Minimum Efficient Scale: Towards a More Coherent Understanding of Special Responsibility and Competition on the Merits under Article 102 TFEU

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Abstract

As two key concepts in the Article 102 framework, competition on the merits and special responsibility suffer from a lack of concretization. As a result, the competition on the merits concept may lead the abuse assessment into an illusion of inherent impropriety, whereas the special responsibility concept is susceptible to expansive interpretations that undermine the pivotal role of dominance in the Article 102 paradigm. These issues are shown in cases concerning exclusive dealing and exclusivity rebates.

This article suggests using the as efficient competitor rationale—complemented by the no economic sense rationale—to distinguish competition on the merits and abuse with respect to exclusionary conduct. The distinction can be expressed as “efficiency-based versus non-efficiency-based exclusions”. Nonetheless, the limitations of the as efficient competitor test necessitate some calibrations. To that end and to give content to the special responsibility concept, this article spotlights the notion of minimum efficient scale, which has been somewhat overlooked and mischaracterized in the law enforcement. This concept deserves more appreciation in producing more coherent theories of harm under Article 102.

1. Introduction

The “abuse of dominance” paradigm is the EU’s choice of approach to tackle unilateral (mainly exclusionary) conduct that harms competition in the internal market. It is laid down in Article 102 of the Treaty on the Functioning of the European Union (TFEU).1 This Article has been in place since the European Economic Community Treaty (EEC Treaty) entered into force in 1958.2 But with it came the difficulty of formulating a clear doctrine

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2 Article 86 of the Treaty establishing the European Economic Community, effective on 1 January 1958 (hereinafter, “the EEC Treaty”). This is the earliest version of the Treaty provision that is now Article 102 TFEU. It was renumbered as Article 82 in the Treaty establishing the European Community (Consolidated version 2002), [2002] OJ C 325, 33–184 (hereinafter, “the EC Treaty”), and renumbered again as Article 102 of the TFEU. The content of this Treaty provision remains the same. To avoid confusion, this article uses “Article 86” (of the EEC Treaty), “Article 82” (of the EC Treaty), and Article 102 of the TFEU to refer to the same Treaty provision in the different time periods.
on account of the vaguely stipulated concepts therein. This explains why this Article was not activated until Continental Can in 1971. Supposedly, Article 102 condemns abusive conduct by dominant undertakings, rather than their dominant statuses as such. This accords with the economic idea that the pursuit or the holding of a dominant position as such is acceptable, for it is the expected outcome of the competitive process. Nonetheless, the wording of Article 102 was unclear about what qualifies as abusive and so unlawful conduct.

The concept of competition on the merits is paradigmatic of this ambiguity. Introduced by the Commission and adopted by the Court of Justice in annulment cases, this concept is the antithesis of abuse, and together they form a dichotomy for explicating what is unlawful under Article 102. The virtue of this dichotomy lies in that it responds to the question of how to protect competition instead of competitors, or put differently, how should competition law deal with monopolization behavior when “to achieve monopoly” is what that drives competition. In that regard, this dichotomy concedes that, despite being prohibited from abusing its position, a dominant undertaking is still entitled to equal opportunities of competition, namely competition on the merits.

Unfortunately, however, the line between abuse and competition on the merits is not entirely clear, making the concept of competition on the merits ostensibly vacuous. The

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4 The Commission decided in this case that a merger between Continental and TDV had infringed Art 86 of the EEC Treaty, on the ground that such a merger eliminated the competition still remaining in the market. See Case 6/72 Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities [1973] ECR 215, 228 (hereinafter, “the ECJ judgment on Continental Can”).

5 Case C-209/10 Post Danmark A/S v Konkurrencerådet, ECLI:EU:C:2012:172, para 21 (hereinafter, “the ECJ ruling on Post Danmark I”).

6 Richard A. Posner, Antitrust Law, 2nd ed. (Chicago: University of Chicago Press, 2001) 248–249 (“The more protection from competition the firm that succeeds in obtaining a monopoly will enjoy, the more competition there will be to become that monopolist; and provided that the only feasible or permitted means of obtaining the monopoly are socially productive, this competition may be wholly desirable.”)

7 See Section 2.2.2. below.

8 Ryan R Stones, “The Chicago School and the Formal Rule of Law,” Journal of Competition Law & Economics 14, no. 4 (2018): 539 (describing the Chicagoan arguments that market concentration could be the result of improved efficiency and that to condemn big firm on account of the concentrated market structure is to suggest that they “should compete but should not win”).

9 See Section 3.1.

10 OECD, “Competition on the Merits,” 2005, http://www.oecd.org/daf/competition/abuse/35911017.pdf (accessed January 27, 2020) 17 (observing that this concept was widely used “in a manner that presumes a common understanding of what the phrase means” and thus served as a “shortcut” to
term “competition on the merits” assumes a priori a metaphysical distinction between normal business practices and abnormal ones. Taken at face value, this distinction borders on the passing of normative judgments as to what is rightful and wrongful business conduct. This could be problematic, as it may divert us from identifying competitive harms and to an “inherent impropriety” illusion. In other words, the competition on the merits concept runs the risk of contradicting the pragmatic nature of competition law, which is a legal instrument to achieve certain social and policy goals rather than to protect natural rights. The tendency of resorting to normative judgments appears strong, as we shall see in the various attempts to construct a baseline test for delineating competition on the merits and abuse. Besides, there is the practical challenge that conduct may have both pro- and anti-competitive effects, thus making the said dichotomy not straightforwardly applicable. Consequently, rifts could easily arise in the approaches to finding abuse, as exemplified by the Intel case.

To further complicate the situation, we have another vague concept: the special responsibility of a dominant undertaking. It imposes on a dominant undertaking the obligation not to allow its conduct to impair genuine undistorted competition in the market where competition is already weakened because of the presence of the dominant firm. This concept treads a thin line between condemning dominance as such and preserving competition on the part of dominant firms. It singles out dominant firms, suggesting that certain conduct that is lawful when carried out by non-dominant firms may be unlawful when carried out by dominant firms. The underlying rationale can be expressed as follows: “Article 102, therefore, is not a prohibition of socially harmful competitive assessments); Einer Elhauge, “Defining Better Monopolization Standards,” Stanford Law Review 56, no. 2 (2003): 255 (“Vacuous standards, in contrast, are utterly conclusory, failing to identify a coherent norm that provides any real help in distinguishing bad behavior from good or even in know which way certain factual conclusions cut.”); Damien Geradin, “The Uncertainties Created by Relying on the Vague ‘Competition on the Merits’ Standard in the Pharmaceutical Sector: The Italian Pfizer/Pharmacia Case,” Journal of European Competition Law & Practice 5, no. 6 (2014): 347; Herbert Hovenkamp, “Exclusion and the Sherman Act,” The University of Chicago Law Review 72, no. 1 (2005): 149.

11 Elhauge, “Defining Better Monopolization Standards,” 265, 266, 272 (discussing the uncertainties caused by such normative judgments).


13 Elhauge, “Defining Better Monopolization Standards,” 263 (posing a series of questions relating to the difficulty of implementing a similar dichotomy established by the US Supreme Court in Grinnell); Nazzini, The Foundations of European Union Competition Law, 53 (“Different forms of conduct that, in the abstract, could all produce the same anti-competitive result may in reality be more or less likely to have an anti-competitive purpose and more or less likely to be competition on the merits.”).


15 Case 85/76 Hoffmann-La Roche & Co. AG v Commission of the European Communities [1979] ECR 461, para 91 (hereinafter, “the ECJ judgment on Hoffmann-La Roche”).

conduct that applies only to dominant undertakings but is a prohibition of conduct that is socially undesirable because it is carried out by dominant undertakings."17 However, the problem is that the lack of concretization makes the special responsibility concept susceptible to expansive interpretations and potentially in breach of the said rationale. This is discussed in Section 2.1.1.

There are excellent scholarly works that reflect on the concept of abuse—which is in implicit relation to competition on the merits—against the backdrop of a more economics-based approach to Article 102.18 Nonetheless, not enough studies have been done to explore a way forward that accounts for the trade-off between enforcement precision and enforcement costs. This article is an effort in that regard. It asks (1) how the concepts of special responsibility and competition on the merits can be concretized more coherently for the sake of enforcement precision, and (2) along this line, whether the economic concept of minimum efficient scale (MES) can help ameliorate the cost-effectiveness of the Article 102 enforcement. It searches for answers through systematic case law-analysis and critical literature review.

The remainder of this article is structured as follows. Part II situates the concepts of special responsibility and competition on the merits in the Article 102 legal framework. Part III examines the solidity of an efficiency-based conception of competition on the merits and why the as efficient competitor (AEC) rationale is indispensable in that regard. Part IV discusses how the notion of MES can be of use in resolving the limitations of the AEC rationale and concretizing the special responsibility concept. Part V concludes. Two clarifications of the scope should be made. First, this article focuses on exclusionary conduct, which is the main subject of Article 102 enforcement. Other enforcement subjects include exploitative conduct and (by a strict distinction) discriminatory conduct.19 Second, this article terms the said main subject more specifically as "unilateral exclusionary conduct", which includes agreements (such as exclusive dealing agreements) and unilateral practices in the strict sense (such as refusal to deal). In that sense, it

19 Nazzini, The Foundations of European Union Competition Law, 51 (adopting “the traditional taxonomy whereby abuses are distinguished as exclusionary, exploitative, or discriminatory” and explaining that “the difference lies in the way in which long-term social welfare may be harmed by the unilateral conduct of firms”).
acknowledges but does not address the possible overlap between Articles 101 and 102 on vertical competitive restraints.  

2. Situating competition on the merits

This section examines what competition on the merits means in the context of Article 102. Theoretically speaking, Article 102 is a paradigm that consists of two parts: the dominance premise and abuse assessments. These two parts are inextricably linked, and that holds the key to understanding competition on the merits.

2.1. The dominance premise

Finding a dominant position is a prerequisite for declaring conduct in violation of Article 102. Traditionally, the law enforcers rely heavily on structural criteria such as market shares and concentration levels. As the digital economy grows and our antitrust learning advances, they are becoming more receptive of criteria that show nuance in light of the changing economic reality. However, the Article 102 legal framework develops in a common-law manner, and that suggests the instrumentality of certain long-established legal principles. This subsection looks at two of those: the special responsibility concept and the link between dominance and abuse.

2.1.1. The special responsibility concept

How the case law construed dominance shaped the legal approach to tackling abusive conduct. Dominance is construed in a way that accentuates an undertaking’s ability to foreclosure competition and thus entails from the outset a vigilant view of the undertaking in question. According to the definition of dominance in United Brands and the definition of abuse in Hoffman-La Roche, the Court of Justice construed dominance as “a position of economic strength”, which is an indicator that the market competition has already been weakened and is a potential risk of further weakening the competition. In that sense, holding a dominant position means having the ability to foreclosure competition, and any conduct used to actualize that ability would be identified as abuse and considered unlawful. Along this line, one can say that dominance is never perceived as neutral; rather, the law considers that holding a dominant position, although not yet reaching to the point of being condemnable as such, entails certain behavioral restraints on the dominant undertaking.

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20 For a proposition that separates these two and puts the former under the regulation of Article 101, see Rousseva, Rethinking Exclusionary Abuses in EU Competition Law, 478.
23 The ECJ judgment on Hoffman-La Roche, para 91.
The Court of Justice elaborated the behavioral restraints as the special responsibility concept in *Michelin I*. Responding to Michelin’s contention that it was being punished for having superior performance, it stated the following:

A finding that an undertaking has a dominant position is not in itself a recrimination but simply means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market.  

Supposedly, this special responsibility is the legal implication of finding dominance, but ambiguity arises as to what it entails exactly. This ambiguity makes this concept subject to expansive interpretations, thus serving as a shortcut for finding abuse, especially when the market power of the dominant firm in question is not so great compared to those of non-dominant firms.  

25 When this happens, the assessment focus shifts away from “whether the conduct is harmful in the particular dominance context” and to “whether the conduct can be harmful in general and whether there is dominance in particular”.  

This is exemplified by the presumptive illegality treatment of exclusive dealing (including exclusivity rebates) in the Article 102 case law.  

26 2.1.2. The non-causal link between dominance and abuse

To this point, the law has made clear that dominance is, by definition, the ability to foreclose competition, which entails behavioral restraints on the undertaking in question, and that an abuse of dominance is prohibited for actualizing that ability. This line of logic gives rise to the question of whether a practice has to be an exercise of the market power underlying the dominant position for it to constitute an abuse.

When prescribing the objective conception of abuse in *Hoffmann-La Roche*, the Court of Justice held that no causation is needed between dominance and abuse.  

The Advocate General to this case gave the same opinion.  

This “no causal link needed” standpoint is

27 ibid. (“As a result, the special responsibility is invoked by the Community Courts most often when they fear that a dominant undertaking’s conduct may harm competitors, but at the same time they lack a sufficient explanation or evidence to establish truly harmful effects on competition.”).  
29 The ECJ judgment on *Hoffmann-La Roche*, para 91 (“the interpretation suggested by the applicant that an abuse implies that the use of the economic power bestowed by a dominant position is the means whereby the abuse has been brought about cannot be accepted”).  
30 Opinion of Mr Advocate General Reischl (delivered on September 19, 1978) in Case 85/76 Hoffmann-La Roche & Co. AG v Commission of the European Communities [1979] ECR
consistent with the *Continental Can* ruling that activated Article 102. There, the Commission considered an acquisition by a dominant undertaking of a competitor an abuse of dominance because this acquisition would entail a scale of competition restriction that normal concentrations would not entail.\(^{31}\) The Court of Justice agreed, holding that a practice strengthening the dominant position needed not to be objectionable as a manner of exercising market power to trigger the Article 86 prohibition, if “the degree of dominance reached substantially fetters competition”.\(^{32}\) The Advocate General to this case advised otherwise, but the Court of Justice did not follow.\(^{33}\)

This “no causal link needed” standpoint developed more nuances in *Tetra Pak*. There, the Court of Justice stated that generally, “application of Article 86 presupposes a link between the dominant position and the alleged abusive conduct”, but in “special circumstances” (such as the ones in this case where the alleged abuse was carried out in a market different from the dominated one), this link requirement could be lifted.\(^{34}\) At first sight, this may seem like a contradiction to *Hoffmann-La Roche*, but arguably it is not: in *Tetra Pak*, the “link” that the Court of Justice was referring to can be understood as a dimensional one (which supposes the abuse and the dominance to be in the same market), rather than a causal one. In the absence of follow-up clarifications from the Court of Justice, there is no reason to doubt the validity of the “no causal link needed” ruling in *Hoffmann-La Roche*. In that sense, *Tetra Pak* complements *Hoffmann-La Roche* by explaining that the waiving of a *causal* link does not preclude the need for a link of a different kind between dominance and abuse.\(^{35}\)

This “no causal link needed” standpoint may appear odd theoretically.\(^{36}\) What puts it into perspective is the “ability to foreclose” definition of dominance: given that the presence of a dominant position is already a sign of weakened market competition, any further weakening on account of the dominant undertaking—causal to the dominant position or not—would be unacceptable. In that sense, it is not surprising that this standpoint effectively widened the application scope of Article 102 to include almost all kinds of business practices.\(^{37}\) This widened scope of application ensures that the vigilance

461, 583 (“the criterion is not the exercise of market power but that there is abuse where an undertaking in a dominant position influences the structure of competition by its acts”).  
\(^{31}\) The ECJ judgment on *Continental Can*, 229.  
\(^{32}\) ibid., paras 26–27.  
\(^{33}\) Opinion of Mr Advocate General Roemer (delivered on November 21, 1972) in Case 6/72 Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities [1973] ECR 215, 254 (suggesting that, according to the wording of Article 86, “its application can be considered only if the position on the market is used as an instrument and is used in an objectionable manner”).  
\(^{34}\) Case C-333/94 *Tetra Pak International SA v Commission of the European Communities* [1996] ECR I 5951, para 27.  
\(^{36}\) Elhauge, “Defining Better Monopolization Standards,” 331–333 (arguing for the presence of such a link in the US antitrust law).  
underlying this Article is uncompromised. To be clear, however, the abuses do appear to be causally linked to dominance in most cases.\textsuperscript{38}

The implication is that both dominant and non-dominant firms are capable of carrying out a particular type of practice that potentially constitutes abuse in individual cases.\textsuperscript{39} But only dominant firms carrying out such a practice would infringe Article 102. In that light, it would be nonsensical to say that the abusiveness derives inherently from the conduct type since the conduct is perfectly lawful when carried out by non-dominant undertakings. A more reliable answer would be that the abusiveness flows from the market power underlying the dominant position.\textsuperscript{40} But the problem is that in particular circumstances, the market power of a dominant firm may not be qualitatively different from that of a non-dominant firm.\textsuperscript{41} So it becomes the law enforcer’s choice to either resort to the assessment shortcut provided by the legal framework or devise a more coherent benchmark.

2.2. Abuse assessments

After the finding of a dominant position, the law application moves on to the assessment of the allegedly abusive conduct at hand. This subsection examines two issues essential to abuse assessments: the effects threshold and the conceptual delineation of abuse from lawful conduct. Two premises underpin the examination in this subsection:

- First, under the direct legal objective underlying Article 102—the protection of the competitive process,\textsuperscript{42} what qualifies a contentious practice as an unlawful abuse is essentially the competitive harms it generates. To be sure, it is an open question as to what legal interests the competitive harm concept should reflect.\textsuperscript{43}
- Second, although a divergence may still exist between a “form-based” approach and an “effects-based” approach to the case-by-case assessment of competitive harms,\textsuperscript{44} it is indisputable that competitive harms need to be in place—either


\textsuperscript{39}Nazzini, \textit{The Foundations of European Union Competition Law}, 177.

\textsuperscript{40}ibid., 178.

\textsuperscript{41}Rousseva, \textit{Rethinking Exclusionary Abuses in EU Competition Law}, 72.

\textsuperscript{42}This direct objective of EU competition law can be identified from a literal reading of Protocol 27 of the TFEU, the preceding version of which was Article 3(f) of the EEC Treaty. See also, Maurice E. Stucke, “What Is Competition?,” in \textit{The Goals of Competition Law}, ed. Daniel Zimmer (Cheltenham: Edward Elgar, 2012), 29.

\textsuperscript{43}Anne C Witt, \textit{The More Economic Approach to EU Antitrust Law}, Hart Studies in Competition Law, volume 14 (Oxford, United Kingdom: Hart Publishing, 2016) 110 (describing that although one gets “the general idea that the investigated conduct needs to harm competition, or at least be likely to do so”, it is still questionable as to what is harm to competition).

\textsuperscript{44}Viktor J. Vanberg, “Consumer Welfare, Total Welfare and Economic Freedom – On the Normative Foundations of Competition Policy,” in \textit{Competition Policy and the Economic Approach: Foundations and Limitations}, ed. Josef Drexel, Wolfgang Kerber, and Rupprecht Podszun (Cheltenham: Edward Elgar Publishing, 2011), 62–63 (pointing out that the choice between a form-based and an effects-based approach is not easy to make when complicated by other issues, such as the fact that “competition agencies and their
presumed or verified—in a particular case before an Article 102 prohibition is triggered.\textsuperscript{45} Therefore, the concept of competitive harm can be paraphrased as “anticompetitive effects”—at least for assessment purposes.

2.2.1. The “potential effects” threshold

The case law consistently held that potential effects, as opposed to actual effects, are enough for establishing an abuse of dominance.\textsuperscript{46} To a large extent, expressions such as “the potential of”, “the likelihood of”, and “the capability of having such effects” are used interchangeably in the case law.\textsuperscript{47} Also, the objective or intention of causing anticompetitive effects is often equated to the potential of having such effects.\textsuperscript{48} This is more controversial.\textsuperscript{49}

Like the “no causal link needed” standpoint, the potential effect threshold is also attributable to the “ability to foreclose” definition of dominance: the presence of dominance is already a sign of weakened competitive structure and any further
weakening would be unacceptable, so a dominant undertaking bears the special responsibility of not letting that happen on its account.\textsuperscript{50}

The “potential effects” threshold brings two potential problems. First, it may leave the causation between the contentious practice and the identified exclusionary effects unascertained, in the sense that the exclusion of competitors could just be the natural outcome of the competitive process.\textsuperscript{51} This point was exemplified in the \textit{Microsoft} decision. The Commission dismissed Microsoft’s defense that the success of WMP (the tied product in the allegedly abusive tie-in) was the result of competition on the merits.\textsuperscript{52} It did so by presuming the causal link between the tie-in and the decline of RealNetworks (a competing media player product).\textsuperscript{53} Admittedly, the Commission managed to draw from factual findings that Microsoft’s defense was unsubstantiated,\textsuperscript{54} but in the same vein, it could also be said that these facts did not conclusively support the Commission’s presumption.

Second, attached to this potential threshold is a counterfactual premise that is capable of arbitrarily dismissing positive evidence of competition remaining.\textsuperscript{55} The General Court ruled that evidence of competition remaining in the market cannot cancel the anticOMPETITiveness of the conduct in question since it is not for the dominant undertaking to dictate what level of competition should exist.\textsuperscript{56} In the presence of such evidence, it ruled that the level of competition could have been even better in the alternative scenario where the accused conduct did not take place.\textsuperscript{57}

\textbf{2.2.2. The competition on the merits concept}

\textit{AKZO}

The notion of competition on the merits emerged in \textit{AKZO} as the antithesis of abuse.\textsuperscript{58} But the line between these two was unclear. By adding vaguely defined conditions such as “unfair”, “intended”, and “smaller competitors” to the rule of prohibition, \textsuperscript{59} the

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\textsuperscript{50} Note 46 above.
\textsuperscript{51} Colomo, \textit{The Shaping of EU Competition Law}, 154.
\textsuperscript{52} Commission Decision of 24 March 2004 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-3/37.792 Microsoft), recitals 947–48.
\textsuperscript{53} ibid., recital 948.
\textsuperscript{54} ibid., recitals 949–51.
\textsuperscript{55} O’Donoghue and Padilla, \textit{The Law and Economics of Article 102 TFEU}, 268 (pointing out the circular logic in using the counterfactual scenario to dismiss the fact that sometimes the competitors are actually thriving).
\textsuperscript{56} Case T-286/09 \textit{Intel Corp. v European Commission}, ECLI:EU:T:2014:547, paras 117, 124 (hereinafter, "the referred-back GC judgment on Intel").
\textsuperscript{57} The CFI judgment on \textit{British Airways}, para 298.
\textsuperscript{58} 85/609/EEC: Commission Decision of 14 December 1985 relating to a proceeding under Article 86 of the EEC Treaty (IV/30.698 - ECS/AKZO), [December 31, 1985] OJ L 374, para 81 ("The Commission emphasizes that it does not consider an intention even by a dominant firm to prevail over its rivals as unlawful. A dominant firm is entitled to compete on the merits.").
\textsuperscript{59} ibid., para 74.
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Commission advanced certain equity concerns that were latent in the law. The problem is that these concerns obscured, instead of clarifying, how the foreclosure of competition (as opposed to competitors) would transpire and how competition on the merits was to be recognized. In other words, it seems that, when adopting this concept, the Commission was not prepared to fully embrace the ensued implications. This is exemplified by its leaving open the question of whether less efficient competitors should be protected.

In the appeal, the Court of Justice approved the notion of competition on the merits as the antithesis of abuse. But it also sidestepped the question of whether the targeted competitors deserved to be excluded for having inferior performance. It only speculated that those excluded competitors “are perhaps as efficient as the dominant undertaking”. This contradicted the standpoint of encouraging “competition on the basis of quality” and could only be rationalized under the market integration mandate of the EEC: structural preservation of competition (which is likely to result in protecting less efficient competitors) served as an expedient to rectify certain trade-restraining practices and an intermediary step to foster competition in the stage of establishing a common market.

AstraZeneca

AstraZeneca hosted a more extensive discussion on this concept. Based on AKZO, the General Court held in this case that Article 82 of the EC Treaty prohibits a dominant undertaking from employing non-merits-based methods to compete. The Court of Justice approved this standpoint. More importantly, the General Court linked

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60 ibid., para 77.
61 Case 62/86 AKZO Chemie BV v Commission of the European Communities [1991] ECR I 3359, para 70 (“Article 86 prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality.”)
62 ibid., para 72.
63 The case involves two abuses of dominance: (1) making misleading representations to national patent agencies so as to obtain Supplementary Protection Certificates that, without the misleading representations, would have been obtained for a shorter period of validity or would not have been obtained at all; (2) a strategy including the selective deregistration of market authorizations and the switch from capsules to tablet of the medical product in question. See Commission Decision of 15 June 2005 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/A.37.507/F3 – AstraZeneca), recitals 144, 255, 788, (hereinafter, “the Commission decision on AstraZeneca”).
65 Case C-457/10 P AstraZeneca AB and AstraZeneca plc v European Commission, ECLI:EU:C:2012:770, para 75 (hereinafter, “the ECJ judgment on AstraZeneca”).
“competition on the merits” to the special responsibility concept. The Court of Justice approved this as well.

When it came to determining whether a practice falls outside the scope of competition on the merits, the General Court held that intent could be a relevant criterion, although not a necessary condition for finding abuse. This follows the objective conception of abuse established in Hoffmann-La Roche. The Court of Justice approved this and further clarified that, when assessing whether misuses of the patent process are outside the scope of competition on the merits, a contextualized approach should be taken, instead of presuming all fallible practices in regulatory proceedings condemnable under Article 82. In that sense, the ECJ seems to have suggested a consideration of the proportionality principle for balancing “competition preservation” and “respecting an undertaking’s right to defend its legitimate business interests”.

Post Danmark I

The distinction between competition on the merits and abuse became much clearer in Post Danmark I. The Court of Justice clarified that domination or monopolization “on its own merits” is not condemnable, because it could be the natural process and manifestation of competition on the merits, which is to be encouraged under Article 82 of the EC Treaty. It distilled this point from Michelin I, Compagnie maritime belge transports, and TeliaSonera. Accordingly, the Court of Justice ruled that Article 82 protects competition instead of less efficient competitors, as their being excluded is the expected outcome of competition on the merits.

To that point, the Court of Justice advanced two aspects of consideration for finding abuse in the “all circumstances” analytical framework:

- The “methods” dimension requires that, to trigger the prohibition of Article 82, the methods employed should not be “part of competition on the merits”;
- The “effects” dimension requires that there should be exclusionary effects on as-efficient competitors.

Critically, these two aspects of consideration should not be understood respectively as “the forms” and “the competitive effects” of the conduct in question and so as two cumulative conditions for finding abuse. Rather, they should be understood as the two aspects describing the same thing: a qualified level of anticompetitive effects that leads to the abuse finding. The reason is discussed earlier: the law does not require a causal link

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66 The GC judgment on AstraZeneca, para 671 (“Article 82 EC imposes on an undertaking in a dominant position, irrespective of the reasons for which it has such a dominant position, the special responsibility not to impair, by using methods other than those which come within the scope of competition on the merits, genuine undistorted competition in the common market.”).
67 The ECJ judgment on AstraZeneca, paras 98, 134, 149.
68 The GC judgment on AstraZeneca, para 359.
69 The ECJ judgment on AstraZeneca, para 99.
70 The ECJ ruling on Post Danmark I, paras 21–22.
71 ibid., para 22.
between dominance and abuse, and therefore both dominant and non-dominant undertakings can carry out a type of conduct that is potentially abusive. So, the abusiveness of conduct essentially boils down to “effects” and has no innate connection with the forms of conduct. Admittedly, conduct forms could be relevant in analyses, but only in the sense that they are proxies of anticompetitive effects. The dissociation of abusiveness from forms also means that there is no inherent impropriety—at least not in the non-effects sense—of an abuse.

**Intel**

Whether “forms” should be understood as a (less than ideal) proxy of “effects” was at the base of the whole Intel dispute. In this case, the General Court presumed the abusiveness of exclusivity rebates on the sole basis of the exclusivity element.\(^73\) To be sure, this presumption was well supported by a string of case law starting from Hoffmann-La Roche,\(^74\) but the General Court overlooked the reason why the precedents supported this presumption: it was because the exclusivity element was considered a workable proxy (in combination with the dominance factor) for identifying the relevant anticompetitive effects at a time when no better approaches were available. The exclusivity element alone is illusory in the sense that there is no inherent impropriety behind it.

Therefore, when the Commission performed on its initiative an AEC analysis to ascertain the level of anticompetitive effects caused by Intel’s rebate schemes, the single-minded adherence to the presumption by the General Court became rather irrelevant. The Court of Justice referred back the General Court’s judgment, precisely because of this irrelevance. Thus, in the pending new judgment, the General Court is confronted by the task of re-examining the solidity of the presumption regarding exclusivity.

**Generics**

*Generics* is the newest addition to the case law that clarifies the concept of competition on the merits. In this preliminary ruling, the Court of Justice reiterated the “effects” threshold and the “all circumstances” framework for finding abuse.\(^75\) It implicitly referred to the distinction between abuse and competition on the merits by stating that a dominant firm has the right to defend its commercial interests, although that must be done by taking “reasonable steps”.\(^76\) Such reasonable steps include, \textit{inter alia}, the exercise of an exclusive intellectual property right that does not “fall outside the scope of competition on the merits”.\(^77\) When it came to the delineation of the scope of competition on the merits in this particular case, the Court of Justice advanced the element of intent,\(^78\) but, to be clear, intent is only one of the many aspects of consideration in the all circumstances framework and under the objective conception of abuse.\(^79\)

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\(^73\) The referred-back GC judgment on Intel, para 85.
\(^74\) ibid., paras 80–81.
\(^75\) Case C-307/18 Generics (UK) Ltd and Others v Competition and Markets Authority, ECLI:EU:C:2020:52, para 154 (hereinafter, “the ECJ ruling on Generics UK”).
\(^76\) ibid., para 149.
\(^77\) ibid., paras 150–52.
\(^78\) ibid., paras 151, 162.
\(^79\) ibid., paras 148, 154, 169.
In that sense, the Court of Justice pointed to the principle of proportionality. Namely, it suggested that, to distinguish “abuse” from “competition on the merits involving the exercise of an intellectual property right”, due efforts must be made towards a weighing of the pro- and anti-competitive effects of the conduct in question to ascertain whether the exercise of right went beyond its justifiable scope. This corresponds to the standpoint that “the economic and legal context” is instrumental for establishing a concerted practice as a “restriction by object” under Article 101. The Court of Justice made it abundantly clear in this case that the “context”—which includes but is not limited to the consideration of the alleged pro-competitive effects—plays an essential part in the establishment of both restrictions by object and restrictions by effect. By implication, the mere existence of pro-competitive effects does not necessarily save an agreement from being qualified as a restriction by object. Accordingly, in this case, a restriction by object is established when, put through a contextualized weighing analysis, a patent-dispute settlement agreement has no plausible explanation other than the collusive restriction of competition.

To sum up this section, the EU case law points to a contextualized approach for distinguishing competition on the merits from abuse. In the two-tier Article 102 paradigm, however, undertaking such a contextualized approach necessitates not only confronting the practical, evidentiary challenges but also reconciling the frictions stemming from the “ability to foreclose” conception of dominance. In that consideration, the next section examines competition on the merits in a theoretical context.

3. An efficiency-oriented conception of “competition on the merits”

The EU is not the only competition law regime struggling to rationalize the distinction between competition on the merits and abuse of dominance. Section 2 of the US Sherman Act deals with a similar issue. Around the time of the EU competition law modernization, there was a heated debate in the US on the appropriate standard for identifying unlawful exclusionary conduct under Section 2. This Section looks at the scholarship concerning this debate for a better understanding of the normative meaning of competition on the merits.

The thesis of this section can be outlined as follows. First, under the premise that the law pursues non-efficiency-based exclusionary conduct, the idea of inherent impropriety has no content and the benchmarking of competitive harms is inevitable. Second, we should forgo the idea of constructing a unifying abuse test because it is too costly from the

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80 ibid., para 167.
81 ibid., para 67.
82 ibid., paras 67, 70, 82, 104.
83 ibid., para 106.
84 ibid., paras 87–90.
85 Mark S. Popofsky, “Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules,” Antitrust Law Journal 73, no. 2 (2006): 438 (pointing out the lack of “a clear principle or operational legal test that separates lawful from unlawful conduct” under Section 2 of the Sherman Act).
viewpoint of decision theory. What we need instead is a coherent way to rationalize the existing abuse tests. In that regard, we should also consider how the predictability of laws help sustain *ex-ante* the incentives to innovate, and so it may be desirable to devise some presumptions of legality and illegality under the existing abuse tests.

3.1. The “competing to monopolize” process: the static and dynamic perspectives

Inherent in the concept of competition on the merits is the logic that unilateral exclusionary conduct employed by a firm in the presence of business rivals can be *conceptually* classified into two kinds:

- non-merits-based competitive conduct, which is prohibited supposedly because it impairs, as opposed to enhancing, competition;
- merits-based competitive conduct, which is lawful because it is the manifestation of efficiency and enhancement of competition.  

Some clarifications are needed. Here, this article describes the distinction as “whether conduct harms competition”, but this is only an intermediate description, in the sense that there can be more fundamental objectives at play. For example, one value-laden way to describe the distinction is “whether conduct increases efficiency and welfare”. Other fundamental concerns include fairness and, most relevant to the EU, market integration.

Underlying this conceptual distinction is the internal friction of the competitive process: “competition to obtain a monopoly is an important form of competition”. This can be explained in the static model of price theory. Supposing that firms are driven by rational profit maximization and that the two poles of market performance are perfect

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87 Note 42 above.

88 Bork, *The Antitrust Paradox*, 116 (classifying business behavior into three types according to their relationships with consumer welfare: “primarily efficiency creating, primarily output restricting, or neutral in its consumer welfare impact”), 137 (distinguishing “efficiency exclusion” from “improper exclusion”, and suggesting “The conceptual apparatus now in use is incapable of making that crucial distinction.”), 311 (characterizing non-merits-based competition as artificial barriers that “are not forms of superior efficiency and which yet prevent the forces of the market—entry or the growth of smaller firms already within the industry—from operating to erode market positions not based on efficiency. Care must be taken to distinguish between forms of efficiency and artificial barriers.”).


competition and monopoly, all firms aspire to monopolize (by whatever means), because monopoly rewards the most opportunities for reaping profits whereas perfect competition the least. But since monopoly is attainable only by one firm, competition comes into being and intensifies as the monopoly rewards become greater. This “competing to monopolize” process inevitably leads to the exclusion of certain rivals.

From a static viewpoint, rivalry-induced exclusions are inevitable. From a dynamic viewpoint, they are potentially efficiency-enhancing: when dynamic competition is factored in, a somewhat concentrated market structure may be an indication of improved efficiency, and in turn, it is perhaps more likely to stimulate innovation than a highly fragmented one, considering the complexity of impact factors on innovation. This dynamic viewpoint underscores the importance of preserving ex-ante dominant undertakings’ incentives to innovate by allowing them to reap their business success manifested as market power, especially in scenarios where firms would only invest in innovation if there were the prospect of supra-competitive returns.


92 Elhauge, “Defining Better Monopolization Standards,” 262–63 (pointing out that firms compete in, for example, product development “in order to reap the profits that come from producing a product that is sufficiently superior to what rivals can provide that it reaps monopoly profits”), 298 (discussing how the prospect of monopoly profits drives firms to innovate).


94 A. Douglas Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?,” Antitrust Law Journal 73, no. 2 (2006): 382–383 (describing the powerful intuition that “one is entitled to compete on the merits and to reap the fruits of his success” in the form of monopoly power).


Competition policy responds to these economic insights with the following normative notion: monopolists (and dominant firms) are entitled to equal opportunities of competition and to reap the fruits of their success manifested as market power. Accordingly, competition law does not concern itself with every practice that excludes. Rather, it is intended to separate condemnable ones (abuse) from permissible ones (competition on the merits) through abuse tests. The key question is how.

3.2. The formal requirements of a good test

3.2.1. Administrability and predictability

Two points can be distilled from the preceding subsection: (1) exclusionary effects are inherent in the competitive process, and (2) it is normatively necessary and socially desirable to sustain competitive behavior of dominant firms. They prescribe both formal and substantive requirements on an abuse test. This subsection discusses the formal requirements.

On the one hand, serving as a roadmap for decision-makers, an abuse test is set out to reduce enforcement errors (false positives and false negatives) in individual cases. In other words, it aspires to induce precise findings of unlawful exclusionary conduct in varying case circumstances. On the other hand, however, the level of precision attainable in individual cases will be inherently limited considering the reality of imperfect information. Besides, the pursuit of precision is costly and enforcement resources are scarce. Allocating more resources to one case means fewer resources for another. Therefore, it would be unsustainable to indulge in the pursuit of perfect precision in individual cases and generalization would have to be introduced at a certain point. This requires an abuse test to be administrable, so as to help the courts and enforcement

Economic Definition of Predation: Pricing and Product Innovation," *Yale Law Journal* 91, no. 1 (1981): 22 (finding that even genuine innovations can be anticompetitive in the sense that they may be driven solely by exclusionary objectives and do not provide consumer benefits that worth the cost).

98 Melamed, "Exclusive Dealing Agreements and Other Exclusionary Conduct," 379, 382, 394 (reiterating the "normative intuition that firms ought to be permitted to reap the fruits of competition on the merits, even if less skillful or less lucky rivals are disadvantaged"); Nazzini, *The Foundations of European Union Competition Law*, 78.


101 Another way to describe this “generalization” element is “categorization”, which “not only specifies the substantive standards, but also determines (implicitly) what information is relevant to the analysis and in what sequence that information should be considered”. See C. Frederick Beckner and Steven C. Salop, “Decision Theory and Antitrust Rules,” *Antitrust Law Journal* 67, no. 1 (1999): 42.
agencies navigate through the informational constraints and pursue precision within an affordable range of enforcement costs.\textsuperscript{102}

A dynamic perspective advances another quality requirement: a test should be \textit{predictable} enough for firms to assess \textit{ex ante} their business practices. One that fails this requirement would chill innovation and undermine competition in the long run.\textsuperscript{103} This requirement also calls for generalization at a certain point, because pursuing precision regardless of the ensued cost would cause unpredictability and undermine innovation incentives.\textsuperscript{104}

One test that fails these two requirements is the welfare-balancing test. This test examines “whether the conduct harms competitors by raising their costs and whether those higher costs harm consumers and competition by allowing the defendant to achieve, maintain, or enhance monopoly power”.\textsuperscript{105} It was critiqued as being insufficiently predictable and administrable, making it difficult for firms to assess \textit{ex ante} their conduct and thus undermining dynamic efficiencies.\textsuperscript{106} To be fair, the consumer welfare test does reflect some predictability considerations: it may guide a decisionmaker to make the optimal decision based on the limited available information, and when operationalized, this decision-making process would be able to guide firms’ self-assessments.\textsuperscript{107} But still, it does not appear attractive under the administrability requirement and so its application can be costly.

3.2.2. A unifying abuse test is costly

Notably, there is a difference between “the somewhat generalized roadmap guidance that an abuse test offers” and “the level of generalization that the test itself possesses”. The former is the substance of the test whereas the latter is the form. Regarding forms, there is the commonly referenced dichotomy between rules and standards.\textsuperscript{108} An abuse test, functioning as a roadmap, is more likely to fall under the latter than the former. Therefore,

\textsuperscript{104} Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 387 (phrasing the reduced incentives for investment and innovation as “the dynamic costs of antitrust intervention”); Elhauge, “Defining Better Monopolization Standards,” 301 (doubting from an \textit{ex-ante} perspective whether a case-by-case analytical approach to balancing patent protection and competition protection would be socially desirable).
\textsuperscript{105} Salop, “Exclusionary Conduct,” 318 (the quote), 331.
\textsuperscript{107} Salop, “Exclusionary Conduct,” 343–45, 352.
\textsuperscript{108} Ehrlich and Posner, “An Economic Analysis of Legal Rulemaking,” 258 (“A standard indicates the kinds of circumstances that are relevant to a decision on legality and is thus open-ended.”; “A rule withdraws from the decision maker’s consideration one or more of the circumstances that would be relevant to decision according to a standard.”).
the costs identified in decision theory for devising a precise rule may not be entirely applicable to an abuse test. But there is a degree of commonality. Particularly, applicable to both an abuse test and a precise rule are the two determinants of formulation costs: how homogeneous the addressed conduct types are and how frequent the test/rule encounters them. The (marginal) costs for the pursuit of precision go down as the level of conduct type homogeneity or the encounter frequency goes up.

In that sense, applying a unifying abuse test would be costly. First, the level of homogeneity across all types of unilateral exclusionary conduct is low. Some subtypes, such as exclusive dealing and loyalty rebates, are somewhat homogeneous, in the sense that their theories of harm are arguably analogous to each other. But other subtypes, such as predatory pricing and refusal to deal, are much less so. Second, the chance for the law to encounter different conduct types varies. In that regard, it is difficult to give a precise answer regarding the chances because that would require an empirical study, but it should be relatively easy to make a general observation from an EU competition law textbook that records the case precedents under Article 102.

3.3. The illusory notion of inherent impropriety and the no economic sense test

3.3.1. The meaning of inherent impropriety

A popular suggestion as to what justifies the separation of abuse from competition on the merits is the inherent impropriety—more specifically, the inherent competitive harms—of abusive conduct. As a leading figure of the “chastised Harvard School”, Areeda (1989) construed “impropriety” as “the conduct requirement—not just market power—necessary to constitute monopolization under Section 2 of the Sherman Act”. The underlying idea is that all unilateral business conduct excludes so there has to be a qualification of some kind for the prohibition of conduct. As he explained,

It is perfectly clear that the concept of monopolization requires some element of impropriety; it has to be monopoly power coupled not with building the better mousetrap, but monopoly power coupled with some impropriety in its achievement or maintenance.

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109 ibid., 267–71 (identifying the costs of devising and implementing highly precise rules). See also, Popofsky, “Defining Exclusionary Conduct,” 458 (“At some point, the costs of creating a more refined rule (including litigation costs in a common-law system) become prohibitively high.”).


114 ibid., 846.
Some of the Chicago School scholars also embraced the “inherent impropriety” notion. In his seminal *The Antitrust Paradox*, Robert Bork upheld Chief Justice White’s statement in *American Tobacco* that antitrust law condemns certain practices—which were found contrary to “normal methods”—“either because of their inherent nature or effect or because of the evident purpose of the acts”. He understood “normal methods” as superior efficiency. He considered the “inherent nature” of abnormality to be a trigger of *per se* rule of illegality. He furthered suggested that such “inherence” dismissed the need to examine and weigh the actual effects of a contentious practice and that inference from other aspects of fact would suffice.

What Bork found unsatisfactory in Justice White’s opinions was the ambiguity as to what “abnormality” meant: all business practices exclude, so it would be impossible to distinguish a good one from a bad one without an external benchmark. Along the line, he adopted the benchmark of efficiency, “one that distinguishes exclusion through efficiency from exclusion by means unrelated to efficiency”.

Bork understood “means unrelated efficiency”—which was inherent impropriety—specifically and narrowly as a practice’s misalignment with the profit maximization premise of price theory. This is exemplified by his idea of adopting the predation rationale as the overarching approach to regulating all unilateral exclusionary practices. For example, Bork considered predatory price-cutting to be one of the few practices potentially condemnable, because the short-run profit sacrifice made no apparent sense under the profit maximization premise; for other practices, as long as they were profit-maximizing, they would be permissible. Even so, he concluded, upon further examination, that predatory pricing was unlikely to generate competitive harms.

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116 Bork, *The Antitrust Paradox*, 36, 38 (“When economic analysis shows that a practice can have no significant beneficial effects but is solely a means of restricting output, the ‘inherent nature’ of the practice is injuriously to restrain trade. The practice then is labeled illegal per se, which means that there is no defense and that the court need not examine either intent or market power before pronouncing the behavior unlawful”).

117 Robert H. Bork, “The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,” *The Yale Law Journal* 74, no. 5 (1965): 804 (“If the word ‘inherent’ in White’s sentence modifies ‘effect,’ as seems likely, it may be that the test contemplated not an examination of actual effects but an inference of the effect from some other fact, probably from the market size or power of the party or parties.”).


119 ibid., 38–39 (quote), 137, 311 (distinguishing “artificial barriers to entry” from barriers that are “forms of superior efficiency” and equating the former with unlawful exclusionary practices).

120 ibid., 119–21.

121 Bork used “predation” to characterize unilateral exclusionary conduct, which was to impose losses on rivals by bearing insignificant or recoupable short-run losses itself. See ibid., 137, 144, 147–48. See also, Elhauge, “Defining Better Monopolization Standards,” 269.


123 ibid., 144; Elhauge, “Defining Better Monopolization Standards,” 269.
according to the single monopoly profit theory: the lowered short-run prices would benefit the consumers in a way that cancels any possible competitive harms that are directly ensued, and the expectation of long-run recoupment is unfeasible because any attempt of price increase would immediately attract new entrants.\footnote{The same logic was applied to other practices such as exclusive dealing: a monopolist cannot coerce a distributor into an exclusive dealing agreement while charging a monopoly price; so when it signs a distributor for exclusive dealing, it must have lowered the monopoly price in exchange. According to Bork, this would be “to buy a less profitable market share”. Under the profit maximization premise, it would be a nonsensical strategy for excluding competitors, but it would make sense as a strategy of efficiency-enhancing integration.}{Bork, The Antitrust Paradox, 149–54.} The same logic was applied to other practices such as exclusive dealing: a monopolist cannot coerce a distributor into an exclusive dealing agreement while charging a monopoly price; so when it signs a distributor for exclusive dealing, it must have lowered the monopoly price in exchange. According to Bork, this would be “to buy a less profitable market share”. Under the profit maximization premise, it would be a nonsensical strategy for excluding competitors, but it would make sense as a strategy of efficiency-enhancing integration.\footnote{ibid., 306–09.}{ibid., 306–09.}

\subsection*{3.3.2. The no economic sense test}

Melamed (2006) distilled from the Alcoa precedent the normative notion that a monopolist should be allowed to reap its success in the form of monopoly power and to exclude rivals in that process.\footnote{Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 382.}{ibid., 306–09.} On that basis, he construed competition on the merits as “competition that meets some notion of fair play—even if rivals are harmed by it”, and suggested that the law finds illegality in “the nature of the defendant’s conduct”.\footnote{ibid., 387–88. This reference to the intuitive and unspecified idea of “fair play” is the key in his conceptualization of unlawful exclusionary conduct and endorsement of “the sacrifice test”.}{ibid., 387–88.} Along the line, he advocated the no economic sense test—which is an improved version of the profit sacrifice test proposed by Bork—as the unifying standard for assessing unilateral exclusionary conduct.\footnote{Andrew I. Gavil, “Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance,” Antitrust Law Journal 72, no. 1 (2004): 52–53.}{In essence, the no economic sense test is an improvement of the original profit sacrifice test because it takes a dynamic account of what is profit maximization. This is exemplified in the former’s application to predatory pricing. See ibid 391–92, 396–98; Werden, “Identifying Exclusionary Conduct under Section 2,” 415–16, 424.}

According to this test, competition on the merits essentially means “conduct that makes business sense” for being \textit{profitable},\footnote{Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 392, 398.}{ibid., 392, 398.} and so the \textit{per se} lawfulness of the conduct needs no weighing of its pro- and anti-competitive effects.\footnote{ibid., 388.}{ibid., 388.} In fact, this test sees competition on the merits as not capable of generating counterweighing anti-competitiveness at all.\footnote{ibid., 388.}{ibid., 388.} Meanwhile, conduct that makes no economic sense \textit{but for} its likelihood of excluding rivals and gaining market power for charging supra-competitive prices would denote a bad nature and therefore should be presumed unlawful.\footnote{Andrew I. Gavil, “Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance,” Antitrust Law Journal 72, no. 1 (2004): 52–53.}{ibid., 388.} These two categories of conduct are distinguished through the counterfactual “continued viability of the rival” rationale: for a contentious exclusionary practice, if it appears profit-maximizing in the counterfactual scenario where the rival was not excluded, it makes economic sense;
otherwise, it does not.\textsuperscript{133} The underlying idea was that “making no economic sense” essentially means “making no \textit{efficiency} sense” and thus is welfare-reducing.\textsuperscript{134} This is shown in Table 1.

Table 1: The presupposed and deduced distinctions of the no economic sense test

<table>
<thead>
<tr>
<th>Presupposed distinction</th>
<th>Efficiency-based exclusionary conduct: lawful</th>
<th>Non-efficiency-based exclusionary conduct: unlawful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduced distinction</td>
<td>Conduct making economic (profit-maximization) sense</td>
<td>Conduct making sense only in the “but for” exclusionary way</td>
</tr>
</tbody>
</table>

However, there is a problem with this presupposed distinction of “good (efficiency-based)” and “bad (non-efficiency-based)” competitive behavior: it is unverifiable—at least not by the making economic sense standard—because “economic sense” is a subjective and dynamic notion. It is difficult to draw a clear line between \textit{making economic sense} and \textit{making sense in the “but for” exclusionary way}.\textsuperscript{135} It is more difficult when we factor in strategic interactions between firms. Under certain circumstances, conduct can be profitable and at the same time exclusionary in a non-efficiency-based way. This is the case with exclusive dealing agreements, where profitable but inefficient exclusions can rise if there are collective action problems among the customers of a dominant firm or if these customers can collude as intermediaries with the dominant firm to exploit end-consumers.\textsuperscript{136} In that sense, the economic sense standard is unreliable for distinguishing efficiency-based (lawful) and non-efficiency-based (unlawful) conduct and for preserving the efficiencies that it is set out to preserve. In comparison, the welfare-balancing test addresses this issue,\textsuperscript{137} but as discussed earlier, this test fails the requirement of being administrable.

In other words, this “good and bad competitive behavior” presupposition is intuitive but futile by itself when confronted by the fact that rival exclusions are inherent in the

\textsuperscript{134} Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 393. See also, ibid., 13 (defining “predatory behavior”).
\textsuperscript{135} As Salop pointed out, “it could well be that the firm would be able to recover its investment cost in a more efficient technology only if it were able to gain a monopoly market share and raise its price” (emphasis in original). Salop, “Exclusionary Conduct,” 346.
\textsuperscript{136} Elhauge, “Defining Better Monopolization Standards,” 284–92. See also, Ilya R Segal and Michael D Whinston, “Naked Exclusion: Comment,” \textit{American Economic Review} 90, no. 1 (2000): 298–305 (showing that, even if buyer do not have coordination problems, exclusive dealing can still profitably exclude rivals by exploiting the contract externalities among buyers as long as buyer discrimination is possible).
\textsuperscript{137} Salop, “Exclusionary Conduct,” 315–16 (emphasizing that this test is particularly useful for assessing conduct that is harmful by raising rivals’ costs rather than by being predatory).
competitive process,\textsuperscript{138} and the no economic sense test championed by it provides no objective and coherent criteria for applying the presupposed distinction.\textsuperscript{139} Melamed suggested using “intent” to draw the distinction,\textsuperscript{140} but anticompetitive intentions as such are not legally condemnable. As explicated in the Article 102 case law, they are relevant only as a proxy for ascertaining the likeliness of the competitive harms transpiring.\textsuperscript{141} In the same vein, the absence of fault does not guarantee exemption either.\textsuperscript{142} This is discussed in the next subsection.

3.3.3. The element of intent

Intent plays a significant role in the conception of inherent impropriety. Bork considered exclusionary intentions to be a necessary but not sufficient condition for finding unlawful conduct. As he stated,

\begin{quote}
Antitrust should attack no practice or arrangement on the grounds that it is exclusionary or foreclosing unless deliberate predation can be proved. Improper exclusion (exclusion not the result of superior efficiency) is always deliberately intended.\textsuperscript{143}
\end{quote}

The hard question is how “improper exclusion” intentions could be qualitatively distinguished from efficiency-based competitive intentions, because, as Bork said himself, “Whenever a competitor competes he intends to take business away from rivals, which involves excluding them.”\textsuperscript{144} In other words, under the premise that all business activity excludes,\textsuperscript{145} the idea that there is a difference between “good” and “bad” intentions is incompatible with the adoption of efficiency as an external benchmark for separating lawful and unlawful conduct. This is because intent does not correlate with efficiency. In that sense, by requiring that there must be a finding of an improper exclusionary intention before finding an unlawful practice, Bork narrowed the antitrust prohibition scope without justification.

\begin{thebibliography}
\bibitem{Gavil} Gavil, “Exclusionary Distribution Strategies by Dominant Firms,” 21 (identifying an unanswered question in the Aspen judgment by the US Supreme Court: “what is the proper approach to assessing dominant firm conduct under Section 2 when it produces both anticompetitive effects on rivals and consumers (i.e., inefficiencies) and procompetitive effects for the alleged excluding firm (i.e., efficiencies)?” emphasis in original).
\bibitem{Melamed} For example, it was pointed out that in the \textit{United States v. Microsoft Corp}, the D.C. Circuit adopted a no economic sense rationale to assess certain unilateral conduct. Instead of assessing the conduct in question, it \textit{de facto} presumed that efficiency-based exclusionary conduct is naturally benign and not capable of causing any competitive harm whereas non-efficiency-based exclusionary conduct is incapable of having efficiency justification. See Popofsky, “Defining Exclusionary Conduct,” 445–447.
\bibitem{Bork} Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 393–94.
\bibitem{Bork1} See notes 78–79 and accompanying text.
\end{thebibliography}
Areeda also resorted to the element of intent for tracing the inherent impropriety. He considered relevant the examination "whether the defendant had an intention to exclude by improper means", but he did not clarify what was his understanding of "improper means". On that account, taking the inherent impropriety notion at face value risks being trapped in circular reasoning: there is a preconceived notion of what is proper and improper in the ways that firms compete, and we would just know when we see it—either in actual manifestations or in the undertaking's intentions, and this, in turn, would reinforce the preconceived notion.

3.3.4. A repositioning of the no economic sense test under Article 102

To sum up the preceding subsections, the idea of inherent impropriety is illusory because exclusions are inherent in the rivalry process. The distinction between efficiency-based and non-efficiency-based exclusions is a quantitative one rather than a qualitative one. Accordingly, the rationale should be to find conduct unlawful when the exclusionary effects exceed a certain level that is benchmarked against certain external criteria. Attempting to define unlawfulness any other way would be futile at best and misleading at worst.

To be clear, the no economic sense test does show strength for assessing certain types of abuses. For example, it works well on refusal to deal, because normally it would make no sense for a firm to willingly forgo marginal profits unless the firm has an ulterior motive. But this feature can also be accounted for by devising presumptions. In that light, there is no point in choosing the more costly option of adopting "no economic sense" as a unifying test. Instead, we should limit the use of the no economic sense test (including the profit sacrifice test) as a presumption of illegality applicable only to the types of unilateral conduct that can be identified as "having no plausible prospect other than competition restriction" (or put differently, "naked exclusions") by external, objective criteria.

One of the objective criteria is the infringement of non-competition laws as a means to the abuse of dominance at issue. Take for example the conduct of misusing the patent process in AstraZeneca, or the destruction of a rival's infrastructure in Lithuanian Railways. In the less blatant former case, the deceitfulness of this conduct was contrary to the rules laying down the patent application procedures, and because of AstraZeneca's dominant position, it raised Article 102 concerns. What mattered was that AstraZeneca knowingly violated the relevant patent rules—as indicated by the obvious deceitfulness, and that

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148 For examples of references to the “naked exclusions” concept, see Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 399; Salop, “Exclusionary Conduct,” 317; Popofsky, “Defining Exclusionary Conduct,” 447 (characterizing “nakedly anticompetitive conduct” as “reasonably likely to cause anticompetitive effects and lacked any justification”).
149 The Commission decision on AstraZeneca, recital 144.
violation provided a shortcut for ascertaining the ensued competitive harms. Other objective criteria include but are not limited to the intentions behind the contentious conduct.\textsuperscript{151} These criteria serve the purpose of confirming the presupposed inherent impropriety that is at the heart of the no economic sense/profit sacrifice test. Overall, considerations of these criteria are to be understood as part of the “all circumstances” approach to abuse assessment\textsuperscript{152} and a correspondence to the context-based dichotomy of “by object versus by effect restrictions of competition” under Article 101.\textsuperscript{153}

In short, this article argues that the “no economic sense” rationale should only apply, as a rebuttable presumption of illegality, to unilateral conduct that is found to have no plausible pro-competitiveness after a contextualized, objective assessment. If this assessment suggests otherwise, we need a standard against which competitive harms can be benchmarked to find abuse.

3.4. The benchmarking of exclusionary effects and the as efficient competitor test

3.4.1. Disproportionality as an alternative to inherent impropriety for finding abuse

Elhauge (2003) proposed an abuse test alternative to the no economic sense test. He considered that all rivalries exclude and suggested that, when determining the unlawfulness of exclusionary conduct, the key is to track how the conduct contributed to the furthering of monopoly power. If the conduct in question furthered the monopoly by enhancing the firm’s own efficiency, the conduct should be cleared; but if the conduct furthered the monopoly power by undermining rival efficiency, the conduct should be unlawful, irrespective of whether the conduct enhanced the firm’s own efficiency.\textsuperscript{154} This is shown in Table 2.

Underlying this test is the idea that “the undermining of rival efficiency” and “the enhancement of firm’s own efficiency” are mutually exclusive, even in cases (of vertical restraints for example) where ambivalent effects are identifiable. Accordingly, being the result of justifiable exclusionary practices, a firm’s own efficiency enhancements would not come at the expense of rival efficiency. Any rival exclusions—and the implied ex-post inefficiencies—resulted from such practices would simply be the permissible outcome of the firm’s exploitation of its greater efficiency, rather than an undermining of rival efficiency.\textsuperscript{155}

Table 2: The presupposed and deduced distinctions of the Elhauge test

\begin{flushleft}
\footnotesize
\textsuperscript{151} See notes 78–79 and accompanying text.
\textsuperscript{152} See note 72 and accompanying text.
\textsuperscript{153} See notes 81–82 and accompanying text. The Generics UK ruling puts “the relevant legal and economic context” to the center stage for identifying restrictions both by object and by effect. Accordingly, adopting a contextualized approach to identifying a “by object” restriction does not undermine the “by object versus by effect” dichotomy under Article 101.
\textsuperscript{154} Elhauge, “Defining Better Monopolization Standards,” 256.
\textsuperscript{155} ibid., 318–20 (agreeing with the US Supreme Court’s per se rule of legality in Aspen on “a monopolist’s efforts to make itself more efficient than rivals and then exploit that greater efficiency in a way that drives out rivals”).
\end{flushleft}
This test identifies two scenarios where an exclusionary practice would be found unlawful. The first scenario is where a practice undermined rival efficiency without enhancing its own efficiency (such as pricing below cost). Indubitably, it should be outlawed. The second scenario is more delicate. It is when a practice (such as exclusive dealing and refusal to deal) undermined rival efficiency and at the same time enhanced to a certain extent the firm’s own efficiency. There, the practice in question should still be outlawed, because it was a disproportionate way of enhancing or exploiting the firm’s own efficiency. For example, a refusal to deal—which is supposedly a firm’s exercising of its property rights and a reflection of its efficiency—would be unlawful if it was discriminatorily targeting at rivals, because this discrimination element—which caused the undermining of rival efficiency—went beyond the exclusionary effect that was necessary for securing the property rights. The same reasoning was applied to exclusive dealing: the exclusivity conditions “discriminate against those who deal with rivals”, and “in such cases achieving those efficiencies by internal expansion will generally be a less restrictive alternative to achieving them with exclusionary conditions”.

This reasoning bears a striking resemblance to the “ability to exclude” conception of dominance under Article 102, which entails a special responsibility on a dominant undertaking of not to distort the competitive process. In that sense, essentially what Elhauge did was upholding the Chicago School’s efficiency objective (as the criterion according to which lawful and unlawful conduct is distinguished) and at the same time factoring in the dominant/monopoly market structure. Consequently, Elhauge refused to take at face value the idea that dominant firms’ behavior is generally well-aligned with the robust self-correction forces of the markets, and instead adopted a more nuanced approach. Elhauge’s test can be compared with the AEC rationale: the former accentuates the need to preserve ex-ante efficiencies (which permits rival-exclusions flowing from the exploitation of superior performance) whereas the latter focuses on ascertaining ex-post whether the exclusion of certain rivals was indeed the result of efficiency enhancement and exploitation. Despite the different viewpoints, they reach similar conclusions concerning the idea of competition on the merits: it is all about benchmarking the exclusionary effects.

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156 ibid., 256–57.
157 ibid., 323.
158 ibid., 321.
159 ibid., 256, 324.
160 ibid., 327.
161 ibid., 325–26, 336 (contrasting the robust forces of free market competition with “private self-regulation” of the monopolists).
3.4.2. The as efficient competitor test

Judge Richard Posner is credited for pioneering the AEC test. He acknowledged that “a practice may be at once exclusionary and efficient” from an ex-post viewpoint, and suggested using the AEC benchmark to weigh these two kinds of effects. Supposedly by the weighing, the AEC benchmark distinguishes non-efficiency-based exclusions from efficiency-based ones. Posner understood non-efficiency-based exclusions as the ones that eventually result in “an increase in the market price above the competitive level.” Notably, his advocacy for the AEC test was accompanied by a distrust of using exclusionary intent as a proxy for identifying non-efficiency-based exclusions. Accordingly, this test dives directly into the measuring and weighing of efficiency-impairing and -enhancing effects, and for that, it has no other choice but to rely heavily on price-cost comparisons. However, it is important to note that, although the price-cost comparison plays a big role in the application of the AEC test, it is not a necessary condition of the latter, as pricing is not the only means of non-efficiency-based exclusions.

A major doubt of the AEC test is its under-inclusiveness. First, it was suggested that the AEC test does not take a dynamic account of how less efficient competitors could pose a significant competitive restraint, especially when economies of scale or scope are present. Second, it was pointed out that the AEC test may be functionally irrelevant.

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163 As he wrote, “in every case in which such a practice is alleged, the plaintiff must prove first that the defendant has monopoly power and second that the challenged practice is likely in the circumstances to exclude from the defendant’s market an equally or more efficient competitor. The defendant can rebut by proving that although it is a monopolist and the challenged practice exclusionary, the practice is, on balance, efficient.” See ibid., 194–95.
164 ibid., 196 (“Only when monopoly power is used to discourage equally or more efficient firms and thus perpetuate a monopoly not supported by superior efficiency should the law step in.”)
165 ibid., 200–01.
166 ibid., 214–15 (“Any doctrine that relies upon proof of intent is going to be applied erratically at best.”). For an opposing opinion this, see Nazzini, The Foundations of European Union Competition Law, 64.
167 O’Donoghue and Padilla, The Law and Economics of Article 102 TFEU, 232–33 (explaining the price/cost test proposed by the Commission for finding abusive pricing practices under the AEC rationale).
168 Salop, “Exclusionary Conduct,” 328 (discussing the inadequacy of the AEC test from the perspective of potential competition). See also, Gavil, “Exclusionary Distribution Strategies by Dominant Firms,” 59 (disapproving the AEC standard as being “a snapshot of competition at a brief moment in time”).
169 Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 388 (“a rival that is less efficient today might become equally or more efficient if permitted time to develop learning-by-doing economies or if its sales grew and enabled it to gain scale economies”).
when it comes to practices like the misuse of the patent process. Such practices would effectively exclude all competitors, no matter how efficient they are.\textsuperscript{170}

Another doubt is the predictability of the test. Firms would find it difficult to assess \textit{ex-ante} their business practices (especially non-pricing practices), because the criteria this test uses for finding unlawful conduct may not be foreseeable or controllable by the firm responsible for the conduct.\textsuperscript{171} Here the AEC test is in contrast with the no economic sense test, which relies on “the objective economic considerations for a reasonable person” as the preliminary criterion for finding illegal conduct.\textsuperscript{172}

In sum, the AEC test has limited tools for assessing non-pricing conduct and it raises two formal requirement concerns. Critically, however, none of these issues are inherent in the AEC rationale. With some calibrations in applying this test, these issues can be addressed. This is discussed in the next section.

4. Concretizing competition on the merits by way of minimum efficient scale

4.1. The concept of minimum efficient scale

The concept of MES is associated with economies of scale. When the marginal cost of production is below the average cost per output, with every additional output unit there is a \textit{less-than-proportional} cost increase, and so it is more cost-effective to produce at a larger scale. As a feature of market structure, economies of scale exist when there are large fixed costs.\textsuperscript{173} A related concept is economies of scope, which exist when the total costs of producing two or more products by the same firm are less than the aggregate costs of each product being produced by a different firm. This is because there are common costs for producing multiple products or there are cost complementarities in production.\textsuperscript{174} Economies of scope can reinforce economies of scale in a multiproduct setting.

The extent of scale economies depends on the marginal cost curve. This is shown in Figure 1. Suppose that marginal cost appears as a U-curve as it usually does. So, it has the lowest point (A): marginal cost falls to a bottom as the output level increases up to the quantity coordinate of that point ($q_a$), and starts to rise thereafter. Thereon, as marginal cost keeps rising with the output expansion, at a certain point (B) the amount of marginal cost is bound to catch up to the amount of average cost and marginal cost increase becomes proportional to the total cost increase.\textsuperscript{175} When that happens, economies of scale are


\textsuperscript{171} Melamed, “Exclusive Dealing Agreements and Other Exclusionary Conduct,” 388. See also, Rousseva, \textit{Rethinking Exclusionary Abuses in EU Competition Law}, 427 (summarizing the Commission’s utilization of the AEC rationale for finding abuses of dominance).

\textsuperscript{172} Werden, “Network Effects and Conditions of Entry,” 417–18.

\textsuperscript{173} Pepall, Richards, and Norman, \textit{Industrial Organization}, 69.

\textsuperscript{174} ibid., 75.

\textsuperscript{175} In that sense, one way to detect the presence of economies of scale is to verify whether the total cost increase is proportional to the total output increase. This can be done by
exhausted. This exhaustion can be delayed by widening the gap between average cost ($c_{a2}$) and marginal cost ($c_{a1}$) at that lowest point (A). In other words, the larger the fixed production costs are, the more extensive the economies of scale are.

Figure 1: Economies of scale and the marginal cost and average cost curves

MES can thus be defined as the lowest level of output at which economies of scale are exhausted.\textsuperscript{176} As the extent of scale economies correlates positively with the level of fixed costs, the size of MES does too. In markets where the production requires a large amount of fixed (sunk) costs, a firm would need to be relatively large to reach MES. MES can be measured by estimating firm cost functions, the same way that economies of scale can be measured.\textsuperscript{177}

For antitrust, the variable size of MES necessitates the consideration of the relevant market size. If by definition the total amount of demand is large enough to accommodate many firms, a large MES will not necessarily entail a concentrated market structure. However, if by definition the relevant market is limited and the MES is large, the market structure is likely to be concentrated. Normally market demand increases as the price (or cost) goes down, and it reaches the full potential at the point where the production cost is driven down to a minimum. Also, it may be the case that the total demand of a market is increasing or decreasing inter-temporally.\textsuperscript{178} These factors have a limiting impact on how many firms can achieve MES. To be sure, there are many determinants of market

\begin{itemize}
  \item dividing the percentage increase in total output by the percentage increase in total cost.
\end{itemize}

See ibid., 70–71.
\textsuperscript{176} ibid., 70.
\textsuperscript{177} ibid., 83–85.
structure, and the impact of MES on the market structure can be negated or overshadowed by other factors. This is shown in Table 3.

The extreme of a concentrated structure is a natural monopoly. More specifically, if the amount of market demand at the minimum long-run cost level (which means the cost cannot be lowered any further by static efficiency) is less than twice the size of the output of a firm’s MES, the market would be a natural monopoly.\(^{179}\) In that case, there should no realistic expectation of long-term competition, and so non-efficiency-based exclusions would be unlikely.

A less extreme scenario is where the potential total demand is more than twice the size of the MES and so at least two firms (an incumbent and an entrant) can stay viable. In that case, the incumbent and the entrant are equally efficient from the start,\(^ {180}\) albeit some incumbency advantages enjoyed by the former. There should be no problem unless the incumbent is using the advantages to foreclose rivals, because then non-efficiency-based exclusion becomes a valid concern.\(^ {181}\) There is also the likelihood of horizontal collusion,\(^ {182}\) but this would be within the purview of a different antitrust segment.

Table 3: The different MES sizes in relation to the relevant market size

<table>
<thead>
<tr>
<th>Size of the Relevant Market</th>
<th>Size of MES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small MES and large market: fragmented</td>
<td>Large MES and large market: indeterminate</td>
</tr>
<tr>
<td>Small MES and small market: indeterminate</td>
<td>Large MES and small market: concentrated</td>
</tr>
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So far this subsection describes MES from a static viewpoint. Market size can change, however. In a fast-growing market, a rival is unlikely to be inefficiently excluded from

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\(^{179}\) ibid., 790.

\(^{180}\) ibid., 791.


reaching MES because of the plentiful contestable demands. Moreover, in many cases, it is more about competing for the market and less about competing in the market, as dynamic competition drives firms to create new demand curves and new consumer surplus gains. In such cases, the market may be narrowly defined and the MES found large (on account of, for example, significant R&D investments), but inefficient exclusions of rivals would still be unlikely.

4.2. The use of MES under Article 102

4.2.1. Deutsche Post

In Deutsche Post, the Commission resorted to the MES notion for determining whether the disputed fidelity rebates were abusive. As found regarding the relevant market, “Successful entry into the mail-order parcel services market requires a certain critical mass of activity”. This critical mass was quantified as some 100 million parcels a year. The underlying logic is that a new entrant can compete with the incumbent head-on only after it gets a stable foothold in the market. The Commission considered that the exclusive-dealing requirements attached to the disputed rebates prevented, by locking in the customers, the competitors from achieving that MES. For confirmation, it pointed to the finding that there was no entry and the incumbent had a consistent market share of over 85% for ten years. Thus an abuse of dominance was established.

Although plausible for taking an initiative of quantitative analysis, the Commission’s use of MES in Deutsche Post was somewhat superficial. It did not explain how the “100 million parcels a year” quantification came about. Nor did it further assess how this large MES might be indicative of the market structure. If a successful entry into the relevant market indeed required “considerable sunk costs” for infrastructure, the lack of entry attempts would make at least some efficiency sense: the incumbent (Deutsche Post) enjoyed significant economies of scope as well as scale, as it had significant common fixed costs for (1) providing the commercial mail-order parcel services and (2) fulfilling the public obligation of maintaining a reserve capacity for over-the-counter parcel services. The scope and scale economies were in a way compensation for the postal universal service obligation it bore. Under such circumstances, an entry would not be

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186 ibid., paras 32, 37.
187 ibid., paras 39, 42.
188 ibid., para 32.
190 The Commission decision on Deutsche Post, para 32.
191 ibid., paras 8–10.
easy indeed, but to be fair, the potential entrants needed not to bear any public service obligation either. Therefore, the fact that there was no entry and the market share was consistently above 85% might not be entirely attributable to the fidelity rebates. Of course, this does not necessarily mean that the fidelity rebates were not abusive, but a more nuanced analysis following the MES logic would have been appreciated.

4.2.2. The Contestability Distinction in the Guidance Paper

In the Guidance Paper, the Commission distinguished contestable and non-contestable shares of demand when introducing the AEC rationale to rebates analyses. The point is to acknowledge that the dominant position yields an incumbency advantage that renders only a certain proportion of the market open for competition, so it is necessary to ascertain how the non-contestable part can be used as leverage to lock in customers and to foreclose rivals on the contestable part. Accordingly, a price-cost comparison in the AEC spirit must address the following issue: when a rebate scheme is based on all the purchases from the incumbent, a competitor for a customer’s certain contestable demands would need not only to match the incumbent’s price discounts on those contestable demands but also to compensate the customer’s loss of discounts on the remaining purchases from the incumbent (the main part of which are non-contestable).

This incumbency advantage can be explained by, among other factors (such as learning-by-doing), the presence of significant sunk and fixed costs for entry and expansion. The incumbent made such investments, but the rivals are either constrained from committing such investments or still waiting for the invested infrastructures or technologies to become operational (which could take years), so the customers have no alternative supply sources but the incumbent for large proportions of their demands. Importantly,

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193 Fumagalli and Motta, “A Simple Theory of Predation,” 612 (explaining how, in such a scenario, the reserved monopoly in one market can effectively exclude a more efficient rival in a second market).
194 Segal and Whinston, “Naked Exclusion,” 298–305.
196 ibid., recital 39.
197 ibid., recitals 41–42 (“The effective price that the competitor will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate the customer loses by switching, calculated over the relevant range of sales and in the relevant period of time.”).
199 Commission Decision of 13 May 2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (COMP/C-3 /37.990 - Intel), recital 886 (hereinafter, “the Commission decision on Intel”) (observing that, in the x86 CUP production industry, “Expanding output requires additional (sunk) investment into new property, plant and equipment as well as several years’ lead time.”). See also, Elhauge, “Why Above-Cost Price Cuts to Drive out Entrants Are Not Predatory,” 778 (“There might be economies of scale or scope at low output that are only available over time as production is ramped up.”).
the sunk and fixed costs also yield extensive economies of scale, which give the incumbent a sizeable cost advantage compared to rivals that have not yet made such investments. Therefore, it is equally necessary to delineate this cost advantage before assessing whether an as-efficient competitor is being excluded. As the Commission explained in the Intel decision, the AEC analysis is “a hypothetical exercise in the sense that it attempts to analyze whether a competitor which is as efficient as Intel, but which would not have as broad a sales base as Intel, would be foreclosed from entering”.\textsuperscript{200} To that end, determining the incumbent’s MES is crucial, for it can serve as an AEC benchmark that filters out the excessive impact of the incumbent’s unrivaled sales volume on the cost structure.

Unfortunately, however, this task of isolating scale economies is not always thoroughly undertaken. This is largely attributable to the conception of contestable and non-contestable shares: as an oversimplified account of the incumbency advantage,\textsuperscript{201} it automatically diverts the analytical attention to “the leveraging of the non-contestable shares to lock in customers” and away from “the delineation of the incumbent’s cost advantage derived from the scale economies that a potentially as-efficient rival can but does not yet have”. This is problematic, as the incumbency advantage of holding non-contestable demand shares and the cost advantage from having scale economies are not the same thing: the former is ultimately the result of high barriers to entry and expansion and thus raises potential concerns, whereas the latter is the result of fixed and sunk costs and a neutral feature of the market at hand. The conception of contestable and non-contestable shares emphasizes the former and downplays the importance of the latter.

On top of that, the case law instructs a potential effects threshold\textsuperscript{202} and a rather unforgiving standpoint towards exclusivity\textsuperscript{203} This renders unnecessary the looking into of the extent and possible changes of the non-contestable proportion in the given circumstances. Consequently, the possible efficiency accounts that flow from scale economies are seriously overlooked. This is shown in the Commission’s AEC analysis in Intel.

4.2.3. The Commission’s AEC analysis in Intel

The Intel case is the newest addition to a long line of precedents on rebates. At the center of this decade-long legal controversy is the Commission’s AEC analysis on rebates featuring an exclusivity element. There, the Commission considered the presence of non-contestable shares,\textsuperscript{204} mostly along the line of how they might be leveraged to make it impossible for a rival to match the price discounts.\textsuperscript{205}

The mission of isolating scale economies for an accurate AEC analysis\textsuperscript{206} was skewed, in the sense that a determination of the MES was nowhere to be found. The Commission did

\textsuperscript{200} The Commission decision on Intel, recital 1004.
\textsuperscript{201} O’Donoghue and Padilla, The Law and Economics of Article 102 TFEU, 232.
\textsuperscript{202} See Section 2.2.1 above.
\textsuperscript{203} The ECJ judgment on Hoffmann-La Roche, para 89.
\textsuperscript{204} The Commission decision on Intel, recital 1009.
\textsuperscript{205} ibid., recital 1006.
\textsuperscript{206} ibid., recital 1004.
note the large MES present in the market, but only as an indicator of high entry barriers. 207 As explained in the previous subsection, this is a mischaracterization of MES. A large MES as such is not necessarily an obstacle for an as-efficient competitor to enter or expand. Unlike the incumbency advantage, MES is attainable by all rival firms—unless the incumbent is actively inhibiting them from doing so.

The Commission rejected Intel’s efficiency justification of scale economies, on the grounds that the justification was imprecise and that the rebates were still unnecessarily restrictive of competition. 208 However, following the AEC rationale, a question can be asked as to what would be a “necessary” or “proportionate” restriction that enables as-efficient competitors to enter and expand while unproblematically ridding off less-efficient ones. This begs a discussion on the MES in the relevant market. But since the Commission understood MES as nothing more than an indicator of entry barriers, it should not come as a surprise that the Commission dismissed Intel’s scale economies justification so effortlessly.

In sum, the same can be said about Intel as about Deutsche Post: the rebate schemes at issue may very well be abusive, but the lack of an MES examination invites doubts about the abuse finding. The Guidance Paper devised the contestability and non-contestability distinction to introduce the AEC rationale to rebates analyses, but the result is compromised because this distinction ignores the cost-saving effect of scale economies. This calls for an integration of MES into the AEC test.

4.3. A bigger role for MES

As discussed in Section 3.4.2., the AEC test has been criticized for overlooking the exclusion of potentially as-efficient competitors, which could be welfare-reducing. Another issue is that the AEC test tends to be associated with the predatory pricing analogy for its strong reliance on price-cost comparisons. Consequently, when it comes to non-pricing conduct, there is a tendency to mistake the toolkit limitations of the AEC test for its inapplicability. This is exemplified in the Intel controversy. Some scholars objected to the AEC test being applied to exclusivity rebates. They argued that the exclusive-dealing requirements set these rebates apart from predatory pricing practices and so warranted a presumptive illegality treatment without the need of an AEC analysis. 209

To that point, it should be reiterated that the AEC rationale does not have to be reduced to a price-cost comparison, much like that an exclusive dealing requirement does not necessarily call for an illegality presumption. The still-existing illegality presumption on

207 ibid., recital 866.
208 ibid., recitals 1635–36 (stating that Intel failed to demonstrate “how the exclusivity/quasi exclusivity conditions of the discounts was capable of achieving” the alleged efficiencies and why the “efficiencies of scale could not be generated by another discounting structure or by undiscounted lower unit prices for all customers”).
exclusive dealing under Article 102 is not because the exclusivity element is inexcusable, but because the special responsibility concept is expansively interpreted. The concept of MES can be helpful for both complementing the AEC test and calibrating the interpretation of the special responsibility concept.

4.3.1. MES and the AEC rationale

The concept of MES is complementary to the AEC rationale, in the sense that firms being restrained from reaching MES is a sufficient but not necessary condition for as-efficient competitors being excluded. Rival firms can become as-efficient only after they reach an MES. Meanwhile, as-efficient firms will regress to an MES or worse if they are being foreclosed—more specifically if their costs are raised to the extent that they cannot afford to produce as-efficiently anymore. Therefore, if firms are found not being able to achieve MES, it may be that they are being foreclosed from reaching or maintaining an as-efficient cost level.

In any event, it is important to look at the market circumstances as to how difficult it is to reach an MES and whether the incumbent is actively contributing to that difficulty. Admittedly in that regard, the MES concept may not be very straightforward. A smooth application is more likely to happen in circumstances that feature large sunk costs, such as the ones of Deutsche Post. The application would be more complex in circumstances where a handful of firms were able to achieve MES while others could not. In that case, we would need to ascertain further if the situation was the result of a relatively small-size market or certain "raising rivals' costs" practices are at play.

4.3.2. MES and the special responsibility concept

The MES concept respects and accentuates the role of dominance in the Article 102 paradigm. It directs the attention to whether a dominant incumbent is actively making it more difficult for rival firms to achieve MES. In that sense, it corresponds to the special responsibility concept by implying that, when a firm holds market-wide control of prices and competition, it has to be subject to a proportionality principle when enhancing and reaping its efficiencies. The special responsibility concept can thus be concretized as a dominant firm’s obligation not to impede a rival firm from reaching MES. In the same vein, abuse can be understood as behavior that undermines rival efficiencies to the extent below the MES baseline.

The special responsibility borne by the dominant firm can be put on a sliding scale, on account of the size of the MES in relation to the market size in the particular case circumstances. Take for example a stylized scenario: if the MES takes up 30% of the maximum market demand, then the firm is allowed of exclusive dealing up to 70% of the

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213 Ibid., 321.
market demand. But if the MES is 40%, the allowed number becomes 60% at most. If the MES is 50%, exclusive dealing will not be allowed altogether.\textsuperscript{214}

5. Conclusions

The competitive process inevitably results in rival exclusions. This necessitates the distinguishing of lawful and unlawful exclusionary conduct under Article 102. The law has adopted the dichotomy of competition on the merits and abuse to underscore this distinction, but the conception of competition on the merits is susceptible to the guidance of inherent impropriety.

Considering the trade-off between enforcement precision and enforcement costs, this article suggests that, instead of the inherent impropriety notion, Article 102 needs simply a presumption of illegality for conduct that has no plausible explanation other than competition restriction. This is where the no economic sense test can be useful, provided that it adheres to the contextualized approach laid down in the case law. In general (and for conduct that has ambivalent effects in particular), the distinction between abuse and competition on the merits should be the measuring of competitive harms against a certain benchmark. Among the various proposed abuse tests, the AEC test stands out as the most qualified for this task.

The AEC test is critiqued as being potentially under-inclusive and analytically limited to price-cost comparisons. Although valid, these critiques do not undermine the theoretical strength of the AEC rationale for drawing the said distinction. The concept of MES can help address these issues: it calibrates the AEC rationale on account of dynamic competition; it also equips this rationale with analytical tools for non-pricing conduct such as exclusive dealing.\textsuperscript{215}

The “abuse versus competition on the merits” distinction pertains to the abuse assessment, but we should not forget that the dominance premise is pivotal in the Article 102 paradigm. This pivotality is crystalized as the special responsibility concept. Unfortunately, this concept lacks specification, and often it functions no more than a shortcut for the abuse assessment. This ultimately undermines the dominance premise. The MES concept may help address this problem; we can understand the special responsibility concept as a dominant firm’s responsibility not to prevent a rival from reaching its MES. Accordingly, a sliding scale of special responsibilities can be formulated under the “all circumstances” analytical framework in individual cases. In sum, the MES concept deserves more attention for potentially making Article 102 enforcement more robust.

\textsuperscript{214} ibid., 324.