superior performance it may lead to the exclusion of a competitor, but also to an improvement of the supply conditions and to a better treatment of the consumer. We have seen that criteria can be devised to take into account the effects from the side of the consumer, as well as from the point of view of the excluded enterprise. However, most EC decisions in the field of unilateral practices do not appear to conform to these criteria. In fact, the EC approach, has continued to be guided by the idea that the working of the competitive process is related to a certain structure of the market. And this seems at the moment the most relevant problem with the treatment of unilateral practices.

## **2.6 New Rethorics in EC Competition Law**

In the previous pages we have argued that the traditional approach to EC competition law is not incompatible with an increasing role of economic analysis. However, in recent years the Commission seems to have taken a different orientation. The change seems to have taken place with the arrival of Commissioner Monti, who soon put the emphasis on the role of competition law and policy in increasing consumer welfare.<sup>94</sup> This orientation has soon become the official position of the Commission: this is the approach followed in the 2004 Commission notice on the application of Article 81/3, where it is specified that the objective of antitrust law “is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources”.<sup>95</sup>

In a number of speeches, the successor of Mr Monti, Commissioner Neelie Kroes, and Director General Philip Lowe stated even more clearly that “competition is not an objective itself, but is an instrument for achieving consumer welfare and efficiency.”<sup>96</sup>

In a recent speech, Lowe explicitly underlined the difference between the old and the new approach.<sup>97</sup> He made direct reference to the old ordoliberal paradigm calling for protection of the competitive process, and argued that the Commission has now decided to follow a different paradigm, based on an economic interpretation of competition as an instrument for achieving consumer welfare and efficiency. It follows that practices will be examined on the basis of their effects on these objectives. The new attitude of the Commission has therefore be taken as a clear sign that, as a consequence of more attention to economic analysis and effects of the practices, application of EC competition law is now inspired by the same principles which appear to inspire US antitrust<sup>98</sup>.

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<sup>94</sup>In one of his last speeches as Commissioner “Competition for Consumer’s Benefit”, at the 2004 Competition Day in Amsterdam, Mr Monti recalled that “I said in my hearing before the European Parliament back in 1999(...)that I would give “central importance to the consumer”.

<sup>95</sup>See Guidelines on the application of Article 81(3) of the Treaty, above, par. 13.

<sup>96</sup>See speech of Neelie Kroes at the London Competition Day, September 2005; in the same vein speech of Philip Lowe at the Cartel Conference held by the Bundeskartellamt in Munich, march 2007, “Consumer Welfare and Efficiency – New Guiding Principle for Competition Law”.

<sup>97</sup>See the speech quoted above.

<sup>98</sup>Heimler (2007).

However, this new approach rises a number of issues. The first one is how effective the shift has been. While it is true that in some decisions the CFI and the ECJ have recognized the role of consumer welfare as a criterion for evaluating restrictiveness, as we have seen the ECJ in particular still seems to refer to the competitive process as the objective of the law.

Second, while the Commission undoubtedly appears to be willing to base its decisions on an approach grounded on economic analysis, the general context in which this is taking place does not appear to be similar to the one in which the diffusion of the efficiency-based approach has taken place in the US. There the establishment of the efficiency-based paradigm has taken place in connection with a vision of competition guided by incentives, characterized by the preoccupation of what we have called “type 1” errors, i.e. that enforcement of antitrust law may hamper efficient practices. In this context, an efficiency-based approach was seen as ensuring that the constraints to the creative force of competition were minimal.

This approach seems hardly compatible with the current evolution in Europe. Here there seems to be less confidence about the ability of the incentives to lead to vigorous competition, and more confidence in the ability of antitrust law to achieve desirable results. And a vigorous application of antitrust is suggested in order to remove private obstacles to competition, which are considered to still pervasive<sup>99</sup>. Such an application, in fact, is guided by very activist intervention, at the basis of which it is possible to discover a preoccupation with the market structure and the appropriate behaviour of dominant firms. The differences between the attitudes in the application of US and European antitrust are therefore becoming wider<sup>100</sup>. In such context it is not surprising that there are some ambiguities in the self-proclaimed orientation of the Commission towards an efficiency-based paradigm, as we have seen with reference both to decision making, and to the way in which guidelines for action (in particular for Article 82) are devised.

In fact, the call for a different approach to the application of competition law could be interpreted as a rhetorical argument in order to underline the serious commitment of the Commission to an approach to antitrust law based on objective criteria. In turn, a number of factors may explain the need for this..

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<sup>99</sup>Venit (2007), Padilla-Ahlborn (2007).

<sup>100</sup>See the article by former Assistant Attorney General for Antitrust of the Clinton Administration W. Kolasky (2008), raising doubts on the US approach.

First, the initial emphasis by Commissioner Monti on the approach was undoubtedly dictated by the need to find a ground of convergence with the US approach. In the late nineties and at the beginning of this decade controversies have arisen between the Commission and the US Antitrust Authorities concerning the treatment of efficiencies in merger. In particular, in two cases, *Boeing/Mc Donnell Douglas*<sup>101</sup> and *GE/Honeywell*<sup>102</sup>, the US Authorities argued that the analysis of the Commission was guided by a scant attention to economic analysis and efficiency effects of mergers, with the result of protecting competitors rather than competition. The Monti approach was meant to show that the Commission approach is not different from the one of the US Authorities and that the conclusions reached in particular in the GE/Honeywell case depended only on different evaluations on the ground of economic analysis.

A second relevant factor is the drive of the Commission towards a vigorous application of competition law, in the framework of a wider competition policy directed to remove the obstacles to competition in the European Union. Since the late-1980s the Commission is leading a drive towards liberalization of previously regulated sectors and elimination of State-created barriers to an integrated market in service sectors<sup>103</sup>. This attitude has been strengthened by the conclusion of the 2000 Lisbon Intergovernmental Conference, fixing ambitious goals for the European economic system (THE II. In this scenario, the reference to a paradigm of application based on objective, efficiency based, criteria represented a guarantee for the European enterprises that such a rigorous approach would be applied on the basis of objective criteria.

A third relevant factor concerns an evaluation of the political alliances, which could help the Commission in its enforcement efforts. While competition has become a bi-partisan paradigm, Commissioner Monti appears to have perceived that there wasn't much support for the liberalization policies of the Commission in a number of important countries. Therefore, he thought that the political backing of consumers represented an important asset for the Commission: and accordingly he intensified efforts to create links

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<sup>101</sup>Commission decision of 30 July 1997, *Boeing/McDonnell Douglas*, Case No IV/m.877 (1997).

<sup>102</sup>Commission decision of 3 July 2001, *General Electric/Honeywell*, Case No. COMP/M.2220. (2004).

<sup>103</sup>See Anderson-Heimler (2007)

with consumers' associations and to show consumers the role that competition could play in fostering consumers' welfare (for example, by introducing the Consumer Liaison Office). In this sense, he could also profit from the development in the policies for the protection of consumers undertaken by the Community in the late 1990s.

Finally, the recourse to an efficiency paradigm also appeared useful to overcome the traditional dilemma that afflicted the application of competition law in the previous decades: as we noted, competition law has been seen not only as a tool aimed at maintaining competition in the market, but also to eliminating obstacles to market integration. This explains the role of vertical restraints in the EC experience. Also drawing on his previous experience as Commissioner for the Internal Market, Monti's approach was to see these two objectives as just instruments to achieve the final goals of consumer welfare and efficiency: "competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the community for the benefit of the consumer."<sup>104</sup> In fact, in its exposition of the benefits brought by the application of competition law to the European consumers, Monti usually referred to cases in which benefits to consumers derived from interventions against practices aimed at segmenting the common market<sup>105</sup>.

While the new approach may satisfy some of the strategic objectives pursued by the Commission, and in particular by the Competition Commissioner and Directorate General, it raises the issue whether the call for a competition policy in the interest of the consumers may not induce an application of the law in which consumers interest substitute for competition and a distributional "consumerist" element is introduced in the administration of competition law. The Commission seems conscious of this problem. In the speech we quoted earlier, Lowe argues that once we define consumer welfare as the objective of the law, a trade-off may appear with respect to practices which may be the result or the consequence of efficient competitive behaviour of firms.

Such a preoccupation seems justified by the presence in the EC competition law, and in particular in Article 82, of a pro-consumer orientation represented by the prohibition of excessive price by a company in dominant

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<sup>104</sup>Guidelines on Vertical Restrictions 2000 quoted above, par. 7.

<sup>105</sup>See for instance his speech in Athens. "Competition Enforcement and the Interest of Consumers: a Stable Link in Times of Change" February 2003.

position. There are a number of reasons for the introduction of the excessive pricing provision in the EC legislation. One is the displeasure of the traditional ordoliberal approach with monopolistic power, and the ensuing precept that dominant companies should behave “as if” they were in competition, also with respect to consumers. Other reasons may be found in the situation of the European economy at the time of the institution of the European Community. At that time markets were fragmented by national borders, and in a number of sectors they were dominated by large national champions, while regulatory institutions were not well developed; therefore, a provision against excessive pricing may well have been justified.

However, many of these reasons do not seem to hold any longer: the European market is highly integrated; most previously monopolistic sectors have been liberalized and regulatory institutions have been established in all countries; in a number of innovative sectors high prices compared to costs may reward previous investment in research, or may just be the reward for the first to reach the market; there seem to be good reasons to leave the market be oriented by profit opportunities provided by high prices compared by costs, when they are not the result of collusion.

In fact, the main reason against the use of an excessive price provision is that it goes straight against the rationale of antitrust law: protecting the competitive process guided by rivalry and therefore by incentives. It ends up transforming the Competition Authority in a regulator, stifling competition.<sup>106</sup> That is why such a provision should be used only when the monopoly depends on legal exclusives, and in any case it represents a second best solution with respect to elimination of the limits to competition. A second reason, and the one on which the European Courts have found most convincing, is the great difficulty in evaluating when a price is actually excessive. As we noted, there have been a few cases in which the Commission pursued companies for practicing excessive prices. While the ECJ has recognized the applicability of Article 82 in these cases, it has generally found unsatisfactory the criteria according to which the price was considered excessive<sup>107</sup>.

However, in recent times there seems to be a trend toward a wider appli-

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<sup>106</sup>Motta - de Steel (2003).

<sup>107</sup>In particular, Emil Paulis, an influential officer at the Commission has recently argued that this is the main obstacle to the application of Art. 82 to exclusionary practices. See Paulis (2007).

cation of the excessive price provision. Pressure for its application is coming from a number of national authorities, now empowered to apply Article 82<sup>108</sup>. The Commission itself is thinking of widening the Guidelines on the application of Article 82 to exclusionary abuses to include exploitative abuses, if only to clarify the limits to its application. In this context, the issue of an application of the law not guided by a consumerist orientation arises.

## 2.7 The role of competition law in the Community legal order

The change intervened in the approach to the final objective of competition law may be seen in the context of the recent debate about the role of competition in the reform of the EC Treaty, following the failed attempt to adopt a Constitutional Treaty.

We have already mentioned that in the original Treaty of Rome competition stands in Article 3 as one of the actions guaranteeing the achievement of the objective of the Communities as defined in Article 2. While competition was not among the direct objectives of the Treaty, nevertheless it was a necessary instrument. Furthermore, as we have noted, Article 3 puts competition within the first part of the Treaty, referring to the Principles. This is why in a number of cases the EC Courts have made reference to the position of competition in the Treaty for giving an extensive interpretation of the competition rules in the Treaty (Article 81-86) with respect to the economic agents and the member States.

We have already noted that the ECJ referred to the role of competition in Article 3 in order to extend the interpretation of Article 82 to prohibition of certain kinds of exclusionary abuses. Such a teleological interpretation has been at times adopted in order to allow use of the law to effectively pursue the objectives of competition. Another instance in which such interpretation was used has been in considering anti-competitive behaviour of enterprises, which appeared to be justified by national legislation. In such cases the ECJ argued for an application of relevant competition rules on the basis of the need to safeguard the application of competition law and of the principle of loyal cooperation of the member States in the Commission, stated in Article 10 of the EC Treaty<sup>109</sup>. Finally, as we have seen in the case of the merger reg-

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<sup>108</sup>See for instance the views of A.Fletcher, an OFT official, at the round table on excessive prices held by the Global Competition review, in January 2008.

<sup>109</sup>The first case was *Inno v. Atab* C 13/77 (1977), a more recent case, concerning the application of sanctions was *Consorzio Industrie Fiammiferi v. Autorità garante della*

ulation, the reference to competition in Article 3 also allowed the adoption of normative instruments, which were thought to be necessary for guaranteeing a competitive regime on the basis of Article 308.

The role has been even more important in the activity of the Commission with respect to measures regarding competition undertaken by member States, and therefore in the context of its approach to competition policy, which we do not discuss here.

In any case, from these examples it seems that while a competitive regime does not appear among the final objectives of the Treaty, competition law was given a special role in the European construction, very much according to the ordoliberal principles. This role has remained through the various changes induced by the Maastricht and Amsterdam Treaties. It was enhanced during the discussion leading to the Project of Constitutional Treaty approved by the European Convention, delivered in July 2003 and abandoned four years thereafter. Competition entered in fact twice in part 1 of the Project, which included the objectives of the Union. First Article I.3 of the project, listing the objectives of the Union, includes *an internal market where the competition is free and not restricted*. Therefore, a competitive regime is recognized as a stated objective of the European political construction. Furthermore, Article I.13 gives the Union exclusive competences in the field of competition.

However, the Lisbon Intergovernmental Conference has disavowed the central role of competition among the objectives of the Project, due to the action of the French Delegation. As a result of the Conference, the single text of the Project of Constitutional Treaty has been rearranged in two different Treaties, one concerning the objective and institutional structure of the European Union (the Treaty of the European Union – TEU) and another one specifying the instruments (the Treaty on the Functioning of the Union – TFU). The objectives of the Union are now in the TEU and article 3 of the TEU does not include competition any more. However, Article 3 of the TFU includes competition among the policies for which the Union is exclusively competent.

While the provision of exclusive competence of the Commission in the field of competition may be considered as a positive point, there is little doubt that the disappearance of competition from the Treaty of the European Union, which is the fundamental charter of the Union, would have put in jeopardy the legal context in which the application of competition law has taken place

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*Concorrenza e del Mercato* C 198/01 (2003).

in the last decades. Furthermore, it would have prevented the use of Article 308 for the adoption of legal instruments, which would have been considered necessary to the attainment of the objectives of the Union. This situation has been partially reversed by the decision adopting a Protocol according to which “*the Union can take measures in the context of the provision of the Treaties and in particular of Article 308 of the TFEU, taking into account that the internal market defined in Article I.3 of the TEU includes a regime where competition is not distorted.*” Different opinions have been raised with respect to the effect of the change in the role of competition in the Treaties. The official position is that not much has changed: competition was not an objective of the Union before and it is not now. The legal context has not changed. Because of the legal role of protocol, competition is in any case in the European Treaty and the EC Court may continue applying the teleological interpretation which has allowed a wider role for competition law and policy in Europe<sup>110</sup>.

Other commentators think that the change risks having negative consequences in the application of competition law in Europe. In particular, they underline the role that the articles concerning principles have always had in guiding the interpretative process of the Court of Justice. From this point of view, the presence of competition in Article 3 of the EC Treaty induced the Court to define competition as “essential for the accomplishment of the task entrusted to the Community and, in particular, for the functioning of the internal market”<sup>111</sup>. There is some doubt that the Protocol may have the same interpretative status of the text of the first few articles of the preamble of the Treaty. This consideration seems to be particularly important when the application of competition law must be balanced against social objectives, which are now listed in the key interpretative articles.<sup>112</sup>

Finally, there are also some opinions that at the end the role of competition may end up being strengthened. Indeed, the protocol links expressly the internal market with its competitive working, as it starts from the consideration that an internal market *must* include a system guaranteeing free competition. Furthermore, Article 308 has been redrafted in the new TFEU

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<sup>110</sup>See the position taken by Concurrences Kroes and the intervention of the Head of the Commission Legal service at the Conference organized by Concurrences. See Concurrences (2007).

<sup>111</sup>See *Courage Ltd vs Crehan* C 453/99 (2001).

<sup>112</sup>See Riley (2007).

so that legislative innovation may only concern the objectives of the Union. From this point of view, the fact that according to the Protocol Article 308 applies with respect to competition provisions would show that these provisions are really essential to the working of the Union<sup>113</sup>.

### **3 Conclusions**

The objective of this paper has been to illustrate developments in the application of EC antitrust law in light of the debates concerning the role of competition in the economy and developments of economic analysis of the market. From this point of view, we argued that the establishment and the application of EC competition law has been guided by a specific vision of the role of competition law in the legal order which gave a central role to the protection of the competition process. Over the years the application of EC competition law has progressed toward an approach guided by a better understanding of the way in which markets work, and by a wider recourse of economic analysis. Finally, in recent times the Commission, seems to have moved to a view of competition law incompatible with the ordoliberal vision: a move that at the moment is not shared by the European Courts of Justice.

It is obviously too soon to assess the effect of the modifications stemming from the Lisbon Treaties on the application of EC competition law. However, the debate we just reviewed shows how important is the role that competition law has in the legal order of the EU. It is somewhat baffling that the attempt to include competition among the objectives of the Union, therefore definitely codifying the ordoliberal constitutional vision of the role of competition, took place at a time in which the Commission (not the Court) was suggesting the abandonment of such an approach in favour of one based exclusively on economics.

At the end of Section I we noted the criticism levied at the purely economic approach to competition by those who think of competition as a regime stemming from the formal and informal rules governing the market, and not only as a way of guaranteeing the most efficient use of property rights. Their main point was that once competition is seen just as an instrument for welfare maximization there is the risk that it may be substituted by other means, which are considered more efficient. From this point of view, it is not surprising that the main argument advanced in the debate about the role of

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<sup>113</sup>See the intervention of M. Waelbroeck in the Concurrences Conference (2007).

competition in the European Union was that competition is an instrument and not an objective for European policies: and therefore a competitive order may well take second place with respect to other more fundamental aims<sup>114</sup>.

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<sup>114</sup>See the intervention of L. Idôt at the Concurrences Conference (2007).

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