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Volume 3 Issue 2 pp 121-173**March 2007****The Controversies of the Consumer Welfare Standard***KJ Cseres**

This article deals with the consumer welfare standard in competition law enforcement. It explores the inherent economic and legal ‘geography’ of this notion by looking beyond the borderlines of competition rules. While the consumer welfare standard has been widely discussed as a legal and economic notion of competition law, this article approaches this concept from a new angle by making use of its interpretation in consumer law. In competition law the primary role of the consumer welfare standard is to verify the goals of competition policy and to delineate the general legal framework of competition law enforcement by establishing the basis for the standard of proof. In consumer law consumer welfare stands for correcting market failures in order to improve the consumer’s position in market transactions. Consumer welfare is concerned with efficient transactions and cost-savings but it is also directed at social aspects of the market such as the safety and health of consumers. Consumer welfare is an economic concept with relevant socio-political and legal implications. However, the economic rationale seems to be often overridden by a political rationale, which is to legitimize the enforcement work of competition authorities’ and to reflect society’s preferences on income distribution. This article addresses the implications of the consumer welfare standard in welfare economics, political economy and law. The analysis points out to what extent the enforcement of competition law can prevent (final) consumer harm and make (final) consumers better off and what the inherent limits of the promotion of consumer interests are in competition law. Such comparisons clarify and identify the function of this standard and delineate the borderlines between the two disciplines, the possible gaps and unnecessary overlaps they create in regulating markets.

INTRODUCTION

This article deals with the notion of the consumer welfare standard in competition law enforcement. The underlying idea is to explore the inherent economic and legal ‘geography’ of the consumer welfare standard by looking beyond the borderlines of the competition rules and making reference to notions common to consumer law. The discussion will in the first place focus on the application of the consumer welfare standard in competition law enforcement but will approach this issue from a new angle. While the consumer welfare standard has been widely discussed as a notion of competition law, and explained with the help of legal and economic terms common to competition law, this article will make use of the interpretation of this standard in consumer law. In competition law the primary role of the consumer welfare standard is to verify the goals of competition policy and to delineate the general legal framework of competition law enforcement by establishing the basis for the standard of proof required in investigation and litigation. In consumer law consumer welfare stands for correcting market failures in order to improve the consumer’s position in market

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transactions. Consumer welfare is concerned with efficient transactions and cost-savings but it is also directed at social aspects of the market such as the safety and health of consumers

Consumer welfare is an economic concept with relevant socio-political and legal implications. However, the economic rationale behind the consumer welfare standard seems to be often overridden by its political rationale, which is to legitimise the enforcement of competition rules by competition authorities and reflect society's preferences on income distribution. The discussion below will address the implications of the consumer welfare standard in welfare economics, political economy and law. Its application is neither without practical difficulties nor without the requirement to make considerable tradeoffs in decision making. The implementation of the consumer welfare standard in competition law is a political choice rather than an economic or legal rationale. The legal and economic implications of consumer welfare may differ and various combinations are possible when it comes to enforcement. These combinations have a direct impact on the way competition cases are decided and how competition policy is shaped by competition authorities.

The term consumer welfare has several interpretations and it has often been misinterpreted or even misunderstood in competition law analysis.¹ It is sometimes used to refer to economic efficiency or a certain consumer interest without defining its real content. Depending on its exact content the consumer welfare standard can lead to different policy decisions in competition law enforcement. This is most explicit in merger cases such as *GE/Honeywell*,² but has relevant implications for cases of collusive and unilateral behaviour, as in the recent judgment of the European Court of First Instance in *GlaxoSmithKline*,³ or some of the controversial predatory pricing cases of the European Court of Justice.⁴

In economics the consumer welfare standard has a number of shortcomings vis-à-vis the total welfare standard. The consumer welfare standard lacks a firm basis in welfare economics and its enforcement confronts private companies with a complicated burden of proof. Competition authorities can take various approaches when they want to reconcile the overall interest of society with the particular interests of consumers.

¹ 'The term consumer welfare is the most abused term in modern antitrust analysis', Brodley, JF, 'The economic goals of antitrust: efficiency, consumer welfare, and technological progress', (1987) 62 NYUniv LR 1020, p 1032.

² Both the US DOJ and the European Commission based its decision on the consumer welfare standard in their decision in the *GE/Honeywell* merger case. Nevertheless, the two competition agencies reached opposing decisions. The American antitrust enforcement agencies pursued the consumer welfare standard by recognizing certain efficiency gains that produce no short-term consumer benefit but benefit consumers in the long term. The European Commission seemed to be less satisfied with promises of long-term benefits for consumers and preferred to see short-term advantages. Commission's Decision In General Electric/Honeywell, Case No. COMP/M.2220, July 3, 2001.

³ Case T-168/01 *GlaxoSmithKline Services Unlimited v Commission*, judgment of 27 September 2006.

⁴ Case C-62/86 *AKZO v Commission* [1991] ECR 3359, Case T-83/91 *Tetra Pak International SA v Commission* [1994] ECR II-755.

Moreover, the approach of lawyers and economists may diverge as well. The need for unambiguous standards and consistency and uniformity among these standards worldwide is gaining importance as transactions more frequently take place in global dimensions.

A discussion of the possible interpretations of the consumer welfare standard is topical considering the fact that it is, today, a commonly proclaimed goal of competition policy and an often applied benchmark of competition law enforcement. European competition policy has recently come to acknowledge that besides market integration the enhancement of consumer welfare is the ultimate goal of the enforcement of competition rules. This recognition has taken place parallel to the decentralisation of European competition law enforcement and the introduction of a more economics and effects based approach. Effective enforcement, and an enhanced role of enforcement agencies, has increased through the introduction of the new enforcement system under Regulation 1/2003. The success of the new enforcement system will fall or triumph on whether national courts and competition authorities will develop a sufficient degree of expertise to handle cases consistently in a uniform manner. A clearly set and uniformly enforced standard is, therefore, of utmost relevance for European and national enforcement agencies, the business community and final consumers.

This article will contribute to a more realistic picture as to what extent the enforcement of competition law can prevent (final) consumer harm and make (final) consumers better off. The analysis will also point out which consumer interests competition law can effectively address and what the inherent limits of the promotion of consumer interests are in competition law. Comparing the consumer welfare standard in competition law and in consumer law helps to clarify and identify the function of this standard. Such comparisons also help to delineate the borderlines between the two disciplines, and the possible gaps and unnecessary overlaps they create in regulating markets. It, moreover, contributes to understanding how markets work, how markets fail to work, and how these market failures can efficiently be corrected.

This article will be structured into four parts. In the first part the different interpretations of the consumer welfare standard in competition law and consumer law will be set out. The second part will discuss the application of the consumer welfare standard in competition law enforcement. This part will deal with the implications of the welfare standard with regard to efficiency claims and the pass-on rate in merger cases as well as with the implications of the consumer welfare standard in cases of collusive and unilateral behaviour by addressing the nature of consumer harm and the efficiency defense. The third part will give a short discussion of the consumer welfare standard against the backdrop of EC competition law with minor references to the US antitrust system. This part will explain the implications of this welfare standard under Article 81 EC in more details. The fourth part will describe the legislative policy and the institutional implications of the accepted welfare standard in competition law.

THE INTERPRETATIONS OF THE CONSUMER WELFARE STANDARD

While for many the derived consumer benefits of competition policy seem to be obvious, the role competition law and policy have in pursuing consumer interests is not always well understood or even misunderstood.⁵ Competition law is primarily concerned with economic efficiency and with the overall welfare of society, without distinguishing between different groups of society. While competition regimes all around the world pursue this goal they are usually not based exclusively on efficiency arguments. Accordingly, competition law guarantees that consumers get a fair share of the economic benefits resulting from the effective working of markets and economic and technical progress. Such economic benefits can be realised through lowering the costs of production, expanding output, improving the quality of the product or creating a new product and spurring innovation. This implies that competition policy has as one of its goals the improvement of consumers' economic interests. However, is this the ultimate goal of competition policy? And does this goal correspond to the consumer welfare standard applied in consumer law? Which consumer interests can competition policy effectively pursue and how does it maximise consumer welfare? These questions will be discussed below.

Consumer Welfare as the Goal of Competition Policy

Consumer welfare is generally defined as the maximisation of consumer surplus, which is the part of total surplus given to consumers. This is realised through, 'direct and explicit economic benefits received by the consumers of a particular product as measured by its price and quality'.⁶ The consumer welfare model argues that the ultimate goal of competition law should be to prevent increases in consumer prices, restriction of output or deterioration of quality due to the exercise of market power by dominant firms.

Competition policy generally has as its aim to increase the overall material welfare of society through maintaining rivalry among firms. The ultimate goal is to increase overall economic efficiency while providing consumers with a fair share of this total wealth. While society's total welfare is usually the ultimate goal of competition policy it is rarely its exclusive goal. Competition policy usually focuses on a specific reconciliation of the

⁵ Such a misconception can be found in the way Judge Bork explained the goal of antitrust law. In his view the ultimate goal of antitrust policy was the maximisation of consumer welfare. Bork argued that, '... the whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.' Bork identified consumer welfare with overall economic efficiency when he considered productive efficiency as part of consumer welfare as he considered the sum of consumer and producer surplus. Bork, R.H. *The antitrust Paradox: a policy at war with itself*, New York, Basic Books, 1978.

If the aim of antitrust is the maximisation of consumer welfare then, it gauges the level of allocative efficiency, typically measured by the difference between marginal cost and the valuation of a marginal production unit by consumers. Therefore, it cannot be equated with economic efficiency, which stands on the basis of the total welfare standard. The consumer welfare standard does not seek to maximise total surplus, it is only concerned with consumer surplus.

⁶ Brodley, op cit, n 1, p 1033.

overall interest of society with the particular interests of consumers. The difference between competition policies lies in the particular way in which they reconcile these interests. Whether a given competition policy strives to achieve pure economic goals, in particular economic efficiency, or whether it includes non-economic goals, like income distribution, diffusion of economic and political power or fostering business opportunity, as well depends on the economic goals of the political system it is part of.

Three approaches are possible. First, competition policy may ignore consumer interests and focus solely on total welfare and economic efficiency. Second, it may recognise the immediate and short-term interests of consumers as the primary aim of competition policy. Third, competition policy might recognise consumer welfare as an essential long-term goal where the immediate interests of consumers are subordinated to the economic welfare of the society as a whole.⁷

The first approach seems to have little attraction for policy-makers as it ignores the wealth transfer from consumers to producers and thereby neglects any kind of protection for consumer interests. This approach would find little support in society as it ignores consumers who 'by definition include us all'.⁸ Still, certain scholars, especially those associated with the Chicago School, argue that competition law is not suited to deal with income distribution and that other public policies are better suited to deal with such equity goals – 'Antitrust thus has a built in preference for material prosperity, but it has nothing to say about the way prosperity is distributed or used.'⁹ The school considered efficiency gains as politically neutral, but regarded wealth transfers as politicised. Wealth should go where it is the most appreciated.¹⁰ This Chicago premise stands for a policy which is considered to be efficient when the total gain of those who gain from the policy is greater than the total losses to those who lose as a result of the policy. The Chicago School therefore considers a policy which produces greater gains to business than losses to consumers to be efficient. This approach, considers a monopoly which produces cost savings, but at the same time higher prices for consumers, as legitimate. Despite its economic rationale, it is unlikely that competition agencies or courts would adopt a policy that permits fixed cost-savings of producers and thus increase in total welfare but harms consumers by increasing prices.

The second approach would prefer immediate short-term consumer interests to the overall social interests. This approach ignores the inherent tension between consumers' immediate interests and producers' incentives to sustain innovation and productive efficiency.¹¹ It disregards efficiency gains and benefits that drive productivity growth and innovation and that could actually benefit consumers in the long run.

⁷ Brodley, op cit, n 1, p 1035.

⁸ President Kennedy's message to the United States Congress in 1962.

⁹ Bork, op cit, n 5, p 90.

¹⁰ Posner, RA, *The Economics of Justice*, Harvard University Press, 1981, p 92; Bork, op cit, n 5, pp 418-25.

¹¹ Brodley, op cit, n 1, p 1036.

The third approach aims at long-term consumer interests through subordinating short-term consumer interests to the overall welfare of the whole society on condition that consumers are provided with a fair share of the overall economic welfare:

Antitrust policy, therefore, need not concern itself directly with increasing the purchasing power of the poor because it accomplishes this indirectly when it prohibits cartels and monopolies in the single-minded pursuit of efficiency.¹²

Competition policy following this approach will, however, only allow activities that increase the overall welfare of society but harm consumers' short-term interests if three conditions are fulfilled. First, the activity must increase total welfare by realising substantial production and innovation efficiencies. Second, the activity has to be necessary, reasonable and proportionate so as to harm consumers as little as possible. Third, it must not lastingly impair competition and be able to re-establish competition on the market. This condition requires that a fair share of efficiency gains is passed on to consumers.¹³

The Debate on the Proper Welfare Standard: insights from welfare economics

Ideally, competition policy makers select the goals of competition policy on the basis of economic needs of society. These goals should correspond to the actual failures of the market and economic problems consumers face. Almost unavoidably these goals will be part of political bargaining and as such may not always correspond to the practical realities of enforcement. There might be potential conflicts between the selected policy goals and the way they can be enforced. These potential conflicts are discussed below.

The debate about the proper welfare standard for competition policy implies that the chosen standard makes a significant difference when it comes to enforcement of competition rules. However, some commentators argue that under both the total welfare as well as the consumer welfare standard similar outcomes can be attained.¹⁴

Economists traditionally favour a total welfare standard on the basis that it generates the most for society as a whole and strives for the maximisation of efficiency. The total welfare standard stands for allocating resources to those who value them most and it takes account of both allocative and of productive efficiency. It, furthermore, treats wealth distribution between consumers and producers neutrally. Economists consider the consumer welfare standard as arbitrarily favouring one group over another, at the same time impeding the maximisation of efficiency, innovation, competitiveness and economic growth. As Okun argued, 'We can't have our cake of market efficiency and share it equally'.¹⁵

¹² Elzinga, KG, 'The Goals of Antitrust: other than competition and efficiency, what else counts?' (1977) 125 U Pa LRev 1191 at 1194-95.

¹³ Brodley, op cit, n 1, p 1037-9.

¹⁴ Baker, JB, 'Competition Policy as a Political Bargain', Working Paper, 26 December 2005, p 59.

¹⁵ Okun, A, *Equality and efficiency: the big tradeoff*, Washington, DC, The Brookings Institution, 1975, p 2, cited in Elzinga, op cit, n 12, p 1194.

The consumer welfare criterion lacks a firm foundation in welfare economics. In welfare economics equal gains will yield equal increases in utility and these will have equal effects on social welfare. According to the consumer welfare standard utility transferred from consumers to producers will not improve total social welfare, although it will make someone better off. This standard discriminates between individuals in different interest groups as it assigns zero weight to seller-shareholder profits and disregards the fact that gains to sellers, producers and shareholders can be socially positive. As the consumer welfare approach considers wealth transfers from consumers to producers as being rather harmful than neutral, it is more critical of efficiency claims.¹⁶

Competition policy is an economic efficiency-oriented policy and therefore apt to target and promote the overall economic welfare of society instead of making value judgments on how such economic welfare should be distributed between different social groups. There are other public policies that are better suited to address the distribution of income on the basis of fairness and relative deservingness such as taxation or consumer protection.¹⁷ Moreover, while it could be argued that real world markets do not correlate with the theoretical assumptions of economic theory, a competition policy focusing on pure efficiency arguments has an important virtue as compared with a competition policy pursuing equity goals. Efficiency is relatively objective and predictive as compared to equity. It avoids the uncertainty associated with value judgments about the fair distribution of economic benefits and about determining relative deservingness.¹⁸

Still, efficiency should not be absolute. It should not be the end but the means to achieve social goals.¹⁹ Competition policy is not made on the basis of simple derivations from analytical models and policy goals have to be transformed into feasible enforcement objectives on the basis of which a clear benchmark in competition cases can be put forward. If we accept that competition policy arises out of repeated interaction and coordination between two large interest groups and is eventually the result of political bargaining between consumers and producers²⁰ then the selection of policy objectives also has to be regarded as a result of this bargaining process. In other words, a certain set of policy objectives is the result of political bargaining aiming at maximizing economic efficiency gains rather than being a pure economic or legal rationale. If we, furthermore, accept that consumers usually have a weaker position in the process of bargaining, lobbying and litigation then a pro-consumer policy objective

¹⁶ Duhamel, M, & Townley, PGC, 'An effective and enforceable alternative to the consumer surplus standard' (2003) 26(1) *World Competition* 18; Piascoski & Finkelstein. 'Do Merger Efficiencies Receive "Superior" Treatment in Canada? Some Legal, Policy and Practical Observations Arising from the Canadian Superior Propane Case' (2004) 27(2) *World Competition* 259, pp 280-281.

¹⁷ Farrell, J, & Katz, M.L, 'The Economics of Welfare Standards in Antitrust', *Competition Policy Center Paper CPC06-061* (2006), pp 9-10.

¹⁸ Farrell, Katz, *ibid*, p 9.

¹⁹ Elzinga, *op cit*, n 12, pp 1212-3.

²⁰ Baker, *op cit*, n 14, p 2.

seems justified. Therefore, the consumer welfare standard can be seen as a kind of 'rebalancing' measure.

This seems to be in line with the rationale that enforcers of competition rules are increasingly concerned about political support for their work. Any competition law enforcement, which transfers rents from consumers to firms, by allowing firms to adopt practices that generate allocative efficiency benefits while reducing consumers' surplus threatens to undermine consumer confidence. Confidence of consumers in the market is relevant in order to have consumers' political support for the political bargain in favour of competition law.²¹

No democratic government would impose legal rules that are based on sole efficiency arguments and the total welfare standard. Lyons gives a number of further explanations for the political considerations in favour of the consumer standard. These include the following: voter preference under majority rule, when more people think of themselves as consumers than as recipients of profits, evolution of legislation originally targeting different goals like conserving small firms for social reasons, national indifference to foreign owners, second-best counterbalance to trade protection lobbyists and random historical events.²²

What is more, lawyers and policy-makers tend to think in a more nuanced way. Lawyers become lawyers by partly studying legal traditions and becoming familiar with the underlying values of a certain legal system. In a way they absorb these values in their legal thinking. When lawyers make policies or draft laws they take these traditions and values of their legal system into account. Moreover, they take wider public interests into account in cases where economists would be solely concerned about efficiency arguments. In this way, the dilemma between the total welfare standard and the consumer welfare standard reflects the conflict between the approach of lawyers and economists.

Competition authorities all around the world are becoming more conscious of the impact that competition policy and law enforcement has on consumers. They seem to be ever more anxious to declare and demonstrate the significant role they play as enforcers of competition law in consumers' economic life. The European Commission is no exception.²³ In the footsteps of former EC Commissioner Mario Monti, Neelie Kroes formulated the competition policy message of her cabinet as the following, 'Our

²¹ Baker, *op cit*, n 14, p 56. 'Can we imagine a press release by an enforcement agency that claims its enforcement of the antitrust laws, instead of vindicating consumer interests, has protected competitors, dispersed political or economic power, advanced populism, or eliminated corporate corruption?' WH Rooney, 'Consumer injury in antitrust litigation: Necessary, but by what standard?' (2001) 75 *St John's LRev* 561 at 563.

²² Lyons, B. R. 'Could Politicians Be More Right Than Economists? A Theory of Merger Policy', Centre for Competition and Regulation, UEA, Working Paper 02-01, 2002 p 2.

²³ The European Commission emphasizes that anti-competitive practices raise the price of goods and services, reduce supply and hamper innovation, which in turn increase the input costs for European businesses and as a result consumers end up paying more for less quality. European Commission, Annual Report, 2005, p 7.

aim is simple: to protect competition in the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources'.²⁴ Director General of DG Competition, Philip Lowe emphasized that, 'competition is not an end in itself, but an instrument designed to achieve a certain public interest objective, consumer welfare'.²⁵

Thereby the European policy makers finally synchronize with other enforcement agencies around the world. In the United States antitrust enforcement has a much longer tradition. Besides the Antitrust Division of the Department of Justice, 'the FTC acts to ensure that markets operate efficiently to benefit consumers'. In the United Kingdom the Office of Fair Trading's Statement of purpose declares, 'The OFT's goal is to make markets work well for consumers'. These and similar statements imply that competition policy works towards the improvement of consumer interests. Who are the consumers and which are the interests consumer welfare as the goal of competition policy refer to?

This is the question that is going to be discussed in the following. This discussion will take place against the backdrop of consumer protection laws and EC competition law with minor references to the US antitrust system. It will deal with efficiency arguments in merger cases and with the nature of consumer harm as well as the efficiency defense in other anti-competitive practices.

Consumer Welfare as the Goal of Consumer Protection

Consumer protection rules are to provide final consumers assistance in their market transactions either through preventing or remedying market failures. These rules target areas where competition rules are inapplicable or ineffective. Consumer law can address information inefficiencies like imperfect information, information asymmetries or even bounded rationality as well as health and safety aspects of market transactions. The provision of good quality and cost of consumer information makes free and well-informed decisions possible. Furthermore, while health and safety measures might be less efficient in terms of economic efficiency, they achieve social objectives of overriding interest.

In consumer law everything revolves around the consumer. This special economic actor, and his psychological mind set, is the subject of consumer rules. Accordingly, consumer law follows a subjective approach by paying more attention to the consumer, rather than to the 'act of consuming'.²⁶ The consumer's point of view, his interests and needs and his economic role define the content and orientation of consumer law. Consumer law has to take account of the individual as well as the collective interests of consumers. While most of the measures concern the collective market position and

²⁴ European Commissioner for Competition Speech at the European Consumer and Competition Day. London, 15 September 2005

²⁵ 'Preserving and Promoting Competition: A European Response', EC Competition Policy Newsletter, 2006 - Number 2 – Summer, p 1.

²⁶ Bourgoigne, T, 'Characteristics of Consumer Law', (1991) 14(3) Journal of Consumer Policy 293, p 298.

general interests of consumers, individual consumer problems have to be analysed in order to find credible and efficient ways to resolve them in a collective dimension.

Consumer law consists, first of all, of mandatory rules that guarantee that parties will not depart from the legislative rules to the detriment of the consumer. It comprises the obligation of information disclosure as information plays a significant role in consumers' lives. Measures address safety and quality controls of consumer goods and services, indebtedness and dispute resolution. Consumer law, further, contains legal rules aimed at the improvement of existing substantive law, like liability, standard form contracts, competition or advertising. Consumer law is considered to be a more effective instrument of consumer protection when it prevents rather than provides a remedy for loss or damage. The advantage of preventive measures is avoiding the social costs of loss and damage and that they focus on collective consumer interests, while remedial consumer law is aimed at the loss and damage suffered by individuals.²⁷

Consumer welfare is also the benchmark of consumer protection laws. While various theories exist on the goals of consumer protection, their starting points coincide: market failures have to be corrected in order to assist the weaker party in their transactions. Consumer related regulations are aimed at correcting market failures in order to improve the consumer's position in market transactions. Such regulation should concentrate on empowerment of rational market players rather than the protection of weak dummies. In this context the notion of consumer means the final consumer and the protected consumer interests extend beyond economic benefits to non-economic aspects of market transactions. Consumer law is not only concerned about efficient transactions and cost-savings but it is also directed at social aspects of the market such as the safety and health of consumers. It focuses on people's standard of living and on its improvement. Besides cost-efficient substantive rules, the toolbox of a modern consumer law system contains procedural rules for cheap, fast and easy access to justice and is concerned about effective enforcement methods.

Welfare is, therefore, expressed in both economic and non-economic aspects within the realm of consumer protection. Economic efficiency is not the sole guiding principle in this realm of the law. There is almost always a social justice component as well. Economic efficiency is, however, of utmost relevance when regulatory tools and enforcement institutions are being selected and implemented. Efficiency can be maintained when consumers' capacity and resources are improved in a way that allows them to promote and enforce their interests instead of a mechanism where the state does so.

Analysing the consumer welfare standard against the backdrop of consumer protection theories sets the discussion in competition law in a different light and provides a challenging contrast to the competition law framework.

²⁷ Goldring, J, 'Consumer Law and Legal Theory' (1990) 13(2) *Journal of Consumer Policy* 113, pp 124-126.

Whose Welfare Standard Counts?

For analytical clarity it is illuminating to have a look at the question whether the consumer welfare standard in competition law is the same or similar to the consumer welfare standard of consumer laws. In other words, whose welfare is taken into account through competition rules and whose welfare is the benchmark in consumer protection. Such an analysis can point out to what extent separate consumer protection legislation is justified and necessary in order to enable consumers to capture the advantages that had been made possible by effective competition and competition law enforcement. In the following the difference between these two interpretations will be analyzed through first, explaining the different notions of the consumer and the various consumer interests that are addressed by the two legal areas.

It is difficult to find a consistently applied consumer notion in consumer law. EC Directives on consumer matters lack a uniform definition. However, four decisive features can be distinguished. Most EC Directives on consumer protection refer to consumers as natural persons acting for purposes outside their trade, business or profession.

In contrast, under the competition rules consumers usually constitute a broader group. In EC competition law, for example:

[T]he concept of “consumers” encompasses all users of the products covered by the agreement, including wholesalers, retailers and final consumers. In other words, consumers within the meaning of Article 81(3) are the customers of the parties to the agreement and subsequent purchasers. These customers can be undertakings as in the case of buyers of industrial machinery or an input for further processing or private individuals as for instance in the case of buyers of impulse ice cream or bicycles.²⁸

This definition makes it clear that competition rules promote intermediate buyers to ‘honorary’ consumers.²⁹ Trade practices that come before competition authorities concern intermediate inputs and final products. The direct consumers of these inputs, and thus the entities most frequently involved in the impact assessment of a merger or other unilateral or collusive practice are intermediate buyers and not or not exclusively final consumers. The effects of a certain commercial conduct on these intermediate

²⁸ Guidelines on the application of Article 81 (3), point 84

²⁹ ‘If we think of competition as a regime in which the different suppliers contend to sell their products to participants on the other side of the market, then the benefits reaped by the other side of the market will themselves provide a measure of how well competition works. For final-products markets, this observation leads directly to a consumer welfare standard. For primary- or intermediate-products markets, a consumer welfare standard is obtained by adding the observation that the vertical organization of industry itself is a subject of competition the ultimate beneficiaries of which are the final consumers. In either case, competition forces the supply side of the economy to be responsive to consumers needs with respect to price, quality, variety, etc.; business strategies that respond to these needs and raise consumer welfare are likely to be legitimate competitive strategies.’ Report by the EAGCP, ‘An economic approach to Article 82’, July 2005, p 8.

customers can be different from the effects on the ultimate consumers to whom they sell. Purchasers of intermediate goods may employ different production techniques in producing the competing final goods. On the one hand, some of these producers may rely less heavily on a particular input than do others, and therefore the impact on the former group may be positive even if a merger threatens to raise the incremental costs for that firm and its rivals. On the other hand, some producers may have substantial stocks of the input either warehoused, or incorporated into final products not yet sold and thus they may benefit from the higher incremental costs. In effect, firms that face relatively small cost increases may benefit on net from the fact that consumers shift towards them and away from competitors whose costs have increased even more. Moreover, where final demand is inelastic and pass-through is likely to be nearly complete, intermediate goods customers may believe that they will not be very much harmed by even a substantial post-merger increase in the price of what they buy. Final consumers, however, may be harmed.³⁰

Competition authorities, therefore often examine the intermediate impact on these direct buyers and presume that any harm to intermediate buyers create harm to final consumers, i.e. harm to final consumers can be inferred from harm to direct buyers and the benefits flowing to these direct buyers are passed through to the final consumers. In any case, competition rules do not differentiate between final consumers and firms who are the immediate buyers of the products or services of the parties being investigated. Such a differentiation does not seem necessary in every case and harm to intermediate buyers can be presumed to create harm to final consumers. However, there are situations where end consumers will be affected in a different way than intermediate buyers. As has been illustrated above most welfare standard analysis takes place in a simple framework where firms are selling products to final consumers and where the firms are the sellers and consumers are the buyers. However, economic conduct often takes place between producers on one level selling inputs for intermediate sellers who produce their own products and then sell on the retail market. When intermediate firms have some market power and thus competition is not strong they may decide not to pass on efficiencies in the form of lower prices but keep these savings as rents. Pass-through of efficiencies to final consumers depends on demand side conditions and the oligopoly game firms are playing.³¹ Thus there are situations where final consumers would be left worse off, even as some (or even all) intermediate good producers benefit. The investigation competition authorities conduct today pay no attention to these differences except in cases where the retail market is the relevant market where the parties set off their products. Such a case has been the subject of the recent judgment of the Court of First Instance in *GlaxoSmithKline Services*.³² In this case

³⁰ Heyer, K, 'Welfare Standards and Merger Analysis: Why not the Best?', Economic Analysis Group Discussion Paper 06-8, March 2006, pp 17-18.

³¹ Heyer, *ibid*, p 11.

³² Case T-168/01 *GlaxoSmithKline Services v Commission*, Judgment of 27 September 2006.

the CFI explicitly referred to the impact of an agreement on the welfare of final consumers throughout the whole judgment.

In sum, competition rules and the enforcement agencies consider the welfare of final consumers in a broader pool of intermediate sellers and customers of the firms and only occasionally consider the impact on the economic interests of final consumers.

The consumer who is protected through consumer protection legislation is in most cases restricted to final consumers. This difference between the broader notion of consumer in competition law and the narrower notion in consumer law can be understood by the diverging goals of competition law and consumer law. Competition law focuses on the maintenance of competitive markets without artificial restraints and it is more concerned with the general economic interests of society than with the specific interests of final consumers. The benefit of competition law enforcement will, therefore, not always have a direct and immediate impact on final consumers. For example, the advantages innovative firms generate by spurring the overall economy and using resources in order to develop new and improved products and services whereby they increase the variety and the quality of goods and services available for consumers, takes time and cannot be translated into immediate consumer benefits. When these long-term benefits are passed-through to final consumers in the form of improved quality and output or even lower prices is not always predictable.

Claiming that competition laws and enforcement should be at all times concerned with the interests of final consumers seems neither a realistic nor a feasible requirement. A more robust assessment of the impact of trade practices on final consumers is nevertheless necessary. It helps to design objective, effects based, standards for investigation and self-assessment. Furthermore, a sound market regulatory system should take account of the useful effect competition law enforcement has for consumers' economic well-being and identify those consumer interests and market failures that competition laws cannot take care of and that can be addressed by other regulatory means. Consumer protection legislators sometimes disregard the potential benefits of an effective competition regime for final consumers and impose overreaching regulations or do not single out the blank areas.

Which Consumer Interests Are At Stake?

Consumer interests are difficult to define. They are diffuse and diverse. They vary between different groups of consumers and they are mixed with the interests of suppliers. This, however, is not conclusive to argue that consumer interests cannot be represented and protected.

While it would be difficult to draw an exhaustive list of the various consumer interests consumer law and enforcement aim to guarantee low prices, a wide variety and high quality of products and services, free choice among these, and adequate information about the nature and consequences of purchasing decisions. Besides these aspects access to justice through effective judicial or extra-judicial means to enforce consumer rights and seek appropriate remedies are the core goals. Effective enforcement of

consumer rights and efficient access to justice are just as important as the substantive rights themselves.³³

Information plays a significant role in consumers' lives; they communicate to sellers their preferences and provide firms with incentives to compete by producing goods and services that consumers value. Information, therefore, functions as a competitive constraint on firms to compete on price, quality and other terms of transactions. Information is an important sunk cost in many transactions and plays a key role in bargaining processes. It is of strategic value and trading and contracting practices are all about either exploiting or securing this advantage or protecting against such an advantage. Buyers of information often have difficulty in determining the value of the information and thus the price they are willing to pay for it.³⁴ Further, the nature and the distribution of the information is crucial in assessing how consumer markets work. Identifying potential information failures such as misallocation of consumer resources, informational market power, artificial product differentiation and problems of information processing are key to designing strategies and measures from make markets work more efficiently.³⁵

Potential sources of information failures are also present in fully competitive markets. Information failures then may lead to situations where consumers face high search and switching costs. Consequently, consumers conclude bad deals or might get disconnected to markets which in turn may retard competition in the marketplace.³⁶

Consumer interests are not only directed at economic, but also at social aspects of the market. The protection of consumers is thus not limited to preventing enterprises from asking excessively high prices and to oppose the one-sided communication structure on the market. Consumers also attach great importance to the quality of living standards. These non-economic interests include health and safety concerns, environmental

³³ Directive 98/27 EC on injunctions for the protection of consumers' interests, OJ 1998, L166/51, Regulation 2006/2004 on consumer protection cooperation, OJ 2004, L364/1. The International Consumer Protection Enforcement Network is a worldwide network of national authorities with the aim of strengthening and improving the enforcement of consumer protection legislation (except product safety and the prudential regulation of financial institutions). The Network of European Consumer Centres is there to help with such questions and any other problems you may have concerning your activities as a consumer in Europe.

³⁴ Good examples are credence goods and especially those liberal professions that involve complex technical services. Liberal professions often have a legislative monopoly and can therefore influence access to the profession as well as they are involved in fixing the fees. The customers of these professional practitioners, for example the clients of a lawyer may never be able to precisely assess whether their lawyer did indeed provide high quality services. Information is thus essential for consumers to assess the possibilities the market offers and to select the best combination of price and quality that fit their individual needs.

³⁵ Ramsay, I, 'Framework for Regulation of the Consumer Marketplace' (1985) 8(4) *Journal of Consumer Policy* 353, p 360.

³⁶ Examples can be found in the recently liberalized utility markets, such as telecommunications, electricity or gas. For more on this issue Cseres, KJ, 'The impact of consumer protection on competition and competition law: switching of consumer in deregulated markets', 2005 OECD Roundtable discussion on demand-side economics for consumer policy: summary report, DSTI/CP(2006)3 Final, 2006.

protection, culture or even sports.³⁷ Some of these specific interests of consumers have been promoted a special status within the EC Treaty, like environmental considerations³⁸ in Article 6 EC or services of general economic interest through Article 86(2) EC,³⁹ and consequently are given more emphasis in other policy areas including competition law.

The time-frame within which consumer benefits should be realised is another issue that calls for a more nuanced approach. In merger cases, but to some extent in cartel and monopolization cases, consumers' immediate interests through lower prices and no restriction of output are balanced with long-term economic interests of the whole economy in the form of firms' cost savings and technical development. The balancing of these short-term and long-term benefits requires a careful analysis that needs to take into account a reasonable time period in which innovative firms are able to make investments and produce efficiencies. Exact quantification of such a time period depends on the nature of the products or services, and the industry characteristics; thus the nature of the expected consumer benefits might differ greatly from case to case.

This trade-off and the relevance of innovation has been recently spelled out in a US monopolization case. The United States Supreme Court in its *Trinko* decision⁴⁰ declared that:

the mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices - at least for a short period - is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth.⁴¹

The Court then proceeded to reject expansive views of a monopolist's duty to deal with its competitors, emphasizing that compelling firms to share the source of their advantage, 'is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities'.⁴² Thus innovation and the prospect of a wider range

³⁷ Sports seem to be another area, which has been given special attention in the enforcement of competition law. Case C-415/93 *Bosman and others v Union Royale Belge des Sociétés de Football Association and others* [1995] ECR I-4921, On 23 July 2003, the Commission exempted the joint selling agreements regarding the media rights of the UEFA Champions League, Commission Decision of 23 July 2003, Case COMP/C-2/37.398, OJ 2003, L291/25.

³⁸ Case IV.F.1/36.718. *CECED*, OJ 2000, L187/48.

³⁹ See also the Commission's Communication on services of general economic interest in Europe, OJ 2001, C17/4, point 10: 'The needs of users should be defined widely. Those of consumers clearly play an important role. For consumers, a guarantee of universal access, high quality and affordability constitutes the basis of their needs.'

⁴⁰ *Verizon Communications Inc. v Law Offices of Curtis v. Trinko, LLP*, 124 S. Ct. 872 (2004).

⁴¹ *Trinko, LLP*, 124 S. Ct. 872 (2004) at 879.

⁴² *Trinko, LLP*, 124 S. Ct. 872 (2004) at 879.

of products in the future should be balanced with short-term restrictions of competition.

This section can be concluded by two remarks. On the one hand, it has been shown that competition rules and enforcement equate consumer welfare with the welfare of intermediate sellers and customers of the firms together with final consumers and only occasionally considers the impact on the economic interests of final consumers. On the other, reviewing the list of various consumer interests, it can be argued that competition law is first of all to benefit consumers in terms of price and output and it is less capable of taking into account broader consumer interests, like health, safety or information problems. Although competition enforcement might incidentally address consumers' non-economic interests, it is neither fit nor effective in doing so.

THE ROLE OF CONSUMER WELFARE STANDARD IN COMPETITION LAW ENFORCEMENT

The primary role of the consumer welfare standard in competition law enforcement is to form the framework of reference where liability under competition rules is determined. On the one hand, it provides the standard of proof required from competition agencies and from private individuals in order to prove the negative effects of companies' conduct and thus a violation of the competition rules. On the other, it determines what companies need to bring as evidence to demonstrate positive effects in order to justify their otherwise restrictive conduct on the market. In other words, the consumer welfare standard sets the criteria of the assessment and measurement of the anti-and pro-competitive effects of business practices.

It is generally acknowledged that increased prices, reduced output and decreased quality are the prime indicia of negative effects on competition. These indicators are the hallmarks of consumer injury, which is generally regarded as an inherent part of the adverse effects on competition. It is generally accepted that a business conduct which makes consumers worse off in terms of price, output and quality makes the competitive process worse off.

Consumer Welfare as the Benchmark of Competition Law Enforcement

The consumer welfare standard plays a different role in merger cases and in cases of collusive or unilateral behaviour. A separate discussion of these practices seems justified as a consequence of the different time framework of enforcement and the standard of proof required in their assessment. The consumer welfare standard has different implications in anti-competitive practices that are the result of cartel agreements, unilateral behaviour and in merger cases.⁴³

In merger cases the discussion strongly focuses on efficiency claims and whether enforcement policy should be based on the total welfare standard or the consumer

⁴³ State aid and the granting of exclusive and special rights to undertakings will be outside of the scope of this paper.

welfare standard. The debate is reduced to the question whether the total welfare standard favours producers to the disadvantage of consumers and whether the consumer welfare standard has a distributional bias in favour of consumers. Moreover, should the analysis of efficiencies focus on price effects (i.e., the likelihood that the transaction will raise price and reduce consumer surplus) or on effects on productive or technical efficiency (i.e., the prospect that the transaction will lower or eliminate costs), or both? It is regularly debated whether the two welfare standards lead to significantly different enforcement outcomes in terms of welfare and what the advantages and drawbacks of both welfare standards are. This discussion is vivid both in the US, where recently the Antitrust Modernization Commission⁴⁴ discussed the issue as well as in the EU.⁴⁵ Alternative welfare models try to provide possible compromises between the consumer welfare and total welfare standards. They explain and demonstrate that considering these welfare standards in a broader political economy framework can prove their practical usefulness. Whether these alternative approaches can be transferred to other parts of competition law should be further considered.

In collusive and unilateral trade practices the main question is what has to be proved by the competition agencies and private parties before liability under the competition rules can be established. Is it harm to competition, harm to consumers or harm to competitors that counts? What is the impact of the given conduct on the competitive process and on the welfare of consumers? In the following these issues are addressed in more detail.

Merger Cases

It is in merger cases that the balancing of efficiencies and anticompetitive effects is the most explicit and therefore the outcome of competition enforcement depends very much on the chosen welfare standard. This has been illustrated by Williamson's famous trade-off model.⁴⁶

The consumer welfare standard is concerned with direct welfare of the purchasers in the relevant output market. While a competition authority operating on the basis of the total welfare standard makes full trade-offs between consumer and producer benefits in merger cases, a competition authority pursuing the consumer welfare standard does not

⁴⁴ Summary of Antitrust Modernization Commission Hearing on the Treatment of Efficiencies in Merger Enforcement, November 17 2005, <http://www.abanet.org/antitrust/at-links/pdf/at-mod/efficiencies-merger-enforcement.pdf>

⁴⁵ De la Mano, M. Enterprise Directorate – General European Commission, 'For the customer's sake: The competitive effects of efficiencies in European merger control', Enterprise Papers No 11, 2002, European Communities.

⁴⁶ Williamson's model demonstrates the anti-competitive as well as the pro-competitive effects of a merger. It describes the economic effects of a merger that leads to both an increase in market power and cost savings. As the firm's market power increases, it reduces its output and increases its prices. This results in a loss in allocative efficiency. But at the same time the merger generates cost savings as the firm's level of average costs drops. The model demonstrates that in spite of increased market power, society might still be better off. Williamson, O, 'Economies as an antitrust defense: the welfare tradeoffs', (1968) 58 *AmEconRev* 18; Williamson, O, 'Economies as an antitrust defense revisited', (1977) 125 *U Pa LRev* 699.

weigh producer benefits against consumer losses. In this sense it favours consumers to producers. The total welfare standard considers transfers from consumers to producers as not being harmful from an efficiency point of view. There are several relevant questions: does the total welfare standard favour producers to the disadvantage of consumers, does the consumer welfare standard have a distributional bias in favour of consumers, and, ultimately, which welfare standard leads to more efficient market performance? In other words, does it matter which welfare standard is applied and do they lead to significantly different results in terms of welfare?

The following alternative welfare standards imply that the actual outcome of merger decisions depend more on the way a given welfare standard is enforced than on the fact which welfare standard has been chosen as the basis of the competition policy.

Alternatives to the Two Welfare Standards

In the following three alternative models will be presented that all provide a possible compromise for having to choose one or the other welfare standard and thereby disadvantaging either consumers or producers. Actually all three models provide a new approach to the way welfare standards should be enforced rather than a new welfare standard. The first model of 'long-term consumer interest' is an approach that harmonizes immediate consumer interests with the overall welfare of society. This model has been adopted in New Zealand and might be considered in other countries as well. The second model, a balancing of weights approach, is a Canadian 'invention' and it strikes a balance between the redistributive effects that would arise as a result of increases in firms' market power post-merger. The third model is based on insights from political economy.

Long-term consumer interest

This approach harmonizes immediate consumer interests with the overall welfare of society by subordinating consumer interests to aggregate social interest. However, it does so only temporarily.⁴⁷ This approach is based on the idea that efficiency gains that are not of immediate benefit to consumers should nevertheless be considered as welcome because in the long run producers' innovation and efficiency gains will benefit consumers. This approach is based on the condition that consumers at one point in time receive a reasonable part of the efficiencies realized by firms. A reasonable or fair share of the efficiencies is 'simply the share of economic surplus that a competitive market would provide'.⁴⁸

The difficulty of this approach lies in its enforcement. How can a competition authority assess whether the efficiency claims should be allowed because it is highly probable that a fair share thereof will be passed on to consumers or, conversely, whether they should not be allowed. Furthermore, it requires a prediction as to long-term competitiveness.

⁴⁷ Ahdar, R, 'Consumers, Redistribution of Income and the Purpose of Competition Law' [2002] ECLR 341, p 351.

⁴⁸ Brodley, op cit, n 1, p 1039.

How long can the time-lag be between implementation of the merger and the realisation of efficiencies for consumers?

This approach has been followed by New Zealand in amending its competition law statute, the Commerce Act 1986. The new Act reads that, '[t]he purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand'.⁴⁹

In the United States there is a widespread perception that the consumer welfare test is applied in a way that takes into account only those efficiencies that are likely to be passed on to consumers in the form of lower prices. On the basis of the 1992 Horizontal Merger Guidelines US competition agencies give most weight to efficiencies that will be passed on to consumers through lower prices in the short term, but will consider the effects of cognisable efficiencies with no short term, direct effect on prices where they think that those efficiencies will ultimately benefit society's welfare. This approach is based on the idea that efficiencies that benefit consumers immediately through decreased prices or increased output will receive the most weight, but others will be considered to the extent that they will ultimately benefit consumers.⁵⁰ The discussion around and the recent Supreme Court judgment in *Weyerhaeuser v. Ross-Simmons*⁵¹ pointed out the difficulties of applying the consumer welfare standard to monopsony power cases, where the focus is not primarily on the impact of the predatory bidding on consumers but on sellers. Nevertheless, the discussion within the Antitrust Modernization Commission demonstrates that even though there are considerable economic arguments for the total welfare standard, serious proposals for shifting away from the consumer welfare standard have not been made in the US. The overall conclusion is rather that a consumer welfare standard should not be applied in a rigid manner that would lead to absurd outcomes.⁵²

The balancing weights approach

This approach tries to find a balance between the negative effects on consumers and the positive effects on sellers/shareholders that result from the income or wealth redistribution as a result of increases in firms' market power post-merger. Increasing a firms' market power has a negative effect on consumers as they lose consumer surplus and a positive effect on sellers and shareholders who gain extra profits. This approach

⁴⁹ 1A Purpose of the New Zealand Commerce Act 2001

⁵⁰ Goldman, CS, & Gotts, IK, 'The role of efficiencies in M&A global antitrust review: still in flux?', Fordham Corporate Law Institute 29th Annual Conference on International Antitrust Law and Policy, New York, November 2002 pp 254-5, see also Heyer, op cit, n 30.

⁵¹ *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.* No.(05-381)

⁵² Salop, SC, 'Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The True Consumer Welfare Standard', presented to the Antitrust Modernization Commission (Nov 4, 2005) http://www.amc.gov/public_studies_fr28902/exclus_conduct_pdf/051104_Salop_Mergers.pdf; Summary of Antitrust Modernization Commission Hearing on the Treatment of Efficiencies in Merger Enforcement, November 17, 2005 <http://www.abanet.org/antitrust/at-links/pdf/at-mod/efficiencies-merger-enforcement.pdf>

attempts to consider the wealth transfers or redistributive effects by assigning relative weights to each of the losses to consumers and the gains to sellers and shareholders when weighing the costs and benefits of a transaction. The difficulty in making this efficiency equity trade-off lies in the fact that while efficiencies are to some degree measurable, equity impacts are partly qualitative in nature. This is a mathematical equation that has to make an ethical decision by using value judgements.⁵³

The balancing weights approach is allegedly one way to deal with this trade-off problem. It starts from calculating the ratio of gains and losses in a specific merger case. Then the question is whether there is sufficient evidence that the merger has distributional impacts that are so immense that the losses of the losers should be given a premium in excess of the formerly established ratio of gains and losses. If evidence shows that such an excess premium is needed then the merger should be prohibited. The test makes it possible to avoid the shortcomings of both the total welfare and the consumer welfare standards. The total welfare standard neglects distributional impacts even when they deserve consideration and the consumer welfare standard considers distributional impacts to be severe, even when they are not. The balancing weights approach is allegedly capable, on the basis of the facts of the specific case to consider distributional impacts as severe when they indeed are so and neglecting them when they are negligible.⁵⁴ This approach involves a socio-economic decision and a value judgment depending on the individual characteristics of the consumers and sellers/shareholders affected by the merger.

In Canada, this test has been applied by an expert witness of the Canadian Commissioner of Competition in the Propane merger when interpreting the efficiency defence under Section 96 of the Canadian Competition Act. The Competition Act adopts a standard somewhere between the total and consumer welfare standard by allowing a merger that substantially lessens competition if efficiencies attributable to the merger are 'greater than and offset' the anticompetitive effect. Thus, if efficiencies are strong enough then even a merger that raises prices for consumers can be allowed.

While the test was rejected by the Competition Tribunal⁵⁵ at first instance, it was accepted by the Federal Court of Appeal on appeal.⁵⁶ The Competition Tribunal in *Superior Propane* rejected this test and opted instead for a 'part total welfare, part wealth distribution weighting' test, which it held was mandated by the Canadian statute.⁵⁷ The total surplus standard had been the proper test since the early 1990s in

⁵³ Duhamel, M, & Townley, PGC, 'An effective and enforceable alternative to the consumer surplus standard' (2003) 26(1) *World Competition* 3, p 11.

⁵⁴ Duhamel & Townley, *ibid*, pp 11-12.

⁵⁵ *The Commissioner of Competition v. Superior Propane Inc.*, 2000 Comp.l Trib. 15, File No. CT1998002 (Aug.30, 2002)

⁵⁶ *The Commissioner of Competition v. Superior Propane and ICG Propane Inc.* (2001), 199 DIL.R. 94th 130

⁵⁷ Under this test, the Tribunal would approve a merger even if it is likely to result in higher prices, so long as the cost savings exceed what economists call the 'deadweight loss' from any reduction in output plus any negative wealth distribution effect on poor consumers. *Commissioner of Competition v. Superior Propane, Inc.*, CT-98/02 (Competition Tribunal, April 4, 2002) (Reasons and Order Following the Reasons for Judgement of

Canada and it has also been adopted by the Canadian Merger Guidelines. The Tribunal rejected the balancing weights approach, because among others it was of the view that the adoption of this test would lead to inconsistent decisions based on the individual and perhaps subjective views of the members of the Tribunal and that the members of the Tribunal were not qualified to make assessments on the social merit of competing social interests.⁵⁸

In this case the redistributive effects relating to low-income households that used propane for essential purposes and had no good alternative was argued to weigh more heavily than the interests of the shareholders of the merged firm. However, the number of households was rather small. Therefore the adverse redistributive effects of the merger were eventually found to be too small in comparison with the efficiency gains.⁵⁹ Propane eventually also led to the amendment of the Canadian Competition Act.

The shortcomings of this test is on the one hand, the problem of how to determine the appropriate weights assigned to each of the societal groups and on the other, the problem of predictability as well as the inevitable risk of subjectivity. While it might improve political flexibility it at the same time endangers legal certainty.⁶⁰

The 'rebalancing' model

This concept is based on insights from political economy and it argues that there are a number of reasons for applying the consumer welfare standard in merger cases. Information asymmetry and information advantages for firms, lobbying advantages and better representation, and the first mover advantage of firms in selecting mergers are the strategic considerations in favour of the consumer welfare standard. It is argued that these advantages on the firms' side create a bias in favour of the firms and the consumer welfare standard can rebalance or counterbalance this bias in the assessment of mergers.⁶¹

Besanko and Spulber argue that the consumer welfare standard functions as a compensation for information asymmetry. They hold that the information advantage which firms have vis-à-vis regulators in respect of cost savings is a justification for adopting the consumer welfare standard. The consumer welfare standard can rebalance firms' information advantage.⁶²

the Federal Court of Appeal Dated April 4, 2001), available at: <http://www.ct-tc.gc.ca/english/cases/propane/0238a.pdf>

⁵⁸ *Commissioner of Competition v. Superior Propane, Inc.*, CT-98/02 paras 431-437, Goldman, CS, & Gotts, IK, 'The Role of Efficiencies in Telecommunications Merger Review' (2003) 56 FCLJ 87, pp 138-139.

⁵⁹ Gotts, Goldman, op cit, n 50, p 240.

⁶⁰ See also Kiljański, K, "Pass-on" in merger efficiency defence' (2003) 26(4) World Competition 651, p 661.

⁶¹ Lyons, op cit, n 22, p 14, see also Baldwin, R, & Cave, M, *Understanding Regulation: theory, strategy and practice*, Oxford, OUP, 1999.

⁶² Besanko, D, & Spulber, D, 'Contested mergers and equilibrium antitrust policy' (1993) 9(1) J Law Econ Organ 1.

Lyons shows that there are circumstances where the consumer welfare standard achieves higher total welfare than the direct application of the total welfare standard. The conditions for this to hold true are more likely to be satisfied in large, complex or internationally integrated economies. He provides a forward-looking rationale for total welfare to be enhanced ex post by the strategic adoption of an ex ante consumer welfare standard. He argues that competition authorities have the disadvantage that they are only able to appraise a merger brought before them. They cannot propose mergers. Firms have a first mover advantage as they can choose whichever merger they wish, including one that just fulfils the criteria of the substantive test. The sequence of mergers they propose can block a more desirable market structure that would evolve under a more restrictive standard. Inasmuch as profits and consumer benefit are negatively correlated along the margin, firms are likely to choose mergers that create negligible total welfare benefit – these would just pass the total welfare standard and maximise profits. Lyons concludes that while the consumer welfare standard is not inevitably optimal, it does have advantages in large, complex economies where there are socially preferable but privately less profitable merger opportunities. When also taking into consideration other reasons in favour of the consumer welfare standard, such as informational advantages of the firms or the effect of lobbying activities, it is far from obvious that economists are right to argue that the total welfare standard provides a better policy rule than the consumer welfare standard. According to Lyons both welfare standards fall short of being optimal rules, but given the need for a single, simple rule, their relative merit is an empirical matter, depending on the prevalent market conditions in merger intensive sectors.⁶³

Neven and Röller analyzed merger control in a common agency framework where firms and their competitors can influence the competition authority and where transparency, which makes lobbying less effective, also implies real resource costs.⁶⁴ Distinguishing between working under a total welfare standard and a consumer welfare standard Röller examined the performance of the two welfare standards that can be assigned to the antitrust agency in the presence of regulatory failures. Regulatory failures can arise from asymmetric information between the merging firms who have an information advantage with regard to the merger-specific cost savings that are unknown to the competition authority. Röller found that, while under the total welfare standard, the lobbying of firms leads to type I errors, that block efficient mergers, the consumer welfare standard leads to type II errors, namely the clearance of relatively inefficient mergers, that decrease welfare.⁶⁵

Röller found that lobbying could show significant differences between the two welfare standards. Lobbying is characterised by transparency and co-ordination costs. Transparency and co-ordination costs make lobbying less effective. Under the total

⁶³ Lyons, op cit, n 22, pp 3, 13.

⁶⁴ Neven, DJ, & Röller, L-H, 'Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control', Discussion Paper FS IV 00-15, Wissenschaftszentrum Berlin, 2000.

⁶⁵ Neven & Röller, *ibid*, p 20.

welfare standard lobbying, on the one hand, reduces the number of undesirable deals that firms can complete, while on the other, firms can cope with transparency and coordination costs only at a certain cost. Under the consumer welfare standard transparency merely affects the balance between incorrect decisions and waste in lobbying. More transparency reduces the effectiveness of firms' lobbying.⁶⁶

Under a total welfare standard, Röller argues that when authorities make mistakes it is most likely to be a mistake of allowing relatively inefficient mergers that decrease welfare to go ahead. In this case, lobbying of firms is a waste of social resources since it is likely to increase the risk of this event. The policy conclusion of this is that, under a total welfare standard, transparency should be maximised in order to minimise wasteful lobbying. In other words, lobbying is more costly when transparency is low.

However, under a consumer welfare standard, Röller finds that there is effectively a bias against firms and that the lobbying of firms 'rebalances' this disequilibrium. Under a consumer welfare standard, the risk of a mistake by the authorities is likely to be in not permitting a merger that is relatively efficient and that would increase consumer welfare, because they only permit those where the efficiencies are very large and clear. In this situation, Röller argued that lobbying by the merging parties is desirable and should be encouraged. In addition, he concludes that transparency is not desirable under a consumer surplus standard as it would reduce the effect of this necessary lobbying.⁶⁷ One may question the extent to which a competition authority can be or should be open to being 'lobbied' directly by the parties when they submit their own economic evidence.

Pass-on Rate

The previous sections discussed the implications of the chosen welfare standard when efficiency claims are made. The assessment of these efficiency claims and of the proposed mergers from a consumer perspective is not complete without discussing the pass-on rate of claimed efficiency benefits. The pass-on requirement is the proportion of the efficiencies that have to be passed on to consumers. In order to measure the effects of a merger the extent of price increase has to be set off against the extent to which cost savings are passed through into consumer prices. In a case where the second element is greater than the first, the merger will be beneficial for consumers.⁶⁸

Firms are profit maximizing organizations. Economics teaches us that when the consumer welfare standard is applied the distinction between fixed and marginal cost savings is of particular consequence. Fixed cost savings have no effect on a firm's profit maximizing price or the level of output of profit-maximizing. Thus fixed cost savings alone will not effect consumer welfare and are assumed not to be passed-on to

⁶⁶ Neven & Röller, *ibid*, p 21.

⁶⁷ Neven & Röller, *ibid*, p 21.

⁶⁸ Stennek, J, & Verboven, F, 'Quantitative techniques to assess price effects in European merger control from a consumers' perspective', Report for EC Contract no B5-1000/02/000519 between the European Commission and Frank Verboven, 2003, p 4.

consumers. Marginal cost savings will more likely be passed on even in the case of a monopoly. The reason is that demand curves slope downwards and profit-maximizing firms set marginal revenue equal to marginal cost. At least they do not have considerable effect on consumers in the short-run even though might be given some weight with regard to the fact fixed cost savings have substantial efficiency implications for the whole economy and as such may produce benefits for consumers in the long-run.⁶⁹

Pass-on rate will depend on the pass-on level, whether it is industry-wide or firm-specific, on the nature of product, whether it is homogenous or heterogeneous, and on the form of competitive interaction; whether it is perfect, monopolistic or oligopolistic. The question is whether the firm will have incentives to share its cost savings with consumers by lowering prices? For example, a pure price taker, an 'infra-marginal producer' will not find it profitable to pass on marginal cost savings in the form of lower prices but will keep those as rents.

Without elaborating on the pass-on rate in detail, one point should be made from a consumer perspective. When pass-on rate is considered the assessment generally will be restricted to measuring the pass on rate to consumers in the competition law sense, which as has been explained above are all the customers downstream the market. The consumer price at the next level of the production chain, i.e. the price paid by the customers of the firms, will not be the same as the consumer price which these intermediate firms pass on to lower levels of the production chain and eventually for final consumers. Especially if the firms at the intermediate level have some market power they can keep some of the cost savings as rents and not pass it on to the next level.

The current discussion on pass-on rate is vigorous in cartel cases when considering the pass-on of cartel price overcharge to consumers. It is a complicated and complex economic assessment, but one without which damages claims for final consumers would be ruled out altogether.⁷⁰ On the basis of the rationale that passing on will be an essential component of cartel litigation, a more elaborated discussion seems legitimate in merger cases too.

Implications of the alternative models

The alternative models described above loosen the strict division between consumer welfare and total welfare standards. They demonstrate that considering these welfare standards in a broader social and political framework, by taking not just pure economic arguments into account, proves their practical usefulness. However, at the same time they demonstrate that both welfare standards in their pure and strictly interpreted form contain little value for efficient enforcement policy. It follows that policy-makers and

⁶⁹ Heyer, op cit, n 30, pp 7-8; Stennek, & Verboven, *ibid*, pp 6-8.

⁷⁰ Cseres, KJ, 'Collective consumer actions: a competition law perspective', in, WH Van Boom & M Loos (eds), *Collective Consumer Interests and How They are Served Best in Europe; Legal aspects and policy issues on the border between private law and public policy*, Europa Law Publishing, forthcoming April 2007.

enforcers should not only make their choice for the total or the consumer welfare standard, but also elaborate on the shortcomings of the chosen welfare standard and try to find their refinement in order to maximise their benefits.

One might ask the question whether these alternative standards can be transferred to other parts of competition law. Their practical relevance is explicit in efficiency claims when evaluating anticompetitive conducts that are the result of restrictive agreements and unilateral behaviour. The first alternative advocating a long term view of consumer interests can be considered when efficiencies of an otherwise anti-competitive practice are assessed. Obviously, the assessment of such practices is *ex post* and therefore the evidence of long term consumer benefits will be substantial.

The political economy arguments of the rebalancing model can similarly find their way in the other parts of competition law. It has, for example, been taken into account by the Economic Advisory Group for Competition Policy in its report on Article 82 EC:

Referring to this [consumer welfare added] standard is all the more important because, in the actual proceedings on a given case, competitors are usually much better organized than consumers. The competition authority receives more complaints and more material from competitors, so the procedure tends to be biased towards the protection of competitors. Developing a routine for assessing consumer welfare effects provides a counterweight to this bias.⁷¹

The different role consumer welfare standard plays in collusive and unilateral trade practices will be discussed in the following section.

Collusive and Unilateral Practices

In the case of collusive and unilateral trade practices the relevant questions are less about the choice between a total or a consumer welfare standard than about the criteria on the basis of which the effects of business practices are assessed. Application of a total welfare standard would quickly lead to cases where harm to competitors would qualify as competition law liability and this would lead to undesirable decisions protecting competitors. The established standard should assist competition authorities and private parties to evaluate the effects of business practices on an objective basis. The standard of actual or potential harm to consumers seems to provide such an objective standard of assessing competition law liability. The consumer welfare standard provides a suitable benchmark, when it evaluates the impact of the business conduct on prices, output, choice, quality and innovation. Such a standard has to provide clear guidelines on what amounts to consumer harm. Should there be a direct proof of (final) consumer harm or can such a liability be inferred indirectly from harm to competition or even harm to competitors? When restriction of competition has been established in a case what does a private party need to bring as justification in order to prove that the otherwise anti-competitive agreement brings about substantial efficiencies and therefore the restriction on competition is objectively necessary.

⁷¹ Report by the EAGCP, 'An economic approach to Article 82', July 2005, p 9.

The answers to these questions are directly linked to and largely depend on how explicitly enforcement agencies require evidence of consumer injury. Formulating an adequate standard of proof brings analytical clarity and legal certainty into the enforcement of competition law, which saves transaction cost for enforcement agencies and for private firms.

The Consumer Harm Test

A competition enforcement regime based on consumer welfare cannot but focus on the impact of business practices on consumers as the core issue to establish liability under the competition rules both in public and private enforcement.⁷² Therefore, when competition authorities and courts challenge business practices they should require explicit proof of consumer harm in the relevant output market. However, such an explicit requirement of proving actual harm to consumers is often absent from competition cases. It is generally believed that competition is always good for consumers and it is often believed that restriction of competition has detrimental effect on consumers.⁷³ However, that is not always the case. Even a clear reduction of competition can at the same time bring substantial economic benefits for consumers. This has been overtly the case, for example, in *Broadcast Music Inc. v. CBS*,⁷⁴ where the Supreme Court challenged a blanket license issued by a group of corporations consisting of owners of performance rights compositions. The blanket license allowed the licensee to play any composition in Broadcast Music Incorporated's collection. The challenged measure escaped the per se prohibition under Section one of the Sherman Act against price fixing because it promoted competition and increased efficiency in terms of saving millions of dollars in transaction costs for consumers. This case demonstrates that exclusively focusing on the effects of the arrangements on competition one may neglect the efficiencies that had positive economic effect on consumers of music.⁷⁵

In monopolization cases, better known in Europe as abuse of a dominance cases, assessing the business conduct requires an even more finely tuned assessment of consumer harm. In these cases effects on competition and effects on competitors through exclusionary practices should be clearly distinguished from cases where consumers suffer material harm as a result of increased prices or reduced output and quality. What might be unfair vis-à-vis competitors and result in foreclosure is not

⁷² Joffe briefly discusses the proposition for a divergent standard of proof in private enforcement cases. He rejects this proposal. Joffe, RD, 'Antitrust law and proof of consumer injury' (2001) 75 St John's L Rev 615 at 623.

⁷³ 'The economics of antitrust policy is based upon the proposition that competition ends up, in one way or another, always being good for consumers. That proposition is the central proposition of microeconomics.' Fisher, 6/2/99am, 20:14-19. Microsoft Trial Transcript at 20 (No.98-1232; 98-1233) (June 2, 1999, AM Session) *United States v Microsoft Corp*, 97 F. Supp. 2d 59 (DDC 2000).

⁷⁴ *Broadcast Music Inc. v. CBS*, 441 U.S. 1 (1979).

⁷⁵ See also Joffe, op cit, n 72, pp 620-621.

necessarily anti-competitive. The controversial assessment of predatory pricing⁷⁶ and rebate systems⁷⁷ in the EC is well-known. The need for a more economic effects based approach and sharpened evidentiary requirement of explicit consumer harm is indispensable if enforcement agencies want to reliably differentiate between anti- and pro-competitive conduct.

There has always been a tension in competition cases over the risks of enforcing the law so leniently that firms think they can get away with anti-competitive conduct and being so strict that courts would condemn trade practices that benefit consumers but at the same time stifle the competitive process itself.⁷⁸ An appropriate consumer harm test should, therefore, be based on objective and hard evidence in order to evaluate the state of competition in the relevant market and the negative effects of practices. Similar evidence should be required from enforcement agencies and private parties when they prove the negative or positive impact of corporate conduct on consumers. Mere assumptions and pure theoretical presumptions do not suffice as once competition liability is established structural and behavioural relief is imposed which on the one hand, reduces the competitiveness of the defendant and on the other, imposes costs on both firms and consumers. Such relief should only be imposed when substantial harm to consumers and competition has been proved.

In the US the Clinton Administration had been criticised for relying on a relatively weak consumer harm test in the assessment of competition liability in cases brought against Intel, Microsoft and Visa. In these cases the US Government argued that explicit proof of consumer harm does not always mean evidence of immediate and actual consumer harm, potential harm suffices. In *FTC v. Intel Corp.* the FTC argued that the undertakings were 'reasonably capable'⁷⁹ of making a significant contribution of preserving dominance without factual evidence on reduced rate of innovation, lowered prices or restricted output. Similarly, in *Visa U.S.A., Inc.* the government put forward that:

to show consumer harm, it is not necessary to prove precisely what choices consumers would have made, precisely how individual firms would have tried to respond to consumers, or whether they would have won or lost the competitive battle; it is sufficient to prove that the challenged restraint had a significant impact on the process by which competitive decisions were made.⁸⁰

⁷⁶ Case C-62/86 *AKZO v Commission* [1991] ECR 3359, Case T-83/91 *Tetra Pak International SA v Commission* [1994] ECR II-755.

⁷⁷ Case T-219/99 *British Airways plc v Commission*, [2003] ECR II-5187, Case T-203/01 *Michelin v Commission (Michelin II)* [2003] ECR II-4071.

⁷⁸ HH Chang, DS Evans, & R Schmalense, 'Has the consumer harm standard lost its tooth?', AEI-Brookings Joint Center for Regulatory Studies, 2002, p 41.

⁷⁹ *Intel Corp.*, FTC Docket No.9288 (Feb.25, 1999)

⁸⁰ Pls.' Post-Trial Proposed Conclusions of Law P 10 (No. 98-7076) (Sept. 22, 2000), *Visa U.S.A., Inc.*, 1999-2 Trade Cas. (CCH) P 72, 584 (S.D.N.Y. 1999).

The Court in *Microsoft* even described the standard employed by the government as ‘toothless’.⁸¹

Strong evidence can show substantial restriction of the competitive process and material harm to consumers in light of the impact of the practice on the allocation of resources. From the perspective of allocative efficiency, an anti-competitive effect occurs when the challenged conduct restricts output, in a properly defined relevant market, by a material amount for a material duration. A pro-competitive effect takes place when the practice in question expands output in the relevant market by a material amount for a material duration.⁸²

A credible enforcement system cannot accept evidence of consumer injury when it is merely inferred from harm to competition or even harm to competitors. Consumer harm can be inferred from harm to competition when the nature and the effect of the conduct is plainly anti-competitive; these are the so-called per se illegal cases in the US and the so-called hard-core cases in the EC. In these cases it can reasonably be presumed that consumers have been harmed and no further analysis is necessary. In all other cases, in the US often labelled as rule of reason cases, substantial and actual harm to consumers has to be proved before competition liability can be established. Strict standards of actual and substantial harm to consumers have been established by the US Supreme Court in *Brooke Group*,⁸³ for predatory pricing, and in *California Dental As’n*.⁸⁴

In *Brooke Group Ltd v Brown & Williamson Tobacco* the Supreme Court introduced a strict standard for a showing of predatory conduct. The Supreme Court held that a plaintiff alleging that the seller of a product had engaged in predatory pricing must show: (i) that the defendant had engaged in below-cost pricing in the short term; and, (ii) that the defendant had a dangerous probability of recouping its losses in the long term.

The Supreme Court argued that, ‘the mechanism by which a firm engages in predatory pricing -- lowering prices -- is the same mechanism by which a firm stimulates competition’.⁸⁵ The Court emphasized that ‘unsuccessful predation is in general a boon to consumers’,⁸⁶ and that the government must be very careful not to ‘chill the very conduct the antitrust laws are designed to protect’.⁸⁷ The Court referred to *Brown Shoe*⁸⁸ to affirm that, ‘below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: it is axiomatic that the antitrust laws were passed for “the protection of competition, not competitors”’.⁸⁹

⁸¹ *United States v. Microsoft*, 253 F.3d 34, 106-7 (2001) at 79.

⁸² Rooney, op cit, n 21, p 562.

⁸³ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

⁸⁴ *California Dental As’n v. FTC* (97-1625) 526 U.S. 756 (1999).

⁸⁵ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) at 226.

⁸⁶ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) at 224.

⁸⁷ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) at 224.

⁸⁸ *Brown Shoe Co. v. United States*, 370 U.S. 294, 320, (1962).

⁸⁹ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) at 225.

In *California Dental Association v Federal Trade Commission*, the Supreme Court adopted another narrowly formulated test. The Federal Trade Commission (FTC) condemned as anticompetitive some advertising restrictions, including restrictions affecting price advertising, adopted by a dentists' association in California. The Supreme Court reversed the finding of the Ninth Circuit Court endorsing the FTC allegation, on the basis of a lack of empirical evidence of consumer harm. The Supreme Court argued that in the absence of empirical evidence:

the point is that before a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of pro-competitive effects, as quick-look analysis in effect requires, there must be some indication that the court making the decision has properly identified the theoretical basis for the anticompetitive effects and considered whether the effects actually are anticompetitive. Where, as here, the circumstances of the restriction are somewhat complex, assumption alone will not do.⁹⁰

A clear and explicit benchmark in competition law enforcement is not only essential because of legal certainty and predictability. Such a standard helps swift resolution of legal disputes and establishes clear and objective guidelines for businesses. It reduces transaction costs associated with uncertainty and enables firms to develop business strategies with greater confidence. In the field of private enforcement such bright line rules help the courts to screen out merit less private claims.⁹¹

Difficulties of Enforcement and Burden of Proof

The difficulties of enforcing the consumer welfare standard concerns two aspects. On the one hand, the consumer welfare standard discriminates between individuals in different interest groups, namely between producers and consumers. On the other, the proof of actual consumer harm and the inherent requirement that consumers have to be provided a fair share of the overall economic welfare, can be difficult to prove. Both these issues can be further complicated by introducing the question of who is considered as a consumer: intermediate sellers as customers or final consumers?

The consumer welfare standard will permit a certain trade practice when there is no net reduction in consumer surplus irrespective of the increase or decrease in total surplus. It discriminates between different efficiencies depending on whether consumers or producers will benefit from them. It assigns zero weight to seller-shareholder profits and actually disregards the fact that gains to sellers, producers and shareholders can have significant positive effect on the overall welfare of society. As it considers wealth transfers from consumers to producers as being rather harmful than neutral, it is more critical of efficiency claims. This means that a consumer welfare-based policy will take into account only those firms' cost savings that are passed on into lower consumer prices and that are of direct benefit to consumers.

⁹⁰ *California Dental As'n v FTC* (97-1625) 526 U.S. 756 (1999) at 775, n 12.

⁹¹ Joffe, *op cit* n 72, pp 616-617.

Another concern that consumer welfare might raise is connected to the way it is applied. If the consumer welfare standard is applied in a static framework it can lead to sub-optimal outcomes. This is especially the case when the consumer welfare standard is applied in a way that believes that any profit earned by firms is at the cost of consumers. In a dynamic framework, where firms innovate and invest to the ultimate benefit of consumers focusing rigidly on immediate consumer benefits can stifle competition and can have adverse effects for consumers. A short-term consumer welfare standard can be damaging to firms' incentives to invest. If regulators treat firms' profitability with too much suspicion they remove the profits that firms expected to be rewarded for their risky investments by forcing the successfully investing firms to lower their prices. This regulatory approach can lead to discouraging firms from investing and innovating. However, such an approach involves difficulties of enforcement. The impact of trade practices on consumers is often measured and limited to effects in price and output. While price and output effects are easily quantifiable measurements, they are not always accurate indicators of competitive or anti-competitive effects. Quality, consumer choice and innovation are of critical importance when a market's competitiveness is assessed. However, consumer choice and innovation are less apparent and more difficult to prove.⁹² The non-economic nature of these efficiencies makes it more difficult to translate their value into terms of economic efficiency.

A further concern is that when measuring consumer harm is complicated and time consuming there might be a concern for the substantial time lag between violation and remediation. This might risk the infliction of severe harm to consumers before remedial measures can be ordered.⁹³

Enforcement of the consumer welfare standard can be further complicated by the passing on requirement. The rationale for passing on efficiencies to consumers may fail altogether when 'consumers' are actually large companies who are customers of the parties in the transaction. In these cases the buying firms, not final consumers, will be the beneficiaries of the passed-on efficiencies.

In competition law enforcement it is commonly presumed that efficiencies are passed through to end consumers and where the trade practices have no harmful effects on intermediate buyers the same will be true with regard to the impact on final consumers. However, there might be situations where otherwise restrictive trade practices produce substantial efficiencies and parties have demonstrated the probability of passing on of the efficiencies to consumers at the next level of the supply chain, however, final consumers will not benefit; as a result of for example monopoly pricing by the intermediate buyers.

In the following sections the consumer welfare standard will be discussed against the backdrop of EC competition law.

⁹² Houck, SD, 'Injury to competition/consumers in high tech cases' (2001) 75 St John's LRev 593 at p 603.

⁹³ Houck, *ibid*, p 597.

THE ROLE OF CONSUMER WELFARE STANDARD IN EUROPEAN COMPETITION LAW

Even though early Commission Reports on Competition Policy strongly suggested that European competition policy was aimed at the promotion of consumer welfare,⁹⁴ there was a certain vagueness about the precise goals of EC competition law and what role economic efficiency played in competition decisions. One goal of EC competition law has always been a political consideration to integrate the markets within the European Community. Besides market integration, the Ordoliberal concept of competition, namely achieving effective competition through the realisation of individual economic freedom, has been a relevant standard for interpreting EC competition rules. On the basis of Commission decisions such as *GE/Honeywell*⁹⁵ it could reasonably be argued that the structural goal of European competition policy is a diversified market with as many players as possible and no dominant competitor.

Until recently market integration and economic freedom seemed to have overshadowed efficiency considerations in the objectives of European competition policy. Accordingly, European competition policy was risking adverse effects on consumer interests. For example, the prohibition of absolute territorial protection is clearly directed at market integration; although economic analysis can show that a vertical agreement may have outcomes enhancing allocative efficiency and thereby consumer welfare.⁹⁶ Similarly, the utmost protection of openness, access to markets, and levelling the playing field by the prohibition of foreclosing markets by dominant firm strategies might have negative effects in the long run. It might scare off innovative firms that would deliver substantial consumer benefits.

Market integration actually became an aim in itself and after more than forty years it is still a relevant objective of EC competition law.⁹⁷ However, the primacy of market

⁹⁴ European Commission, 1st Report on competition policy 1971, 11-12 (1972): 'competition policy endeavours to maintain or create effective conditions of competition by means of rules applying to enterprises in both private and public sectors. Such a policy encourages the best possible use of productive resources for the greatest possible benefit of the economy as a whole and for the benefit, in particular of the consumer'. See also European Commission, VIth Report on competition policy 1975, (1977): '[competition policy's] aims is to ensure that business operates along competitive lines, while protecting the consumer by making goods and services available on the most favourable terms possible. It therefore endeavours to cut monopoly profits'. Neven, Papandropoulos and Seabright were also often cited arguing that, 'it seems reasonable to say that the promotion of consumer welfare is one of the main goals of European competition policy. At least in its declared objectives, the choice has clearly been made to favour income redistribution from producers with market power to consumers'. Neven, D, Papandropoulos, P, & Seabright, P, 'Trawling for minnows. European competition policy and agreement between firms', London, Centre for Economic Policy Research (CEPR), 1998, p 12.

⁹⁵ Commission Decision 2004/134/EC (Case IV/M/2220), OJ 2004, L48/1.

⁹⁶ For a detailed analysis on the adverse effects of market integration of consumer interests in the enforcement of EC competition law see Buttigieg, E, 'Consumer interests under the EC's competition rules on collusive practices' (2005) 16 EBLR 643, pp 696-700.

⁹⁷ It has been considered as the most significant means of creating and maintaining economic freedom, even if the market integration imperative has to take priority over other goals of competition law, like economic

integration among the policy goals of European competition law does not hold anymore.

Shift to Consumer Welfare Standard: an economics and effects based approach

Since the end of the 1990s a noticeable shift has taken place from a form based legal approach to an effects based approach making use of economic insights. The discussion around European competition policy has focused on exactly which efficiency standard should be implemented in policy making and how that standard should be effectuated when European competition law is enforced.⁹⁸ The role of the consumer welfare standard in EC competition law has been fuelled through the intention of the European Commission to modernise and improve its competition law enforcement by introducing more economic insights in its overall approach. In the course of the modernisation of European competition law the Commission has been anxious to make the goals of EC competition law more explicit and accordingly adjust policy tools. Competition Commissioner Neelie Kroes has made clear that, ‘consumer welfare is now well established as the standard the Commission applies when assessing mergers and infringements of Articles 81 and 82’.⁹⁹

In the first place, the adoption of a consumer welfare standard in EC competition law took shape through endorsing a more economics based approach. The Commission has considerably reviewed and revised its policy documents such as block exemption regulations and the accompanying guidelines and notices and pronounced a new line of enforcement that focused on the effects of business conduct and the way they impact consumer welfare. Neelie Kroes explained that, ‘an effects-based approach, grounded in solid economics, ensures that citizens enjoy the benefits of a competitive, dynamic market economy’.¹⁰⁰ This new line of policy should be considered and criticised with realistic expectations. European competition policy has not taken up new legislative responsibilities in the interest of consumers and DG Competition has not turned into an agency enforcing both competition rules and consumer protection rules. The new developments have evolved along the lines of an enforcement agenda, which focused on an efficient allocation of resources to address the most severe competition law violations and which rationalized old analytical tools and introduced new policy measures such as the advanced leniency programme and private enforcement. Even though consumer welfare has been in the forefront of every major policy statement, viewed realistically these activities were first and foremost targeted at stepping up overall enforcement efforts and increasing the deterrent effects of competition rules.

efficiency. The Commission’s Irish Distillers decision is an example of how this kind of one-sided policy can lead to adverse effects on market integration, (Case IV/28.282) *The Distillers Company Limited*.

⁹⁸ For example the debate after *GE/Honeywell* (Case COMP/M.2220, July 3, 2001) pushed the role of economic models and especially the treatment of efficiencies into the spotlight. This case made it clear that the Commission was unclear about which welfare standard it pursued.

⁹⁹ European Commissioner for Competition, Speech at the European Consumer and Competition Day, London, 15 September 2005.

¹⁰⁰ *Ibid.*

Improving legal predictability, analytical clarity and decisional accuracy is expected to result in more credible enforcement and indirectly benefit consumers. A consumer welfare based approach can improve the standard of proof by introducing sound economics in the identification of competitive harm and by requiring factual and empirical evidence of consumer harm. It can, moreover, require proper identification and quantification of efficiencies and how they are passed on to consumers and in what way they benefit them. However, beyond these indicators the consumer welfare standard cannot evaluate how business behaviour affect consumers or let alone press firms to respond to consumers' needs. Competition policy is in the first place a reactive policy tool and cannot intervene in order to prevent market failures. The only area where the consumers' role has been made more explicit, and has been somewhat increased, is in the procedural framework of Articles 81 and 82 EC. Consumers' contribution to the enforcement of EC competition law by providing market information, bringing complaints and in the future bringing damages claims has been considerably encouraged by the Commission. This has been reaffirmed by the European CFI in *Österreichische Postsparkasse*:

It should be pointed out in this respect that the ultimate purpose of the rules that seek to ensure that competition is not distorted in the internal market is to increase the well-being of consumers. That purpose can be seen in particular from the wording of Article 81 EC. ... Competition law and competition policy therefore have an undeniable impact on the specific economic interests of *final customers* who purchase goods or services.¹⁰¹ (emphasis added)

In the second place, however, European competition policy has been pursuing a proactive policy which is addressing consumer interests more directly and more explicitly. Such policy tools are the European Commission's recent sector inquiries and its advocacy work by which it makes competition policy more visible for consumers. Since Mario Monti became Commissioner in 1999, consumer interests have been high on the agenda of DG Competition. Monti has repeatedly pointed out how competition law is to protect consumers and Commission documents have explicitly referred to the relevant role competition law can play in consumers' lives. One of Monti's priorities was to make consumers aware of the fact that, 'the protection of the interests of consumers, and therefore of European citizens, is at the heart of Community competition policy'.¹⁰²

¹⁰¹ Cases T-213/01 & T-214/01 *Österreichische Postsparkasse and Bank für Arbeit und Wirtschaft v Commission* [2006] ECR II-1601, para 115.

¹⁰² XXIXth Report on Competition Policy – 1999, p 5, see Monti's other speeches: Monti Content, Competition and Consumers: Innovation and Choice, European Competition Day, Stockholm, 11 June 2001, Competition and Consumer: the case of Pharmaceutical Products, European Competition Day, Antwerp - 11.10.2001; What are the aims of European Competition Policy, European Competition Day, Madrid, Spain - 26.02.2002; Competition enforcement and the interests of consumers - a stable link in times of change, European Competition Day, Athens, Greece - 14.02.2003; Competition for consumers' benefit, European Competition Day, Amsterdam, 22 October 2004

The EC competition rules refer to consumer welfare only in one provision of the EC Treaty: Article 81(3) EC. Further Article 2(1)(b) of the Merger Regulation makes reference to the development of technical and economic progress in the interest of consumers.¹⁰³ These provisions form a relevant starting point in the assessment of which consumer interests competition law can take care of and which consumer problems it cannot address. The new decentralised enforcement of Article 81 in its entirety indicates a change in the way the Commission will deal with the assessment of the criteria under Article 81(3) EC. The analysis below will concentrate on the interpretation of the consumer welfare considerations under Article 81(3) EC both in the decisions of the Commission as well as in judgments of the European courts.

The Implications of the Consumer Welfare Standard under Article 81 EC

The explicit adoption of the consumer welfare standard has reacted to the long emphasised requirement of the European Courts to refine the definition of what constitutes a restriction of competition since the early 1980s. The Courts have been developing a more differentiated analysis of the purpose of Article 81 EC than the European Commission. These attempts have included an increased demand for economic analysis of competition cases under Article 81 EC. Since 1966 the ECJ has been emphasising that all agreements are to be evaluated by their factual, legal and economic context:¹⁰⁴

It is settled case-law that, in defining the criteria for the application of Article 81(1) EC to a specific case, account should be taken of the economic context in which undertakings operate, the products or services covered by the decisions of those undertakings, the structure of the market concerned and the actual conditions in which it functions.¹⁰⁵

Throughout the years the ECJ and the CFI have developed an approach that followed a narrow interpretation of Article 81(1) EC and denied the existence of a US kind of rule of reason.¹⁰⁶ In the recent *GlaxoSmithKline* the CFI added that:

[in] effect, the objective assigned to Article 81(1) EC, which constitutes a fundamental provision indispensable for the achievement of the missions entrusted to the Community, in particular for the functioning of the internal market ... is to

¹⁰³Council Regulation 139/2004/EC of 20 January 2004 on the control of concentrations between undertakings, OJ 2004, L24/1.

¹⁰⁴Case C-56/65 *Société La Technique Minière v. Maschinenbau Ulm GmbH* [1966] ECR 235, para 8, Case C-23/67 *Brasserie De Haecht v Wilkin* [1967] ECR I-407; Case C-234/89 *Delimitis v. Hanninger Bräu* [1991] ECR I-935

¹⁰⁵Case C-399/93 *Oude Luttikhuis and Others v. Commission* [1995] ECR I-4515, para 10, see also C-180-184/98 *Pavlov and others* [2000] ECR I-6451, para 91

¹⁰⁶In the US under the Sherman Act certain restraints of trade are automatically, in other words per se prohibited and further investigation of the effect of the restraint is considered unnecessary. Per se rules declare certain arrangements to be illegal without exception. This approach had a negative impact on business and, accordingly the US courts began to examine on a case-by-case basis whether the restraint could be found to be reasonable. This was the more general use of the so-called rule of reason, which requires courts to measure a practice's anti-competitive effect against its pro-competitive benefits.

prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the *final consumer* of the products in question.¹⁰⁷ (emphasis added)

The adoption of a more economics based approach focusing on consumer welfare began in the field of vertical agreements, where a new block exemption¹⁰⁸ accompanied by the Commission's Guidelines¹⁰⁹ was adopted in 1999. This block exemption ensured undertakings a more tolerant approach and broader exemption possibilities. In the field of horizontal agreements three new block exemptions were published concerning specialisation agreements,¹¹⁰ research and development agreements¹¹¹ and technology transfer agreements.¹¹² The first two block exemptions are accompanied by the Commission's Guidelines on the applicability of Article 81 to horizontal co-operation agreements¹¹³ and the last one is accompanied by Guidelines on the applicability of Article 81 to technology transfer agreements.

The more economics based approach in Vertical Guidelines is apparent in the extensive discussion of the efficiency-enhancing effects of vertical agreements that way counterbalance their possible anti-competitive effects.¹¹⁴ The Guidelines also devoted a substantial part to explain the economic analysis of the negative and positive effects of vertical agreements.¹¹⁵

The Guidelines on horizontal cooperation agreements presume that if parties have a low combined market share, co-operation is not likely to restrict competition. The horizontal guidelines do not prescribe a single rule, because market conditions such as the nature of the agreement, the nature of the products, market concentration, barriers to entry, stability of shares and the countervailing power of buyers or suppliers and effects can vary considerably, but they do suggest particular levels for certain kinds of agreement. The horizontal guidelines devote separate sections to explain how cooperation between competitors in the framework of production specialisation and

¹⁰⁷Case T-168/01 *GlaxoSmithKline Services v Commission*, para 118

¹⁰⁸Regulation 2790/99/EC, OJ 1999, L336/21.

¹⁰⁹Commission Notice - Guidelines on Vertical Restraints, OJ 2000, C292/1.

¹¹⁰Regulation 2658/2000/EC on the application of Article 81(3) of the Treaty to categories of specialisation agreements, OJ 2000, L304/3.

¹¹¹Regulation 2659/2000/EC on the application of Article 81(3) of the Treaty to categories of research and development agreements, OJ 2000, L304/7.

¹¹²There is a new block exemption regulation and guidelines on the application of Article 81 to technology transfer agreements, Commission Regulation 772/2004/EC on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, OJ 2004, L123/11, Commission Notice - Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, OJ 2004, C101/2.

¹¹³OJ 2001, C3/2.

¹¹⁴The Regulation refers to the presumption of pro-competitive effects of vertical agreements when the parties' market share does not exceed 30%. Points 6 and 7 of the Guidelines on vertical agreements refer to the case-law of the European Courts when it is explained why vertical agreements have to be analysed in their legal and economic context.

¹¹⁵Guidelines on Vertical Restraints, op cit, n 109, paras 103-118.

R&D agreements can contribute to economic welfare without restricting competition to a significant extent. They do, however, as a general rule recognize that the effects of the agreements have to be analyzed in the following way:

For this analysis it is not sufficient that the agreement limits competition between the parties. It must also be likely to affect competition in the market to such an extent that negative market effects as to prices, output, innovation or the variety or quality of goods and services can be expected.¹¹⁶

This implies that the impact on consumers is a relevant part of the assessment.

The Commission's new approach to vertical and horizontal agreements was a considerable step in terms of introducing more economics-based insights in its assessment and developing a policy that is more flexible and attractive for business. In 2004 in the framework of the modernisation package the Guidelines on the application of Article 81(3) have been adopted, which described in detail how the Commission is going to proceed in Article 81 cases in the future. In the following first the standard of restriction to competition and consumer harm as established under Article 81(1) will be analysed and second, the benefits under Article 81(3) will be assessed.

Restrictions of Competition: harm to consumers?

The assessment under Article 81 EC has been several times explained by the European Courts. The analysis is first to be conducted under Article 81(1) EC in order to ascertain in a rather abstract way whether the conduct in question constitutes an appreciable restriction of competition. When this is the case an economic balancing takes place under Article 81(3) EC in order to evaluate whether the economic advantages of the agreement outweigh its restrictive effect on competition so that an exception can be granted from the general prohibition. This approach has always pleaded for a 'market effect' based evaluation as opposed to the old-fashioned formalistic 'clause' driven approach.

The Commission has now followed up on this approach and has set the benchmark for assessing the negative effects of corporate behaviour under Article 81(1) in its Guidelines on the application of Article 81(3).¹¹⁷ In paragraph 18 of the Guidelines the relevant test constitutes of two parts. The first test asks whether, 'the agreement restrict actual or potential competition that would have existed without the agreement?' and the second whether, 'the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)?' The two tests examine two possible scenarios, namely when inter-brand and when intra-brand competition is effected by the arrangement under investigation. While the first test evaluating the effects of the arrangement on inter-brand competition is logical and rational from both an economic and a legal point of view, the second test focusing on the effects on intra-brand competition is less straightforward. There are categories of vertical agreements

¹¹⁶ Guidelines on Horizontal Cooperation Agreements, op cit, n 113, para 19.

¹¹⁷ Commission Notice – Guidelines on the application of Article 81(3) of the Treaty, OJ 2004, C101/97.

that cannot be justified for the restrictive effect they have on intra-brand competition, however, they are from an inter-brand competition perspective consumer welfare enhancing.¹¹⁸ Absolute territorial protection is once again called into question and shows little recognition of its underlying economic reason: free-riding.¹¹⁹

The following paragraphs of the Guidelines explain what the Commission means by restrictions of competition. Paragraph 21 says that:

restrictions by object such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources, because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.

Paragraph 24 adds that:

[for] an agreement to be restrictive by effect it must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability.¹²⁰

Footnote 84 summarizes once again what is meant by competitive harm: it is referred to in terms of higher prices; competitive harm could also mean lower quality, less variety or lower innovation than would otherwise have occurred.

This formulates a proper benchmark that focuses on the impact of the agreement on consumers. The factors that are considered as evidence of proving of competitive harm are:

in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an

¹¹⁸Hancher and Lugaard bring the example of an exclusive distribution agreement obliging the distributor not to actively sell outside of his contract territory. This obligation cannot be justified by the argument that the distributor has to be protected outside his contract territory. Hancher, L, & Lugaard, P, 'Honey, I shrunk the article! A critical assessment of the Commission's Notice on Article 81 (3) of the EC Treaty' [2004] ECLR 410, p 414.

¹¹⁹Guidelines on vertical restraints, OJ 2000, C291/1, point 7.

¹²⁰Paragraph 25 adds that, 'negative effects on competition within the relevant market are likely to occur when the parties individually or jointly have or obtain some degree of market power and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power. Market power is the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time'.

agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect.¹²¹

However, this benchmark has to be made hard in the actual enforcement.

In *GlaxoSmithKline* the CFI made a considerable contribution to what actual consumer harm means under Article 81(1).¹²² Glaxo Wellcome, a Spanish subsidiary of the GlaxoSmithKline group (GSK), one of the world's leading producers of pharmaceutical products adopted new General Sales Condition in March 1998, which stipulated that its medicines would be sold to Spanish wholesalers at prices differentiated according to the national sickness insurance scheme which will reimburse them. In practice, medicines intended to be reimbursed in other Member States of the Community would be sold at a higher price than those intended to be reimbursed in Spain. This system was introduced in order to limit parallel trade in medicines between Spain, where the administration sets maximum prices, and other Member States, in particular the United Kingdom, where prices are fixed at a higher level, with a view to allocating the surplus thus obtained to innovation. GSK notified those General Sales Conditions to the Commission in order to obtain a decision declaring that they are not prohibited by Community competition law (Article 81(1) EC) or, failing that, a decision granting them an exemption (Article 81(3) EC) as an agreement contributing to promoting technical progress. At the same time, the Commission received a number of complaints directed against the General Sales Conditions from a number of Spanish or European wholesalers' associations and from one Spanish wholesaler.

On 8 May 2001, the Commission decided that the General Sales Conditions were prohibited by Community competition law, because they constituted an agreement in restriction of competition. It also decided that GSK had not proved to the Commission that the conditions necessary for such an agreement to be able to benefit from an exemption were satisfied. It therefore ordered GSK to bring the practice to an end.

GSK requested the Court of First Instance to annul the Commission decision in its entirety. The CFI came to the conclusion that the Commission's analysis is invalid in part. Among other things, the CFI concluded that the Commission's main conclusion, that the General Sales Conditions have as their object the restriction of competition because they make provision for differentiated prices which seek to limit parallel trade in medicines, was incorrect. The CFI emphasized that case-law, such as *Consten and Grundig* and *Société Technique Minière* require that examination of the clauses of an agreement is carried out in their legal and economic context and when such an examination reveals in itself the existence of an alteration of competition, it may be presumed that that agreement has as its object the prevention, restriction or distortion of competition. In such a case there is no need to examine its effect.¹²³

¹²¹ Paragraph 22

¹²² Case T-168/01 *GlaxoSmithKline Services v Commission*.

¹²³ Cases 56 & 58/64 *Consten & Grundig v Commission* [1966] ECR 299, para 110; Case 56/65 *STM* [1996] ECR 235, para 55.

Earlier cases have required the Commission to analyze agreements by reference to their legal and economic context and determine whether they have as their, ‘object or effect the prevention, restriction or distortion of competition on the relevant market, to the detriment of the final consumer.’¹²⁴ Moreover, as the CFI noted the wholesalers, whose function is to ensure that the retail trade receives supplies with the benefit of competition between producers, are economic agents operating at an intermediate stage of the value chain and may keep the advantages of the price differentials which parallel trade may entail, in which case that advantage will not be passed on to the final consumers.¹²⁵

However, in the present case the Commission did not take proper account of the specific nature of the pharmaceuticals sector. Unlike the situation in other economic sectors, the prices of medicines reimbursed by the national sickness insurance schemes are not freely determined by supply and demand, but are set or controlled by the Member States.¹²⁶ For that reason, it cannot be presumed that parallel trade tends to reduce prices and thus to increase the welfare of final consumers, as it would do in the absence of those special regulations.¹²⁷ It is the repercussions which that restriction of parallel trade has or may have on one or other of the parameters of competition, such as the quantity in which a product is supplied or the price at which it is sold, that provides evidence of such a restriction.¹²⁸

While the Court considered that GSK has not succeeded in invalidating the Commission’s subsidiary conclusion that the General Sales Conditions have as their effect the restriction of competition, it found that the measures taken by the Member States to recover a part of the profits made by parallel traders, for the benefit of the national sickness insurance schemes and patients, a specific examination of the situation in the sector lead to the finding that parallel trade permits a limited but real reduction in the price and the cost of medicines. Therefore, in so far as they prevent that advantage from being produced, the General Sales Conditions diminish the welfare of final consumers.¹²⁹

The relevance of the CFI’s analysis is, however, that it shifts the scope of analysis of the effects of the agreements from the limitation of parallel trade and the freedom of action of the wholesalers unambiguously to the question whether the agreements had the effect of reducing the welfare of final consumers.¹³⁰ This is significant in cases where

¹²⁴T-168/01 *GlaxoSmithKline*, para 119.

¹²⁵T-168/01 *GlaxoSmithKline*, para 122.

¹²⁶T-168/01 *GlaxoSmithKline*, para 133.

¹²⁷T-168/01 *GlaxoSmithKline*, paras 134-135, 147.

¹²⁸T-168/01 *GlaxoSmithKline*, para 167.

¹²⁹T-168/01 *GlaxoSmithKline*, paras 187-195.

¹³⁰ However, not every agreement which restricts the freedom of action of the participating undertakings, or of one of them, necessarily falls within the prohibition in Article 81(1) EC ... In the present case, whatever the price at which the Spanish wholesalers agree to buy a medicine from GW on the Spanish market (the Clause 4A price or the Clause 4B price), they are limited in their freedom of action since, from an economic point of

the negative effects of an agreement may simply be to alter the division of profits among producers and intermediaries up and down the distribution chain, but without real adverse effects on final consumers. Even if such cases might be exceptional, as they arise where, legitimately, price competition at the retail level is already limited, the explicit requirement to explain and support by factual evidence the impact on final consumers as the ultimate benchmark of restricting competition and thus competition liability under Article 81(1) is to be welcomed.

Consumer Benefits under Article 81(3) EC

In the following Article 81(3) EC will be analysed in order to show how the Commission has proceeded in the past when considerations of consumer welfare had to be balanced with other competition objectives. This analysis clarifies, on the one hand, how consumer interests are perceived in EC competition law and, on the other, how economic and non-economic benefits are balanced when the two are in conflict. Article 81(3) EC is concerned about the benefits consumers would get as a result of an agreement that otherwise restricts competition. The broad and open formulation of Article 81(3) makes it possible to balance the core values of competition, like market integration, economic efficiency and undistorted competition with certain non-competition policy objectives.¹³¹ The Commission's task is to make a trade-off between the efficiency gains for consumers and the efficiency losses that are the result of the agreements restricting competition. Resolving this conflict is one of the essential tools to take account of consumer interests through the application of competition rules.

What 'consumer benefit' exactly means under Article 81(3) EC used to be decided by the Commission on a case-by-case basis. Until May 2004 the Commission had a monopoly on the application of Article 81(3) and enjoyed a considerable margin of discretion in applying the conditions under Article 81(3). The European Courts have on several occasions acknowledged the Commission's discretionary powers to pursue other non-competition related Community objectives under Article 81(3).¹³² The Courts have neither dealt with the Commission's substantive application of the criteria

view, they are not capable in the long term of reselling them at a lower price on the other national markets of the Community. However, as the objective of the Community competition rules is to prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the final consumer of the products in question (paragraph 118 above), it is still necessary to demonstrate that the limitation in question restricts competition, to the detriment of the final consumer', T-168/01 *GlaxoSmithKline*, para 171.

¹³¹ As AG Cosmas in *Delège* said: 'It must also be recognised, however, that Article 85(1) does not apply to restrictions on competition which are essential in order to attain the legitimate aims which they pursue. That exception is based on the idea that rules which, at first sight, reduce competition, but are necessary precisely in order to enable market forces to function or to secure some other legitimate aim, should not be regarded as infringing the Community provisions on competition'. Opinion of AG Cosmas delivered on 18 May 1999, Cases C-51/96 and C-191/97 *Christelle Delège*, para 110.

¹³² Case C-26/76 *Metro I* [1977] ECR 1875, para 45, Case C-71/74 *Fruho* [1975] ECR 563, para 43. The Courts have held that the judicial review of the Commission's decisions under Article 81(3) is limited to establish whether the Commission committed a manifest error of assessment, whether procedural rules had been complied with, whether proper reasons had been provided. Case C- 42/84 *Remia* [1985] ECR 2545, para 38.

under Article 81(3), nor intervened with Commission decisions that took non-competition policy objectives into account under the same provision.¹³³ More explicitly, the CFI even noted that, ‘the Commission is entitled to base itself on considerations connected with the pursuit of the public interest in order to grant exemption under Article 85(3) of the Treaty’.¹³⁴

Article 81(3) EC initially refers to the economic interests of consumers in terms of price and output. Despite this express recognition of consumer interests, this criterion has not become a substantive right of consumers. It has not been made explicit whether a direct or indirect benefit suffices, what is meant by a ‘fair’ share of the benefit and whether there is a guarantee that those expected benefits would be passed on to the consumers.

In its past practice the Commission has focused mainly on the two last conditions of Article 81(3) EC concerning indispensability and no elimination of competition. Up until now the first two conditions under Article 81(3) concerning efficiency gains and verifying that consumers receive a fair share of the efficiencies played a limited role in the Commission’s analysis. As long as competition was not eliminated the last two conditions were assumed to had been fulfilled.¹³⁵ As the Commission has generally assumed that consumers receive a fair share of any benefits as long as competition has not been eliminated explains why Article 81(3) has not been developed into an autonomous objective of consumer protection.

The Commission usually has required some kind of economic advantage for consumers, like increasing the range of products or the quality of products or services. This criterion has not been extended to much more than requiring increased choice for consumers or the guarantee of high quality services. For example in *Metro-Saba I* the improvement in supply was sufficient to prove that the agreement produced substantial efficiencies for consumers.¹³⁶

¹³³Bailey, D, ‘Scope of judicial review under Article 81 EC’ (2004) 41 CMLRev 1328, p 1347; This, however, did not mean that the logic and rationality of Commission decisions under Article 81 (3) have not been scrutinized and criticized. The CFI has on several occasions criticized the lack of a proper economic analysis in the Commission’s decisions. See for example Case T-374/94 *European Night Services* [1998] ECR II-3141, paras 103-15, 140, 159; Case T-528/93 *Métropole* [1996] ECR II-649, para 120.

¹³⁴Case T-528/93 *Métropole* [1996] ECR II-649, para 118.

¹³⁵The reason behind this approach was the following. The condition of indispensability was well suited for the system of prior notification and authorisation created by Regulation 17/62. This system led to a reactive enforcement culture where the Commission spent a considerable amount of time checking individual clauses in notified agreements. Kjolbye, L, ‘The new Commission Guidelines on the application of Article 81(3): an economic approach to Article 81’ [2004] ECLR 566, p 573.

¹³⁶Case C-26/76 *Metro/Saba I* [1977] ECR 1875, para 47: ‘According to the contested decisions the conditions of supply for wholesalers under the cooperation agreement are such as to provide direct benefit for consumers in that they ensure continued supply supplies and the provisions of a wider range of goods by retailers for private customers. Furthermore, the lively competition existing on the market in electronic equipment for leisure purposes exercises sufficient pressure to induce Saba and the wholesalers to pass on to consumers the benefits arising from the rationalization of production and the distribution system based on the cooperation agreement’.

Furthermore, the cumulative nature of the conditions in order to grant an exemption meant that the agreement at stake had to show improvement either in the production or in the distribution or in the technical or economic progress.¹³⁷ When these conditions are fulfilled there are inevitably going to be some resulting benefits for the consumers as well.¹³⁸ Thus the assessment of consumer benefit could easily become a formality in the examination. The Commission in the past often used consumer interests to support the application of competition policy, where consumer benefit was only a consequence of efficient competitive structures. Under Article 81(3) EC there was no independent significance credited to consumers and consumer benefit was not given separate identity.

In the following the difference between the substance of the Commission's decisions under Article 81(3) EC in the past and what the expected substance of these decisions will be in the future will be reviewed. The main difference originates from the fact that Article 81(3) is directly applicable since May 2004 and therefore the Commission no longer enjoys a monopoly on the application of this Treaty provision, but shares this competence with the national competition authorities (NCA) and the national courts of the Member States. Consequently, the Commission's past practice will provide less guidance for undertakings who have to self-assess their agreements. The new approach is laid down in the Guidelines on the application of Article 81(3).¹³⁹ However, the question whether and to what extent non-competition policy objectives can be taken into account under Article 81(3) remains unclear.

The Commission's Decisions in the Past

In most decisions of the Commission under Article 81(3) EC consumer benefits comprised the economic interests of consumers. For example, agreements were exempted on the basis of reorganisation and expansion of airline operators' existing networks¹⁴⁰ or developing a new technically advanced engine reducing operating costs, servicing longer routes on a non-stop basis and meeting new airport noise restrictions as well as offering customers substantial cost savings.¹⁴¹ Similar examples are the

¹³⁷ Evans, AC, 'European competition law and consumers: the Article 85(3) exemption' [1981] ECLR p.429

¹³⁸ Evans, *ibid*, p 430.

¹³⁹ OJ 2004, C101/97.

¹⁴⁰ The Commission exempted a joint venture agreement between British Midland International, Lufthansa and SAS under which they agreed to coordinate their services within the EEA to and from London Heathrow and Manchester International airports. The Commission concluded that British Midland's withdrawal from the London-Frankfurt route represented an appreciable restriction of competition but the agreement allowed Lufthansa and SAS to compete for domestic UK traffic as well as for traffic between the UK and Ireland and to carry passengers from any point in the STAR network to regional destinations in the UK and also led furthermore to an increase in network competition. Case COMP/37.812, public notice of 14.3.2001 (OJ 2001, C83).

¹⁴¹ The Commission considered environmental issues and the benefits of a new technological product, but eventually granted exemption on the basis of efficiency arguments in a case concerning three agreements between General Electric Aircraft Engines (GEAE) and Pratt & Whitney (P & W). The agreement created a joint venture in order to develop, manufacture, sell and support a new aircraft engine. The Commission found that this cooperation enabled the parties to develop an engine that was less expensive in maintenance

improvement of beer distribution ensuring supplies of goods of satisfactory quality at fair prices and conditions and wider range of products of different manufacturers,¹⁴² reducing transaction costs and realising efficiencies in distribution and improving a wide range of services and raising the quality of services for consumers,¹⁴³ or qualitative improvement of European telecommunications through larger product portfolio of newly developed services and lower pricing.¹⁴⁴ These examples illustrate that in most of the cases the enforcement of the consumer welfare standard leads to better prices, greater product and service choice as well as higher quality.

Consumer protection is concerned with more than mere economic interests and covers health, safety and information issues, which often cannot and should not be considered under Article 81(3) EC. Nevertheless, in the past the Commission has on a number of occasions granted exemption to restrictive agreements on the basis of public interest objectives or social concerns. Furthermore, in a number of cases the European Courts affirmed that the Commission was free to take considerations connected with the pursuit of the public interest into account under Article 81(3). In *Métropole Télévision and Others* the CFI stated that the Commission was entitled to base itself on considerations connected with the pursuit of the public interest in order to grant exemption under Article 81(3). However, in the present case it did not show that such considerations required exclusivity of rights to transmit sports events and that that exclusivity was indispensable in order to allow them a fair return on their investments.¹⁴⁵ In *Verband der Sachversicherer*¹⁴⁶ the ECJ stated the wording of Article 81(3) makes it possible to take account of the particular nature of different branches of the economy.

Thus, in some of the Commission's decisions consumer benefit was interpreted so as to encompass wider consumer interests than mere economic ones. For example, in *Asahi* the exempted agreement was to introduce new technology, which would enhance product safety.¹⁴⁷ In *CECED*¹⁴⁸ the Commission took environmental considerations

and cost per passenger and per mile covered, and also had lower gas and noise emissions than the parties' existing engines. Furthermore, there was no engine which fulfilled these criteria on the market. Case IV/36.213/F2 — *GEAE/P & W*, paragraphs 79-82.

¹⁴²Case No IV/35.079/F3 – *Whitbread*, Commission Decision of 24 February 1999.

¹⁴³Case IV/36.592 — *Cégétel + 4* Commission Decision of 20 May 1999.

¹⁴⁴Case No IV/35.337 – *Atlas*, Commission Decision of 17 July 1996.

¹⁴⁵Cases T-528/93, T-542/93, T-543/93 and T-546/93 *Métropole Télévision and Others v Commission* [1996] ECR II-649, para 118.

¹⁴⁶Case C-45/85 *Verband der Sachversicherer e.V. v Commission*, [1987] ECR 405, para 15.

¹⁴⁷Case IV/33.863 - *Asahi/Saint-Gobain* OJ 1994, L354/87, paras 24-26: 'There is a demand from the side of the automotive glazing industry for safety glazing products which are more flexible in shape and lighter in weight than existing multi-layer products.... This product could have a significant impact on the design, safety and price of cars and other motor vehicles. ... It is thus expected that the cooperation in developing urethane-based bi-layer product will contribute to improving the production of goods and to promoting technical progress... The greater impact resistance of bi-layer glass could reduce personal injuries in the event of collision. Improved optical quality would contribute generally to driver safety. The lighter weight would reduce costs and help fuel efficiency. The cooperation between AG and SG will further reduce the R& D costs for bi-layer products and thus also the price of such products to consumers and the entry of such products on the market will thus be accelerated'.

into account. It approved for the first time an agreement where the parties had agreed to cease the production of certain categories of washing machines with a view to improving the environmental performance of products. The parties to the agreement, nearly all the European producers and importers of domestic washing machines, agreed to stop producing or importing into the EU the least energy-efficient machines in order to reduce the energy consumption of such appliances and thereby reduce pollutant emissions from power generation.¹⁴⁹ The Commission noted that although the participants restricted their freedom to manufacture and market certain types of washing machine and thereby restricted competition within the meaning of Article 81(1) EC, the agreement would bring advantages and considerable savings for consumers, in particular by reducing pollutant emissions from electricity generation.¹⁵⁰ The Commission said that its decision to exempt the agreement took account of this positive contribution to the EU's environmental objectives, for the benefit of present and future generations.¹⁵¹

Future decisions

Under the new approach Article 81 EC is to be assessed in its entirety and the emphasis is more on the self-assessment of undertakings under Article 81(1) EC and not under Article 81(3). The latter now becomes a legal exception.

It is clear from the White Paper as well as from the Guidelines that Article 81(3) will be interpreted in a narrower and more economic effects oriented way in the future. According to the Guidelines the general principles of the assessment under Article 81(3) will be the following. Only objective economic criteria can be taken into account in the assessment.¹⁵² This has been declared by the ECJ already in *Consten and Grundig*:

this improvement must in particular show appreciable objective advantages of such a character as to compensate for the disadvantages which they cause in the field of competition.¹⁵³

Efficiencies can take the form of distribution, licensing of technology, joint production, joint research and development or wider efficiency enhancing effects like reducing industry wide costs.¹⁵⁴

¹⁴⁸ Case IV.F.1/36.718, *CECED*, OJ 2000, L187/48.

¹⁴⁹ Case IV.F.1/36.718, *CECED*, paras 19-20.

¹⁵⁰ Case IV.F.1/36.718, *CECED*, paras 47-57.

¹⁵¹ XXXth Report on competition policy, European Commission 2001, paras 96-97; The Commission's decision in DSD has already signalled the increased willingness to exempt restrictive agreements on the basis of environmental objectives. Cases COMP/34493 – DSD, para 144, 'Regular collection from private final consumers of used sales packaging differentiated into specified reusable materials, and subsequent sorting or preparation for full recovery, gives direct practical effect to environmental objectives'.

¹⁵² See points 33 and 49 of the Guidelines on the application of Article 81(3), op cit, n 112.

¹⁵³ Cases 56/64 & 58/64 *Consten and Grundig*, op cit, n 123.

However, point 42 of the Guidelines states that, ‘goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Art 81(3)’. Besides a high degree of competitiveness and convergence of economic performance Article 2 EC lists a number of other Community goals like a high level of employment and of social protection, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States. Will non-economic benefits be recognized as defence in the primarily economic context of Article 81(3)?

A non-economic objective can only be pursued under Article 81(3) EC if doing so translates into economic benefits that satisfy the four conditions thereof. In principle, it is not possible to use Article 81(3) as a basis for pursuing non-competition aims that cannot be subsumed under these conditions.¹⁵⁵ In, for example *Metro-Saba I* the Court did not consider employment to qualify as an objective economic benefit falling under Article 81(3). It did, however, take the stabilising effect on employment into account as it improved production. The argument was that the stabilising effect of an agreement on employment may translate into cost savings and other efficiency gains.¹⁵⁶ While it does not seem very clear from this case where the border between economic and non-economic interests, in this case social concerns are, the following case is more illuminating.

In *Ford/Volkswagen* the Commission examined the setting up of a joint venture company between Ford and Volkswagen for the development and production of a multi-purpose vehicle (MPV) in Portugal. Although the agreement between Ford and Volkswagen fell within the prohibition of Article 81(1) EC, the Commission argued that it exempted the agreement between Ford and Volkswagen. The ground of the exemption was that the cooperation made available an advanced vehicle designed to meet the requirements of European consumers, which was to be separately offered by the partners in differentiated versions throughout the Community.¹⁵⁷ The Commission

¹⁵⁴See EC Guidelines on the application of Article 81(3), op cit, n 117, point 53 The Guidelines mention cost efficiencies and efficiencies in the form of new or improved products as examples of consumer benefits. See points 59-72.

¹⁵⁵Kjolbye, op cit, n 135, pp 570-71; Van de Gronden, JW, Mortelmans, KJM, Wouters; is het beroep van advocaat een aparte tak van sport/, AA 51, 2002/ 6 p 324

¹⁵⁶Case C-26/76, [1977] ECR 1875, para 43, ‘Furthermore, the establishment of supply forecasts for a reasonable period constitutes a stabilising factor with regard to the provision of employment which, since it improves the general conditions of production, especially when market conditions are unfavourable, comes within the framework of the objectives to which reference may be had pursuant to Article 85(3)’. This analysis was restated in Case C-42/84 *Remia*, [1985] ECR 2545, para 42.

¹⁵⁷As a result of the cooperation, mainly due to the sophisticated production technology and the economies of scale, the consumer was offered two versions of a high-quality and reasonably priced MPV. The Commission further argued that Ford and Volkswagen was forced to pass on the benefits to the consumer, because as a result of their entry other manufacturers would enter into the expanding MPV segment, which would increase competitive pressure on all suppliers leading to a more balanced segment. Case IV/33.814 - *Ford/Volkswagen* paras 24, 27.

further stated, that in its decision for an individual exemption it took note of the fact that the project constituted the largest ever single foreign investment in Portugal, it was estimated to lead, inter alia, to the creation of about 5,000 jobs and indirectly create up to another 10,000 jobs, as well as attracting other investment in the supply industry. It therefore contributed to the promotion of the harmonious development of the Community and the reduction of regional disparities. It also furthered European market integration by linking Portugal more closely to the Community through one of its important industries. However, the Commission stated that these facts, 'would not be enough to make an exemption possible unless the conditions of Article 85(3) were fulfilled, but it is an element which the Commission has taken into account'.¹⁵⁸

The CFI in *Matra* affirmed that the Commission was right to conclude that the impact of a joint venture between Ford and Volkswagen for the production of a multi-purpose vehicle on public infrastructures and on employment in Portugal, and its impact on European integration was not enough to make an exemption possible.¹⁵⁹ This implied that non-economic objectives alone are not sufficient to save a restrictive agreement under Article 81(3) EC.

The time-horizon within which consumer benefits have to be realised can be the decisive element in an assessment of an otherwise anti-competitive practice. Although the Commission acknowledges that in some cases a certain period of time may be required before the efficiencies materialise, it declares that, 'the greater the time lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding the pass-on'.¹⁶⁰ In *Shaw* the CFI argued that:

from the point of view of the grant of an individual exemption, it is not material that the benefits produced by the notified agreements do not entirely compensate the price differential suffered by a particular tied lessee if the average lessee does enjoy that compensation and it is therefore such as to produce an effect on the market generally.¹⁶¹

The Commission does, however, indicate that it prefers direct and short-term benefits to long-term future benefits to consumers:

In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. A gain for consumers in the future therefore does not fully compensate for a present loss to consumers of equal nominal size. In order to allow for an appropriate comparison of a present loss to consumers with a future gain to consumers, the value of future gains must be discounted applying an appropriate discount rate.¹⁶²

¹⁵⁸ Case IV/33.814 - *Ford Volkswagen*, para 36.

¹⁵⁹ Case T-17/93 *Matra* [1994] ECR II-595, para 139.

¹⁶⁰ EC Guidelines on the application of Article 81(3), op cit, n 117, point 87.

¹⁶¹ Case T-131/99 *Michael Hamilton Shaw and Timothy John Falla v Commission* [2002] ECR II-02023, para 163.

¹⁶² Point 88 of the EC Guidelines on the application of Article 81(3), op cit, n 117.

However, point 44 of the Guidelines seems to take long-term investments also into account:

Article 81 cannot be applied without taking due account of such ex ante investment. The risk facing the parties and the sunk investment that must be committed to implement the agreement can thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, for the period of time required to recoup the investment.

Similarly, point 92 of the Guidelines seems to refer to recognising the relevance of long-term efficiencies.¹⁶³

Immediate consumer benefits is clearly closer to what a pure consumer oriented approach would prefer, however competition law enforcement has to be careful in this aspect. Focusing solely on short-term consumer benefits will have adverse effects on both competition and consumers in the future. Certain trade practices might restrict competition to a certain extent in the near future in order to produce substantial efficiency gains in the long-run. Competition law enforcement has a difficult task distinguishing such cases. The balancing of such efficiency gains and losses has been one of the issues the CFI ruled on in *GlaxoSmithKline*. The CFI found that the Commission did not carry out an adequate examination of GSK's request for an exemption. In particular, the question whether the General Sales Conditions might give rise to an economic advantage by contributing to innovation, which plays a central role in the pharmaceutical sector, was not examined with sufficient thoroughness. The Commission did not validly take into account all the factual arguments and the relevant economic evidence and did not sufficiently substantiate its conclusions.¹⁶⁴

According to the second condition¹⁶⁵ under Article 81(3) EC consumers must receive a fair share of the efficiency gains generated by the restrictive agreement. As has been mentioned above, consumers within the meaning of Article 81(3) are not only final consumers, but also the customers of the parties to the agreement and subsequent purchasers.¹⁶⁶ The Commission's concept of 'fair share' under Article 81(3) sets the

¹⁶³If the agreement has both substantial anti-competitive effects and substantial pro-competitive effects a careful analysis is required. In the application of the balancing test in such cases it must be taken into account that competition is an important long-term driver of efficiency and innovation. Undertakings that are not subject to effective competitive constraints such as for instance dominant firms have less incentive to maintain or build on the efficiencies. The more substantial the impact of the agreement on competition, the more likely it is that consumers will suffer in the long run'.

¹⁶⁴T-168/01 *GlaxoSmithKline*, paras 258-276.

¹⁶⁵The Guidelines on the application of Article 81(3) EC, op cit, n 112, state that first the types of efficiency gains that can be taken into account as objective benefits created by the agreement and the economic importance of such efficiencies have to be defined in order to be subject to the further tests of the second and third conditions of Article 81(3). Therefore it is necessary to verify what is the link between the agreement and the claimed efficiencies and what is the value of these efficiencies. Efficiency claims must therefore be substantiated so that the nature of the claimed efficiencies, the likelihood and magnitude of each claimed efficiency can be verified, and how and when each claimed efficiency would be achieved. Points 50-58 of the EC Guidelines on the application of Article 81 (3) EC

¹⁶⁶Point 84 of the EC Guidelines on the application of Article 81(3), op cit, n 117.

benchmark against which it is assessed whether a sufficient portion of the efficiencies are passed on to consumers. Fair share implies that the passing on of benefits must at least compensate consumers for any actual or likely negative impact that they will experience by the restriction of competition under Article 81(1). The Commission holds that the net effect of the agreement must at least be neutral from the point of view of consumers within each relevant market. This is once again clear evidence of the consumer welfare approach, which does not allow an agreement as a result of which consumers are worse off.¹⁶⁷

However, it is not required that consumers receive a share of each and every efficiency gain generated by the agreement and identified under the first condition. It suffices that sufficient benefits are passed on to compensate for the negative effects of the restrictive agreement in which case consumers obtain a fair share of the overall benefits. If a restrictive agreement is likely to lead to higher prices and consumers are not fully compensated through increased quality or other benefits, the second condition of Article 81(3) EC will not have been fulfilled.¹⁶⁸

The Commission acknowledges on the one hand, that it is difficult to accurately calculate the consumer pass-on rate and other types of consumer pass-on and on the other, that certain types of efficiencies are more likely to be passed on than others. Therefore the following guidelines have been provided in this respect. Efficiencies of qualitative nature, that take the form of improved goods or services are generally passed on.¹⁶⁹ In case of cost efficiencies the likelihood that these will be passed on to consumers requires a more detailed assessment of the characteristics and the structure of the market, the nature and magnitude of the efficiency gains, the elasticity of demand, and the magnitude of the restriction of competition. Reductions in variable costs are more likely to be passed on than fixed cost reductions.¹⁷⁰ These new

¹⁶⁷The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers within each relevant market. When that is the case consumers are not harmed by the agreement. Moreover, society as a whole benefits because the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources', EC Guidelines on the application of Article 81 (3), op cit, n 117, point 85.

¹⁶⁸EC Guidelines on the application of Article 81(3), op cit, n 117, point 86; see also Case C-26/76 *Metro (I)* [1977] ECR 1875, para 48: 'In the circumstances of the present case regular supplies represent a sufficient advantage to consumers for them to be considered to constitute a fair share of the benefit resulting from the improvement brought about by the restriction on competition permitted by the Commission. Even if it is doubtful whether the requirement in this connexion of Article 85(3) can be said to be satisfied by the assumption that the pressure of competition will be sufficient to induce Saba and the wholesalers to pass on to consumers a part of the benefit derived from the rationalization of the distribution network, the grant of exemption may, however, in the present case be considered as sufficiently justified by the advantage which consumers obtain from an improvement in supplies'.

¹⁶⁹Point 104 of the EC Guidelines on the application of Article 81(3), op cit, n 117.

¹⁷⁰According to economic theory undertakings maximize their profits by selling units of output until marginal revenue equals marginal cost. Marginal revenue is the change in total revenue resulting from selling an additional unit of output, and marginal cost is the change in total cost resulting from producing that additional unit of output. If marginal costs fall even undertakings with market power may have an incentive to reduce prices. Points 95-101 of the EC Guidelines on the application of Article 81(3), op cit, n 117.

guidelines reflect more economics based approach and correspond to the insights introduced above on pass-on rate.

Evaluation of the Commission's Approach

The Commission's future approach to the criteria under Article 81 EC is clear. On the one hand, under Article 81(1) effects count and not presumptions, and on the other, under Article 81(3) efficiency gains will gain more weight in the future assessment under Article 81(3). Article 81(3) is first of all to take account of efficiencies of objective economic nature. However, the question is still whether non-economic interests can also be subsumed under Article 81(3). The Commission has accepted in the past non-economic interests, especially related to environmental issues as justification for agreements distorting competition in the common market. As was mentioned above the White Paper emphasised that the integral nature of Article 81 requires economic analysis of the overall impact of agreements and it declared that the Commission would adopt a more economic approach to the application of Article 81(1) in its handling of individual cases.¹⁷¹ But even more important the Commission made clear that the purpose of Article 81(3), 'is to provide a legal framework for the economic assessment of restrictive practices and not to allow application of the competition rules to be set aside because of political considerations'.¹⁷²

The application of Article 81(3) EC to non-economic objectives can prove to be an especially dangerous exercise when national courts apply that provision. National courts are unlikely fit to assess whether the restriction of competition within the internal market can be justified by non-economic objectives of other Community policies. National authorities might justify anti-competitive practices on the basis of national policies. Therefore, as the Commission argues a pure economic approach is more appropriate in the decentralised enforcement.

The Commission wants to transform Article 81(3) EC from a discretionary norm to one of pure economic efficiency. This increased economic approach under Article 81 is understandable in the light of the fact that on 1 May 2004 this provision became directly applicable. This means that from May 2004 the NCAs as well as the national courts of all European Member States can also apply this Treaty provision. This change eliminates the Commission's discretionary powers under Article 81(3) as well as considerably reduces the possibility to take other Community objectives into account. The application of Article 81(3) is now subject to 27 national procedural laws and unlike the European Courts the national courts have full jurisdiction on the merits of Article 81(3). The possibility that national authorities will reach divergent decisions and judgments as regards Article 81(3) is very real. Therefore the Commission's efforts to provide an economic framework for and to rationalise the application of Article 81(3) in its previous decisions seems logical and necessary in order to preserve the uniformity of EC law.

¹⁷¹ White Paper, paras 49, 78.

¹⁷² White Paper, para 57.

The Implications of the Accepted Welfare Standard in Competition Law Enforcement

The consumer welfare standard in competition law enforcement implies in the first place an effects based approach, which measures the impact of corporate behaviour on consumers. Such a standard is argued to provide an objective benchmark for establishing the anti- and pro-competitive effects of the conduct by assessing its impact on consumer prices, scope of output, quality and innovation in the relevant market. In this respect competition law enforcement is an indirect way to enforce consumers' interests. The adoption of the consumer welfare standard vis-à-vis the total welfare standard places consumers' economic needs and responses to firm behaviour further into the focus of competition law enforcement. It, moreover, can counterbalance firms' information advantages, lobbying advantages, the fact they are better represented, as well as their first mover advantages in selecting the strategic moves they pursue. The consumer welfare standard seems, from both the legal and political aspect, an appropriate standard of enforcement.

How consumer interests are perceived and taken into account in the enforcement of competition law was examined previously. While it is apparent that the awareness of (final) consumer interests in the enforcement of competition law is increasing, it is obviously not capable of protecting certain final consumers' needs. Competition law has inherent limits in that respect. First, the notion of consumer under competition law is broader than under consumer law. This means that competition law might acknowledge certain situations as favourable for consumers while such situations do not benefit the final consumers; only the direct customers of the undertakings. Second, competition law is mostly concerned with the economic interests of consumers and while in a few cases it might take account of wider consumer interests it is definitely not concerned with other significant consumer interests like health and safety issues or information disclosure.

The role of competition law is above all to address economic efficiency concerns and it should consider non-economic objectives merely in exceptional cases. These issues should be the primary objectives of consumer protection laws and other sector specific regulation.

Consumer protection rules ideally should provide protection for final consumers in those areas where competition rules are ineffective. Consumer protection should address information inefficiencies like imperfect information, information asymmetries and bounded rationality. Its true focus is to provide good quality and cost of consumer information and to make free and well-informed decisions possible. Furthermore, while health and safety measures might be less efficient in terms of economic efficiency, they achieve social objectives of overriding interest.

In sum, when competition law is enforced on the basis of the consumer welfare standard, it can be reasonably assumed that consumers' economic interests in terms of price, output and quality are being seriously pursued. Acknowledging this effect should influence the point where and the category of consumer needs for which consumer

rules have to be legislated and enforced. Consumers need to be empowered to make use of the possibilities offered by effective competition law enforcement rather than being protected against the stronger producers on the marketplace. A more coordinated approach between these two fields of the law and policy making seems necessary.

INSTITUTIONAL QUESTIONS

Coordination may focus beyond the process of legislating substantive rules to another dimension of the consumer welfare standard: enforcement methods and the institutional setup. The effect of the institutional structure on consumer welfare is not yet proved. However, several agencies have positive experience with an integrated approach. Combining competition law and consumer protection matters under one administrative institution has practical benefits and produces useful synergies through taking a broader look at the whole market. It helps to achieve complementarities and to avoid potential conflicts between the enforcement of competition law and of consumer protection. Bringing a “consumer welfare” perspective to competition law enforcement can also increase public awareness and approval of the agency’s activities, with potential derivative benefits for competition enforcement.¹⁷³

There are cases where both competition law and consumer law violations are present that can give rise to a mix of competition and consumer issues and which can be more efficiently viewed and solved together. Considerations in one policy area can provide useful guidelines in the other policy area and mutually draw the attention of enforcers in one area to the concerns of the other area. Co-operation between the competition policy and consumer protection officials through effectively sharing information and collaborating can help to adjust the two policies to each other which in turn prevents thwarting each other’s goals.¹⁷⁴ The combination of functions allows the consideration of whether competition or consumer protection remedies are the most appropriate and permits consumer protection decisions to be guided by considerations of economic efficiency. Examples of the practical advantage of such a combined approach can be seen in cases of recently liberalised markets, where abuse of a dominant position and unfair trade practices often go hand in hand.

However, there are also a number of questions that should be considered before the choice is made for such a single combined agency. The experience gained in the

¹⁷³Consumer outreach by ICN Members, A report on outreach undertaken and lessons learned, April 2005, p 41.

¹⁷⁴As FTC Commissioner Muris said, ‘well-conceived competition policy and consumer protection policy take complementary paths to the destination of promoting consumer welfare. I also submit that there are benefits from combining both functions in a single public institution. Our experience at the Federal Trade Commission suggests several synergies. First, performing the consumer protection function can provide useful insights about how we should execute competition policy. In several important instances, enforcing our laws concerning advertising and marketing practices has improved our understanding of how markets operate’. Muris, TJ, ‘Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy’ (New York, N.Y., Dec. 10, 2002) (remarks for the Milton Handler Annual Antitrust Review), available at http://www.ftc.gov/speeches/muris/handler.htm#N_103_ (last visited in July 2006), p 5.

consumer protection function could provide useful information for addressing competition issues and consumer protection activities might enhance the credibility of the agency with the public and improve public understanding of the agency's antitrust mission. Competition agencies have to develop a consumer welfare standard that makes appropriate distinctions between generally 'unfair' conduct and conduct that harms the competitive process.¹⁷⁵

Conversely, enforcement authorities should be alert to avoid taking actions in either competition law or consumer protection enforcement that may have potentially adverse consequences in the other area. Further, a more integrated approach can increase public awareness of anti-competitive and anti-consumer corporate conduct and may gain support for the agency's enforcement activities with potential derivative benefits for both enforcement areas.¹⁷⁶

CONCLUSIONS

This article went behind the notion of consumer welfare in competition law by applying insights about and interpretation of the same notion in consumer law. The purpose of this exercise was twofold. On the one hand, it was to point out that the consumer welfare standard proves to be the appropriate benchmark of competition law enforcement in order to identify anti- and pro-competitive firm behaviour on an objective basis. Acknowledging the fact that the notion of consumer in competition law stands for intermediate sellers and customers of firms, unlike in consumer law the impact of trade practices on final consumers is not explicitly spelled out. While the focus of the assessment is on the actual economic effects of the conduct on consumers in terms of price, output and quality for analytical clarity as well as for the achievement of a more economic effects based approach more outspoken assessment of the effects on final consumers can be argued for.

On the other hand, the article explained the inherent limits of competition law enforcement to protect consumer interests. Competition law is primarily concerned with economic efficiency and with the overall welfare of society, without distinguishing between different groups of society. Competition policy also has other goals than improving final consumers' welfare and therefore final consumers cannot and should not become the sole focus of competition laws. Although none of its policy goals is exclusive, consumer protection in its broad meaning is not a goal of competition policy. Consumer measures concerning health, safety and information disclosure are public policy considerations that may be analysed or even recognised in competition cases but should not represent overriding concerns.

The promotion of consumers' economic interests, namely lower prices and unrestricted or even increased output nevertheless does remain one of the core values of

¹⁷⁵Consumer outreach by ICN Members, A report on outreach undertaken and lessons learned, April 2005, p 28.

¹⁷⁶Ibid, p 41.

competition policy. A more economics based competition law enforcement can contribute to a better monitoring of what exactly the effects will be or have been of a certain trade practice on final consumers. US case-law and policy decisions provide useful guidelines that may be transferred into European competition law thinking with certain limitations. One such lesson is that of *California Dental Association*, namely that an economics based approach should not result in decision making relying on theoretical assumptions. Actual and empirical evidence and ultimately the affect on consumers should be always required. The CFI seems to have acknowledged these insights and required similar hard evidence in *GlaxoSmithKline*.

Understanding more about the consumer welfare standard can be one way to understand more about the relationship between competition law and consumer law as well as between their enforcement methods and their enforcement agencies. Consumer protection and competition law seems to have developed in many legal systems along each other and not in cooperation with each other. This has lead to overlaps and gaps between the legal rules and the ways these rules are enforced. Both the complements and the tensions have to be addressed between the two areas. Synergies should be more extensively discussed and taken into consideration when policy decisions are made. Outlining neglected tensions between the two areas enhances conceptual clarity as well as the protection of both competitive markets and individual consumers. When policy claims are made about the benefits of competition law enforcement for consumers hard cases and solid evidence should support these claims. At the moment, at least in EC competition law, there are little of both.

These two areas of the law share a common goal that is to provide consumers with access to a range of competitively priced goods and services in markets free of unfair and deceptive practices. It is commonplace that a competitive market structure needs active consumers and vice versa. Yet, this fact seems to be more often forgotten than realised.