



‘Consumer’ versus ‘Customer’: the Devil in the Detail

by

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Abstract: The ultimate objective of EC competition rules is arguably the enhancement of ‘consumer welfare’. In EC competition law, however, ‘consumer’ merely means ‘customer’. Not being limited to final consumers, the concept also encompasses intermediate customers. Moreover, according to the EC Commission, under Article 82EC, harm to intermediate customers is generally presumed to create harm to consumers and where intermediate customers are not competitors of the dominant undertaking, there is no requisite to assess the effects of conduct on users further downstream. This paper questions the appropriateness of this presumption in light of recent advances in economics, specifically that of vertical restraints and in particular non-linear pricing. It uses this literature to show that there are many instances where an increase (decrease) in ‘customer welfare’ does not cause an increase (decrease) in ‘consumer welfare’. In these cases, the presumption is devoid of economic justification and likely to lead to decisional errors. The paper concludes that if the law is to serve the interests of ‘real’ consumers, the EC Commission should reconsider this presumption and its interpretation of the ‘consumer’ in ‘consumer welfare’. Until then, it remains questionable and objectionable whose interests EC competition law and in particular, Article 82EC, serve.

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1 Introduction

According to the EC Commission DG Competition, the objective of Article 82EC is the ‘protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources’.¹ The very recent Guidance on Article 82EC similarly establishes that the EC Commission’s aim of enforcement activity in this area is to ensure that dominant undertakings do not impair effective competition in an anticompetitive way leading to an adverse impact on ‘consumer welfare’.² As such, ‘consumer welfare’ is a fundamental concept in understanding the objective of the law prohibiting the abuse of a dominant position, as well as other EC competition law rules.³ Yet, it is not obvious who and/or what ‘consumer welfare’ is concerned with. This paper questions whose welfare ‘consumer welfare’ is actually about and what the implications of this are.

It has been remarked elsewhere that despite the constant repetition of the EC Commission in policy statements that the objective of EC competition law is to enhance ‘consumer welfare’, it is not easy to discern such a principle in the decisional practice of the EC Commission or Courts.⁴ This paper takes that proposition further and argues that even if the EC Commission has a ‘consumer welfare’ standard that it applies in practice, it has a very peculiar understanding of ‘consumer welfare’ with wide policy implications. There are two interrelated reasons for this.

¹ EC Commission ‘DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses’ (Brussels, December 2005) available at <http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf> [4], [54], [88]

² Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (draft text) (Brussels, 3 December 2008) [19]

³ See e.g. EC Commission Guidelines on the Application of Article 81(3) of the Treaty [2004] OJ C101/97, [13] expressing the objective of Article 81EC as enhancing consumer welfare. Although there is no clear consensus on the definition of ‘consumer welfare’, in economics ‘consumer welfare’ is usually understood as ‘consumer surplus’ which is the aggregate measure of the surplus of all consumers. The surplus of a given consumer is the difference between her valuation of a good and the price she actually pays for it. ‘Total welfare’ is the sum of ‘consumer welfare’ and ‘producer welfare’. ‘Producer welfare’ understood as ‘producer surplus’ refers to the sum of all profits made by producers in an industry; see Motta *Competition Policy: Theory and Practice* (Cambridge University Press Cambridge 2004) 18

⁴ P Akman “Consumer Welfare” and Article 82EC: Practice and Rhetoric’ (forthcoming) (2009) 32 *World Competition Law and Economics Review*

First, according to the EC Commission, the concept of ‘consumer’ encompasses all direct or indirect users of products covered by the practice under scrutiny, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes outside their trade or profession.⁵ This is in contrast to the usage of the term in, for example, economics and consumer law under which only those persons who are acting for purposes outside their trade, business or profession as end-users would be deemed as ‘consumers’.⁶

Second and more importantly, the EC Commission DG Competition included in its Discussion Paper on Article 82EC a presumption according to which ‘[h]arm to intermediate buyers is generally presumed to create harm to final consumers’.⁷ Hence, harm to ‘customers’ is presumed to create harm to final consumers, implying that a reduction in ‘customer welfare’ would be assumed to result in a reduction in ‘consumer welfare’. This presumption has also been included in the EC Commission Guidance on Article 82EC, albeit in a less explicit way. According to the Guidance, the EC Commission will address ‘anticompetitive foreclosure both at the intermediate level and/or at the level of final consumers’.⁸ However, regarding when such assessment would be made at which level, the Guidance stipulates that ‘[w]here intermediate users are actual or potential competitors of the dominant undertaking, the assessment focuses on the effects of the conduct on users further downstream’.⁹ Thus, when intermediate users are *not* competitors of the dominant undertaking, the EC Commission does not see it a requisite to assess effects on ‘consumers’. Moreover, it is unclear whether when the intermediate users are competitors of the dominant undertaking, it suffices to focus on the effects on the ‘customers’ of these competitor-customers or whether the assessment will actually take into account the effects on ‘consumers’ at the end of the vertical chain. Further, it is also questionable how ‘anticompetitive foreclosure’ can be

⁵ Guidelines on Article 81(3)EC (n 3) [84]. See similarly Guidance on Article 82EC (n 2) 8 n 15

⁶ See e.g. Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts [1993] OJ L95/29 Article 2(b); Council Directive 2005/29/EC on Unfair Commercial Practices [2005] OJ L149/22, Article 2(a)

⁷ Discussion Paper (n 1) [55]

⁸ Guidance on Article 82EC (n 2) [19]

⁹ Guidance on Article 82EC (n 2) 8 n 15

assessed at the final consumer level since final consumers cannot be 'foreclosed' as they are not the competitors of a dominant undertaking. Hence, the presumption persists in a less explicit, but more ambiguous form.

This presumption, however, does not have any obvious basis in economic theory. As such, it does not conform to the aspirations of the EC Commission to adopt a 'more economic and effects-based approach' to Article 82EC.¹⁰ Moreover, the presumption implies an inappropriate shift of burden of proof. If proof of harmful effects on 'customers' under this presumption by the EC Commission suffices to find abuse, the burden would then shift to the dominant undertaking to prove that there is *no* actual harm to rebut the presumption. This would require it to prove the negative contrary to general rules of burden of proof, and it is also unclear the lack of harm to *whom* should be proved, since it is unclear whether the standard is about the welfare of *consumers* or *customers* due to the presumption of the EC Commission. Further, this understanding can cause particular problems with private enforcement since it blurs the issue of who can and should claim damages in a private case.

The presumption has direct implications for the assessment of allegedly anticompetitive conduct. This is because in most markets, producers do not sell their products to 'consumers' directly, but reach them through intermediaries, such as wholesalers and retailers.¹¹ These intermediaries are the 'customers' of producers. Firms at different levels of the production chain generally do not rely on spot market transactions, but enter into agreements with one another to reduce costs, guarantee stability of supply and better coordinate actions and these agreements are called 'vertical restraints'.¹² To demonstrate how (in)appropriate the EC Commission's presumption is, this paper investigates some of the recent economics literature on vertical

¹⁰ See Discussion Paper (n 1) in particular Section 5. See also Report by the EAGCP 'An Economic Approach to Article 82' (July, 2005) available at http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf. See also 'Antitrust: consumer welfare at heart of Commission fight against abuses by dominant undertakings' Press Release IP/08/1877 Brussels, 3 December 2008

¹¹ Motta (n 3) 302 and R Inderst and N Mazzarotto 'Buyer Power in Distribution' in WD Collins et al (eds) *ABA Section of Antitrust Law, Issues in Competition Law and Policy (2008)* (ABA Book Publishing Chicago 2008) 1953

¹² Motta (n 3) 302

restraints, examining the different effects of a practice on 'customer' and 'consumer' welfare. Thus, it uses examples from this literature to show that an increase (decrease) in 'customer welfare' may not correspond to an increase (decrease) in 'consumer welfare'. As such, it seeks to show that so long as the relation of the dominant undertaking with its customers involves, in particular, 'non-linear pricing', which is a type of vertical restraint, the effects on 'customers' may not coincide with the effects on 'consumers'.

Whereas 'linear pricing' occurs when there is a constant unit price for the product, 'non-linear pricing' refers to the case where the price paid depends on the amount purchased and the (average) price per unit varies with the number of units purchased.¹³ When there is non-linear pricing in the vertical chain, the insight from economics is that whilst the transfer price between the upstream and downstream level can be used to increase the size of gains from trade between these levels, the upstream undertaking can use a fixed fee or discounts to divide these gains between the two levels of the production chain. The upstream undertaking would aim to incentivise the downstream customer to set the output price which would maximise their joint profits by use of non-linear pricing. Achieving efficient transfer pricing between two levels of the production chain through non-linear pricing can increase the 'size of the pie' and 'consumer welfare' by increasing output and reducing price.

Yet, during this process 'customer welfare' may decrease where the upstream undertaking can extract a bigger portion of the 'pie' from the 'customer' due to its bargaining power through the fixed component of the price, compared to the counterfactual of linear pricing. Hence, so long as the conduct of the upstream undertaking eliminates some type of inefficiency in its contracts with downstream customers, 'consumer welfare' may improve, although 'customer welfare' may or may not improve depending on the change or lack thereof in the bargaining power of the upstream undertaking. In contrast, there may also be instances where the upstream undertaking may use non-linear pricing to increase the surplus of the downstream customer, for example, for inefficient

¹³ Motta (n 3) 307 and DW Carlton and JM Perloff *Modern Industrial Organization* (3rd ed Addison Wesley Longman Reading, MA 1999) 274, 297

exclusionary purposes. In this case, although ‘customer welfare’ may increase, ‘consumer welfare’ would decrease compared to the counterfactual without exclusion.

In all these scenarios, the presumption of the EC Commission would lack economic justification. Indeed, except for the unrealistic world of perfect competition on the intermediate level which would imply the exact pass-on of any harm or benefit to intermediate customers, to consumers, it is hard to find support for the presumption.¹⁴ This implies that in certain circumstances, effects of conduct on ‘consumer welfare’ should not be *presumed*, but proved. This is particularly true for cases where conduct directly affects the retail level and thus effects on ‘consumers’ – who are only one level further downstream – can easily be scrutinised. Hence, although presumptions like that of the EC Commission may be used as long as they do not lead to errors, and this particular presumption might have been apt in the past where economics of vertical restraints and in particular non-linear pricing was less advanced, recent advances in economics demonstrate that the presumption may lead to Type I (over-enforcement) and Type II (under-enforcement) errors. Moreover, the likelihood of such errors is not trivial; non-linear pricing can take many forms. Rebates, discounts, tying practices with discounts on the bundle and two-part tariffs are all instances of non-linear pricing since the price a customer pays per unit is not constant and changes depending on the amount purchased. In fact, the abusive practices in some of the most prominent cases on Article 82EC such as *Hoffmann-La Roche*, *British Airways* and *Michelin I* and *II* were examples of non-linear pricing. Thus, the presumption has potentially important consequences and deserves closer scrutiny.

Thus, Section 2 sets out the problem and discusses why the difference between ‘customer’ and ‘consumer’ matters in terms of the objective of competition rules and in particular Article 82EC whose objective is claimed to be enhancing ‘consumer welfare’. Section 3 uses examples from the

¹⁴ A scenario similar to perfect competition would be two intermediate customers in Bertrand competition with homogenous products as this would drive prices to marginal cost. However, similar to perfect competition this is also an unrealistic possibility

economics literature to demonstrate that there are instances when the effects of a practice on ‘customers’ will not coincide with the effects on ‘consumers’. Section 4 elaborates on the implications of the findings of Section 3 for Article 82EC. Section 5 concludes.

2 The Problem

It must first of all be pointed out that it is not just the EC Commission, but also the EC Treaty itself that fails to differentiate between ‘customers’ and ‘consumers’ in Articles 81 and 82EC. In fact, although both provisions incorporate the term ‘consumer’, neither of them actually refers to the ‘consumer’ in the sense of ‘end-user’ which is not only the usual everyday usage of the term, but also the understanding in consumer law. The term ‘consumer’ as used in EC competition law, simply means ‘customer’, namely anyone who deals with the undertaking(s) whose practice is in question.¹⁵

Although the term ‘customer’ includes ‘consumers’ in the real sense – if the undertaking directly deals with the end-users – it also includes other undertakings that are acting for purposes of business, trade or profession. In other words, the latter will not necessarily be ‘consuming’ the products/services purchased, but will be using them for their own commercial purposes. This has implications for both competition law and consumer law since their usage of the same term for different concepts creates confusion and perhaps an illusion. It creates confusion since two interrelated branches of law refer to different concepts by using the same term and this is misleading in itself. It creates an illusion since the ‘consumer’ is perceived as the beneficiary of both branches of law, although by including other undertakings in its conception of ‘consumer’, competition law does not always in effect serve the interests of consumers since the interests of other

¹⁵ See e.g. Guidelines on Article 81(3)EC (n 3) [84]. The French, Italian and Dutch versions of the EC Treaty use the equivalent of the term ‘customer’ in Articles 81 and 82EC. Similarly, the *travaux préparatoires* of the negotiations of the EC Treaty show that ‘consumer’ was used to mean ‘customer’. For the *travaux préparatoires* see P Akman ‘Searching for the Long-Lost Soul of Article 82EC’ (forthcoming) (2009) 29 (2) Oxford Journal of Legal Studies

undertakings will not always be aligned with those of end-users. Thus, even though competition law also appears to be at face value about the protection of consumers and this can lead one to think that it is a tool for protecting consumers, its inclusion of business interests in the analysis means that it is not necessarily so. The fact that 'consumer welfare' is advocated as the ultimate objective of competition law aggravates the illusion. This is clearly observed when one notes that the Chicago School indeed promoted 'total welfare' by calling it 'consumer welfare'.¹⁶ In fact, this illusion has been named as the 'Chicago trap', referring to the difference between the notion of consumer in competition law and in consumer law.¹⁷

The 'Chicago trap' can take place in every competition regime that does not elaborate on the difference between end-users and other buyers.¹⁸ Advocating consumer welfare as the ultimate goal of competition law is deceptive as it may support the interests of businesses to compete on a level playing field instead of benefiting final consumers.¹⁹ Thus, it has been argued that the ultimate test of assessing the 'consumer welfare' standard of a particular competition regime should include an analysis focusing on the way business practices affect 'consumer welfare' in terms of price, choice and availability, and whether measures can be taken to prevent any negative impact on *final* consumers.²⁰ What should be monitored is how the interests of end-users are served by the competition rules. This should be decisive when one examines whether the terminological reference to 'consumer welfare' is

¹⁶ Under the Chicago School, there was a single goal of competition law and policy: maximisation of 'consumer welfare'. As Bork famously put it, 'the whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare'; RH Bork *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, Inc New York 1978) 91. According to Bork, consumer welfare is greatest when society's economic resources are allocated so that consumers are able to satisfy their wants as fully as technological constraints permit; consumer welfare, in this sense, is merely another term for the wealth of the nation; *ibid.* 90. Hence, for the Chicago School, 'consumer welfare' actually meant 'total welfare'. Indeed, due to this confusion created by Bork's usage of the term, one commentator has called the 'consumer welfare' standard the '*true* consumer welfare' standard to emphasise the focus on *consumers*; see SC Salop 'Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The *True* Consumer Welfare Standard'

http://www.amc.gov/public_studies_fr28902/exclus_conduct_pdf/0511_04_Salop_Mergers.pdf 22

¹⁷ KJ Cseres *Competition Law and Consumer Protection* (Kluwer Law International The Hague 2005) 331

¹⁸ Cseres (n 17) 332

¹⁹ Cseres (n 17) 332

²⁰ Cseres (n 17) 332

merely a catchword which has nothing to do with the interests of end-users or whether it serves those interests directly or indirectly.²¹

The problem arises since in competition analysis the final consumer is very often one step removed from the competitive process.²² This is particularly true in intermediate goods markets. It has been noted that there tend to be two options in such cases; first, to treat the 'customers' as if they were the 'consumers' and secondly, to make some vague statements about consumer impact and largely ignore the final consumers in the analysis.²³ A mixture of these seems to be the stance of the EC Commission DG Competition since, as mentioned above, it assumes that harm to intermediate buyers generally creates harm to final consumers, although it may sometimes also refer to the consumer impact without being very specific.²⁴ The EC Commission Guidance on Article 82EC takes one step forward and one step back; although it does mention that an assessment may be made both at the intermediate level and/or at the level of final consumers, this is not seen as a requisite in all cases and the assessment focusing further down the vertical chain appears to be limited to the case of the intermediate users being competitors of the dominant undertaking.²⁵ Even in this latter case, it is not obvious from the Guidance whether the assessment will focus on the effects on 'consumers' or whether it will suffice it to focus on the effects on the 'customers' of the competitor-customers of the dominant undertaking.

Both treating 'customers' as consumers and ignoring the impact of conduct on final consumers are problematic approaches, since although the interests of 'customers' may in certain situations be deemed to be in conformity with the interests of 'consumers', this will not always be the case, and if the aim is to

²¹ Cseres (n 17) 332-333. See H Vedder 'Competition Law and Consumer Protection: How Competition Law Can Be Used to Protect Consumers Even Better – Or Not?' [2006] *European Business Law Review* 83, 87 for the argument that the fact that the reference to 'consumers' in Article 82(b)EC refers in general to parties in a downstream relation to the undertaking abusing its dominant position instead of final consumers disqualifies it as evidence of the fact that Article 82EC is about consumer protection

²² P Evans 'Assessing Consumer Detriment' (2007) 28 (1) *European Competition Law Review* 26, 26

²³ Evans (n 22) 26

²⁴ See Discussion Paper (n 1) [55] for the presumption. See e.g. *Microsoft* Commission Decision (Case COMP/C-3/37.792) 2007/53/EC [2007] OJ L32/23, [415] considering consumer demand and Section 5.3.1.3 considering 'consumer welfare'.

²⁵ Guidance on Article 82EC (n 2) [19] and 8 n 15

benefit 'consumers' in the real sense, protecting the interests of intermediate customers may not always achieve the objective. Although when harm to intermediate customers is directly passed on to consumers, harm to the former may be taken as a proxy for harm to the latter, when this is not the case, protecting buying undertakings against selling undertakings is difficult to legitimise as an objective without this being justified by ultimately benefiting 'consumers'. Moreover, arguing that 'consumer welfare' is the ultimate goal without actually scrutinising the impact of conduct on consumers, and ignoring the final consumers who are the alleged beneficiaries, raises doubts about the credibility of the policy.

That the EC Commission simply takes effects on customers as effects on consumers can also be seen in the Guidelines on Vertical Restraints. According to these, in vertical relationships – as opposed to horizontal – the product of one company is the input for the other and thus the exercise of market power by either the upstream or downstream company would hurt the demand for the product of the other. Hence, the companies involved in the agreement usually have an incentive to prevent the exercise of market power by the other which leads to the more lenient treatment of vertical agreements compared to horizontal agreements in competition law.²⁶ On the other hand, this self-restraining character should not be overestimated; when a company does have market power it can try to increase its profits at the expense of its direct competitors by raising their costs and 'at the expense of its buyers and ultimately consumers by trying to appropriate some of their surplus'.²⁷ This can happen when the upstream and downstream company share the extra profits or when one of the two uses vertical restraints to appropriate all the extra profits.²⁸

As such, the Guidelines clearly treat the 'buyers', i.e. intermediate customers and 'consumers' as being subject to identical effects from a vertical restraint.²⁹

²⁶ EC Commission Guidelines on Vertical Restraints [2000] OJ C291/01, [100]

²⁷ Guidelines on Vertical Restraints (n 26) [101]

²⁸ Guidelines on Vertical Restraints (n 26) [101]

²⁹ Guidelines on Vertical Restraints (n 26) [96] do differentiate between intermediate markets and final-products markets to an extent by expressing that for final products, an analysis limited to the market between supplier and buyer is less likely to be sufficient since vertical restraints may have negative

The examples from economics in Section 3 below clearly show that this is not necessarily true and the sharing of profits between the parties to a vertical agreement may imply nothing about the welfare of the 'consumers'. Interestingly and oddly enough, the Guidelines do not even mention avoiding 'double marginalisation' as a positive effect of vertical restraints which is one of the most obvious welfare-enhancing effects of vertical restraints as will be explained in Section 3.³⁰ Further, according to the Guidelines on Vertical Restraints, quantity forcing which is deemed a weaker form of non-compete agreements may take the form of 'non-linear pricing, such as quantity rebate schemes, loyalty rebate schemes or a two-part tariff (fixed fee plus a price per unit)'.³¹ Clearly, many Article 82EC cases, such as *British Airways*, *Hoffmann-La Roche*, *Michelin I* and *II* were indeed examples of non-linear pricing and assuming that the effects on 'customers' were equivalent to effects on 'consumers' could have led to insufficient assessments if the effects on 'consumers' were not separately examined. That this has been the case will be elaborated on in Section 4.

Guidelines on Non-Horizontal Mergers do recognise the internalisation of doublemark-ups by vertical integration, although they also refer to 'customers' by the term 'consumers'.³² Similarly, the efficiency defence for both horizontal and non-horizontal mergers considers efficiencies benefiting 'consumers' which are understood as 'customers'.³³

The presumption of the EC Commission that harm to customers will generally mean harm to consumers can in particular cause problems with private enforcement. This is because according to both the EC Commission and the ECJ, *any* individual who has suffered harm due to an antitrust infringement

effects of reduced inter-brand and/or intra-brand competition on the resale market. The resale market is in particular important if the retailer is selling to final consumers

³⁰ The positive effects mentioned are solving a 'free-rider' problem, to 'open up or enter new markets', the 'certification free-rider issue', the so-called 'hold-up' problem, the 'specific hold-up problem in case of transfer of substantial know-how', 'economies of scale in distribution', 'capital market imperfections' and 'uniformity and quality standardisation'; Guidelines on Vertical Restraints (n 26) [116]

³¹ Guidelines on Vertical Restraints (n 26) [152]

³² EC Commission Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings[2008] OJ C265/6, [13], [16].

³³ Non-Horizontal Mergers Guidelines (n 32) [21]; EC Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings [2004] OJ C31/05, [79]

must be able to exercise his/her right to compensation effectively and be allowed to claim damages before national courts.³⁴ Given in the White Paper on damages actions for breach of competition rules the EC Commission is also supporting indirect purchasers, i.e. those purchasers who had no direct dealings with the infringer but may have suffered harm due to the passing of an overcharge to claim damages,³⁵ a peculiar outcome may result: since there is also the presumption that harm to intermediate customers means harm to consumers, both customers and consumers can argue to have a claim for damages against the infringer. Indeed, the presumption is adapted to the context of private enforcement and repeated in the White Paper; indirect purchasers should be able to rely on the rebuttable presumption that the illegal overcharge was passed on to them in its entirety.³⁶ The consequence of this would be the infringer being asked for compensation by both customers and consumers, although only one of these would have in reality suffered the harm. Having seen the possibility of joint, parallel or consecutive actions brought by customers at different levels of the chain, as a solution the White Paper merely encourages the national courts to 'make full use of all mechanisms at their disposal under national, Community and international law in order to avoid under- and over-compensation ...'.³⁷ It is not obvious what these mechanisms could be. As the EC Commission actually refers to 'customer welfare' by its use of the term 'consumer welfare' when expressing the objective of competition rules, it is also not obvious who in such a case *should* receive the compensation since it is not clear whose welfare is to be protected. This would be particularly problematic where a practice causes harm merely to 'customers' since in this case the 'customers' can claim compensation although consumers would not have been harmed or may have even benefited from the conduct.

³⁴ EC Commission White Paper on Damages Actions for Breach of the EC antitrust rules COM(2008) 165, 2.4.2008, 4; Case C-295/04-298/04 *Vincenzo Manfredi v Lloyd Adriatico Assicurazioni SpA, Antonio Cannito v Fondiaria Sai SpA, Nicolo Tricarico, Pasqualina Murgolo v Assitalia SpA* [2006] ECR I-6619, [61]

³⁵ White Paper (n 34) 4

³⁶ White Paper (n 34) 8

³⁷ White Paper (n 34) 8

3 Examples of 'Consumer Welfare' and 'Customer Welfare' Clashes

3.1 Increase in 'Customer Welfare' may not Increase 'Consumer Welfare'

That the interests of end-users and intermediate customers and the effects of any conduct on these will not always coincide can easily be conceptualised in the context of 'naked exclusion'. 'Naked exclusion' refers to exclusionary conduct that is obviously meant to exclude competitors without any efficiency justification being offered.³⁸ One means of 'naked exclusion' can be exclusivity contracts by which buyers agree not to purchase from any other undertaking than the incumbent. Although the Chicago School has argued that exclusivity contracts can only be explained by efficiency considerations as upstream competition maximises the joint surplus of the incumbent and buyers, and thus should be *per se* legal, later literature has provided examples of exclusivity contracts leading to inefficient exclusion.³⁹

A particularly relevant example from this literature is the scenario where the incumbent monopolist is able to use exclusive contracts to monopolise the market when the buyers are intense competitors, rather than consumers. Simpson and Wickelgren show that when the buyers of an upstream incumbent are intermediate customers competing with one another, the incumbent can induce the intermediate customers to sign exclusive contracts by offering them a small side payment and thereby deter efficient entry.⁴⁰ This is because in this case, vigorous downstream competition significantly reduces the benefits of greater upstream competition for buyers since downstream competition drives price toward marginal cost, leading to most benefits of lower input prices being passed on to consumers. Hence, unlike the Chicago School argument, according to which upstream competition

³⁸ See EB Rasmusen JM Ramseyer and JS Wiley 'Naked Exclusion' (1991) 81 (5) *The American Economic Review* 1137, 1137

³⁹ For the Chicago School see A Director and EH Levi 'Law and the Future: Trade Regulation' (1956) 51 *Northwestern University Law Review* 281; RA Posner *Antitrust Law: An Economic Perspective* (University of Chicago Press Chicago 1976) 212; Bork (n 16) 309. For papers arguing that inefficient exclusion is possible see Rasmusen, Ramseyer and Wiley (n 38); IR Segal and MD Whinston 'Naked Exclusion: Comment' (2000) 90 (1) *The American Economic Review* 296; J Simpson and AL Wickelgren 'Naked Exclusion, Efficient Breach, and Downstream Competition' (2007) 97 (4) *The American Economic Review* 1305

⁴⁰ Simpson and Wickelgren (n 39) 1306

maximises the joint surplus of the incumbent and buyers, when there is intense downstream competition, the incumbent maximises the joint surplus of itself and the buyers, but not total welfare.⁴¹ In this latter case, the incumbent increases the joint surplus of itself and its ‘customers’ by monopolising the upstream market using exclusivity contracts. Because of downstream competition, intermediate customers have no incentive to reject the incumbent’s exclusivity offer and induce entry as all benefits would be passed on to consumers.⁴² Under this model, the contracts are used to allocate some of the surplus to the intermediate customer and since in the case of upstream competition, total welfare and consumer welfare would have been maximised, the exclusivity contracts lead to inefficient exclusion.⁴³ Thus, although intermediate customers benefit from the conduct through the payment from the incumbent and ‘customer welfare’ increases, the welfare of consumers decreases compared to the counterfactual where exclusion did not occur. In such a scenario, focusing the assessment on the effects of conduct on ‘customers’ would lead to a Type II (under-enforcement) error if the objective is to enhance ‘consumer welfare’.

The clash between the welfare of customers and consumers can also be conceptualised in a merger scenario. Mergers are relevant examples for Article 82EC since the main concern from a competition policy perspective in this context is also control of market power. A case similar to mergers under Article 82EC would be where a dominant undertaking strengthens its dominance as a result of exclusion.

Arguably, many – perhaps even most – mergers that come before competition authorities involve inputs, not final products.⁴⁴ The immediate ‘consumers’ of

⁴¹ Simpson and Wickelgren (n 39) 1318

⁴² Simpson and Wickelgren (n 39) 1318 n 35

⁴³ Simpson and Wickelgren (n 39) 1318. Similarly, Comanor and Rey show that where there is a single distributor and a single producer established on the distribution and production levels, with a more efficient potential entrant to the distribution level and alternative less efficient suppliers, the established distributor can use exclusive dealing agreements to exclude the new distributor from the market. This decreases consumer welfare since entry would trigger competition in the vertical structure and benefit consumers at the expense of the incumbents’ profits; WS Comanor and P Rey ‘Vertical Restraints and the Market Power of Large Distributors’ (2000) 17 *Review of Industrial Organization* 135, 141, 144-145. Thus, there is a conflict of interest between the ‘customer’ (distributor) and the ‘consumer’

⁴⁴ K Heyer ‘Welfare Standards and Merger Analysis: Why not the Best?’ (2006) 2 (2) *Competition Policy International* 29, 47

these inputs and the ones most frequently examined about the merger's likely impact are not themselves final consumers. The effects of a merger on some or even all of these customers can be quite different from the effects on the *final* consumers to whom they sell.⁴⁵ This is because purchasers of intermediate goods frequently employ different production techniques in turning out competing final goods, and to the extent that some of these producers rely less heavily on a particular input than do others, the impact on the former may be positive even if a merger threatens to raise the incremental costs for that undertaking and its rivals.⁴⁶ In effect, undertakings that face relatively small cost increases may benefit in net from the fact that consumers shift towards them and away from competitors whose costs have increased even more.

In addition, where final demand is inelastic and pass-through is likely to be nearly complete, intermediate goods customers may (correctly) believe that they will not be very much harmed by even a substantial post-merger increase in the price of what they buy.⁴⁷ Final consumers would unambiguously be harmed. Indeed, the more competition there is on the intermediate level, the greater the pass-on and thus price increase to consumers will be. Moreover, purchasers of intermediate products who already have substantial stocks of the input – either warehoused or incorporated into final products not yet sold – may benefit from the higher incremental costs now faced by all firms.⁴⁸ Again, final consumers would be left worse off, even as some or all intermediate customers benefit. Finally, in some circumstances pass-through of a cost increase will be greater than one hundred per cent and economists have shown that, depending on final demand conditions, higher marginal costs actually increase the profits of intermediate customers.⁴⁹ Thus, in such cases, basing the analysis on the effects of conduct on intermediate customers would

⁴⁵ Heyer (n 44) 47

⁴⁶ Heyer (n 44) 47

⁴⁷ Heyer (n 44) 48

⁴⁸ Heyer (n 44) 48

⁴⁹ Heyer (n 44) 48. For the latter point see S Kimmel 'Effects of Cost Changes on Oligopolists' Profits' (1992) 40 (4) *The Journal of Industrial Economics* 441. The author's model challenges the common assumption that all firms always have an economic interest in low input prices, *ibid.* 441-442. The article uses a Cournot model to demonstrate that some or all firms in an oligopoly can (paradoxically) benefit from an increase in industry common costs and indicates the key parameters that determine when this result holds, *ibid.* 445

not be telling for the effects of conduct on consumers. Adapting this to the context of Article 82EC, when a dominant undertaking strengthens its position by, for example, excluding an actual competitor, the assessment of the impact of this practice would be identical to the post-merger price increase scenario so long as the product is not sold directly to end-users. Hence, an approach assessing the effects on 'customers' and assuming these to be tantamount to effects on 'consumers' would not recognise the potential harm to consumers and may lead to a Type II error by not prohibiting conduct that it should.

Other than naked exclusion and mergers, the implications of treating 'customers' as 'consumers' can also be seen in the context of, for example, 'slotting allowances'.⁵⁰ For the purposes of understanding the consequences of treating 'customers' as 'consumers' in the context of Article 82EC, the relevant situation would be where a dominant producer pays the retailer slotting allowances and the retailer sells the product to 'consumers'. Shaffer shows that where a dominant undertaking and a competitive fringe compete for retailer patronage, the dominant undertaking can use slotting allowances to exclude its rivals even when its product is less socially desirable, that is, welfare would be higher if the fringe obtained distribution.⁵¹ In this model there are two products which are imperfect substitutes, two retailers, and the retailers cannot sell both products at the same time.⁵² One product is produced by the dominant firm and the other by a competitive fringe of rivals. The trade-off for the dominant firm if it opts to exclude the competitive fringe is

⁵⁰ 'Slotting allowances' are fees paid by producers to obtain retailer patronage; see G Shaffer 'Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices' (1991) 22 (1) RAND Journal of Economics 120, 120. The salient characteristic of slotting allowances is that the fee paid does not vary with subsequent retailer sales, *ibid.* The pace of new-product launches in recent years has contributed to making retail shelf space scarce and this proliferation of products has intensified competition among producers for the limited store space. Thus, producers pay retailers lump-sum money to be able to get their products onto the market and distributed to consumers; see G Shaffer 'Slotting Allowances and Optimal Product Variety' (2005) 5 (1) Advances in Economic Analysis & Policy, Article 3, 1

⁵¹ Shaffer 2005 (n 50) 2. It must also be noted that the more retailers there are, the less the dominant firm's use of slotting allowances to induce exclusion will be, *ibid.* 21. For an example where competition among retailers leads to consumers benefiting from slotting allowances see P Bronsteen KG Elzinga and DE Mills 'Price Competition and Slotting Allowances' (2005) 50 (2) The Antitrust Bulletin 267, 284. The authors show that due to the competition among retailers of cigarettes in the US, slotting allowances increase retailers' revenue and since rivalry prevents retailers from pocketing the payments, the revenues get competed away in the form of lower cigarette prices

⁵² The assumption that the second product is produced by a competitive fringe is made to capture the concerns of small producers that slotting allowances are used by large producers to exclude them from the market, Shaffer 2005 (n 50) 4

that it must balance the cost of paying slotting allowances against the gain from being able to choose its other contract terms to capture the monopoly profit on its product. On the other hand, the trade-off for the dominant firm if it opts to accommodate the fringe is that it must balance savings from not having to pay slotting allowances against the reduced ability to capture the surplus created by its product because of the entry of a competitor.⁵³ Hence, the dominant undertaking sets the price such that the total cost of purchasing q units for the retailer $TC = wq + F$ that consists of a wholesale price (w) and a fixed fee (F) which is negative when the producer pays the retailer slotting allowances. As such, to exclude the fringe the dominant undertaking sets a high w and pays F and to accommodate the fringe, it sets a low w and does not pay F .

Shaffer shows that the dominant undertaking is more likely to exclude the fringe than to accommodate it the more substitutable the two products are.⁵⁴ In this case, the dominant undertaking uses slotting allowances as a way of raising rivals' costs since they are used to bid up the price of an essential input, namely the retailers' shelf space.⁵⁵ The dominant undertaking prefers to pay for shelf space with slotting allowances rather than with wholesale price concessions because the former go directly to the retailers' bottom line, whereas the latter are mitigated by retail price competition. In other words, by paying retailers lump-sum money, the dominant undertaking can compensate retailers for their scarce shelf space without having to lower its wholesale price which would reduce the overall available profit to be split between the producer and retailer.

The implication of this is that if one focuses on the effects of the dominant undertaking's practice on its 'customer' (the retailer), one would find that welfare indeed increases since the surplus of the 'customer' increases as a result of the slotting allowance. Thus, the practice would enhance 'consumer welfare' understood as 'customer welfare'. However, when one considers the

⁵³ Shaffer 2005 (n 50) 2

⁵⁴ Shaffer 2005 (n 50) 11

⁵⁵ Shaffer 2005 (n 50) 3

effects on end-users, they would be harmed in two ways: price is not as low as it could have been had the producer used wholesale price concessions instead of slotting allowances and since the practice leads to exclusion of competing producers, product variety is also reduced.⁵⁶ Thus, when slotting allowances would be used by a dominant undertaking to exclude the competitive fringe, finding the practice abusive would be a Pareto improvement for all end-users, although focusing on the effects of conduct on 'customers' would not lead to this finding.⁵⁷ This example again shows the inappropriateness of deeming effects on 'customers' as necessarily signifying effects on 'consumers' and the potential for Type II errors.

This insight applies to not only slotting allowances, but all uses of vertical restraints involving 'two-part tariffs' and this implies important consequences of an approach whose standard is 'consumer welfare', but assesses the effects in terms of 'customer welfare'. 'Two-part tariffs' is a common example of non-linear pricing which occurs when a contract specifies a fixed amount independent of the number of units bought plus a variable component.⁵⁸ From an *intra-brand* competition perspective, that is the relationship between undertakings which produce and distribute the same brand, vertical restraints allow undertakings at different stages of the vertical process to control for externalities.⁵⁹ The best known example of externalities affecting vertically separated undertakings is given by the 'double marginalisation' problem and two-part tariffs is one way of avoiding this problem.⁶⁰

⁵⁶ For an alternative view on slotting allowances, arguing that when the promotional value of retailer shelf space is high, slotting can be an efficient element of the contract, see B Klein and JD Wright 'The Economics of Slotting Contracts' (2007) 50 *Journal of Law and Economics* 421. Klein and Wright suggest that the claim that slotting allowances are demanded by retailers because they lead to supra-competitive retailer profits and higher consumer prices is inconsistent with intensive competition in supermarket retailing, *ibid.* 426. Hence, they argue that retailers are forced by competition to pass slotting fees on to consumers in terms of lower prices and increased services, *ibid.* 437. For a similar argument based on the examination of slotting allowances in the US cigarette industry see Bronsteen Elzinga and Mills (n 51)

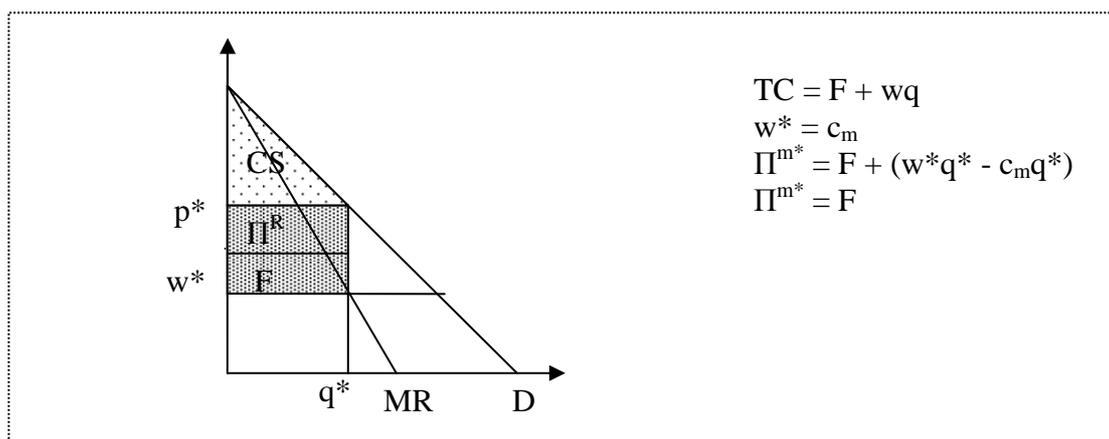
⁵⁷ For an explanation of why it would be a Pareto improvement for all consumers see Shaffer 2005 (n 50) 12

⁵⁸ Motta (n 3) 303

⁵⁹ Motta (n 3) 305

⁶⁰ 'Double marginalisation' occurs when both the producer and retailer want to maximise their profit and in order to do so they both choose the monopolistic mark-up (margin) over their own cost. When both firms add their margin, they end up with consumers paying too high a price with respect to what would be optimal from their joint point of view, i.e. from the point of view of the vertical chain (the sum of the profits made by the upstream and downstream firm); Motta (n 3) 307

Graph 1: Two-Part Tariffs



In a two-part tariff, by setting the variable component identical to the producer's own cost, the retailer would effectively behave in the same way as a vertically integrated undertaking and would choose the optimal final price.⁶¹ As Graph 1 shows, the producer can do this by setting $w^* = c_m$ and its profit (Π^{m*}) would be equal to the fixed fee (F). The retailer would then make the maximum profit. However, part or all of such profit (Π^R) can be appropriated by the producer through the fixed component. The distribution of the profit generally depends on the relative bargaining power of the two undertakings: if the producer has all the bargaining power, it can make exactly the same profit as if it owned the retailer.⁶² A key factor in determining this is what the two firms could realise outside their negotiations, i.e. their 'outside-option' payoffs.⁶³ Regardless of how the profits are shared between the producer and the retailer, i.e. the ratio of F to Π^R , consumer welfare (CS) would increase as a result of the elimination of double marginalisation compared to linear pricing.

What is important for our purposes is that the fixed fee and the wholesale price do not directly affect the aggregate profit of the vertical chain; they directly affect only 'internal' transfers.⁶⁴ In the case of such two-part tariffs, how the downstream and upstream undertaking share the profit amongst

⁶¹ Motta (n 3) 308

⁶² Motta (n 3) 308

⁶³ Inderst and Mazzarotto (n 11) 1955. Other factors include competition between downstream customers, information asymmetries, tacit or explicit coordination between producers, etc; *ibid.* 1956-1957

⁶⁴ J Tirole *The Theory of Industrial Organization* (The MIT Press Cambridge Massachusetts 1988) 173 and 173 n 9

themselves indicates nothing about the welfare of ‘consumers’. As shown in Graph I, how the surplus represented by the shaded rectangle is shared between the retailer, i.e. the ‘customer’, and the producer does not affect the size of ‘consumer welfare’. How much of the surplus accrues to the downstream customer will mainly be dependent on the bargaining power of that firm vis-à-vis the upstream undertaking. Such a pure transfer of profits between two industries would not have any welfare consequences for consumers. Thus, an increase in Π^R may not imply any increase in CS since the sharing of the pie between the two undertakings as such has no effect on the price of the product paid by the consumers.

All in all, these examples point out that there may be instances where an increase in ‘customer welfare’ may not correspond to an increase in ‘consumer welfare’ and thus negative effects on consumer welfare may be overlooked if assessment focuses merely on the effects on ‘customers’. Hence, in these cases, not prohibiting such conduct would lead to Type II errors.

3.2 Decrease in ‘Customer Welfare’ may not Decrease ‘Consumer Welfare’

One can also think of instances where intermediate customers are harmed whilst consumers benefit. In a merger model, O’Brien and Shaffer show that contrary to conventional wisdom, a merger that harms the retailer may increase welfare.⁶⁵ The authors incorporate non-linear supply contracts, bargaining and bundling into a model of upstream competition to examine the effects of horizontal mergers, focusing on a simple market setting where there are at least two upstream producers and a single downstream retailer, namely a monopolist.⁶⁶ Given bundling is a practice which can be abusive under Article 82EC and the increase in market power as a result of a merger can be deemed similar to a strengthening of dominance due to the bundling of

⁶⁵ DP O’Brien and G Shaffer ‘Bargaining, Bundling, and Clout: the Portfolio Effects of Horizontal Mergers’ (2005) 36 (3) RAND Journal of Economics 573

⁶⁶ O’Brien and Shaffer (n 65) 574

products by a dominant undertaking, the model can be used to draw inferences for Article 82EC as well.

O'Brien and Shaffer show that if bundling of the products of merging firms is feasible, a merger between two single-product firms that sell differentiated products to a common retailer need not have any effect on input choices, output choices, wholesale prices or final-goods prices. In this case, the undertakings have an incentive to merge even without cost savings since the merged entity would be able to extract more surplus from the retailer.⁶⁷ When products can be bundled, the contract of the merged firm with the retailer can be structured such that the retailer does not have the option of dropping one of the products; it will sell either both or none of the products.⁶⁸ Thus, in contrast to conventional wisdom, a merger between upstream competitors in concentrated markets need not lead to higher prices for consumers even if there are no offsetting cost efficiencies or post-merger entry. In this instance, it would not be possible to deduce appropriate public policy based on whether the retailer feels it would benefit or be harmed; although the retailer would oppose such a merger since the merging firms can extract more surplus from the retailer by merging, consumer and total welfare would be unchanged.⁶⁹ If there are no cost savings, the merger would increase the profits of the merging firms and decrease the profits of the retailer. However, this is a pure rent transfer and has no effects on 'consumer welfare' although it decreases 'customer welfare'.

Moreover, if there are cost savings, post-merger welfare will indeed be typically higher.⁷⁰ If cost savings are small, the retailer's share of them would be less than the rent transfer and thus its profits would decrease, although welfare still increases.⁷¹ The authors also show that if bundling is not feasible or is prohibited, the effect of a merger on final-goods prices and hence on consumer and total welfare, depends on the relative bargaining powers of the

⁶⁷ O'Brien and Shaffer (n 65) 574

⁶⁸ O'Brien and Shaffer (n 65) 574 n 3

⁶⁹ O'Brien and Shaffer (n 65) 574

⁷⁰ O'Brien and Shaffer (n 65) 583

⁷¹ O'Brien and Shaffer (n 65) 589

merged firm and the retailer. If the merged firm's bargaining power is sufficiently low, the welfare effects are the same as in the case with bundling.⁷²

This finding can be generalised to other forms of horizontal harm, such as the case of exclusion of other competitors by a dominant undertaking. If a dominant undertaking adopts a particular conduct which increases its bargaining power vis-à-vis its downstream customer, the impact on 'consumer welfare' would depend on whether or not the conduct increases efficiency compared to the case without the conduct. The impact on 'customer welfare' would depend on how much the bargaining power of the dominant undertaking against the customer increases compared to the case without the conduct. If the contract between the dominant undertaking and its customer is efficient in that there is no double marginalisation, any efficiency gains from conduct would increase the gains from trade, the profits of the dominant undertaking and 'consumer welfare' by decreasing prices. Although the size of the pie increases in this case, the share of the 'customer' in this bigger pie may be smaller than its share in the smaller pie (that is, the gains from trade before the dominant undertaking adopted the particular conduct). This depends on the increase in the dominant undertaking's bargaining power and this may have increased so much so that the dominant undertaking can extract more surplus from the customer compared to the counterfactual even though gains from trade have also increased. A possible decrease in 'customer welfare' in this case would not imply a decrease in 'consumer welfare'.

A similar scenario occurs where a dominant producer offers a roll-back (all-units) discount contract to its retailers to capture more rent from the retailer.⁷³ Roll-back discounts are discounts used in retail contracts which lower a retailer's wholesale price on every unit purchased once the retailer's

⁷² O'Brien and Shaffer (n 65) 583. If the merged firm has sufficiently high bargaining power, although the merged firm can extract more surplus from the retailer than it would otherwise obtain, it would tend to reduce consumer and total welfare; *ibid.* 574-575

⁷³ S Kolay G Shaffer and JA Ordovery 'All-Units Discounts in Retail Contracts' (2004) 13 (3) Journal of Economics & Management Strategy 429

purchases hit a quantity target.⁷⁴ Kolay, Shaffer and Ordover show that roll-back discounts can eliminate double marginalisation when demand is known by both the upstream and downstream firm at the time of contracting.⁷⁵ Instead of using a two-part tariff, the producer can offer the retailer a roll-back discount contract in which the producer chooses the target quantity to induce the joint profit maximising retail price and the level of the discount off the list price to divide the surplus between the producer and retailer.⁷⁶ Compared to linear pricing, this would be a Pareto improvement. They also show that when the retailer has private information about consumer demand, the producer can use roll-back discount contracts as a screening device to induce the retailer to reveal the state of demand and extract greater surplus from the retailer, compared to, for example, two-part tariff contracts.⁷⁷ The producer can extract a higher profit with a roll-back discount contract since these are more efficient at inducing the retailer to reveal the state of demand than two-part tariffs when demand is unknown at the time of contracting.⁷⁸ In this model, although the retailer is unambiguously made worse-off due to the surplus extraction and thus 'customer welfare' decreases, 'consumer welfare' may increase in some cases, depending on the shape of consumer demand.⁷⁹ Both consumer and total welfare would be higher, for example, when there is uncertainty about the size of the market, but firms have knowledge of the proportion of customers with a certain willingness to pay. Hence, roll-back discounts may not necessarily have exclusionary motives as the producer would have the incentive to offer these without such motives to extract more surplus from its 'customer'.⁸⁰

Finally, when an upstream undertaking sells the downstream customer a product that constitutes a fixed-cost for the customer, increasing the price of this would decrease the welfare of the customer, but would not have any

⁷⁴ Kolay Shaffer and Ordover (n 73) 429

⁷⁵ Kolay Shaffer and Ordover (n 73) 430

⁷⁶ Kolay Shaffer and Ordover (n 73) 430

⁷⁷ Kolay Shaffer and Ordover (n 73) 431

⁷⁸ Kolay Shaffer and Ordover (n 73) 443

⁷⁹ Kolay Shaffer and Ordover (n 73) 449

⁸⁰ Kolay Shaffer and Ordover (n 73) 431

impact on 'consumer welfare' since fixed-cost increases would not increase the price of the final good, at least in the short run.

Therefore, in all these instances, a 'consumer welfare' standard focused on the welfare of the 'customer' would lead to perverse results as these demonstrate that even though the welfare of the 'customer' is reduced, 'consumer' and 'total' welfare remain unchanged or increase. Hence, prohibiting conduct based on the effects on 'customer welfare' in these situations would lead to Type I errors.

4 Implications

The examples above show that as long as the contracts a dominant undertaking enters into with its customers involve non-linear pricing, the presumption of the EC Commission that harm to intermediate customers causes harm to final consumers may lead to incorrect findings. Once non-linear pricing is introduced, the relation between the dominant undertaking and its customers becomes complex and the division of the surplus between these two levels of the production chain depends significantly on their respective bargaining powers and other strategic motives. Indeed, any contractual clause between a buyer and seller which increases the buyer's opportunity cost of purchasing from other sellers can jointly increase the buyer and first seller's payoff.⁸¹ What is important for the purposes of competition law is that the effects on the welfare of the 'customer' as a result of the division of such profits do not necessarily imply anything about the welfare of consumers. Hence, with the recent advances in economics, it is no longer possible to maintain the EC Commission's presumption as a rule-of-thumb that can distinguish well between conduct that can harm and conduct that can benefit 'consumers'.

⁸¹ LM Marx and G Shaffer 'Rent Shifting, Exclusion, and Market-Share Discounts' June 2004 available at <http://www.simon.rochester.edu/fac/shaffer/Published/rentshift.pdf> 1-2

The case law on Article 82EC does not appear to have recognised this potential complication. It is not possible to argue that the decisions have taken into account the possible difference between the welfare of customers and consumers. This is despite the fact that many leading Article 82EC cases such as *Hoffmann-La Roche*, *Michelin I* and *II* and *British Airways* indeed involved non-linear pricing which suggests that the presumption of the EC Commission that harm to intermediate customers would cause harm to consumers might have been misplaced in these cases.⁸²

For example, in *Hoffmann-La Roche*, the dominant vitamins producer entered into contracts with its customers that contained a specific term requiring the purchaser to obtain all or some of its supplies exclusively from Hoffmann-La Roche.⁸³ Almost all these contracts also granted discounts or rebates calculated on the total purchases of vitamins.⁸⁴ These obligations ('fidelity rebates') were found abusive since they were held not to be based on an economic transaction which justifies 'this burden or benefit', but were 'designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market'.⁸⁵

A similar finding was made in *Michelin I* where rebates granted when the customer reached a certain sales target with a long reference period over which the rebates were calculated were abusive since they limited the dealers' choice of supplier and made access to the market more difficult for competitors; 'neither the wish to sell more nor the wish to spread production more evenly can justify such a restriction of the customer's freedom of choice and independence'.⁸⁶ In *Michelin II* the CFI similarly found that a loyalty-inducing quantity rebate system that prevented customers from being able to select freely at any time the most advantageous offers made by various competitors on the market and to change supplier without suffering an

⁸² It must be pointed out that some of these cases might have been driven by the single market imperative which was preferred over (at least short-run) consumer welfare

⁸³ Case 85/76 *Hoffmann-La Roche & Co AG v EC Commission* [1979] ECR 461

⁸⁴ *Hoffmann-La Roche* (n 83) [87]

⁸⁵ *Hoffmann-La Roche* (n 83) [90]

⁸⁶ Case 322/81 *NV Nederlandsche Banden-Industrie Michelin v EC Commission* [1983] ECR 3461, [85]-[86]

economic disadvantage was abusive as it was not based on any countervailing advantage that might economically justify it.⁸⁷ Michelin's argument that orders for large amounts involve economies of scale in production and distribution costs, and that the customer is entitled to have these passed on to him in the price he pays, was found too general and insufficient to provide economic reasons to explain the specific discount rates and thus dismissed.⁸⁸ In *British Airways*, both the CFI and ECJ held that bonuses (in shape of increased commission) granted by British Airways to travel agents selling its tickets on the basis of a comparison of sales between the current month and the corresponding month in the previous year were abusive. The increase in the rate of commission applied not only to tickets sold once the sales target had been met, but on all British Airways tickets handled by the agent during the reference period.⁸⁹ These bonuses tended to remove or restrict the agents' freedom to sell their services to the airlines of their choice and thereby hindered the access of British Airways' competitors to the market.⁹⁰

All of these cases involved non-linear pricing, but neither an assessment of consumer demand nor a comparison of prices against the counterfactual of linear pricing has been made in any of these cases. In *British Airways*, for example, since the 'consumers' who were potential/actual passengers were only one level further down the vertical chain from the 'intermediaries' (travel agents) this assessment could have easily been made on the basis of ticket prices for consumers. This, however, was not done. It appears that in all these cases, the customer's freedom of choice was taken as the proxy for 'customer welfare', but the scrutiny in these cases does not go far enough to test the actual or sometimes even potential impact of the practice in the final consumer markets. From the information available in these decisions, it is not possible to draw inferences for the effects on consumers. Hence, it is not possible to determine whether the presumption of harm to customers leading

⁸⁷ Case T-203/01 *Manufacture Francaise des Pneumatiques Michelin v EC Commission* [2003] ECR II-4071, [110]

⁸⁸ *Michelin II* (n 87) [108]-[109]

⁸⁹ Case T-219/99 *British Airways plc v Commission* [2003] ECR II-5917, [234]

⁹⁰ *British Airways* (n 89) [270]

to consumer harm was well-placed in these cases. Interestingly, Michelin argued in *Michelin II* that removing the practices have led to an increase in its market shares, although its market shares and prices were steadily falling with the practices.⁹¹ If this were true, along with the economic insights explained in Section 3, this would imply that the presumption might have led to perverse results for consumer welfare by prohibiting conduct that should not have been prohibited. Similarly, British Airways argued before both the CFI and ECJ that the advantages granted to travel agents entailed significant cost savings for the benefit of consumers, by allowing British Airways greater latitude to reduce its fares and/or allowing it to offer a greater number of flights on certain air routes or help it to recover its high fixed costs by bringing additional passengers.⁹² These arguments were rejected without an actual assessment of them as the burden of proving an 'objective justification' is on the dominant undertaking, making it impossible to determine whether or not 'consumers' were better off with or without the practices of British Airways.

It is welcome that this implication of the presumption seems to have been recognised by the CFI in its recent *GlaxoSmithKline* judgment. According to the CFI, the legitimacy of the transfer of wealth from producer to intermediary is not in itself of interest to competition law which is concerned only with the impact on the welfare of the final consumer.⁹³ It should be noted, however, that *GlaxoSmithKline* was not an Article 82EC, but an Article 81EC, dispute and it is unknown whether the holding would have been the same if it were an Article 82EC case since the EC Commission and Courts do not always embrace a similar level of economic understanding in these different contexts. For example, in *British Airways* the ECJ explicitly stated that

[t]he [CFI] was ... entitled, without committing any error of law, not to examine whether [British Airways'] conduct had caused prejudice to consumers within the meaning of subparagraph (b) of ... Article 82 EC, but to examine, ..., whether the bonus schemes at issue had a restrictive effect on competition⁹⁴

⁹¹ *Michelin II* (n 87) [236]

⁹² *British Airways* (n 89) [256] and Case C-95/04 P *British Airways plc v EC Commission* [2007] ECR I-2331, [81]

⁹³ Case T-168/01 *GlaxoSmithKline Services Unlimited v EC Commission* [2006] ECR II-2969, [273]

⁹⁴ *British Airways* (n 92) [107]

Although this points to the fundamental issue of the EC Courts not embracing a 'consumer welfare' standard under Article 82EC in any case, the discussion of this remains beyond the scope of this paper since this paper is limited to elaborating on the implications of the EC Commission's understanding of 'consumer welfare' as 'customer welfare'.⁹⁵

It must be recognised that accepting 'consumer welfare' instead of 'total welfare' as the standard of competition rules already has certain problems in itself, such as possibly ignoring the welfare of producers whose conduct is in question and by this damaging their incentives to invest and innovate. This is because the 'consumer welfare' approach considers wealth transfers from consumers to producers due to the behaviour of an undertaking as being harmful rather than neutral and is more critical of efficiency benefits.⁹⁶ Moreover, if 'consumer welfare' is understood entirely in a static framework it can lead to sub-optimal outcomes, especially if it leads to the attitude that any profits earned by firms must be at the cost of consumer welfare.⁹⁷

Understanding 'consumer welfare' as 'customer welfare' and thus taking into account the welfare of some producers but not others exacerbates the problem since the biased preference is not easily justifiable and as seen above, in cases where the interests of consumers are not aligned with those of 'customers', it can lead to perverse outcomes. In these cases, the approach of the EC Commission would lead to focussing on the input prices for an intermediate industry, without simultaneously examining the output prices which are the prices that matter for consumers. Without the latter assessment, preference of the intermediate industry over the upstream industry lacks justification. Thus, if the standard is to be 'consumer welfare' rather than 'total welfare', then it should at least refer to consumers', namely end-users' welfare and unless conduct can be found to harm their welfare, it should not be deemed anticompetitive. Otherwise, the standard of 'consumer welfare' may

⁹⁵ For the discussion of whether or not the EC Commission and Courts indeed apply a consumer welfare standard in their decision-making see Akman (n 4)

⁹⁶ Cseres (n 17) 21

⁹⁷ S Bishop and M Walker *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed Sweet&Maxwell London 2002) 26

imply nothing about the welfare of consumers, but misleadingly lead one to think that it does.

5 Conclusion

This paper has questioned whose welfare the standard of 'consumer welfare' in EC competition law is concerned with and the implications of this. Due to the understanding of 'consumer' as 'customer' and the presumption of the EC Commission concerning Article 82EC that harm to intermediate customers generally cause harm to consumers, 'consumer welfare' which is expressed as the ultimate objective of EC competition rules in effect refers to 'customer welfare'. This presumption may be an adequate reflection of reality when the conduct of the dominant undertaking involves merely linear pricing. However, although this presumption may have been appropriate as a general rule of thumb when the economics of non-linear pricing were not as advanced as today, it is no longer so for conduct involving non-linear pricing. This is because recent advances in economics point out various scenarios where the welfare of the customer and the welfare of the consumer would be affected in opposite directions as a result of a certain business practice.

Hence, this paper has sought to demonstrate that given the recent advances in economics, the presumption of the EC Commission may not be apt any more and may lead to both Type I and Type II errors. Given many cases under Article 82EC to date have involved examples of non-linear pricing, this raises concern and implies that in certain cases the presumption should be given up in favour of an actual assessment of harm. This is all the more important since 'consumer welfare' is promulgated as the ultimate objective of EC competition law, although currently it merely means 'customer welfare' which may not signify anything about the welfare of consumers. It is therefore for the EC Commission to reconsider its presumption if the law is to serve the interests of 'real' consumers. Until then, it remains questionable and objectionable whose interests EC competition law serves.

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