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**Increasing the requirements to show antitrust harm in modernised effects-based analysis: an assessment of the impact on the efficiency of enforcement of Art 81 EC**

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# Background, Method, and Scope

## 2.1 Introduction

This chapter provides essential background information on Art 81 EC and the method that is adopted in this thesis to study the performance of the effects-based standard. The discussion is used, also, to indicate what portions of the law on Art 81 EC are and are not addressed in this work. The chapter begins, in Section 2.2, by providing a first introduction to European competition policy, its role in achieving the general objectives of the EC Treaty, and several important elements in the text of Art 81 EC. Next, in Section 2.3, we zoom in on the law and literature concerning Art 81(1) EC (the European *rule of reason* debate). The economic objectives of EC antitrust and the basic economic insights that, after modernisation, guide the analysis of restraints under Art 81 EC are addressed in Section 2.4. The chapter concludes, in Section 2.5, with an exposition of the approach adopted in this thesis to study the functioning of the legal standard employed in Art 81(1) EC.

## 2.2 A first introduction to Community competition policy

European competition policy cannot properly be appreciated if seen in isolation from the general objectives of the European Community. For this reason, the present section starts by briefly placing competition policy in the broader context of the Treaty and of the conditions that prevailed in Europe at the time it was adopted (Section 2.2.1). With a view to the comparison made in Chapter 4 of EU and US antitrust laws, particular attention is paid to the role of US thinking in the conception

of European antitrust policies. Next, we consider the text of Art 81 EC and zoom in on its most important elements (Section 2.2.2). The section concludes with a brief discussion of instances where policy concerns that are not primarily related to the objectives of antitrust play a role in justifying anti-competitive behaviour (Section 2.2.3).

### 2.2.1 Competition policy and general community objectives

The creation of European Community and the introduction of a European competition policy should be seen against the background of the situation of severe economic and political disarray in which Western Europe found itself in the immediate aftermath of the Second World War.<sup>1</sup> There had been massive destruction of lives and goods. There were severe shortages of basic goods and raw materials. Houses, production capacity, and infrastructure had been destroyed. In the financing of their reconstruction efforts, liberated nations, like occupied Germany, were considerably dependent on the Marshall Plan set up by the US.<sup>2</sup> This dependency increased as tensions with the East grew, following the communist take-over in Czechoslovakia (1948), the blockade of Berlin (1948-1949), the Soviet Union's development of an atomic bomb (1949), and Mao's victory in China (1949).<sup>3</sup> It was in an effort to regain control over their destiny – to reduce dependency on the US and to protect themselves against the threat emanating from the East – that political leaders started a number of pan European initiatives.<sup>4</sup> Thus, the first decade after the war was characterised by a drive towards close political and military cooperation in the form of a European Political Community (EPC) and a European Defence Community (EDC).<sup>5</sup>

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<sup>1</sup> See e.g. Judt (2007), Calvocoressi (1997), and Eichengreen (1995) for an impression of the conditions that prevailed.

<sup>2</sup> On the Marshall Plan see e.g. Killick (1997), Ellwood (1992), Hogan (1987), or Wexler (1983). See also Gerber (1998: 168), who states that '[i]n this cauldron of uncertainty and shifting political currents, the political role of the United States was often as important as its economic aid and not dissociable from it. The war had put the United States in a commanding political and economic position. Like it or not, European governments depended on US economic and military aid for several years, and thus European politicians had to take US reactions into account in a wide range of domestic decisions.

<sup>3</sup> See e.g. Judt (2007).

<sup>4</sup> Id. See also Bermann et al. (1993: 2). Other initiatives worth mentioning that were started in this period are the creation of the Benelux Customs Convention (1948), the OEEC (1948, which was renamed the OECD in 1960), the Treaty of Economic Social and Cultural Cooperation and Collective Self-Defence (1948, signed by France the UK and the Benelux countries), the Council of Europe (1949), and the NATO (1949).

<sup>5</sup> See e.g. Urwin (1995), Gerber (1998: 335, 342) and Bermann et al. (1993: 6).

### *The European Coal and Steel Community*

An urgent matter that had to be addressed before an accord could be expected on these overarching structures concerned the production of coal and steel. All agreed that these sectors were vital for European economic recovery. But at the same time there were serious concerns and conflicting views about the structuring of these industries that had been dominated by Germany before the war. Whilst France sought guarantees against a revival of this industrial supremacy and the military power that it had supported, the US and the UK saw a rearmed Germany as an effective bulwark against Soviet expansionism.<sup>6</sup> The solution found was to subject the production of these materials to a purposely created supra national legal regime, the European Coal and Steel Community (ECSC), established in 1951.<sup>7</sup> It is worth considering the ECSC in some more detail, since its competition provisions were to have a considerable effect on the provisions in the EC Treaty that are the focus of attention in this thesis.<sup>8</sup>

Evidently, rules on competition that would put limits on the behaviour particularly of German producers were essential to secure the objectives of the ECSC. These rules were provided in Art 65 ECSC, containing a prohibition of agreements that restrict competition, and Art 66 ECSC, concerning merger control and the abuse of economic power. It is important to note that the prohibition of restrictive agreements in Art 65 ECSC was without precedent in European law at that time. To be sure, since the end of the nineteenth century, several European countries had acquired experience with laws regulating competition. As a rule, however, these laws did not oppose cooperation between competitors, but sought to prevent that cooperation would be used as an instrument of abuse.<sup>9</sup>

There is some controversy as to why Germany, whose industry was likely to be most affected by Art 65 ECSC, agreed to this new approach. To a certain extent, this may have been the result of US influence. The US Sherman Act of 1892, the principle US antitrust statute, relies on a prohibition system similar to that instituted by the

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<sup>6</sup> See Judt (2007) and Calvocoressi (1997).

<sup>7</sup> The following countries were the original signatories to the ECSC Treaty signed in Paris on April 18<sup>th</sup> of 1951: France, Germany, Italy, The Netherlands, Belgium, and Luxembourg.

<sup>8</sup> The ECSC Treaty eventually expired on the 23<sup>rd</sup> of July of 2003, which means that the coal and steel sectors are no longer governed by a special regime and are subject to Artt 81 and 82 EC. The Commission has published a Communication regarding some of the consequences of this transition ([2002] OJ C152/5).

<sup>9</sup> See Gerber (1998) for a detailed discussion of the development of competition ideas and competition laws in pre-war Europe. It is true that in Nazi Germany cartelisation had been actively encouraged and made obligatory in certain sectors of industry (id, at 147). The same applies to Fascist Italy (in this regard, see Amato, 1997: 40). Gerber's investigation clearly shows these to be exceptions, however.

ECSC (and later by the EC Treaty). As suggested, in this period the US wielded considerable influence in Europe, as one of the occupying powers in Germany and through the Marshall Plan elsewhere. This influence is often taken to have extended over the process of drafting the various Community treaties.<sup>10</sup> A telling example is the fact that a US antitrust professor was actively involved in the process of drafting the ECSC competition provisions.<sup>11</sup> But there are indications, also, that German thinking about the regulation of competition itself had changed.<sup>12</sup> That is, that reflection upon a decade and a half of Nazi industrial policies had made German policymakers susceptible to the idea that stronger safeguards were necessary to protect the competitive process.

### *The EC Treaty and Community competition policy*

Although the ECSC, with its elaborate supra national institutional structure,<sup>13</sup> was intended as a first step towards European political and military unity, the EPC and the EDC never came of the ground.<sup>14</sup> Without participation by the UK, the French feared that these communities would become to be dominated by Germany and eventually withdrew support.<sup>15</sup> With these avenues closed off, proponents of integration shifted their attention towards the economic sphere. Nonetheless, the plan to create a European Common Market, laid down in the so-called ‘Spaak Report’ of 1956,<sup>16</sup>

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<sup>10</sup> See e.g. Wils (2002: 122), who refers *inter alia* to the *Mémoires* of Jean Monnet, the French politician who was one of the principle propagators of the European idea; O’Donoghue and Padilla (2006: 10); and Gerber (1998: 337, 340).

<sup>11</sup> See Gerber (1998: 340). A further indication for such influence is the fact that the US occupation authorities had agreed to relinquish their regulatory competence over the German iron and steel industry in the event the ECSC became a reality. The office of the US high Commissioner for Germany, where Robert Bowie, the antitrust law professor in question had been working, oversaw the preparations of this regulatory transition. See Gerber (1998: 338).

<sup>12</sup> Gerber (1998: 340) and O’Donoghue and Padilla (2006: 9).

<sup>13</sup> In its original form, the ECSC provided for a High Authority (an administrative body that could take binding decisions without prior Member State authorisation), a Special Council of Ministers (representing the participating governments and responsible for advising the High Authority and preparing and enacting legislation), a Court of Justice, (that could be called to evaluate the implementation of the treaty and secondary legislation, as well as decisions of the High Authority), and a Common Assembly (composed of members of the national parliaments and empowered to dismiss the High Authority). Initially, the ECSC and the European Economic Community had separate institutional structures, apart from the shared Court of Justice. On the 1<sup>st</sup> of July of 1967 a shared Council and Commission (the latter replacing the High Authority) were instituted.

<sup>14</sup> See Urwin (1995), and Bermann et al. (1993: 6).

<sup>15</sup> *Id.*

<sup>16</sup> See Urwin (1995), Bermann et al. (1993: 6), and Gerber (1998: 342). Early in 1955 the Benelux countries prepared a memorandum that called for the creation of a common market. At a meeting in Messina (Italy) in June of that same year, this plan was endorsed by the foreign ministers of France, Italy, and Germany and Paul-Henri Spaak of Belgium was asked to coordinate a series of conferences to develop a design and strategy for European integration. The results were laid down in the Spaak

which provided the blueprint for the EC Treaty adopted the next year,<sup>17</sup> had clear political overtones.<sup>18</sup>

The main idea was that close economic cooperation might eventually create sufficient common interest to create the conditions necessary to reach political unity. In any case, it would bind the countries of Western Europe together in a way that would once and for all remove their interests to wage war upon one and other.<sup>19</sup> Of course, it was also expected that economic integration would increase prosperity.<sup>20</sup> It must be realised that at the time the Western European market was highly segmented. Quota and tariff barriers were in place that effectively consigned firms to their home market and, thus, seriously limited their growth potential. Removal of these obstacles would benefit European consumers, since exposure to foreign competition would stimulate firms to increase and improve production.<sup>21</sup> Thus, the drafters of the EC Treaty sought to create the basic conditions for free competition on the Common Market by commanding the Member States to ensure that goods, services, labour and capital can move freely across national borders.<sup>22</sup>

Yet, competition carries within it the seeds of its own destruction. The benefits of integration would not be obtained if firms were left completely free to behave as they want on this newly created market; if, for instance, they would be able to replace the abolished tariffs and quota with private barriers to trade by forming cartels that would segment the Common Market along the lines of national borders, or if economically powerful firms were allowed to manipulate trade flows or to abuse their strength by limiting the commercial freedom of smaller firms. The provision made in Art 3(g) EC for the institution of a system ensuring that competition in the Common Market is not distorted appears to have been primarily motivated by these concerns.<sup>23</sup> This mixture

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report of 1956. Subsequently, an intergovernmental conference chaired by Spaak produced a draft text for a treaty.

<sup>17</sup> The Treaty establishing the European Economic Community (EEC) Treaty was signed in Rome on the 25<sup>th</sup> of March of 1957 by the same six nations mentioned in footnote 7. The EEC was renamed the European Community (EC) by the Treaty on European Union (EU), signed in Maastricht on the 7<sup>th</sup> of February of 1992. This reflects the extension of European cooperation to politically oriented terrains (justice and foreign policy) to which the Member States agreed in the EU Treaty.

<sup>18</sup> See Gerber (1998: 343).

<sup>19</sup> Id.

<sup>20</sup> Id.

<sup>21</sup> It was expected, also, that this would allow European firms to acquire sufficient size to compete effectively on world markets, notably against US firms. In this regard, see Gerber (1998: 348).

<sup>22</sup> In this sense, see Bermann (1993: 628).

<sup>23</sup> See Gerber (1998: 343).

of generic and integration-related objectives is one of the key distinguishing characteristics of European competition policy.<sup>24</sup>

The system to protect competition put in place by the EC Treaty consists of several components. First come two provisions directed at private undertakings, which form the core of European competition policy. Art 81 EC (then Art 85) prohibits firms from concluding anti-competitive agreements and Art 82 EC (then Art 86) prohibits dominant undertakings from abusing their market power. Next, Art 86 EC (then Art 90) subjects public undertakings and undertakings to which member states grant special or exclusive rights to the rules on competition, in as much as the application of those rules does not obstruct the performance of public tasks assigned to them. Finally, Artt 87 – 89 EC (then Artt 92 – 94) are directed at the Member States, since competition may also be distorted when governments grant certain firms subsidies that give them an advantage over other firms. The provisions directed at private undertakings form the core of European competition policy and are the focus of attention in this thesis. The following sections zoom in on Art 81 EC, discussing its text, its application in practice over the past 50 years, and related reforms of substantive and procedural law. Art 82 EC is discussed more briefly at the end of this chapter.

### 2.2.2 Art 81 EC, its components, and the scope of this work

Art 81 EC follows the basic structure of Art 65 ECSC. It starts with a broadly stated prohibition in its first limb.<sup>25</sup> Art 81(2) EC determines that all agreements that fall foul of the first paragraph are automatically void.<sup>26</sup> Art 81(3) EC provides for an exception to the prohibition.<sup>27</sup> The full text of the article reads as follows:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which

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<sup>24</sup> In this regard, see Hildebrand (2002: 12), Whish (2003: 20), Amato (1997: 40), Bermann et al. (1998: 630), Gerber (1998: 347) and the contributions by Ehlermann and Hawk in Ehlermann and Atanasiu (1998). A more detailed discussion of the generic antitrust objectives underlying EC competition policy follows in Section 2.4.

<sup>25</sup> As compared to Art 65(1) ECSC, however, it is more detailed, providing a number of specific examples of the type of agreements that are prohibited. According to Gerber (1998: 344) this greater level of precision is the result of German influence on the drafting process of the EC Treaty.

<sup>26</sup> The counterpart of this provision in the ECSC Treaty is Art 65(4).

<sup>27</sup> A similar exception was provided by Art 65(2) ECSC.

have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

- a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- b) limit or control production, markets, technical development, or investment;
- c) share markets or sources of supply;
- d) apply dissimilar conditions to equivalent transactions with other trading partners, thereby placing them at a competitive disadvantage;
- e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

It follows that the application of Art 81 EC depends on the assessment of a whole range of issues. For the prohibition of Art 81(1) EC to apply (1) the entities concerned must be considered to be undertakings, (2) they must have concluded or behave according to some form of agreement, (3) which may have an impact on trade between Member States and (4) which affects competition. Moreover, it follows from the case law of the European Courts that (5) the restriction of competition must be appreciable if it is to be caught and that, even if all the conditions stated above are satisfied, a restriction may still fall outside the scope of Art 81(1) EC if (6) it is deemed necessary to bring about a legitimate commercial operation to which it is ancillary or (7) to achieve some regulatory objective of a public nature. This thesis



deals with only one aspect in this complex assessment; the question whether there is a prevention, restriction or distortion of competition. For the sake of completeness, the remaining aspects of Art 81(1) EC are briefly introduced.

*The elements of the assessment under Art 81(1) EC that are not addressed*

Art 81 EC (like Art 82) is addressed to undertakings. Neither the EC Treaty nor the case law of the European Courts offers a clear definition of the term undertaking.<sup>28</sup> The European Court of Justice (ECJ) tends to adopt a functionalist approach to the matter, looking at whether the entity concerned engages in *economic activity* and not at its formal status under national law.<sup>29</sup> Problems of interpretation arise mainly where organisations with a public character display market-like behaviour or, conversely, where private entities carry out tasks that appear to be of a public nature.<sup>30</sup> As a general matter it can be said the provision applies to all *entities*, mostly referred to as firms in this thesis,<sup>31</sup> that offer or purchase goods or services.<sup>32</sup> If, however, the activity is best characterised as the exercise of public authority or if its sole purpose is social in nature, the entity in question is not an undertaking and the competition provisions in the Treaty do not apply.<sup>33</sup>

Where Art 82 EC deals with unilateral behaviour, there must be some form of an agreement between two or more undertakings for Art 81 EC to apply. In this regard, the terms agreement, decisions by associations of undertakings, and concerted

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<sup>28</sup> See e.g. Wesseling (2005: 65) who states that the ‘application of the concept ‘undertaking’ in the sense of Articles 81 and 82 EC is unclear and in a state of development’.

<sup>29</sup> See notably *Höfner v. Macrotron* (Case C-41/90, [1991] ECR I-1979, at para 21): ‘the concept of an undertaking encompasses every entity engaged in an economic activity regardless of the legal status of the entity and the way in which it is financed.’ Individuals may constitute an undertaking in the sense of Art 81 EC (see e.g. *Remia v. Commission*, Case 42/84, [1987] ECR 2545). The fact that an organisation lacks a profit-motive does not disqualify it as an undertaking (see e.g. *Van Landwyk v. Commission*, Cases 209/78, [1980] ECR 3125, at para. 88), nor that it does not have an economic purpose (see e.g. *Italy v. Sacchi*, Case 155/73, [1974] ECR 409, at paras. 13-14).

<sup>30</sup> For a detailed discussion, see e.g. Wesseling (2005: 62) and Whish (2003: 82).

<sup>31</sup> In those parts of this work where an economic analysis of antitrust enforcement is offered, the terms ‘potential offender’ and ‘defendant’ are also frequently used. This is done to distinguish between firms that consider signing and implementing an agreement with possible antitrust implications and that are not yet involved in formal antitrust proceedings, from firms whose agreement has been challenged.

<sup>32</sup> In this sense, see Wesseling (2005: 62).

<sup>33</sup> See *Wouters v. Algemene Raad van de Nederlandse Orde van Advocaten*, Case C-309/99, [2002] ECR I-1577, at para 57, where the ECJ stated that the competition rules in the EC Treaty ‘do not apply to activity which, by its nature, its aim and rules to which it is subject does not belong to the sphere of economic activity [...] or which is connected with the exercise of the powers of a public authority [...]’. See also Wesseling (2005: 65) and the discussion below in Section 2.2.3 regarding the introduction of the *rule of reason* developed in free movement law into EC antitrust.

practices are used. All have been interpreted expansively by the Community Courts.<sup>34</sup> An agreement may be oral,<sup>35</sup> and it does not have to be adopted in a form that renders it legally enforceable.<sup>36</sup> Circulars sent by a manufacturer to its distributors may be treated as part of the general agreement that exists between them.<sup>37</sup> The constitution of a trade association may be seen either as an agreement or as a decision.<sup>38</sup> A recommendation made by such an organisation may qualify as a decision.<sup>39</sup> Concerted practices, in turn, are forms of cooperation (substituting competition) based on an understanding between firms that need not have been expressed in words and may be brought about by indirect contact.<sup>40</sup> Arguably, of the three, this is the most problematic category. This is because such subtly coordinated conduct may be very difficult to distinguish from independent behaviour that firms may display in an oligopoly setting.<sup>41</sup> For obvious reasons, cartel members will take great care to destroy or at least conceal all evidence that might directly point to their cooperation, such as meetings entered in an agenda, or correspondence. This may force the Commission to rely substantially on indirect evidence, for instance, of parallel behaviour on the market. It may be, however, that such behaviour is the result of each firms' individual and rational analysis of market conditions.<sup>42</sup>

The requirement that the agreement may affect trade between Member States is of a jurisdictional nature. It serves to mark the boundary between the areas respectively covered by Community law and the law of the Member States.<sup>43</sup> Historically the Courts and the Commission have construed this notion very broadly, thus expanding the scope of Community competition policy.<sup>44</sup> The case law holds that it must be

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<sup>34</sup> See e.g. Whish (2003: 91) for a detailed discussion.

<sup>35</sup> See e.g. *Tepea v. Commission*, Case 28/77, [1978] ECR 1391.

<sup>36</sup> See e.g. *ACF Chemiefarma v. Commission*, Case 41/69, [1970] ECR 661.

<sup>37</sup> See e.g. the Commission's decision in the case of *Volkswagen*, [2001] OJ L262/14.

<sup>38</sup> See *Nuovo CEGAM*, [1984] L99/29; and *ASPA*, [1970] OJ L148/9.

<sup>39</sup> See e.g. *Vereeniging van Cementhandelaren v. Commission*, Case 8/72, [1972] ECR 977.

<sup>40</sup> See *ICI v. Commission*, Cases 48/69 etc., [1972] ECR 619, at para. 64, where the ECJ stated that a concerted practice is 'a form of coordination between undertakings which, without having reached the stage where an agreement properly so-called has been concluded, knowingly substitutes practical cooperation between them for the risks of competition'.

<sup>41</sup> See e.g. Whish (2003: 99).

<sup>42</sup> It follows that this is an issue that concerns the detection and prosecution of hard-core cartels. This type of behaviour, intentionally aligning prices or volume output, is not at issue in this thesis. As is explained directly below (see the text following footnote 52), we are concerned with forms of agreement that are more ambiguous in their effects and which, at least in theory, offer the potential for efficiencies.

<sup>43</sup> See *Hugin Kassaregister v. Commission*, Case 22/78, [1979] ECR 1869, at p. 1899.

<sup>44</sup> See Faull (1990), Wesseling (1997), and Gerber (1998: 353) who comments that 'The Court consistently expanded this concept of 'effect on trade', and it relied on integrationist goals in justifying

possible to foresee with a sufficient degree of probability that the agreement may have a direct or indirect influence on inter-state trade patterns.<sup>45</sup> This requirement is satisfied even if the agreement clearly leads to an increase in trade volumes,<sup>46</sup> which underscores that we are dealing with a technical issue here. The anti-competitive implications of an agreement are assessed under the heading discussed next: the restriction on competition.

#### *The object or effect to restrict competition*

The crucial substantive issue in Art 81(1) EC is the question whether an agreement amounts to a restriction on competition. In this regard, the provision distinguishes between agreements that have the ‘object’ or ‘effect’ to restrict competition. A good understanding of this distinction is important to be able to gauge the scope of this work, since we will be dealing exclusively with agreements that fall in the latter category.

The distinction turns on the degree to which it is obvious that the type of agreement at issue is incompatible with the integration imperative or with the more generic competition objectives of European law. Its inclusion in Art 81 EC reflects the fact that not every agreement that affects competition in the Common Market is necessarily to be avoided. That is, not every restriction of the competitive process, in the literal sense of the word, is a restriction of competition in the sense of the Treaty. The less obvious it is that an agreement is harmful, the more detail is required in its assessment. Two ECJ rulings adopted in the summer of 1966 are of relevance here. In the case of *Consten and Grundig* the Court indicated that if it is evident by looking at the agreement itself (its form or clauses) that its ‘object’ is to limit free competition in a way that frustrates the integration of the economies of Member States, there is no need to take account of the actual market impact of the agreement in order to bring it under the ban of Art 81(1) EC.<sup>47</sup> In its preliminary ruling in the case of *Société*

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this expansion. [...] The effect was to increase the jurisdictional prerogatives of the Commission and to reduce those of the Member States.’ Wilks and McGowan (1996: 238) make the same argument. Whish (2003: 137), however, interprets the ECJ’s ruling in the case of *Bagnasco v. BNP* (Case 215/96, [1999] ECR I-135, at paras. 50-53) and a recent Commission decision as signs of contraction. He notes that now that most Member States have actively enforced domestic competition laws modelled upon Art 81 and 82 EC there is less need for the Community institutions to assert jurisdiction on such a broad basis (and less scope, also, given the principle of subsidiarity (Art 5 EC).

<sup>45</sup> See *Société Technique Minière v. Maschinenbau Ulm*, Case 56/65, [1966] ECR 235, at p. 249.

<sup>46</sup> See *Consten and Grundig v. Commission*, Case 56 and 58/64, [1966] ECR 299, at p. 341.

<sup>47</sup> *Id.*

*Technique Minière* the Court elaborated on the type of assessment required if the agreement at issue is not evidently harmful in this sense.<sup>48</sup> The relevant indicators that are mentioned in this decision suggest that the investigation of the ‘effects’ of the agreement depend more on a broad economic appraisal of its impact on competition than on the analysis of its legal form.<sup>49</sup> The facts of the former case can serve to illustrate the reasons behind this differentiation.

Grundig, a German producer of consumer electronics, had appointed Consten to be its sole distributor in France. As part of this agreement Grundig promised to keep its other resellers from exporting to Consten’s territory. To further protect its territory, Consten registered a trademark (GINT) under French law. In 1961, when French trade barriers were lowered, the French firm UNEF started buying GINT products from German wholesalers and selling them in France. Consten and Grundig brought a case against UNEF before a French court for trademark infringement. UNEF, in turn, requested the Commission to declare the agreement between Consten and Grundig to be in breach of Art 81 EC, which it did.

Before the ECJ, Consten and Grundig argued that their agreement had to be subjected to a wide-angled investigation of the economic effects of the agreement, which would show that it in fact served to invigorate competition with other producers of the same kind of product in France. The ECJ brushed this argument aside. It was sufficient for the Commission to show that the agreement was intended to prevent other resellers from importing Grundig products in France and, thus, acted as an impediment to the integration of the economies of these two Member States. The same method of analysis, focused almost exclusively on the agreement itself, has been

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<sup>48</sup> *Supra*, footnote, 45.

<sup>49</sup> *Id.*, at p. 249, the Court stated that where an analysis of the clauses of the agreement ‘does not reveal the effect on competition to be sufficiently deleterious, the consequences of the agreement should then be considered and for it to be caught by the prohibition it is [...] necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent.’ On the next page it added the following: ‘The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute. [...] Therefore, in order to decide whether an agreement granting an exclusive right of sale is to be considered prohibited [...] it is appropriate to take into account in particular the nature and quantity, limited or otherwise, of the products covered by the agreement, the position and importance of the grantor and the concessionnaire on the market for the products concerned, the isolated nature of the disputed agreement or, alternatively, its position in a series of agreements, the severity of the clauses intended to protect the exclusive dealership or, alternatively, the opportunities allowed for other commercial competitors in the same products by way of parallel re-exportation and importation.’

used to assess other categories of agreements that are evidently harmful to European consumers, such as price fixing and market sharing.<sup>50</sup>

But let us now consider the implications of exclusive dealing in the event that the restriction does not directly touch on cross border trade. A manufacturer could, for example, award an exclusive territory in a portion of the member state from where it operates<sup>51</sup> and allow somewhat more scope for the independent actions of other resellers.<sup>52</sup> In that case, it is decidedly less obvious that the agreement should be caught. An exclusivity clause of this kind does limit the commercial freedom of the supplier and, in that sense, it is restrictive of the competitive process. Yet, at the same time, such restrictions on competition between resellers of the same brand of products (intra-brand competition) may have a beneficial invigorating effect on competition with other brands (inter-brand competition). This is because they can play a crucial role in securing the distributor's willingness to invest in advertisement and in improving the quality of the product by offering a high level of pre- and after-sales services. Without protection against discounters the distributor risks losing money on such efforts.<sup>53</sup> Whether, indeed, the effects on inter-brand competition materialise and outweigh the effect on intra-brand competition depends on whether the supplier faces sufficient competition by other producers of the same or similar goods. Evidently, this question is not answered by examining only the terms or the nature of the agreement. A broader investigation is required that includes the market context in which the restraint operates. This is what is generally referred to in European antitrust as effects-based analysis (as opposed to object-based analysis).

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<sup>50</sup> See e.g. *ACF Chemiefarma* (supra, footnote 36); *Cementhandelaren* (supra, footnote 39); *Suiker Unie v. Commission*, Cases 40/73 etc., [1975] ECR 1663; and *Polypropylene*, Cases C-51/92 etc, [1999] ECR I-4235.

<sup>51</sup> The requirement that the agreement – as opposed to the restriction – must affect interstate traffic (see the text accompanying footnote 43) might then be satisfied if this producer competes on its home market with a manufacturer shipping from another Member State.

<sup>52</sup> In *Consten and Grundig* (supra, footnote 46) Grundig undertook to supply only Consten on the French market and to prevent similar national distributors in other Member States from shipping goods to France. Consten, in turn, agreed not to re-export any GINT products to other Member States where Grundig had installed a distributor. Such a sequence of obligations tightly seals the distribution network along national lines and prevents any parallel trading in the product at issue that might contribute to driving its price down. A less restrictive alternative that would allow for some arbitration would have been for Grundig to undertake the obligation not to sell to anyone else to resell its product in France.

<sup>53</sup> This was, in fact, exactly the argument that Consten and Grundig (supra, footnote 46) presented in support of their agreement.

*The investigation of restrictions, countervailing benefits and ancillary restraints*

European antitrust relies on a series of tests to determine whether an agreement that restricts the competitive process – but which does not pose an unmistakable threat to free competition on the Common Market – may escape the ban of Art 81(1) EC. Two of these are predominantly economic in nature and form the core of effects-based analysis. First there is the question whether the restrictions on competition contained in the agreement somehow create the risk or contribute to the risk that one (or more) of the contracting parties becomes insufficiently constrained by the forces of competition. This investigation is carried out under the scope of Art 81(1) EC. Art 81(3) EC provides an additional way out to agreements that are found restrictive in this sense. If the agreement offers material economic benefits to European consumers that outweigh the negative effects of the restriction – if, in terms of our example, the positive effects on inter-brand competition of the improvements in quality are deemed more important than the effect of the exclusivity on intra-brand competition – the agreement will be cleared. Much of the investigation in this thesis will centre on the proper boundary line between these two economic tests, to which Sections 2.3 and 2.4 will provide an introduction.

A third test is of a predominantly legal nature. It involves the question whether the challenged restriction is directly related, indispensable, and proportionate to the implementation of a larger operation that pursues legitimate objectives.<sup>54</sup> If so, the restriction, like the general agreement, is not caught by Art 81(1) EC. This so-called ancillary restraints doctrine applies exclusively to restrictions that are needed to bring about the general agreement of which they are part, which inevitably implies a relatively abstract investigation. The CFI has expressly indicated that it does not provide scope for clearing restrictions that, in view of the competitive situation in the relative market, can be said to be necessary for the commercial success of such an operation.<sup>55</sup> Given our focus on the examination of restrictions on the basis of economic insights, this doctrine will not feature prominently in this work.<sup>56</sup> The same applies to instances where policy concerns unrelated to the objectives of antitrust play

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<sup>54</sup> See in particular the CFI's ruling in the case of *Métropole Télévision v. Commission*, Case T-112/99, [2001] ECR II-2449, at para. 104 a.f.

<sup>55</sup> *Id.*, at para. 109.

<sup>56</sup> A number of important earlier rulings concerning ancillary restraints will be discussed in Section 2.3. This is because before *Métropole* (supra, footnote 54) there was not necessarily a clear distinction between a legal test applied to ancillary restraints and a more economic test applied under Art 81(1) EC to restrictions that did not qualify as such.

a role in justifying anti-competitive behaviour. Here, too, economic insights do not take centre stage in the assessment. The following discussion of these matters is therefore no more than a brief and incomplete introduction.

### 2.2.3 Art 81 EC and non-competition related objectives

Other Community objectives than those directly concerned with competition policy have been used as a point of reference in the analysis under Art 81(3) EC with some frequency.<sup>57</sup> This includes objectives relating to industrial policies,<sup>58</sup> employment policies,<sup>59</sup> and environmental policies.<sup>60</sup> As a general matter, however, it can be said that in the context of this provision such concerns will not override the objectives of competition policy but run in parallel with them.<sup>61</sup> Yet, recent case law shows that restrictive agreements between undertakings that are reasonably necessary to achieve such objectives may fall outside scope of Art 81(1) EC. There is a basic resemblance between this case law and what is known as the doctrine of inherent restrictions. As will be explained in more detail in Section 2.3, this doctrine holds that restrictions of competition that are objectively necessary to come to an otherwise acceptable or even pro-competitive agreement are not caught by Art 81(1) EC.<sup>62</sup> Traditionally, this type of reasoning was applied to restrictions necessary in relation to some form of commercial transaction.

A first example of the application of the inherent restrictions doctrine to agreements by which objectives of a regulatory or public policy nature are pursued is provided by the case of *Drijvende Bokken*.<sup>63</sup> This case involved a collective agreement by workers and employers to set up a pension fund. The Court interpreted this to be an agreement between undertakings capable of restricting competition. It

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<sup>57</sup> In this respect, it should be noted that a number of provisions in the Treaty (such as Artt 6, 153(2), and 157(3)) require that specific objectives are taken into consideration in the formulation and implementation of Community policies and initiatives in other fields.

<sup>58</sup> See e.g. the Commission's decisions in *BPLC/ICI*, [1984] OJ L212/1, at para. 37, and *Bayer/BPLC*, [1988] OJ L150/35, at para. 27.

<sup>59</sup> See e.g. *Metro SB-Grossmärkte v. Commission*, Case 26/76, [1977] ECR 1875, and *Remia* (supra, footnote 29) at para.42.

<sup>60</sup> See e.g. the Commission's decision in *CEDED*, [2000] OJ L187/47, at paras. 30-37.

<sup>61</sup> See *Matra Hachette*, Case T-17/93, [1994] ECR II-595, at para 139, *Metro* (supra, footnote 59) at para. 43, and the Commission's Notice on the application of Art 81(3) EC, [2004] OJ C101/97, at para. 42. For a detailed discussion, see Monti (2002: 1069).

<sup>62</sup> Important cases in this regard are *Gøttrup-Klim v. Dansk Landbrugs Grovvarereselskab*, Case-250/92, [1994] ECR I-5641, and *Oude Luttikhuis v. Coberco*, Case C-339/93, [1995] ECR I-4515.

<sup>63</sup> Case C-219/97, [1999] ECR I-6121. For a more detailed discussion see Wesseling (2005: 68). Other relevant cases are *Albany Investments v. Bedrijfspensioenfondsen*, Case C-67/96, [1999] ECR I-5751, and *Brentjens*, Cases 115-117/97, [1999] ECR I-6025.

also noted, however, that in a case as this account had to be taken of other the objectives of Community law and, in particular, those relating to social policies and employment. These would be seriously undermined if the outcome of collective negotiations were subject to Art 81(1) EC. Such agreements were therefore held to fall outside the scope of this provision. The ECJ's went considerably further in its *Wouters* ruling, when it gave overriding importance to national rather than Community policy objectives.<sup>64</sup>

This case involved a rule promulgated by the national bar association of the Netherlands, which was vested by a national law with the authority to regulate the legal profession. The rule in question prohibited lawyers from entering into partnerships with accountants and was aimed at protecting the quality of legal services rendered to consumers by preserving the independence and professional secrecy of legal service providers. It was feared that these important principles might be compromised if lawyers belonged to an organisation which is also responsible for producing an account of the financial results of the transactions in respect of which their services were called upon. Mr Wouters, who wished to practise as a lawyer in a firm of accountants, challenged the validity of this rule before a national court. The national court of appeals requested the ECJ to give a preliminary ruling on a number of questions relating to the compatibility of the regulation with European antitrust law. In its analysis of these questions the ECJ relied to a considerable extent on notions developed in the law on free movement, which will have to be introduced here.<sup>65</sup>

Art 28 EC prohibits all quantitative restrictions of trade in goods between Member States, and measures having equivalent effect. The concept of 'measures having equivalent effect' has been construed broadly by the ECJ. It includes both measures that explicitly distinguish between foreign and national goods<sup>66</sup> and measures that apply indistinctly.<sup>67</sup> Indistinctly applied measures are, for example, regulations on food safety standards. These do not explicitly distinguish between foreign and

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<sup>64</sup> *Supra*, footnote 33. For more detailed discussions on this ruling and the convergence between competition rules and free movement rules, see Monti (2002), O'Loughlin (2003), Wesseling (2005), Van de Gronden (2005), and Whish (2003: 120).

<sup>65</sup> For a detailed discussion, see e.g. Bermann et al. (1998).

<sup>66</sup> *Procureur du Roi v. Dassonville*, Case 8/71, [1974] ECR 837.

<sup>67</sup> *Rewe-Zentral v. Bundesmonopolverwaltung für Branntwein*, Case 120/78, [1979] ECR 649.



national goods, but could have this effect.<sup>68</sup> Art 28 EC therefore catches all rules enacted by member states which may hinder intra-community trade.<sup>69</sup> Art 30 EC provides an exception to this rule, listing a number of public policy objectives that can justify such restrictions. Amongst these are public morality, public security, and the protection of health and life of humans. The exception provided by Art 30 is interpreted narrowly in the case law.<sup>70</sup> In particular, the list of legitimate concerns must be seen as limitative.<sup>71</sup>

The broad interpretation of Art 28 EC and the narrow view taken of the exception provided by Art 30 could lead to unsatisfactory results for indistinctly applied measures. Differently so than openly discriminating measures, which almost always have a protectionist aim, such measures may well serve to protect reasonable concerns of public policy. Amongst these are many that are not covered by the explicit justifications listed in Art 30 EC. In the case of *Cassis de Dijon* the ECJ broadened the possibilities to justify not explicitly discriminating government measures.<sup>72</sup> More specifically, it indicated that obstacles to trade resulting from disparities between national laws relating to the marketing of products could take preference over the rules on free movement in so far as those provisions are necessary in order to satisfy mandatory requirements relating to the defence of the consumer.<sup>73</sup>

The acceptance of indistinct measures in restraint of inter-Member State trade that can be said to be reasonably necessary to protect state interests not explicitly listed in the Treaty is often referred to as the *rule of reason* in European law. This approach has also been applied in relation to the other freedoms,<sup>74</sup> including, in *Reisebüro*

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<sup>68</sup> This was the case for example with the German ‘Reinheitsgebot’, at issue in *Commission v. Germany*, Case 178/84, [1987] ECR 1227, which systematically excluded beer from the German market from countries that allowed more than a limited number of specific ingredients for beer.

<sup>69</sup> See e.g. *France v. Jacques Pistre et al*, Cases C321 and 324/94, [1997] ECR I-2360.

<sup>70</sup> See *Bauhuis v. The Netherlands*, Case 46/76, [1977] ECR 5; *Tedeschi v. Denkavit*, Case 5/77, [1977] ECR 1555; and *The Queen v. Ministry of Agriculture, Fishing and Food, ex parte H. Lomas*, Case C-5/94, [1996] ECR I-2604.

<sup>71</sup> *Commission v Ireland*, Case 113/80, [1981] ECR 1625.

<sup>72</sup> *Supra*, footnote 67.

<sup>73</sup> *Id.*, at para. 9. The term ‘mandatory requirement’ is a somewhat awkward translation of the French ‘exigences impératives’, which has later also been translated as ‘imperative state interests’. Later cases confirmed this approach: see e.g. *France v. Rémy Schmit*, Case C-240/95, [1996] ECR I-3179 (again consumer protection); *Industrie Diensten Groep v. Beele Handelsmaatschappij*, Case 6/81, [1982] ECR 707 (fair business practices); *Abbinck*, Case 134/83, [1984] ECR 4097 (efficacy of fiscal checks); and *Aher Waggon v Germany*, Case C-389/96, [1998] ECR I-4483 (environmental protection).

<sup>74</sup> See e.g. *Stichting Collectieve Antennevoorziening Gouda v. Commissariaat voor de Media*, Case C-288/89, [1991] ECR I-4007 (in relation to services), *Commission v. Netherlands*, Case C-353/89, [1991] ECR I-4069 (*idem*), *Säger v. Dennemeyer*, Case C-76/90, [1991] ECR I-4221 (*idem*), *Bachmann v. Belgium*, Case C-204/90, [1992] ECR I-249 (in relation to free movement of workers),

*Broede*, to the provision of legal services.<sup>75</sup> Moreover, in a number of rulings involving obstacles to free movement in the form of sports regulations issued by private organisations, it has been accepted that, like states, private parties may invoke the *rule of reason*.<sup>76</sup> That is, their regulations will not be held to infringe the rules on free movement where they are inherent in the proper functioning of the activity at issue. This brings us back to the case of *Wouters*.<sup>77</sup>

The ECJ started its assessment of the regulation prohibiting partnerships between lawyers and accountants by indicating that it appeared to have an adverse effect on competition.<sup>78</sup> The prohibition of a partnership between lawyers and accountants prevents the introduction in the market of a bundle of services from which clients could benefit substantially. Contrary to what we might expect, however, the Court did not go on to suggest that the agreement would therefore have to be examined under the scope of Art 81(3) EC. It extended the assessment under the first paragraph by stating the general principle that not every agreement between undertakings which restricts the freedom of action of the parties necessarily falls within the prohibition laid down in Art 81(1) EC.<sup>79</sup> For the purposes of application of that provision, it continued, account has to be taken of the purpose of the agreement and the overall context in which it produces its effects.<sup>80</sup> Having reviewed the reasons advanced by the bar organisation for adopting this rule, and referring to the decision in *Reisebüro Broede*,<sup>81</sup> the ECJ indicated that the regulation at issue was not caught by Art 81(1) EC as it could reasonably be considered necessary in order to ensure the proper practice of the legal profession. In so doing the Court appears to have integrated the *rule of reason* known from the law on free movement in European antitrust law.<sup>82</sup> As we will see in the next section, however, this *rule of reason* should be sharply distinguished from the sort of *rule of reason* that European competition lawyers are

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*Commission v. Belgium*, Case C-300/90, [1992] ECR I-305 (idem), and *Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*, Case C-55/94, [1995] ECR I-4165 (with regard to free movement rules in general), and *Alpine Investments v. Minister van Financiën*, Case C-384/93, [1995] ECR I-1141 (idem).

<sup>75</sup> Case C-3/95, [1996] ECR I-6511.

<sup>76</sup> See *Union Royale v. Bosman*, Case C-415/93, [1995] ECR I-4921, *Deliège*, Cases C-51/96 and C-191/97, [2000] ECR I-2549, *Lethonen*, Case C-176/96, [2000] ECR I-2681.

<sup>77</sup> *Supra*, footnote 33.

<sup>78</sup> *Id.*, at paras. 86-94. In paras. 95 and 96 it also indicated that the agreement appeared to affect trade between Member States.

<sup>79</sup> See footnote 62 and accompanying text.

<sup>80</sup> Compare the ECJ's considerations in *Société Technique Minière*, cited above in footnote 49.

<sup>81</sup> *Supra*, footnote 75.

<sup>82</sup> In this sense, see Monti (2002: 1088), O'Loughlin (2003), and Van de Gronden (2005: 84).

used to discuss and which concerns the dividing line between the economic tests of Art 81(1) and (3) EC.

### 2.3 The dividing line between Art 81(1) and (3) EC

The line of demarcation between the analyses carried out under the scope of the first and the third paragraph of Art 81 EC has long been one of the primary controversies in European antitrust. The origin of the debate on this matter can be traced back to a combination of (1) the institutional set-up chosen in 1962 for the enforcement of Art 81 EC and (2) the substantive approach adopted to the analysis under Art 81(1) EC by the Commission in particular. The present section starts by considering and explaining these early choices (Section 2.3.1). Next (in Section 2.3.2), we discuss both the academic debate on this matter, which broke loose right at the start of EC antitrust enforcement, and the string of ECJ case law that contributed to keeping it alive over an extended period of time. This allows us to identify with precision the question of law that will be at issue in this thesis. Finally (in Section 2.3.3), we consider a number of fundamental differences in the environment in which the European competition system currently functions *vis-à-vis* the circumstances that prevailed at the start of the European project and which determined the early choices.

#### 2.3.1 Regulation 17/62 and freedom of trade

It is important, when discussing the enforcement of EC antitrust policy, to note that the EC Treaty does not contain provisions that are specific as to the way the antitrust provisions are to be enforced. Artt 81 and 82 EC are silent on the matter.<sup>83</sup> There is only Art 83 EC, which confers on the EC Council the duty and power to adopt regulations or directives to give effect to the principles stated in these provisions. This open framework was the result of the inability of the founding states to reach agreement on the method of enforcement within the brief period of time in which the Treaty was drafted.<sup>84</sup> The first five years that followed the entry into force of the

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<sup>83</sup> As regards Art 81 EC, there is a difference with the corresponding provision in the ECSC. Art 65(4) ECSC specified that the High Authority had sole jurisdiction to determine whether agreements were compatible with that provision.

<sup>84</sup> In this regard, see Wils (2002: 102), who notes that France favoured a system of ‘*exception légale*’ under which Art 81(1) and (3) EC would both be directly applicable, whereas Germany preferred a system that would require firms to seek authorisation for restrictive agreements. Below, the latter option and its implications are discussed in more detail. See also Gerber (1998: 346 a.f.) as to the effects of competing visions of competition law in the different Member States.

Treaty in 1958 the Commission's Directorate General IV (Competition) devoted much of its attention to the process of producing such implementing legislation. The process involved extensive and sometimes difficult negotiations with Member States and the different Community institutions.<sup>85</sup> The result came in 1962 with the adoption by the Council of Regulation 17/62.<sup>86</sup> Before that, apart from some activity by certain national authorities, the antitrust provisions in the Treaty remained largely inoperative.<sup>87</sup>

The principle objective that the Commission sought to achieve by means of Regulation 17/62 was to turn antitrust policy into an effective instrument for integrating the economies of the member states. There were a number of obstacles to be overcome.<sup>88</sup> Recall that a prohibition of restrictive agreements was without precedent in pre-war Europe. Certain member states had even encouraged or obliged firms to cartelise. The precise meaning and status of these provisions still had to be negotiated, therefore. In this regard, opinions differed considerably across member states. Some viewed them as law and others merely as guidelines for the Commission's decision making in general. Decentralised policymaking would therefore have involved the risk that the antitrust provisions would be significantly shaped by national concepts and preferences and might, thus, be subject to protectionist influences. The difficulties were not limited to the development and application of the antitrust provisions by member state organs, however. Certainty would have to be provided to firms about the implications of the rules for the legality of their agreements. Moreover, given the more permissive way industries were regulated before, firms could not be trusted to respect the new limits imposed on their ways to make profit.

To deal with these issues, Regulation 17/62 centralised the development and application of antitrust policy in the hands of the Commission and urged firms to present restrictive agreements to the Commission for scrutiny and approval. This was made possible by distinguishing between the way in which Art 81(1) and (3) EC would be applied. Art 1 of the regulation provided that Art 81(1) EC would have

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<sup>85</sup> See Gerber (1998: 349).

<sup>86</sup> Regulation 17/62, [1962] JO 13/204.

<sup>87</sup> See e.g. Holley (1993: 670). On pre-1962 enforcement activities by Member State authorities, see Wilks and McGowan (1996: 231) and Gerber (1998: 349).

<sup>88</sup> In this regard, see Forrester and Norall (1984: 18), Gerber (1998: 347), and Wils (2002: 102).

direct effect.<sup>89</sup> This means that the prohibition (and its effects in terms of Art 81(2) EC) applied directly to agreements implemented by firms active on the Common market. This part of the provision could therefore be invoked in proceedings before a national court or by member state competition authorities. Art 81(3) EC was subjected to a very different regime. Art 9(1) made the application of this exception dependent on authorisation. The combined effect was that agreements which fell under the scope of the prohibition were invalid unless they had been notified and expressly exempted. Crucially, the power to grant an exemption was vested exclusively in the Commission. This effectively disqualified national courts and competition authorities as efficient *fora* to resolve suits based on EC competition law.<sup>90</sup> The scope for member state involvement in European antitrust was further reduced by Art 9(3), which determined that national authorities would have to stop their enforcement activities related to conduct that was made the object of an investigation by the Commission.<sup>91</sup> Art 4(1) made exemption contingent on notification of the agreement to the Commission.<sup>92</sup> It was sought to encourage firms to notify as early as possible by determining, in Art 6(1), that exemption decisions could not take effect at a date earlier than the date of notification and, in Art 15(5), that no fines would be imposed relating to conduct engaged in after notification.

The extent to which the Commission's monopoly on the application of Art 81(3) EC would allow it to control developments depended, of course, on the volume of cases in which this stage of the investigation would be reached. Consequently, the Commission adopted a very wide and indiscriminating notion of restrictiveness in the analysis under Art 81(1) EC, leaving more serious economic analysis for the assessment under Art 81(3) EC. Early evidence of its approach came during the proceedings leading up to the ECJ's preliminary ruling in the case of *Société Technique Minière*, when it observed that this provision catches any agreement

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<sup>89</sup> It stated that for an agreement to be prohibited by Art 81(1) EC 'no prior decision to that effect' was required. See also *BRT v. SABAM*, Case 127/73, [1974] ECR 62, at para. 16. In this sense the EC went considerably further than the ECSC did. Art 65 ECSC did not have direct effect. In this regard, see *Banks v. British Coal Corporation*, Case C-128/92, [1994] ECR I-1209.

<sup>90</sup> As they could examine justifications based on Art 81(3) EC, proceedings would have to be stayed until such time that the Commission would have decided whether to grant an exemption. This meant that the route of filing a complaint with the Commission was by far preferable for those harmed by restrictive arrangements.

<sup>91</sup> The Commission's autonomy was limited only by the institution of an advisory committee (Art 10(3) of the regulation) that reflected member state views.

<sup>92</sup> There was, however, no obligation to notify restrictive agreements. In this regard, see *MDF v. Commission*, Cases 100/80 etc., [1983] ECR 1825, at p. 1902.

whereby the freedom of action of one or more of the contracting parties is limited and the position of a third party is affected.<sup>93</sup> In its argument to the ECJ in the case of *Consten and Grundig* the Commission added that the interference with the position of third parties had to be more than theoretical.<sup>94</sup> In practice, however, it would very easily consider this requirement fulfilled.<sup>95</sup>

The case of *Davidson Rubber* provides a good example of the way in which the Commission applied Art 81 EC.<sup>96</sup> Davidson had developed a process for making arm rests for cars that had been successfully launched in the US. In Europe Davidson had granted exclusive manufacturing licenses to three firms. The Commission considered that the licenses restricted competition in the sense of Art 81(1) EC, since they prevented Davidson from licensing to any other firms established in the three territories (France, Germany-Belgium-Luxembourg, and Italy). It went on, however, to exempt the agreement. It considered that the licensees, whose sales were not restricted to their territory, had come to supply a considerable part of the arm rests for cars in the Common Market and that this important process would not have been introduced there without the protection offered by manufacturing exclusivity. It follows from the Commission's own analysis in this case that the restriction found under Art 81(1) EC was more of a hypothetical nature.<sup>97</sup>

The expansive interpretation by the ECJ of the requirement in Art 81(1) EC that an agreement must affect trade between member states had the same effect of increasing the jurisdictional prerogatives of the Commission and reducing those of the Member States.<sup>98</sup> In the next section we discuss the impact of this system and the reactions it provoked.

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<sup>93</sup> *Supra*, footnote 45, at p. 235.

<sup>94</sup> *Supra*, footnote 46, at p. 326.

<sup>95</sup> See Forrester and Norall (1984: 23) and Waelbroeck (1987: 697) and more generally on this matter Korah (1981), Schechter (1982), Korah (1986), Venit (1986), and Hawk (1995).

<sup>96</sup> [1972] JO L143/93. Other early examples are the decisions in *Blondel* ([1965] JO L2194/65) and *Hummel* ([1965] JO L2581/65. In Chapter 4, more recent examples of this approach will be discussed in detail.

<sup>97</sup> In the same sense, see Korah (1986: 94) and Siragusa (1998: 653).

<sup>98</sup> See footnotes 43-46 and the accompanying text.

### 2.3.2 The *rule of reason* debate in EC antitrust

#### *The impact of the notification system*

The immediate effects of the introduction of Regulation 17/62 and the use of a wide notion of restrictiveness are well known. The number of agreements notified to the Commission soon exceeded its capacity to close every file by means of a formal decision.<sup>99</sup> The vast majority of notifications concerned exclusive dealing arrangements.<sup>100</sup> Over the years that followed a number of measures were taken to avoid total system failure. In 1965 the Council gave the Commission the power to exempt whole categories of agreements by means of regulation rather than individual decisions.<sup>101</sup> Two years later the Commission issued the first block exemption regulation on distribution agreements,<sup>102</sup> which was later to be followed by a number of other block exemptions for specific types of agreements.<sup>103</sup> The Commission also developed the practice of doing away with cases by means of ‘comfort letters’. These were non-formal decisions reflecting either the view that the agreement did not infringe Art 81(1), or that the conditions of Art 81(3) seemed to be satisfied, and that the Commission therefore intended to close file. Such a comfort letter was issued if the information contained in the notification gave the Commission little cause to conduct extensive investigations.<sup>104</sup>

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<sup>99</sup> Holley (1993: 684) and Wils (2002: 104) report that the Commission received approximately 40.000 notifications during the first couple of years. Ehlermann (2000: 541) refers to some 34.500 notifications.

<sup>100</sup> According to Holley (1993: 684) and Korah (1997: 194) about 30.000 of these notifications involved exclusive dealing arrangements.

<sup>101</sup> Regulation 19/65, [1965] OJ 533. These broad powers to legislate without Council approval are unique in EC law.

<sup>102</sup> Regulation 67/67, [1967] OJ 849/67. This regulation settled the bulk – over 25.000 – of the cases referred to in footnote 100. See Holley (1993: 684).

<sup>103</sup> See Regulation 3604/82, [1982] OJ L376/33 (specialisation); Regulation 1983/83, [1983] OJ L173/1 (exclusive distribution); Regulation 1984/83, [1983] OJ L173/5 (exclusive supply); Regulation 2349/84, [1984] OJ L219/15 (patent licensing); Regulation 418/85, [1985] OJ L53/5 (research and development); and Regulation 4087/88, [1988] OJ L359/46 (franchising). During this period the Commission also issued a number of notices intended to provide more legal certainty. These covered areas such as patent licensing, agency, and cooperation agreements. All of these regulations and notices have since been replaced. The current generations of block exemption regulations and notices are discussed below in Section 2.4.3.

<sup>104</sup> Two other factors that have helped the notification system function can be mentioned. The first concerns increases in the Commission’s work force, which grew from around 80 in 1962, to 110 in 1984, and 411 in 1993; see Wilks and McGowan (1996: 237) and Forrester and Norall (1984: 19). It should be taken into account, however, that the EC grew considerably over the same period with the accession of Denmark, Ireland, the UK (in 1973), Greece (1981), Spain, and Portugal (1986). Throughout this period, commentators continued to complain that DG IV was seriously understaffed; see e.g. Forrester and Norall (1984: 19) and Wilks and McGowan (1996: 236). The second point to be made is that the Commission did, to a certain extent, reduce the scope of its interpretation of the

These measures were only partially effective. Whilst, as we will shortly see, the Commission and the Court also worked on the substantive side of the law to limit the scope of the prohibition contained in Art 81(1) EC, the system continued to invalidate large amounts of seemingly innocuous agreements, which had to be notified and exempted if they were to be made enforceable.<sup>105</sup> The Commission's backlog of cases was steadily reduced, but never eliminated.<sup>106</sup>

The main critiques centred on consequences in terms of transaction costs and legal certainty.<sup>107</sup> Particularly since the introduction of the revised Form A/B in 1985,<sup>108</sup> the process of completing a notification (together with possible prior or subsequent contacts with Commission officials) could be time consuming and costly.<sup>109</sup> Still, very few notifications would actually lead to a formal exemption.<sup>110</sup> There would generally be no more than a dozen of such decisions every year.<sup>111</sup> Unless the notification raised concerns, a lot of time could go by before any form of response came and it was not uncommon that no response came at all.<sup>112</sup>

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prohibition contained in Art 81(1) EC. This matter is discussed in detail below, together with the relevant case law of the Courts.

<sup>105</sup> Compare with Forrester and Norall (1984: 24). Initially, it was thought that notification suspended the nullity provided under Art 81(2) EC for agreements caught by Art 81(1) EC. However, in *Brasserie de Haecht II*, Case 48/72, [1973] ECR 77, the ECJ indicated that this was not the case. On the concept of provisional validity, see Korah (1981).

<sup>106</sup> In 1989 there was a backlog of 3,239 notifications (see the Commission's XIXth report on competition policy). Five years later, in 1994, there was a backlog of around a thousand cases (see the Commission's XXIVth report on competition policy). Since then, the backlog remained broadly the same (see Ehlermann, 2000).

<sup>107</sup> See Hawk (1995: 983), who suggested that the overbroad application of Art 81(1) EC generated extraordinary legal uncertainty whose practical consequences could not be exaggerated and (on the following page) that the principle effect of the notification system was to increase transaction costs and transfer income from firms to outside antitrust lawyers. See also Forrester and Norall (1984), and Korah (1981, 1986, 1992), Schechter (1982), Kon (1982), and Siragusa (1998). Towards the end of the 1990s a third element of concern became increasingly important: the fact that the notification system forced the Commission to spend the bulk of its resources on processing relatively harmless agreements and prevented it from concentrating on more harmful practices, such as horizontal cartels, which were unlikely to be notified and costly to detect. In this regard, see e.g. Ehlermann (2001) and the discussion below, in Section 2.3.3.

<sup>108</sup> [1985] OJ L240/1.

<sup>109</sup> See Holley (1993: 680), Siragusa (1998: 658), and the survey data presented by Neven et al. (1998).

<sup>110</sup> In this sense, see Korah (1986: 95), Forrester and Norall (1984: 14), and Holley (1993: 678 and 704). In this regard it should be noted, also, that Regulation 17/62 (supra, footnote 86) contained no provision binding the Commission to a time limit for taking a decision on a notified agreement. Case law on this point required a decision to be taken within a 'reasonable' period of time. See e.g. the case of *Dutch Cranes* (joined cases T-213/95 and T-18/96, [1997] ECR II-1746), where the CFI held that in the circumstances of the case 46 months was a reasonable period of time.

<sup>111</sup> See the very useful summary statistics provided in Carree (2008: 4 a.f.) and notably their figures 1, 2 and 3. They report an average number of 15 formal decisions per year over the period 1964-2001. This figure includes Art 82 EC decisions.

<sup>112</sup> See Carree et al. (2008: 8) for an overview of the average number of months required to reach a formal decision and fluctuations therein (over the period 1964-2001). See also Forrester and Norall (1984: 14) and Holley (1993: 678).



It is obvious, then, that, apart from burdening them with costs, the system also left notifying firms relatively uncertain as to the legality of their contracts. The nullity provided for in Art 81(2) EC made unexempted agreements vulnerable to challenges in national courts.<sup>113</sup> Where this was a serious concern, assurances could be sought in the form of a comfort letter.<sup>114</sup> Recall, however, that these were informal decisions that were not binding on national courts.<sup>115</sup> If such a letter indicated that, according to the Commission's assessment, the agreement was not caught by Art 81(1) EC, this will have provided a reasonable measure of certainty. A letter indicating that the agreement merited exemption, however, would have been of little use to firms in such a situation, since this terminology implied that the agreement did infringe Art 81(1) EC.<sup>116</sup> Several scholars with extensive experience as practitioners indicated, also, that the system induced firms seeking certainty to choose a form of agreement that was sub-optimal for their commercial purposes but which could benefit from a block exemption regulation.<sup>117</sup>

Finally, it has been suggested that the legal certainty was affected in a broader sense, relating to the development of the law and the possibility for firms to orientate themselves on existing practice to assess the legality of their intended agreements.<sup>118</sup> As indicated before, the system produced relatively few formal decisions.<sup>119</sup> The decisions available were frequently marked by formalistic reasoning that failed to

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<sup>113</sup> The case of *Pronuptia v. Schillgalis*, Case 161/84, [1986] ECR 353, which will be discussed in more detail below, provides an example. Mrs. Schillgalis, a franchisee, had failed to pay royalties to her franchisor, Pronuptia. Pronuptia sued Schillgalis who, in defence, argued that the franchise agreement were void under German and EC antitrust law. The appellate court of Frankfurt found that the agreement was not prohibited by German cartel law, but that several exclusivity clauses in the agreement did restrict competition in the sense of Art 81(1) EC. Since the agreement was not exempted, it held that the agreement was null and void under Art 81(2) EC. Note, however, that the risk that the competition laws would be used in this way to undermine the validity of contracts will not always have been great. There are good indications that chose simply not to notify their agreements (in this regard, see Forrester and Norall, 1984, and Holley, 1993).

<sup>114</sup> Comfort letters became one of the principle methods of closing files. See e.g. Holley (1993) and Carree et al. (2008: 6) who report that the ratio of the number of cases dealt with using an informal procedure compared to the number of formal antitrust decisions in the period 1997-2001 ranged from 324 : 54 in 2001 to 490 : 27 in 1997.

<sup>115</sup> Notably, in *Procureur de la République v. Guerlain*, Case 253/78, [1980] ECR 2328, the ECJ indicated that comfort letters may be taken into account by a national court asked to enforce the agreement, but do not bind it.

<sup>116</sup> See Siragusa (1998: 663) and Korah (1986: 96).

<sup>117</sup> See e.g. Korah (1986: 96), Hawk (1995: 983), Holley (1993: 687), and Siragusa (1998: 662).

<sup>118</sup> In this sense, see Holley (1993: 702-704).

<sup>119</sup> Holley (1993: 701) mentions a total number of 340 formal decisions taken by the Commission until the month of July of 1992. This includes both Art 81 and 82 EC cases. For reasons explained below and in the Appendix A, the present study will work on the basis of a smaller set of Commission decisions that (1) date from 1998 or after (2) concern Art 81 EC, and (3) apply the effects-based standard.

provide an economic analysis that could explain what material negative effects might ensue that could justify the application of Art 81(1) EC.<sup>120</sup> And, to conclude, comfort letters and press releases were seldom detailed enough to provide guidance of a general nature.<sup>121</sup>

### *The call for a US-style rule of reason in Art 81(1) EC*

Before the end of the 1990s, very few critics proposed the more radical solution of altogether abandoning the enforcement system based on prior administrative authorisation.<sup>122</sup> Instead, most authors called for the prohibition in Art 81(1) EC to be interpreted more narrowly,<sup>123</sup> starting with René Joliet in his influential treatise published in 1967.<sup>124</sup> Drawing inspiration from US antitrust, they envisaged a scenario in which a *rule of reason* would be applied in the analysis under Art 81(1) EC. Given that this is a very different kind of *rule of reason* than the one applied in European law on free movement and in the case of *Wouters*,<sup>125</sup> it is necessary that we discuss some basics of US antitrust.<sup>126</sup>

The principle antitrust statute in US federal law is the Sherman Act of 1890.<sup>127</sup> This act was originally introduced as a complement to the common law restraint of trade doctrine,<sup>128</sup> which was applied in the US by the state courts, mainly in the field

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<sup>120</sup> See Hawk (1995: 985).

<sup>121</sup> See Holley (1993: 701).

<sup>122</sup> Kon (1984) is an exception.

<sup>123</sup> See Forrester and Norall (1984), Korah (1981, 1986, and 1992), Schechter (1982), Hawk (1995), and Siragusa (1998).

<sup>124</sup> See Joliet (1967). Waelbroeck (1987: 694) and Schöter (1987: 647) report that even earlier on, in 1962, Ernst Wolf argued in favour of the introduction of a *rule of reason* in Art 81(1) EC, in an article called 'La législation contre les cartels et les monopoles: Son application dans la CEE, in: *Juris-Classeur Périodique (La semaine juridique)*, part I, no.1718. This publication was unavailable to the author.

<sup>125</sup> *Supra*, footnote 45.

<sup>126</sup> A more detailed introduction to the matters that follow is provided in Chapter 4, Section 4.2.2.

<sup>127</sup> 15 U.S.C.A. §1.

<sup>128</sup> On the common law doctrine with regard to contractual restraints of trade see Trebilcock (1986). This doctrine has a long history, dating as far back as the year 1414, with the *Dyer's Case* (Y.B. Mich. 2 Hen. 5, f. 5, pl. 26 (C.P. 1414)) In this case a promise by one dyer to another to refrain from practicing his trade, was determined to be illegal at common law. As would happen in cases that followed in the 16<sup>th</sup> century (*Moore K.B.* 115, 72 Eng. Rep. 477 (Q.B. 1578), and *Blacksmiths of South-Mims* 2 Leo. 210, 74 Eng. Rep. 485 (C.P. 1587)), the court refused to consider the reasonableness of the scope of the restraint. In *Colgate v. Bacher* (Cro. Eliz. 872, 78 Eng. Rep. 1097 (Q.B. 1602)), the court ruled that it would be against the benefit of the Common-wealth for someone to be abridged of his trade and living. This is generally seen as the first reflection in the law of a public policy reason for invalidating restraints (Blake (1960)). The famous case of *Mitchel v. Reynolds* (1 P. Wms. 181, 24 Eng. Rep. 347 (Q.B. 1711)) of 1711 marks a fundamental change in the doctrine. The case concerned the transfer of a bakery to a new owner, which was accompanied by a promise by Reynolds (the seller) not to compete with Mitchel for a period of five years. The court explained that such restraints were met with a presumption of illegality. To motivate this presumption the court referred to the negative effects

of tort law. The economic turmoil caused by rapid industrialization, the rise of the modern firm, the dramatic increase in scope of many markets due to the advent of railroads and steamships, and the consequent rise of business trusts made this approach inadequate. An important aim of passing the Sherman Act was to complement these private actions based on the restraint of trade doctrine before State Courts, by Federal suits brought (also) upon the initiative of a public prosecutor, so as to make fighting trusts more effective.<sup>129</sup>

Section 1 of the Sherman Act prohibits ‘every’ contract in restraint of trade, much like Art 81(1) EC does. In the earliest cases applying this provision, such as *Trans Missouri Freight*, the US Supreme Court appeared to take the text of this provision on its face.<sup>130</sup> A defense based on the common law restraint of trade doctrine that the price-fixing agreement at issue pursued a reasonable aim was not accepted.<sup>131</sup> It will be easily appreciated that this would have been a problematic interpretation of the statute if applied to something as innocuous as a non-compete obligation in a partnership agreement. In 1911 the Supreme Court provided further clarity on the way restraints must be examined under the Sherman Act. In its opinion in the case of

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both for the promisor and society as a whole of the loss of his work. But a reasonable restraint ancillary to the transfer of a business could overcome this presumption, as to refuse it would mean that a craftsman ready to retire would either have to continue, or sell out cheaply. In the course of the 19<sup>th</sup> century, and culminating in *Nordfelt v. Maxim Nordfelt Guns & Ammunition Co* ([1894] AC 535) of 1894, the *rule of reason* in the restraint of trade doctrine developed into a tool to balance the benefit of freedom of trade, against the freedom of contract, both as between the parties, and society as a whole. Freedom of trade includes and is dependent on the freedom for any to engage in contracts to further his commercial goals. But this same freedom of contract also carries within itself the risk of elimination of competition. The result was a division of restraints in two classes: ancillary, and otherwise. Ancillary are reasonable restraints necessary to achieve the beneficial objective of the agreement as a whole (as in the case of the transfer of the bakery for example); that is, cases in which competition is beneficially restricted by means of a contract, as opposed to where this is to the detriment of one of the parties, or society.

<sup>129</sup> See Thorelli (1955). It should be noted, however, that antitrust law evolved into a distinct field of law with similar but different objectives. What clearly distinguishes the application of the *rule of reason* in antitrust, from the purpose it served in the common law, is that the test is not aimed at satisfying whether the restraint is reasonable as between the parties in the dispute. The reasonableness between the parties (which at least in a publicly prosecuted case will all be on the side of the defense) is not a relevant factor in antitrust. Here only the benefit to society as a whole of preserving competition from restrictive contracting is taken into account. See Chief Justice Warren in *Brown Shoe Co v. US*, 370 US 294, 320 (1962): “Taken as a whole, the legislative history illuminates congressional concern with the protection of competition, not competitors, (...)”; which was repeated in the same words in *Brunswick Corp v. Pueblo Bowl-O-Mat Inc*, 429 US 477, 488 (1977); and in different words e.g. in *Spectrum Sports Inc v. McQuillan*, 506 US 477, 485 (1993): “The purpose of the Act is not to protect business from the working of the market; it is to protect the public from the failure of the market.”

<sup>130</sup> *US v. Trans-Missouri Freight Association*, 171 US 505 (1898), other cases to be mentioned here are *US v. Joint Traffic Association*, 171 US 505 (1898), and *Addyston Pipe & Steel Co v. US*, 175 US 211 (1899).

<sup>131</sup> See footnote 128. It must be added that in *Addyston Pipe* (supra, footnote 130) Justice Taft concluded that even under the restraint of trade doctrine the price fixing at issue could not be termed reasonably necessary.

*Standard Oil* it indicated that, in conformity with the common law restraint of trade doctrine, ‘every’ restraint of trade must be understood as ‘every unreasonable’ restraint of trade.<sup>132</sup> The agreements at issue in the earlier cases were so evidently unreasonable – that is, so inherently irreconcilable with the goals of the antitrust laws – that they required no elaborate investigation.<sup>133</sup> Where this is not the case, however, the reasonableness of a restraint must be established by reference to a fully factual inquiry into the conduct at issue (the agreement), the alleged harm, and the causal relationship between the two. Here, the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed, are essential elements of the analysis.<sup>134</sup>

In light of what was said above concerning US influence and policy in post-War Europe and the implications for the drafting of the Treaty, it appears reasonable to assume that Art 81 EC was intended to codify these US experiences and, more specifically, that Art 81(3) EC was meant as an explicit recognition of the exception based on the reasonableness of the restraint that had been developed by US courts.<sup>135</sup> It should be realised, however, that the call for the introduction of a *rule of reason* in European antitrust centred exclusively on Art 81(1) EC.

Proponents argued that application of a more rigorous economic test in the investigation under that provision – one that would require examination of the actual anti-competitive and pro-competitive effects of the agreement – would benefit the functioning of the notification system in several ways. To begin, this would have reduced the number of agreements subject to the notification requirement.

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<sup>132</sup>*Standard Oil Co v. US*, 221 US 1 (1911). This case was in fact brought under §2 of the Sherman Act, which concerns monopolization. It should be noted, however, that Chief Justice White’s argumentation regarding the applicability of the *rule of reason* explicitly includes Section 1 (see para. 30).

<sup>133</sup>In this regard, see para. 32 of the opinion (supra, footnote 132).

<sup>134</sup>*National Society of Professional Engineers v. US*, 435 US 679, 692 (1978). See also Areeda (1986: 574), who points out that in thinking about *rule of reason* and *per se*, it is important to disaggregate the following two differences between these methods of analysis. *Rule of reason* analysis differs from *per se* analysis not only in that arguments will be heard in defence of the challenged practice. It also requires that the effect of the agreement be shown, whereas proof of conduct of a certain nature alone, is sufficient to find a *per se* violation. Like effects-based and object-based analysis in EC antitrust, therefore, the *rule of reason* and *per se* rules are in fact methods of analysis, that differ in the width of the range of facts considered relevant in deciding whether an agreement restricts competition. If the alleged conduct is of a kind that with sufficient certainty can be said to lead to restrictive results, then the analysis that prepares for the application of a *per se* rule is limited to verifying that the conduct at issue indeed falls within this category. No exculpation is heard and no actual effects are looked at. If on the other hand the effects of an agreement are not so obvious, then the *rule of reason* is applied, in which on the basis of micro-economic insights and by reference to all available relevant facts, both the negative and positive effects of the agreement on the market are examined and balanced.

<sup>135</sup>In this sense, see Wils (2002: 123).

Enforcement and compliance costs would therefore have dropped, and the Commission would have been able to dispense with cases more speedily and to turn some of its attention to other fields. At the same time, for those affected by an infringement of Art 81 EC, commencing civil proceedings in a national court would have become an alternative to filing a complaint with the Commission. In this view, Art 81(3) EC would come into play where non-competition related policy objectives justify an exemption despite the competitive harms.<sup>136</sup>

On the other hand, several authors stressed the need for caution. They argued that the adoption of a *rule of reason* in the analysis under Art 81(1) EC was difficult to reconcile with the text and structure of the provision as a whole, that the Commission's interpretation of Art 81(1) EC assured that the law on restraints of trade would be applied uniformly throughout the Community, and, finally, that formalism provided more legal certainty than case by case analysis.<sup>137</sup> As can be expected, they found the Commission and the Court on their side.

From very early on, the Commission indicated that it would not consider any restriction of competition to fall foul of Art 81(1) EC. It soon became clear, however, that the exceptions that it was willing to make to this basic rule were of limited scope. In a number of respects, the ECJ appears to have been somewhat more progressive. This resulted in a certain divergence between the approaches adopted by the principle agents in EC antitrust. But, on the whole, the Court, like the Commission, did not go so far as to fully adopt a *rule of reason* in the assessment under Art 81(1) EC. The following discussion of the case law and decision practice is intended to provide an impression rather than a complete overview of developments until the year 2001. As will be discussed below (in Section 2.3.3), around that time the Commission launched a comprehensive overhaul of its substantive policies. For the purposes of this thesis, it is the decision practice following this modernisation process that is primary importance.

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<sup>136</sup> See e.g. Hawk (1995: 988) and Schechter (1982: 13).

<sup>137</sup> See Waelbroeck (1987: 696) for an overview of these arguments.

*The rule of reason in practice*

One of the first exceptions to the basic rule recognised by the Commission involved non-compete obligations imposed on the vendor of business as a going concern.<sup>138</sup> The 1976 decision in *Reuter/BASF* made clear that this argument may be advanced in the assessment under Art 81(1) EC where the sale includes know-how or goodwill and where the restriction is necessary to preserve the value of the firm for the buyer and does not go beyond what is necessary to protect his interests.<sup>139</sup> A number of decisions in which the Commission took issue with the duration of a non-compete obligation show that it generally gave a narrow meaning to the necessity-criterion.<sup>140</sup> In its *Remia* ruling, the ECJ indicated that it would not be likely to intervene in such cases by forcing the Commission to adopt a more permissive approach.<sup>141</sup> Over time, the Commission showed itself to be willing to apply the ancillary restraints doctrine more generally, to include restrictions necessary in the formation of a joint venture or a concentration.<sup>142</sup> But as was suggested above, when we discussed the case of *Métropole*,<sup>143</sup> the balancing act performed in such cases depends on a rather narrowly conceived legal test and does not provide scope for an economic analysis of the benefits produced by an agreement.<sup>144</sup> The ECJ came closer to proposing such a more broadly construed test in its preliminary rulings in *Gøttrup-Klim*<sup>145</sup> and *Oude Luttikhuis*,<sup>146</sup> where it suggested that restrictions that are necessary for the *operation* of a joint venture (which are therefore not ancillary in the strict sense) may escape the ban of Art 81(1) EC.<sup>147</sup>

Arguably, it was in the evaluation of selective distribution agreements that the Commission and the Court came closest to weighing pro-competitive effects under Art 81(1) EC. Not all products can be sold over the counter. Costly or complex

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<sup>138</sup> See *Frères/Vitapro*, [1964] JO 136/2287. See Schöter (1987: 677) for a discussion on developments until that year.

<sup>139</sup> [1976] OJ L254/40.

<sup>140</sup> See the decisions in *Reuter/BASF* (supra, footnote 139); *Tyler/Linde*, XXIth report on competition policy; and *Remia/Nutricia*, [1983] OJ L376/22.

<sup>141</sup> Supra, footnote 29, at para. 34. It noted that in assessing the merits of such clauses the Commission has to appraise 'complex economic matters' and that for that reason judicial review would have to be limited to an evaluation of whether there has been a manifest error of appraisal.

<sup>142</sup> In 1990 the Commission published a Notice on ancillary restraints ([1990] OJ C203/5), which was replaced in 2001 by a Notice on restrictions directly related and necessary to concentrations ([2001] OJ C188/5).

<sup>143</sup> Supra, footnote 54.

<sup>144</sup> See the text accompanying footnotes 54 and 55.

<sup>145</sup> Supra, footnote 62.

<sup>146</sup> Id.

<sup>147</sup> The Commission applied the same reasoning in the case of *P & I Clubs*, [1999] OJ L125/12.

products may require extensive pre or after-sales service. In a selective distribution scheme, the manufacturer selects those distributors allowed to resell his product and imposes a prohibition on resale to non-authorised outlets. Since 1970, the Commission takes the view that such restrictions do not infringe Art 81(1) EC, provided that the selection is based on objective criteria of a qualitative nature.<sup>148</sup> This approach was upheld by the Court in the case of *Metro I*.<sup>149</sup> The underlying reasoning appears to be that the positive effects of qualitative selective distribution on inter-brand competition outweigh their restrictive effects on intra-brand competition.<sup>150</sup>

In comparison, territorial restraints, such as exclusive distribution and licensing, were dealt with much more harshly, at least by the Commission.<sup>151</sup> It has consistently held such arrangements to restrict commercial freedom and to fall under the ban of Art 81(1) EC.<sup>152</sup> By doing so, it deviated from the path marked by the Court.<sup>153</sup> As we saw in discussing the case of *Davidson Rubber*, the Commission's approach implies that defences based on the argument that exclusivity may be the only means to penetrate the market of another member state are dealt with under the scope of Art 81(3) EC.<sup>154</sup> Already in 1965, however, in the case of *Société Technique Minière*,<sup>155</sup> the Court had indicated that it was doubtful whether an exclusive dealing contract interferes with competition if it is necessary for the penetration of a new geographical market<sup>156</sup> and as long as it does not confer absolute territorial protection like the agreement in the case of *Consten and Grundig*.<sup>157</sup> Similarly, in *Nungesser*, it held that an 'open exclusive license', which does not eliminate all competition from third parties, need not infringe Art 81(1) EC.<sup>158</sup> Without such protection, it argued, a

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<sup>148</sup> See the decision in the case of *Kodak*, [1970] OJ L147/24.

<sup>149</sup> *Supra*, footnote 59.

<sup>150</sup> *Id.* at paras. 21 and 22, where the Court discusses the effect of the agreements in terms of maintaining a certain price level in the light of its positive effects on other (qualitative) parameters of competition.

<sup>151</sup> In this sense, see Waelbroeck (1987: 711-712), Korah (1986: 98), and more generally Hawk (1995: 982)

<sup>152</sup> See e.g. the decisions in *Blondel* (*supra*, footnote 96); *Hummel* (*supra*, footnote 96); *Burroughs*, [1971] OJ L13/50; *Davidson Rubber* (*supra*, footnote 96); *Neumeyer*, [1975] OJ L222/34; AOIP, [1976] OJ L6/8; and *Maize Seed*, [1978] OJ L286/23.

<sup>153</sup> In this sense, see Waelbroeck (1987: 711-712).

<sup>154</sup> *Supra*, footnote 96. It is worth mentioning that where horizontal agreements between small and medium-sized enterprises were concerned, the Commission has, on several occasions, accepted the market penetration defence in the investigation under Art 81(1) EC. In this regard, see e.g. the decisions in *Safco*, [1972] OJ L13/44; *Socemas*, [1968] OJ L201/4; and *Intergroup*, [1975] OJ L212/23.

<sup>155</sup> *Supra*, footnote 45.

<sup>156</sup> *Supra*, footnote 45, at p. 250.

<sup>157</sup> *Supra*, footnote 46.

<sup>158</sup> *Nungesser v. Commission*, Case 258/78, [1982] ECR 2015.

licensee might be deterred from accepting the risk of further developing and marketing the product and, as a result, competition between the new product and similar existing products would fail to materialise.<sup>159</sup> In its preliminary ruling in the case of *Coditel II*, the ECJ appeared to go further by holding that an exclusive copyright license to exhibit a film in a member state would not necessarily infringe Art 81(1) EC, even though transmission from a neighbouring member state would be blocked to protect the investment of the licensee.<sup>160</sup> And in *Pronuptia* the ECJ held that restrictions necessary to protect the intellectual property rights of a franchisor and to maintain the common identity of his network fall outside Art 81(1) EC.<sup>161</sup> It added, on the basis its decision in *Consten and Grundig*,<sup>162</sup> that restraints imposed on other franchisees to open a second shop in an allocated territory would be caught. But it expressly limited the scope of this observation to cases where the use of the franchisor's trademark is already widely spread.<sup>163</sup> Tight territorial protection might therefore fall outside Art 81(1) EC where the franchisor is a new entrant on the market.<sup>164</sup>

Understandably, the chequered image that emerged from the case law left much room for debate about whether and, if so, how much room there was in the investigation under Art 81(1) EC to consider pro-competitive effects.<sup>165</sup> The debate on the *rule of reason* came to an end only in 2001, when the Court of First Instance (CFI)<sup>166</sup> delivered its ruling in the case of *Métropole*.<sup>167</sup> The case involved an agreement setting up a joint venture active on the French pay-tv market, which was heavily dominated by an incumbent provider. The agreement included a clause granting the joint venture 10 years of exclusive access to content produced by its parents. In its decision, the Commission had found this clause to go beyond what was

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<sup>159</sup> Id. at para. 57. For criticisms of the practical implications of the ECJ's distinction between open and closed exclusivity, see Korah (1986: 98) and Schröter (1987: 714).

<sup>160</sup> *Coditel v. Ciné Vog Films*, Case 262/81, [1982] ECR 3381.

<sup>161</sup> Supra, footnote 113.

<sup>162</sup> Supra, footnote 46.

<sup>163</sup> Supra, footnote 113, at para. 24.

<sup>164</sup> In this sense, see Venit (1986).

<sup>165</sup> See e.g. Venit (1986: 217), Caspari (1987), Holley (1993: 689), Schöter (1987: 686), Waelbroeck (1987: 708).

<sup>166</sup> The CFI was created in 1989, *inter alia* to alleviate the workload of the ECJ. It hears competition cases in first instance. Since its institution, scrutiny of the legality of the Commission's fact finding falls in the domain of the CFI, as subsequent appeal to the ECJ is possible on points of law only.

<sup>167</sup> Supra, footnote 54. Other factors also played a role, notably the substantive and procedural overhaul of the Commission's enforcement. These are discussed in the following sub-section 2.4.



necessary to penetrate the market and limited the duration of the exemption to three years.<sup>168</sup>

Métropole and the other parents argued before the Court that the Commission's investigation under Art 81(1) EC should have included an economic analysis of the restraint seen in its market context. Application of such a *rule of reason* would have shown that the clause served to facilitate the penetration of a market that was heavily dominated by an incumbent. According to Métropole, the Commission should have concluded that the agreement promoted competition, instead of lessening it, which would have obliged it to grant negative clearance. In its findings, the Court considered that there is no room in the analysis under that provision to weigh the pro and anti-competitive effects of a restriction, as this would make Art 81(3) EC lose much of its effectiveness.

In support of their claim the applicants had argued that the existence of a *rule of reason* under Art 81(1) EC had already been confirmed by the ECJ. In particular, they pointed to the rulings in *Société Technique Minière*,<sup>169</sup> *Oude Luttikhuis*,<sup>170</sup> *Nungesser*,<sup>171</sup> *Coditel*,<sup>172</sup> and *Pronuptia*,<sup>173</sup> where, as we have seen, it had refused to adopt *per se*-like reasoning in the investigation of restrictions necessary to create new competition. The CFI explained that these cases cannot be interpreted as establishing the existence of a *rule of reason* in the investigation under Art 81(1) EC.<sup>174</sup> They should rather be seen as part of a broader trend in the case law according to which it is not necessary to hold, wholly abstractly and without drawing any distinction, that any agreement restricting the freedom of action of one or more of the parties is necessarily caught by the prohibition laid down in Art 81(1) EC.<sup>175</sup>

The survey presented above tells us that this trend includes restrictions of commercial freedom that are necessary to sell a business or to create new competition. And the treatment of selective distribution agreements suggests that the

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<sup>168</sup> See the Commission decision in the case of *TPS*, [1999] OJ L90/6.

<sup>169</sup> *Supra*, footnote 45.

<sup>170</sup> *Supra*, footnote 62.

<sup>171</sup> *Supra*, footnote 158.

<sup>172</sup> *Supra*, footnote 160.

<sup>173</sup> *Supra*, footnote 113.

<sup>174</sup> *Supra*, footnote 54, at para. 76. Literally, it stated that those judgments cannot be interpreted as establishing the existence of a *rule of reason* in 'Community competition law'. It will be clear that this cannot be taken to mean exactly what it says. As we saw above (in the text accompanying footnote 133), the analysis of the effects produced by a restraint as it is spread out over Art 81(1) EC and Art 81(3) EC mimics the basic structure of the *rule of reason* as it is applied in US antitrust.

<sup>175</sup> *Id.*

category of agreements that escape the prohibition is wider still and includes restrictions of the freedom of trade that may not be strictly necessary, but which are commercially very useful and can be said to intensify competition on the market. On the other hand, it is by no means so that such agreements falling in one of these categories are always in the clear. It is this question of the legal standard used in individual cases to determine what evidence must be shown in order to establish that the agreement produces the type of anti-competitive effects that bring it within the scope of Art 81(1) EC, which is at the centre of attention in this thesis.

As will be shown in Chapters 4 and 5, case law that is instructive as to the method to be followed in examining negative effects is rather scarce. Still, it is evident that the Courts generally require an investigation of the implications of the competitive structure of the market (notably, the number and relative size of actual and potential buyers and sellers of the same and similar products).<sup>176</sup> Although there were small signs of change, the Commission continued to be criticised during the 1990s for persisting in its rigid approach based on the concept of commercial freedom.<sup>177</sup> One of the reasons why the Commission was able to do so must clearly be that the practice was limited to exemption proceedings, where chances of an appeal were reduced.<sup>178</sup> This part of the *rule of reason* debate – which did not

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<sup>176</sup> See the discussion in Chapter 4, Section 4.3.1.2, of the cases of *Völk v. Vervaecke*, Case 5/69, [1969] ECR 295; *Stergios Delimitis v. Henninger Bräu*, [1991] ECR I-935; *European Night Services v. Commission*, [1998] ECR II-3141; and *Glaxo v. Commission*, judgment of 27 September 2006 in Case T-168/1. As regards the examination of market structure, see also the discussion in Section 2.4.

<sup>177</sup> See e.g. Siragusa (1998), Neven et al. (1998), Amato (1997: 117), Faull (1997), Bright (1996), and Hawk (1995). See also the following Commission decisions. In *Eco System/Peugeot* ([1992] OJ L66/1), the Commission relies wholly on the fact that a circular issued by Peugeot to its authorised dealers was designed to prevent imports to France, combined with a showing in practice that this clause had had an effect on Eco System. The wider impact of the practice on the market, in which Peugeot had a 20% share, was not discussed. In *Astra* ([1993] OJ L20/23), regarding a joint venture between British Telecom and SES, a Luxemburg based satellite operator, the Commission spent more effort on examining the clauses of the agreement, and their implications, than on clearly a market and studying how it would be impacted. In *Langnese Iglo* ([1993] OJ L183/19), although the German market for ice cream was examined in detail, the Commission's legal assessment was wholly clause driven.

<sup>178</sup> Two interesting rulings by the CFI that should be mentioned in this regard are *Langnese Iglo v. Commission* (case T-7/93, [1995] ECR II-1533, and *Schöller v. Commission* (case T-9/93, [1995] ECR II-1615). In both cases the Commission was faulted for not following the analytical framework set out in the case of *Stergios Delimitis v. Henninger Bräu* (supra, footnote 176). Before that, however, the Commission was never seriously faulted for its approach. In this regard, it should be realised that the ECJ may, in a sense, have benefited from the Commission's expansive approach. Particularly in the early period the Court shared the Commission's interest in limiting member states influence. If competition law would be enforced primarily at the national level, this would affect the Court's ability to engineer the development of European antitrust policy. In that case, the ECJ would have been primarily dependent on requests for preliminary rulings by national courts. Whether there is an issue of European law to be clarified, however, is a matter that national courts decide for themselves. Tolerating the Commission's form-based approach offered the Court more secure access to a stream of cases that would enable it to have a serious impact on developments.

concern the scope for taking positive effects into account in the investigation under Art 81(1) EC, but the prior question of the basic requirements for showing a negative effect – more or less abated in the face of a comprehensive overhaul of the Commission’s substantive approach, based on more thorough economic analysis, and the abolishment of the notification procedure, which took place roughly around the same time that the *Métropole* ruling was given.<sup>179</sup>

## 2.4 Modernisation and the generic objectives of EC antitrust

The modernisation of the Commission’s antitrust policies should be seen in the light of the evolution (over the past 50 years) of the objectives of EC antitrust. Our discussion of the modernisation process therefore starts (in Section 2.4.1) with a brief introduction to the dynamics of this evolution. Next (in Section 2.4.2), we zoom in on the generic antitrust objectives of EC competition policy, which are of particular importance to the Commission’s modernised approach to effects-based analysis. This is followed (in Section 2.4.3), by an overview of the substantive reforms.

### 2.4.1 An overview of recent developments

At the start of EC antitrust policy, and for a long time thereafter, integration of Member State economies was the main unifying theme in the case law and decision practice. More recently, however, ‘generic’ antitrust objectives, those related to the creation and exercise of private economic power, have become more important, to a point where they can be said to be pre-eminent or, at least, to be on equal footing with the integration imperative. In addition to contributing to major changes in the substance of the law, these developments have had an effect on the procedural framework surrounding Art 81 EC and have altered the roles played by the different actors in the antitrust field.

The relative decline of the integration imperative has been attributed to the progress that has been made over the years in establishing the Single Market.<sup>180</sup> Particularly after ‘1992’, when most law-based obstacles to intra-community trade were removed, it became less apparent that integration should be the most important

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<sup>179</sup> Supra, footnote 54.

<sup>180</sup> See e.g. Ehlermann (1998: x), Schaub (1998: 126), Gerber (1998: 374-376), and Wilks and McGowan (1996).

immediate policy aim of EC antitrust.<sup>181</sup> In response to these and other developments, the Commission began to re-evaluate the foundations for its decision-making in the mid-1990s. This resulted in a major overhaul of its substantive approach that included several new block exemption regulations and guidelines. As we will see below, these documents, particularly as regards their treatment of the analysis under Art 81(3) EC, reflect an more economic approach that is focused on the actual effects produced by restraints and, in particular, the effects on consumers.

To be sure, even under the new approach absolute territorial protection remains *per se* illegal.<sup>182</sup> There are indications, however, that the scope of this ban has somewhat narrowed.<sup>183</sup> Regulation 2790/99, for example, includes exclusive distribution agreements in the block exemption provided for vertical restraints, as long as they do not contain restrictions on so-called ‘passive’ sales to customers originating in a territory awarded to another member in the distribution network.<sup>184</sup> A sale is passive if the initiative for the transaction was taken by the customer in question. This means that under the new regime manufacturers may legally require their distributors to refrain from actively approaching customers in another reseller’s territory.<sup>185</sup> The CFI’s recent ruling in the case of *Glaxo v. Commission* is also of importance in this regard.<sup>186</sup> This case involved an agreement with wholesalers that required them to pay higher prices for medicines which they exported than for products resold on the Spanish market. The aim was to prevent these resellers from taking advantage of differences in the prices for these same products set by health insurance schemes in other Member States, notably the UK. Glaxo argued that such parallel trading undermined its capacity to develop new products. Despite the fact that such an

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<sup>181</sup> For a discussion of the objective set in 1985 to unify the European market by the 1<sup>st</sup> of January 1993 and of its implications on EC antitrust in particular, see Gerber (1998: 369).

<sup>182</sup> The continued importance of the integration imperative is evidenced by such cases as *JCB*, [2002] OJ L69/1, and *Volks Wagen*, (supra, footnote 37), where the Commission imposed fines of €40 and €102 million, respectively. In the latter case these fines were later reduced by the CFI to 90 million ([2000] ECR II-2707).

<sup>183</sup> This interesting topic is not exhaustively dealt with in this work. Our focus is on the application of the effects-based standard to individual cases (i.e. those involving agreements that cannot benefit from a block exemption regulation). On the whole, restrictions of parallel trade remain prohibited *per se*, meaning that to show that they infringe Art 81 EC it is sufficient that the existence of an agreement with such a purpose is shown. Since effects are generally not examined, the issue of restrictions on parallel trade falls outside the scope of this work.

<sup>184</sup> See Art 4(b) of Regulation 2790/99, [1999] OJ L336/21.

<sup>185</sup> See para. 49 and following of the Commission’s guidelines on vertical restraints, [2000] OJ C291/1. For commentary on these matters, see Korah (2002), Bishop (2002), Ridyard and Bishop (2002), and Whish (2000).

<sup>186</sup> Supra, footnote 176.

agreement would ordinarily be subjected to the object standard,<sup>187</sup> the Court determined that a more broadly construed investigation was called for. In particular, it required that the effect of the agreement on consumers be taken into account. The reason the court adopted this stance is that, in the context of the heavily regulated market for pharmaceuticals, it was not obvious that restrictions on parallel imports would have the effects that could normally be presumed.<sup>188</sup>

Roughly around the same time that the Commission revamped its substantive approach, Regulation 17/62<sup>189</sup> was replaced by Regulation 1/2003.<sup>190</sup> This regulation, which entered into effect on the 1<sup>st</sup> of January 2004, introduced two major changes that removed most of the causes for the debate on a *rule of reason* in Art 81(1) EC. Firstly, by abandoning the notification requirement, the whole of Art 81 was given direct effect. It is important to realise that this implies a shift in the timing of legal intervention. A system of enforcement that relied mainly on ex ante screening was substituted by a system solely dependent on the deterrent effect of ex post interventions. In principle, firms can no longer notify and obtain an explicit endorsement by the Commission at the time the contract is signed; the responsibility to assess the legality of the agreement is left over to firms and their legal counsel. Secondly, the Commission's monopoly to investigate whether an agreement satisfied the conditions of Art 81(3) was abolished. This opened the way for additional public enforcement by national competition authorities and for private enforcement in national courts.<sup>191</sup>

One of the main reasons advanced for the system-change, which had not featured prominently in the *rule of reason* debate and can be taken as a clear sign of the reorientation on generic antitrust objectives, was that the Commission needed to free its hands so that it could concentrate enforcement efforts on more serious types of

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<sup>187</sup> In this regard, it referred i.a. to the rulings in *Consten and Grundig* (supra, footnote 46) and Miller, Case 19/77, [1978] ECR 131.

<sup>188</sup> Supra, footnote 176, at paras. 110-134. For commentary on this ruling, see Korah (2007) and Junod (2007).

<sup>189</sup> Supra, footnote 86.

<sup>190</sup> [2003] OJ L1/1. In Chapter 5 these procedural reforms are discussed in more detail.

<sup>191</sup> Not surprisingly, given the fact that the need to create a uniform system was one of the major arguments to keep member states at bay in the formative period, the fact that over the course of the ensuing 40 years a 'culture of competition' had taken root in Europe features prominently amongst the reasons advanced by the Commission for sharing these powers (see the White Paper on Modernisation of the rules implementing articles 85 and 86 of the EC Treaty, [1999] OJ C132/1, at point 8).

infringements that would never be notified.<sup>192</sup> This should be understood as follows. In the early period, the Commission (and the Court) saw restraints on trans-border trade as the primary threat to be countered by means of the antitrust provisions in the Treaty.<sup>193</sup> This led to a strong focus on vertical restraints, largely because they represent the most obvious and frequently used obstacles to trade.<sup>194</sup> As generic antitrust objectives became more important, the Commission began to devote more serious attention to horizontal cartels and joint ventures.<sup>195</sup> This is because, in general, agreements between competitors have a greater potential to distort the competitive process (on an integrated market) than agreements between firms operating at different levels of the distribution chain. The notification system acted as a break on this policy shift, however, since it compelled relatively large numbers of firms to notify largely innocuous vertical agreements and, thus, forced the Commission to devote part of its resources to processing these notifications. Note, also, that with the promise of a more thorough economic approach and the abolishment of the notification requirement, most of the problems that led to calls for a *rule of reason* appeared to be solved.

Finally, it should be noted that these developments coincided with subtle changes in the roles played by the different actors in the antitrust field.<sup>196</sup> The modernisation process allowed the Commission to assume a position of intellectual leadership. Particularly in the first three decades, it was the Court that fulfilled the leading role in the development of EC antitrust.<sup>197</sup> Many of its rulings contained broad teleological statements that guided the Commission in its attempts to expand the substantive scope of competition policy and to use it as a means to foster integration.<sup>198</sup> The Court's

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<sup>192</sup> See e.g. para. 13 (executive summary) of the Commission's white paper on modernisation of the rules implementing Articles 85 and 86 of the EC Treaty, of 28 April 1999, published on the Commission's website.

<sup>193</sup> See the discussion above in Section 2.3.1.

<sup>194</sup> See Gerber (1998: 354), Amato (1997: 47), Holley (1993: 672), and Wilks and McGowan (1996: 228).

<sup>195</sup> This process started very slowly in the late 1970s and gathered speed in the 1990s. For a discussion, see Gerber (1998).

<sup>196</sup> In this regard, see Gerber (1998: 371-381).

<sup>197</sup> See Gerber (1998: 351) and Wilks and McGowan (1996: 238).

<sup>198</sup> Here one can think of the broad language used in cases such as *Société Technique Minière* (supra, footnote 45); *Consten and Grundig* (supra, footnote 46); *Continental Can* (Case 6/72, [1973] ECR 215), where it opened the road to challenging acquisitions under Art 82 EC; *Commercial Solvents* (Cases 6 and 7/73, ECR 357), concerning the application of Art 82 EC to refusals to deal; and *Metro I* (supra, footnote 59).

mode of adjudication is reported to have gradually changed, however.<sup>199</sup> With a well developed body of case law to rely on, the Court has increasingly come to apply existing concepts and tends to stay relatively close to the facts of the case before it. Arguably, the institution of the CFI has solidified this situation. It has frequently been argued that the CFI subjects the Commission's fact-finding to more intense scrutiny than the ECJ did.<sup>200</sup> Some have pointed out, however, that it is not in a very good position to take bold new steps on matters of substance, since it has to manoeuvre within the framework of the case law developed by the ECJ.<sup>201</sup> It should be noted, also, that the re-orientation on generic antitrust objectives works in the same direction. This follows from the ECJ's ruling in the *Remia* case that was discussed above.<sup>202</sup> In principle, where the Commission has to appraise 'complex economic matters', judicial review is limited to an evaluation of whether there has been a manifest error of appraisal. The larger the role played by economics in antitrust analysis, the less scope there is for the Courts to exercise leadership.<sup>203</sup> In the next section we will zoom in on these generic objectives of EC antitrust, since they are of primary importance in trying to understand the evidentiary requirements imposed by the modernised effects-based standard.<sup>204</sup>

## 2.4.2 Generic antitrust objectives

### *Ultimate objectives*

In discussing the goals of EC antitrust it is useful to distinguish between ultimate and intermediate objectives. The ultimate objectives can be thought of as the general benefits that are expected from competition policy. At this rather abstract level, there

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<sup>199</sup> See Gerber (1998: 371), who notes that the impending evaporation of the integration imperative is likely to have played a role in this less 'activist' stand, and, more generally, Rasmussen (1986).

<sup>200</sup> See e.g. Nehl (1999), Van der Woude (1992), and Wilks and McGowan (1996: 238), who all note that the same applies to the evaluation of procedural shortcomings.

<sup>201</sup> See Gerber (1998: 375) and Brent (1995). We return to this issue below in Chapter 7, Section 7.4, where these arguments are examined in the light of more recent CFI case law.

<sup>202</sup> *Supra*, footnote 29.

<sup>203</sup> In this sense, see Gerber (1998: 373).

<sup>204</sup> Again, this is not to say that the role of the integration imperative in EC antitrust is played out. In this regard, see footnote 182 and the accompanying text. As noted by Amato (1997: 48), however, impediments to integration are generally considered so nefarious in the European context that they are subjected to object-based (*per se*) analysis (the CFI's judgment in the case of *Glaxo v. Commission*, *supra*, footnote 176, provides an exception to this rule). In effects-based analysis – the focus of this thesis – it is mainly the generic antitrust objectives that are of importance, therefore.

seems to be a fair amount of consensus.<sup>205</sup> The basic thought is that competitive markets produce benefits that are lost under private monopoly (or state control). Competition, in this context, must be seen as a process of rivalry between several firms in a market for the business of customers. Under monopoly there is only one firm supplying the market. The social advantages of choosing competition over monopoly are generally divided into three groups: allocative benefits, productive benefits and dynamic benefits.<sup>206</sup>

To begin, competition tends to temper prices. This is because a firm that imposes a price increase that is not matched by an improvement in quality risks losing profits, as customers may decide to buy the lower-priced products offered by competing firms. A monopolist is not constrained in this way and may, thus, charge a higher price. This will lead a number of customers that would buy the product in question for the lower price charged in the competitive situation to spend their money on other types of products. Under monopoly, therefore, society will allocate resources to the production of goods that consumers favour less. In addition, under competition firms will have an incentive to bring their costs of production down. This is a way for them to lower their price and make more profits by expanding their output at the expense of less efficient rivals. A monopoly will also benefit from bringing down costs. But its managers, accustomed to sizable profits, may pursue this cause with less vigour. Competition, therefore, is a way to ensure that as little of society's resources are consumed in the production process as necessary. Finally, it is often suggested that competition may give incentives to firms to expand the range of choices available to consumers by developing new and better products, whilst monopolists may be slow to innovate.<sup>207</sup>

Naturally, none of these benefits is absolute. Although costs reductions may be held back by managerial inefficiency, monopolies may well be in a position to take advantage of economies of scale that are unattainable under competitive conditions.

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<sup>205</sup> See the contributions by Ehlermann, Schaub, and Hawk in Ehlermann and Atanasiu (1998). See also Whish (2003: 2), Bishop and Walker (2003: 11), Hildebrand (2002: 107), and Van Cayseele and Van den Bergh (2000).

<sup>206</sup> For a more detailed discussion of these matters, see e.g. Scherer and Ross (1990).

<sup>207</sup> Note that at this basic level there is no conflict between the integration objective and the generic objectives. The Treaty aims to establish an efficiently functioning trans-national market with no barriers to cross-border trade and where firms can take maximum advantage of scale economies. It is at the intermediate level where these objectives might conflict. In this regard, see the contributions by Schaub, Forrester and Kirchner in Ehlermann and Atanasiu (1998).



This implies that productive efficiency need not be impaired by monopoly.<sup>208</sup> Similarly, it can be argued that some measure of supra-competitive profits is needed or, at least, very helpful to fund the research and development that goes into the marketing of a new or improved product.<sup>209</sup> Still, the adoption of antitrust provisions in the Treaty reflects the judgment that, on the whole, an economy based on competitive markets appears to be preferable to one characterised by monopolies.

### *Intermediate objectives*

It will be evident that these very general notions offer only limited practical guidance in interpreting the implications of the broad language contained in Art 81 EC for individual agreements. This is where intermediate objectives come in. These may be thought of as translations of the ultimate objectives into more concrete criteria for law enforcement that indicate what type of effects we must look for to determine whether a restriction of competition falls foul of the antitrust laws and why these are considered harmful.<sup>210</sup>

Any inquiry into the intermediate objectives of EC antitrust is complicated, however, by a number of factors. As we saw, judgments by the Courts tend to stay relatively close to the facts of the case at bar.<sup>211</sup> The more broadly applicable statements in cases such as *Société Technique Minière* indicate only the type of facts that may be of relevance in determining whether a restriction of the competitive process is caught by Art 81 EC.<sup>212</sup> They do not offer generalised statements about the reasons why prohibited behaviour is considered harmful. The Commission's guidelines offer more insights on these matters.<sup>213</sup> It should be remembered, however, that these do not necessarily reflect the position of the Courts and, as we will see in the chapters that follow, even the Commission may not always apply the framework

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<sup>208</sup> For a broader discussion, see e.g. Scherer and Ross (1990: 97) and Van Cayseele and Van den Bergh (2000).

<sup>209</sup> This argument is most closely associated with the work of Joseph Schumpeter. For a discussion, see e.g. Hildebrand (2002: 125 and 165).

<sup>210</sup> This definition is taken from the contribution by Schaub in Ehlermann and Atanasiu (1998).

<sup>211</sup> See footnote 195 and accompanying text.

<sup>212</sup> *Supra*, footnote 45. The same applies for the cases mentioned in footnote 176 (*Völk v. Vervaecke*; *Stergios Delimitis v. Henninger Bräu*; *European Night Services v. Commission*; and *Glaxo v. Commission*).

<sup>213</sup> See the discussion below on the Commission's notice on the application of Art 81(3) EC (*supra*, footnote 61).

set out in the guidelines in a consistent manner.<sup>214</sup> This leaves considerable room for discussion about the operational objectives of EC antitrust.<sup>215</sup>

The most debated issue, at this time, concerns the width of EC antitrust's generic antitrust objectives.<sup>216</sup> More specifically, it is asked whether EC antitrust focuses exclusively on restrictions of competition that directly harm consumers, or whether it protects a larger class of interests and is therefore aimed at a wider range of restrictions.<sup>217</sup> Note that this question does not concern the scope in EC antitrust for the non-competition related policy objectives of the Treaty (employment, environment, etc).<sup>218</sup> Nor are we dealing with the scope of the integration imperative.<sup>219</sup> Rather, the question is whether restrictions of the competitive process that do not directly hurt consumers may be caught because they disrupt the functioning of the market in a way that could cause damage for the economy (and consumers) in the long term. Here one can think of an agreement between firms that is used to exclude a third company from the market. It has been suggested that allowing such behaviour in cases where there is no noticeable effect on prices, volumes, or quality may eventually act as a disincentive for new firms to participate in the market process.<sup>220</sup> This view appears to find at least some support in our discussion above of the case law concerning the *rule of reason*.<sup>221</sup> There, we saw that, generally, the focus is on the effects of a restraint on the competitive process and not so much on the effects for consumers. On the other hand, the Commission's substantive modernisation programme and, in particular, its 2004 notice on the application of Art 81(3) EC<sup>222</sup> (hereafter: Notice) seems to indicate that the intermediate objectives of EC antitrust, as far as the application of Art 81 EC is concerned, have narrowed over the past years.<sup>223</sup>

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<sup>214</sup> See Chapters 4 and 5.

<sup>215</sup> See, for instance, Ehlerman and Laudati (1998), which contains a total of 34 contributions on this topic.

<sup>216</sup> The Commission's plans for reform of its approach under Art 82 EC (in this regard, see the Commission's 2005 staff paper on exclusionary abuses of dominance and the 2008 draft guidelines on abusive exclusionary conduct by dominant undertakings, both published on the Commission's website) have worked to intensify the debate on this topic. See e.g, Gual (2005), Gerber (2008b), Ahlborn and Padilla (2008), and Zimmer (2008).

<sup>217</sup> On these matters, see e.g. Hildebrand (2002), Fox (2001), Zimmer (2008), Gerber (2008b), and Ahlborn and Padilla (2008).

<sup>218</sup> In this regard, see Section 2.2.3.

<sup>219</sup> In this regard, see Section 2.3.2.

<sup>220</sup> See Zimmer (2008).

<sup>221</sup> See Section 2.3.2.

<sup>222</sup> *Supra*, footnote 61.

<sup>223</sup> In this sense, see in particular Lugard and Hancher (2004) and Marsden and Whelan (2006)..

This Notice defines the objective of Art 81 EC as protecting competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources.<sup>224</sup> The focus on consumer welfare is reflected in the criteria advanced by the Commission for the assessment under Art 81(1) EC. If they do not fall in the object-category, restrictions of (inter and intra-brand) competition are caught if they 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 can be expected ‘with a reasonable degree of probability’. Clearly, then, the Commission did include a ‘consumer harm requirement’ in the assessment under Art 81(1) EC. Sadly, this does not mean that it solves the question at issue in the fundamental debate mentioned above. This is because the Commission considerably qualifies this requirement by stating that harm should be made plausible. And at the same time, it provides fairly little information as to how this determination of plausibility is to be made: what evidence can be relied on and what standard (measure of probability) will be used. It provides only two indications. The first is that a mere restriction of commercial freedom is insufficient evidence to presume that such effects will ensue.<sup>225</sup> The second is that firms must possess market power if they are to adversely affect competition in a way that violates Art 81(1) EC.<sup>226</sup> Before we continue our discussion of the Notice and the way in which it changes competition analysis, it is important that we examine this concept market power in more detail. For this purpose, we must return to our discussion of the economic analysis of competition.

### *Market Power*

When free agents engage in a commercial transaction, we must assume that they attribute different values to the goods exchanged. For the deal to pull through, each party will have to put a higher value on the good delivered by his counterpart than on the good he surrenders. The value that different customers in a market will assign to the commodity in question (their reservation price) will depend on their circumstances and needs. For people living in an isolated part of the countryside or for those who have to travel frequently for work, owning a car may be a necessity. By comparison,

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<sup>224</sup> Supra, footnote 61, at paras. 13 and 33.

<sup>225</sup> Id., at para. 24. In this regard the Commission remarks that a mere restriction of commercial freedom is insufficient evidence to presume that such effects will ensue.

<sup>226</sup> Id., at para. 25.

city dwellers that can easily get to work by bike or metro will attach a lower value to having a car. Economists use the term consumer surplus to refer to the combined satisfaction in excess of the price paid that all customers on a market derive from the product bought. Firms' combined profits are called the producers' surplus.

Market power is the capacity of a firm (or a combination of firms) to capture part of the consumer surplus in a market by restricting competition, that is, to transfer wealth away from consumers. This can be understood as follows. If the market price increases, the total number of units sold will generally go down. This is so, because the market price will come to exceed certain customers' reservation price. The effect on producers' profits depends on exactly how sensitive buyers are, as a group, to the price increase. If demand is inelastic, that is, if there is but a limited reduction in the quantity sold and the extra revenue secured by the price increase more than compensates for the associated loss in revenue, producer surplus will expand at the expense of consumer surplus. It is important to realise that in a competitive market the demand faced by an individual firm will tend to be more elastic than the demand faced by an industry as a whole. If other manufacturers are able to supply the same product in the same area at the lower price, a firm's unilateral attempt to exploit consumers will most likely fail. In such a context, where individual firms lack market power, a joint effort by producers to reduce collective output will be required to increase profits.

The exercise of market power will not only result in the transfer of wealth to producers. In the process, some wealth will be lost altogether. This is because consumers who leave the market will derive less satisfaction from second-choice products and producers will make a relatively smaller margin in producing these.<sup>227</sup> In economic theory such a pure loss for society is often called a deadweight loss.<sup>228</sup> Note, also, that this deadweight loss may be larger still. This is because a monopolist or a cartel may need to invest part of its extra profits in the maintenance of their

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<sup>227</sup> If their reservation price for this other product had been higher than the reservation price for the product in the market where competition is restrained, it would be wrong to count them amongst the customers they

<sup>228</sup> An alternative to the consumer welfare standard defined by the Commission its Notice would be the so-called total welfare standard. As we saw, the consumer welfare model asserts that the pre-eminent goal of antitrust should be to prevent restrictions of the various dimensions of output that lead to decreased consumer welfare due to the exercise of market power by firms. According to the alternative view the main objective of antitrust is to prevent that the exercise of market power leads to the reduction of welfare in society as a whole. Restrictions of competition that lead to harm to consumers that is fully off set by gains in terms of producer surplus are not caught in this model. For a discussion, on this matter see Van den Bergh and Camesasca (2001).

market power (rent seeking behaviour). Potential entrants that would provide customers with an opportunity to satisfy their demand for the product at a lower price will have to be kept off the market. Cartel members also face the threat that insiders might defect. They will need to erect an infrastructure that allows members to communicate and monitor each other's behaviour. Such investments to protect future monopoly profits do not contribute to the production process and represent an additional waste of social resources.

Thus far, we have considered the effects of a reduction of the volume of production combined with a price increase. In actual markets, the exercise of market power can also be manifested in other dimensions of output. Producers may, for example, reduce the quality of the product, whilst continuing to sell it at the same price. This will enable them to reduce their costs of production and, thus, to increase profits. Consumers are left with a product that gives them less satisfaction. Alternatively, the restriction may affect the range of choice available to consumers (product variety) or impose limits on the resources devoted to pursuing innovation.

*Ways to identify market power: structure or conduct*

The final step in making the ultimate objectives operational is to link the intermediate objective of preventing the exercise of market power to types or categories of evidence that may be relied upon in substantiating a claim that Art 81 EC has been violated.<sup>229</sup> In this regard, we must realize that harm to consumers will seldom present itself as a self-evident fact. It tends to be spread out over numerous unidentified persons, who may be affected differently (some may buy at the higher price; others might spend their money on products that they value less). In addition, to understand how they are affected, if harm has indeed been done, it is necessary to construe a hypothetical image of the world without the restraint; that is, an image that shows how consumers would have fared in the absence of the restriction. The so-called Structure-Conduct-Performance framework is highly important in understanding what general form such evidence may take.

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<sup>229</sup> At this level, the Commission's other guidelines are of importance. See, notably, the Commission's Notice on the definition of the relevant market for the purposes of Community competition law, [1997] OJ C372/03; the Guidelines on the applicability of Article 81 to horizontal co-operation agreements, [2001] OJ C3/2; and the Guidelines on Vertical Restraints (supra, footnote 185).

This framework, one of the pillars of the Industrial Organization branch of economics,<sup>230</sup> tells us that market structure and certain basic conditions have an important bearing on the conduct displayed by firms and, ultimately, on how well a market performs from the perspective of consumers and society as a whole.<sup>231</sup> More specifically, it is argued that performance depends on the conduct of sellers in terms of pricing, advertising, inter-firm cooperation, investments in research and development or production facilities, etc. Conduct, in turn, depends on the structure of the market, that is, on such factors as the number and relative size of sellers and buyers, the degree of differentiation between competing sellers' products, and the presence or absence of barriers to the entry of new firms. And, finally, market structure is influenced by a variety of basic conditions. On the supply side, for instance, the ownership of essential raw materials, the nature of the relevant technology, the durability of the product and the value/weight ratio of the product may be of importance, whilst on the demand side price elasticity will be of primary importance. To be sure, not all influences flow from basic conditions and market structure in the direction of performance. There are important feedback effects. Profits may, for example, be used to intensify research and development efforts or to increase advertisement. The former may alter the basic technologies used in the industry, whilst high advertising expenditures may raise barriers to entry.

In effects-based analysis, there are, thus, several options open to parties that set out to gather evidence to support their claim that Art 81 EC has been violated. One option would be to focus on the competitive structure of the market. It could be argued, for example, that the agreement at issue alters the structure of the market by allowing formerly independent operators to act in concert and that their combined mass and the absence of potential entrants affords them the possibility to exploit consumers. In its Notice the Commission indicates that evidence concerning market structure will generally play an important role in the assessment under Art 81(1)

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<sup>230</sup> This conceptual framework was developed in the Harvard tradition of Industrial Organization, where it was used as a theoretical basis for empirical studies into the relationships between structure, conduct and performance in real-life industries. As we will see in Chapter 5, Section 5.3.1.1, the policy agenda based on the work done in this tradition was later criticised by members of a different school, originating at the university of Chicago, who were more oriented towards theoretical analysis. Note, however, that their criticism did not centre on the basic framework itself. The price theory models used by Chicagoans are also structured according to the number and relative size of sellers and buyers, for instance.

<sup>231</sup> For a more detailed discussion of the Structure-Conduct-Performance framework, see e.g. Scherer and Ross (1990) and Hildebrand (2002).

EC.<sup>232</sup> Another option would be to focus more on conduct. An enforcer might build his case on evidence concerning lower volumes and higher prices that are not explained by exogenous factors such as an increase in the prices for inputs. The Notice makes reference to this type of evidence as well. A third alternative, not explicitly discussed by the Commission, would be to combine both types of evidence. Apart from these brief and abstract statements on market structure and direct evidence, however, the Notice is mostly silent on how, in the analysis under Art 81(1) EC, it can be shown with a reasonable degree of certainty that an agreement will produce a negative impact on consumers (through prices, output, innovation or the variety or quality of goods or services).

Arguably, the discussion in the Notice on the assessment under Art 81(3) EC provides some indications on the required level of substantiation. As noted, the assessment under Art 81(3) EC is concerned with countervailing benefits produced by the challenged agreement. Naturally, these may occur in the same dimensions of output as the negative effects: price, volume, innovation or the variety or quantity of goods or services. The Notice holds defendants to quite an exacting test for showing efficiencies. They have to substantiate their claims by providing verifiable data that allows the Commission to determine with a sufficient degree of certainty – note the similarity with the terminology used in the part of the Notice on Art 81(1) EC – that these effects have materialised or will materialise. In principle, there is no reason why the accusing party should be held to a different standard of the evidence than the defendant, that is, why plausible should mean something else in the assessment under Art 81(1) EC than in the assessment under Art 81(3) EC. Moreover, if the Commission requires defendants to provide as much quantitative evidence on efficiencies as possible (particularly where cost efficiencies are concerned) in order to allow them to be balanced in an insightful way with negative effects, then, by implication, the Commission must proceed accordingly in the assessment under Art 81(1) EC.

It will be evident that the approach described in the Notice represents a considerable departure from the Commission's practice prior to substantive modernisation that was described above. Notice, however, that these statements in the Notice are best understood as guidelines on the conceptual framework underlying

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<sup>232</sup> Supra, footnote 61, at para. 27.

competition analysis. As we will see in subsequent chapters, in practice these levels and methods of substantiation are seldom witnessed. In the next section we take a closer look at the Commission's remaining notices and guidelines, which offer more concrete and relevant information about the basic type of facts – of a structural or other nature – that the Commission looks at in assessing the effects produced by restraints.

### 2.4.3 An overview of substantive modernisation

The first component of the substantive modernisation process was a notice on market definition, issued in 1997.<sup>233</sup> In the following years the Commission issued a new block exemption regulation<sup>234</sup> and guidelines<sup>235</sup> concerning vertical restraints, block exemption regulations regarding specialisation agreements<sup>236</sup> and research and development agreements,<sup>237</sup> guidelines on horizontal co-operation in general,<sup>238</sup> and, finally, the notice on the application of Art 81(3) EC.<sup>239</sup> The framework of analysis to be applied in individual cases that emerged from these documents involves a number of sequenced inquiries: (1) classification of the agreement as a vertical or horizontal restriction of the competitive process;<sup>240</sup> (2) definition of the relevant market; (3) examination of the structure of this market; (4) identification of the negative effects produced by the restraint in this market; (5) identification of efficiencies; and (6) balancing of the two effects. In what follows, we will first consider the approach adopted in defining relevant markets. Next, we will discuss the guidelines on vertical restraints and horizontal cooperation, which are particularly informative on points 1 and 3-5. Finally, we return to the notice on Art 81(3) EC which is informative about the method adopted in balancing positive and negative effects. Together, these

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<sup>233</sup> Commission Notice on the definition of the relevant market for the purposes of Community competition law (supra, footnote 229).

<sup>234</sup> Commission Regulation 2790/99, on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (supra, footnote 184).

<sup>235</sup> The Guidelines on Vertical Restraints (supra, footnote 185).

<sup>236</sup> Commission Regulation 2658/2000, on the application of Article 81(3) of the Treaty to categories of specialisation agreements, [2001] OJ L 304/3.

<sup>237</sup> Regulation 2659/2000, on the application of Article 81(3) of the Treaty to categories of research and development agreements, [2001] OJ L 304/7.

<sup>238</sup> Guidelines on the applicability of Article 81 to horizontal co-operation agreements (supra, footnote 229).

<sup>239</sup> Supra, footnote 61.

<sup>240</sup> This phase involves the question whether the agreement must be subjected to the object or the effects standard. The pattern laid out here only applies to effects-based analysis.



documents suggest that the new regime is intended to be more permissive, that is, that the prohibition contained in Art 81 EC catches fewer agreements.<sup>241</sup>

We have seen that the Commission's approach prior to the reforms was predominantly form-based. If an agreement contained clauses tending to restrict the commercial freedom (the ability to make decisions independently), there was a good chance that it would be found to violate at least Art 81(1) EC. The market affected by the restraint at issue would often be addressed, but the results of such inquiries would seldom play a decisive or even explicit role in the determination of legality.<sup>242</sup> This has changed with modernisation. Market definition is seen as a crucial preliminary step in assessing market power and, thus, the effects produced by a restraint. Its purpose is to get an impression of the competitive environment of the undertakings involved in a case, which can act as the background against which their actions can be examined. The investigation centres on the products sold by the undertakings concerned and the possible substitutes for these products that are available to their customers.<sup>243</sup> Before 1997 potential substitutes would be examined in terms of their physical characteristics, their intended end-uses, and their prices, to determine whether they should be included in the relevant market.<sup>244</sup> The focus was therefore mainly on the demand side.<sup>245</sup>

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<sup>241</sup> The relaxation in the application of Art 81(3) EC, the centre of gravity of the reforms, is most clearly evidenced by the block exemption of Regulation 2790/99 (supra, footnote 184), which extends to all possible forms of vertical agreements rather than just a few listed ones. This contrasts starkly with the older block exemption regulations in this field (supra, footnote 103) applied to certain specified forms of vertical agreements and typically contained white lists of clauses that could safely be adopted in such agreements and black lists of prohibited clauses.

<sup>242</sup> Joint ventures may also produce effects that are assessed within the framework of concentration control. A considerable amount of market structure analysis would be engaged in to determine whether the agreement was concentrative or cooperative in nature. For a detailed discussion on pre-modernisation treatment of joint ventures, see Vogelaar (2001: 130).

<sup>243</sup> Substitutability is examined both in absolute terms (to see what inherent competitive relationship exists between the product of the companies and other products) and in a spatial sense (which involves an inquiry into the expanse of the geographical area surrounding the companies in which the pressures arising from the existence of such other products is sufficiently strong to be taken into account).

<sup>244</sup> See the cases *United Brands v. Commission*, Case 27/76, [1978] ECR 207; *Hoffman-La Roche v. Commission*, Case 85/76, [1979] ECR 461, and *Aerospatiale-Alenia/de Haviland*, [1991] OJ L334/42. This approach was often criticised for being impressionistic. In this regard, see Van den Bergh (1996); Ridyard and Bishop (1999: §3.17-37); Camesasca (2001); and Kauper (1997).

<sup>245</sup> In most cases supply side substitution was given much less attention. A number of cases concerning a joint venture form an exception. It has been suggested, however, that the Commission seems to have used supply side arguments mainly for the purpose of defining separate markets where demand side considerations would suggest a single market, that is, in order to let these agreements be caught by Art 81(1) EC rather than to clear them straight away (Bishop and Ridyard, 2002: §3.23). For an example, see the Commission's decision in the case of *KSB/Goulds/Lowara/ITT* (OJ [1991] L19/25).

The Commission's notice on market definition aims to describe a more rigorous process.<sup>246</sup> In the first place, it expands the scope of the investigation vis-à-vis the old approach. In addition to demand side substitution, supply side substitution<sup>247</sup> and potential competition<sup>248</sup> may also be taken into account.<sup>249</sup> Secondly, the examination of substitutability is structured by means of a hypothetical experiment that is referred to as the SSNIP-test, which stands for a small but significant non-transitory increase in price. The experiment tries to identify all products that should be considered to be in the same market as that of the undertaking involved. It starts by supposing that the undertaking involved is a monopolist (i.e. the only supplier of the product, without there being substitutes), and tries to confirm this by imposing a SSNIP. If indeed the firm is a monopolist, it should be able to raise its price profitably. If not, the market was defined too narrowly and the product to which consumers have turned must be included. The process of including other products must continue until a SSNIP is profitable.<sup>250</sup> The notice indicates that the Commission follows an open approach as to the empirical evidence which it considers fit to give substance to this hypothetical experiment.<sup>251</sup> The starting points are physical characteristics and intended end-use of the product, but it considers the analysis thereof insufficient to give full proof of substitutability (or lack thereof). In this regard the Commission will especially give attention to evidence of substitution in the recent past, econometric and statistical tests, and views of customers and competitors. When in this way the relevant market has been defined, we enter the next phase of the analysis: the examination of the structure of this market and the effects thereon produced by the restraint. Here, the guidelines on vertical restraints and horizontal cooperation become relevant.<sup>252</sup>

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<sup>246</sup> For commentary on this notice, see e.g. Veljanovski (1998); Baker (1998); Camesasca and Van den Bergh (2001); Harbord and von Graevenitz (2001); Furse (1997); and Desai (1997).

<sup>247</sup> Here, one must think of manufacturers that are not yet established in the market but which are able to enter and start providing the same products on short notice and without incurring significant and unrecoverable costs or risks.

<sup>248</sup> This relates to the more distant threat that emanates from firms that do face such obstacles and could therefore enter the market only with significant delay.

<sup>249</sup> Demand side substitution is regarded by the Commission as the most immediate and effective of these constraints, and substitution on the supply side is considered only when its effects are equally strong. Potential competition is not taken into account when defining the relevant market, but will be considered if necessary in the later phase of the competition analysis, when assessing the impact on competition of the act under scrutiny. See paras 7-24 of the Market Notice (supra, footnote 229).

<sup>250</sup> *Id.*, at paras. 15-19.

<sup>251</sup> *Id.*, at paras. 25-27 and 36-43.

<sup>252</sup> For discussions on the new approach to vertical restraints, see Whish (2000), Bishop (2002), Bishop and Ridyard (2002: 35), Peepkorn (2002), Hughes (2001), and Van den Bergh and Camesasca (2001). See Griffiths and Nüesch (2000) and Vogelaar (2002) for discussions of the new approach to horizontal cooperation.

The examination of market structure and of the position of the firm in question on the market serves as an indication of their capacity to exploit their customers. The main focus of attention, at this stage of the analysis, will be on the market shares of the defendant and his competitors, on possible barriers to entry on the market and on the market position (countervailing power) of buyers.<sup>253</sup> Even if significant indications are found that the firm in question enjoys a position of strength, this is not in itself sufficient to conclude that Art 81(1) EC has been violated, however. First, the impact of the agreement on the relevant market must be studied.<sup>254</sup> The restrictions of inter-brand competition contained in horizontal agreements<sup>255</sup> may facilitate collusion and may affect prices, output, innovation or the variety or quality of goods and services.<sup>256</sup> Vertical restraints,<sup>257</sup> in turn, may lead to restrictions of inter and intra-brand competition and can lead to foreclosure effects that raise barriers to entry.<sup>258</sup> Both sets of guidelines also identify a number of potential efficiencies that may be generated by means of these types of arrangements. Horizontal cooperation may produce economies of scale, it may lead to improvements in production technologies and it may allow firms to launch products sooner.<sup>259</sup> Vertical restraints will often serve to rationalise distribution by helping to solve certain problems that may arise in the relation between a seller and his reseller. The Commission sums up eight examples of such problems.<sup>260</sup> In this regard, the Commission emphasises the need to calculate or estimate the value of cost efficiencies as accurately as reasonably

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<sup>253</sup> See para. 121 a.f. of the Vertical Guidelines (supra, footnote 185), paras. 53-55 of the Market Notice (supra, footnote 229), and paras. 28-30 of the Horizontal Guidelines (supra, footnote 229).

<sup>254</sup> See para. 103 a.f. of the Vertical Guidelines (supra, footnote 185). This is evident, also, in the discussion of the effects of the various forms of horizontal agreements covered by the Horizontal Guidelines (supra, footnote 229).

<sup>255</sup> A horizontal agreement is an agreement between undertakings operating at the same level of the production or distribution chain.

<sup>256</sup> See paras. 19 and 27 of the Horizontal Guidelines (supra, footnote 229). See also chapter 3 of these guidelines, where the Commission advances the following criterion to judge whether this risk of undue coordination occurs in a specific case. In order for there to be a risk of coordination, the parties normally need to cooperate with regard to a significant part of their activities in order to achieve a substantial degree of *commonality of cost*. In other words, if the joint production agreement covers a substantial part of the parties' production process, their interests become so intertwined, that coordination especially in the form of alignment of prices or output, becomes likely.

<sup>257</sup> A vertical agreement is an agreement between undertakings which operate at different stages of the production chain, and which relates to the conditions under which the parties may purchase, sell or resell goods or services. See Art 2 section 1 of Regulation 2790/99 (supra, footnote 184).

<sup>258</sup> See para. 119 a.f. of the Vertical Guidelines (supra, footnote 185).

<sup>259</sup> See e.g. paras. 3, 32, 67, and 102 of the Horizontal Guidelines (supra, footnote 229).

<sup>260</sup> See paras. 115-118 of the Vertical Guidelines (supra, footnote 185).

possible.<sup>261</sup> In the case of claimed efficiencies in the form of new or improved products and other non-cost based efficiencies, the undertakings claiming the benefit of Article 81(3) must describe and explain in detail what is the nature of the efficiencies and how and why they constitute an objective economic benefit.<sup>262</sup> If an agreement produces both negative effects and benefits, these have to be weighed against each other to see which effect is stronger.<sup>263</sup>

The final section of this chapter discusses the approach that will be adopted in the rest of this work to examine how this modernised analytical framework is applied in practice and what its implications are in terms of legal certainty. This approach is distinguished from the approach adopted in the earlier *rule of reason* debate.

## 2.5 Approach and scope

### *Legal certainty: modernisation as applied in practice*

Legal certainty was an important theme in the debate on the scope for applying a *rule of reason* in the investigation under Art 81(1) EC. We may summarise our discussion of this matter in Section 2.3.2 as follows. There were two related sets of problems. The first related to the ability to enforce contracts. Harmless agreements, in as much as they were caught by Art 81(1) EC, were not valid from the moment of their implementation. They needed to be expressly exempted. Such authorisation was very hard to obtain, however, which, to a certain extent, made contractual relations and related investments vulnerable. In addition, there were problems with legal certainty in a broader sense. The Commission, for a considerable period of time, regarded formalism as a way to provide certainty about the implications for firms of this new and rapidly evolving field of law. As a consequence, however, there were serious problems as regards forms of agreement that did not fit into any of the rigid categories set forth in the block exemption regulations of the day. The low volume of fully reasoned formal decisions produced by the over-burdened system made it hard to

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<sup>261</sup> See para. 56 a.f. of the Notice on the application of Art 81(3) (supra, footnote 61). ‘In the case of claimed cost efficiencies the undertakings invoking the benefit of Article 81(3) must as accurately as reasonably possible calculate or estimate the value of the efficiencies and describe in detail how the amount has been computed. They must also describe the method(s) by which the efficiencies have been or will be achieved. The data submitted must be verifiable so that there can be a sufficient degree of certainty that the efficiencies have materialised or are likely to materialise.’

<sup>262</sup> Id., at para. 57.

<sup>263</sup> Id., at para 83 a.f.

predict whether and, if so, under which circumstances such agreements might, as a matter of law, benefit from an individual exemption or not.<sup>264</sup> Particularly towards the end of the century, a growing number of antitrust scholars took the position that economics (and, thus, economics-oriented objectives) provides better analytical tools than formalism to reach predictable, well reasoned results in European antitrust.<sup>265</sup> The Commission's reform of its substantive policies indicates that, in principle, it now shares this view.

The reform of the regime for the enforcement of Art 81 EC has also generated debate about legal certainty. It has frequently been noted that the shift to *ex post* control has eliminated or reduced firms' options to obtain *ex ante* (that is, prior to implementation) certainty about the legality of their contracts.<sup>266</sup> The argument has also been made that there is a risk that decentralised application might lead to a loss of coherency in the substance of the law.<sup>267</sup> Finally, it has been suggested that the implications for the Commission's fining practice remain unclear.<sup>268</sup> Generally, these works focus on the features of the reforms as described by the Commission; which is understandable given that most date from before or very shortly after the reforms took effect. Despite the strong relation between substantive and procedural reforms, also, their effects on legal certainty are mostly examined in isolation.<sup>269</sup> Lastly, the effects of reduced levels of certainty that might be caused by the reforms are not examined as to their precise implications for firm behaviour, that is, it is not examined how compliance by firms is affected.<sup>270</sup> The objectives of this thesis are to examine (1) how well the way in which the Commission has put both forms of modernisation into

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<sup>264</sup> See e.g. Holley (1993: 687).

<sup>265</sup> In addition to the literature cited in Section 2.3.2, see the contribution by Barry E. Hawk in Ehlermann and Atanasiu (1998: 333). See also the contribution by Jonathan Faull in the same volume, who (at p. 503), states the following: 'The balance between legal certainty and economic analysis, which all competition policies strive to achieve, must be redefined. We must look again at the best way to provide for market-sensitive analysis in a predictable, transparent legal system designed for an imperfect single market among Member States of very different sizes, traditions and economic circumstances.'

<sup>266</sup> See the Commission's summary of the observations submitted to its white paper for reform of Regulation 17/62 (of 29 February 2000, published on the Commission's website) and e.g. Pirrung (2004), Hawk and Denaeyer (2001), Jenny (2001), Bartosch (2001), Gustafsson (2000), Holmes (2000), Möschel (2000), and Paulweber (2000).

<sup>267</sup> See e.g. Siragusa (2001), Immenga (2001), and Hawk and Denaeyer (2001). See also Wils (2003b).

<sup>268</sup> See Hawk and Denaeyer (2001) and Barros (2002).

<sup>269</sup> Concerning these links, see the discussion above in Section 2.4.1 and Gerber (2008a).

<sup>270</sup> Here the works by Neven (2001) and Barros (2002) should be mentioned. They both explicitly address the effects of procedural modernisation on firm behaviour. It should be realised, however, that the element of the reforms on which they focus is the effects of the increased likelihood of the imposition of fines after modernisation. They do not consider the issue of legal certainty (i.e. the effect of the reforms on firms' capacity to assess the legality of their intended agreements).

*practice* serves to guide firms in assessing the legality of their intended agreements, (2) to examine the possible effects of reduced levels of certainty, and (3) to explore avenues for making improvements.

It should be emphasised that the purpose of this exercise is not to re-open debate on the appropriateness of either form of modernisation. Rather, the effects of modernisation on legal certainty are examined so that we may form an image of the possibilities to improve the efficiency of enforcement by adjusting the calibration of the effects-based standard to the new situation. Note, also, that the important question concerning the effect on legal certainty of decentralising the enforcement system, which might result in inconsistent application by national courts or competition authorities, is not addressed here. We look exclusively at modernisation as put into practice by the Commission.

#### *Making the effects of uncertainty visible*

In contemplating the research objectives stated above, it is important to realise that there are inherent difficulties in making the effects of reduced legal certainty visible. What we are concerned with is conduct by firms who – either because the law does not speak clearly in their case or because they reckon that it will be misapplied – end up signing agreements that are harmful (under-deterrence) or, instead, agreements that are made less restrictive than is ultimately necessary to avoid harm (over-compliance). All that is readily available to us for study are decisions finding infringements. For obvious reasons, it is more complicated for researchers to gather information about undetected violations or about equally unscrutinised agreements that, out of fear of intervention, are designed in an unnecessarily cautious way.

The complexities of unearthing direct evidence of such inefficiencies are reflected in the fact that, despite the existence of a large body of literature that models the various circumstances of uncertainty under which under-compliance or over-compliance may occur,<sup>271</sup> not so much can be found in the way of studies applying these insights to the realities of legal practice.<sup>272</sup> Notably, the approaches adopted in the small branch of empirical literature directly measuring inefficiencies generated by antitrust enforcement is not easily adapted to the circumstances of effects-based

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<sup>271</sup> This literature is discussed in Chapter 3, Section 3.4.

<sup>272</sup> Outside the field of antitrust one may look for such literature particularly in the area of tax law. For a discussion, see Kaplow (2000: 507).

analysis under Art 81 EC. Generally, this line of work depends on the identification of an independent variable with which the quality or effect of enforcement action can be evaluated. Such an approach is difficult to adapt to our context, firstly, because the list of decisions to be studied, particularly formal infringement decisions, is very short.<sup>273</sup> And for the following reasons comparable independent variables, assuming that sufficient information could be obtained, are difficult to operationalise in the field of effects-based analysis.

The work on hard-core cartels tends to concentrate on data regarding pricing mark-ups to assess the effects of enforcement.<sup>274</sup> A major problem, here, is that such data is generally absent in the type of cases examined under the effects-based standard. As we will see in Chapter 4, at best, decisions contain data concerning market-structure; overcharges are hardly ever the focus of the investigation.<sup>275</sup> A number of studies in the field of merger policy look at stock market data to learn about the post-merger exercise of market power.<sup>276</sup> One problem here is that most of the Commission's recent decisions in the effects-based field concern horizontal cooperation, in the form of non-listed joint ventures, often between large numbers of firms.<sup>277</sup> Another problem is that the profit and stock market effects of concluding (often nationally-based) agreements assessed under the effects-based standard of Art

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<sup>273</sup> See the list of formal effects-based decisions adopted since 1998 in Appendix A. There are but four infringement decisions amongst these. The remainder are exemption or commitment decisions. Understandably, these are generally much less elaborate in terms of the underlying reasoning.

<sup>274</sup> See e.g. Feinberg (1980); Block et al. (1981); Block and Feinstein (1986); and Clark and Evenett (2003). Also in the cartel context are empirical studies by Arlman (2005) and Brenner (2005, 2006) who study the effectiveness of leniency programmes (in this regard, see also Spagnolo, 2007). See Schinkel et al. (2008) for references to other empirical work done on EC and US antitrust enforcement.

<sup>275</sup> The decision in the case of *Master Card* (of 19 December 2007, published on the Commission's website) provides an exception. Note, however, that, despite their importance to the Commission, the price effects at issue in that case can be interpreted both in an anti-competitive and in a pro-competitive way. In this regard, see the discussion of this case in Chapter 4, Section 4.3.2, and Chapter 7, Section 7.2.

<sup>276</sup> See e.g. Duso et al. (2006c) and Duso et al. (2006b), which contains an elaborate discussion of the available literature on this matter. Another method is to rely on accounting data. For a discussion and comparison of the two methods, see Duso et al. (2006a).

<sup>277</sup> This applies to two more than 50% of the 32 effects-based cases listed in Appendix A. It applies to two of the four infringement decisions: *EATA*, [1999] OJ L193/23, *Morgan Stanley / Visa* (decision of 3 October 2007, published on the Commission's website - note that in the year after this latter decision Visa did launch an initial public offering). It also applies 15 of the exemption and commitment decisions in the Appendix as well. Examples are: *IMA (EPI)*, OJ [1999] L106/14; *P&I Clubs*, OJ [1999] L125/12; *Reims II*, OJ [1999] L275/17; *CEDED* (supra, footnote 60); *Eurovision*, OJ [2000] L187/47; *EcoEmballages*, OJ [2000] L151/18; *Visa MIF*, OJ [2002] L318/17; *IFPI Simulcasting*, OJ [2003] L107/58; *RevisedTaca*, OJ [2003] L26/53; *UEFA*, OJ [2003] L291/25; *Reims II Renewal*, OJ [2004] L56/76; *Argec / ARA*, OJ [2002] C250/3; *DFB* (decision of 19 January 2005, published on the Commission's website); *Premier League* (decision of 22 March 2006, published on the Commission's website); and *Cannes*, (decision of 4 October 2006, published on the Commission's website).

81 EC can be expected to be much less pronounced than those of a merger announcement.<sup>278</sup> In addition, it would be problematic to distinguish the increase in profits caused by the efficiency effects of a transaction from the profits generated by the exploitation of consumers. With regard to mergers, this is often accomplished by considering the effect on the stock price of competitors. In European effects-based analysis, however, the vast majority of decisions that are currently being taken are so brief that they do not contain a sufficiently in-depth description of the relevant market to systematically identify competitors.<sup>279</sup>

A further problem with both types of works (relying on pricing and stock market data) is that they focus on the effects of antitrust intervention on the conduct the firms directly affected, that is, those which are alleged to have already violated the law. They do not consider the possibly divergent effects on potential offenders, that is, on firms in the stage of designing and implementing a new agreement. In a system based on selective ex post control, such as the one instituted for the enforcement of Art 81 EC by Regulation 1/2003,<sup>280</sup> it is the effects on potential offenders that are of far greater concern. This is particularly so in our context, since it is common knowledge that the type of vertical and horizontal agreements assessed under the effects-based standard are very widely used in the production and distribution of goods. Some studies do consider such wider effects, notably by looking at how enforcement action affects the subsequent number of notified mergers.<sup>281</sup> Apart from the fact that the move away from notification would present a serious obstacle to adapting such a frequency-based approach to the study of the effects of enforcement of Art 81 EC, it should be noted that the composition effects of enforcement are not captured at all. That is, firms who respond to enforcement action by implementing needlessly cautious agreements (over-deterrence) are not brought into focus. In conclusion, it can be said that the possibilities of gathering useful direct evidence of inefficient firm behaviour appear to be limited in the field of effects-based analysis under Art 81 EC.

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<sup>278</sup> In this regard, consider, for example, the case of *Van den Bergh Foods*, OJ [1998] L246/1. This is the fourth infringement decision listed in Appendix A. This decision concerns the effects of a network of distribution agreements relied upon by a Unilever-daughter on the Irish market for impulse ice cream. It is hard to see how the modifications required to these distribution contracts could have a serious impact on the stock market performance of this large multinational firm.

<sup>279</sup> In this regard, see the discussion in Chapter 5, Section 5.3.1.2.

<sup>280</sup> *Supra*, footnote 190.

<sup>281</sup> See Seldesachts et al. (2007).



### *An alternative approach*

This thesis adopts an alternative and more qualitative approach. Instead of searching for direct evidence of inefficiencies, it concentrates on properties of the enforcement system that can be expected to lead to such outcomes. To do so, it combines two important methods of modern legal studies: the economic analysis of law, and comparative legal analysis. The principle weakness of this approach, as compared to the work in other fields of antitrust that was just discussed, is that it does not provide us with a quantitative indication of the seriousness of the problems that are detected.

The investigation is based on the construction (in Chapter 3) of a layered analytical framework that describes: (1) the variables that influence the calibration of the legal standard and the division of the burden of proof; and (2) the effect of this calibration of the legal standard on parties in litigation and firms in the market. This framework is used to examine the relevant case law and all effects-based decisions on Art 81 EC taken since the beginning of the substantive reforms in 1998. This makes it possible to interpret the implications of the legal standard as it emerges from practice and official documents for the behaviour of firms. This analysis proceeds along the following lines.

The analytical framework suggests that the legal standard influences the decisions of potential offenders primarily by way of its impact on legal certainty – that is, the ability to predict whether the Commission will qualify an agreement as legal or illegal. A low level of certainty can lead firms to sign inefficient contracts. Three contrasts are examined to determine whether the levels of uncertainty generated by the current legal standard might be excessive. First (in Chapter 4), the results of the study of European effects-based analysis are compared to the legal standard as employed in *rule of reason* analysis under the US Sherman Act Section 1. This analysis shows that there are considerable differences in the design of the investigatory process, which are argued to result in relatively more uncertainty for European potential offenders. Next (in Chapter 5), the effects of the substantive and procedural reforms discussed above are examined. This exercise, comparable to an events-study, indicates that the combined effect of these reforms has been to increase uncertainty. A survey of the observations made by major law firms, consultancies and industry groups in response to the Commission's recent call for submissions

evaluating the performance of the current enforcement regime appears to give considerable support for this finding.<sup>282</sup>

*A final note on the scope of this work*

This work centres on the effects-based standard as applied to individual cases. The core of effects-based analysis, we saw, is the investigation of market power. In this regard, it is important to emphasise that the evaluation of restraints on the basis of rules set out in block-exemption regulations falls outside the scope of this work. Recall that these regulations apply the exemption of Art 81(3) EC to whole classes of agreements that are not restrictive by object. Notably, modern block exemption regulations make application of Art 81(3) EC dependent on the combined position of the parties to the agreement not exceeding certain market share caps, which are used as a proxy for the absence of market power.<sup>283</sup> If the parties do not exceed the relevant cap, the effect of their agreement on consumers is assumed to be neutral or beneficial. No assessment of the actual impact on the market is necessary in such cases. Essentially, then, even though block exemption regulations are supported by effects-based reasoning, they contain *per se* rules (rules of legality, though) akin to those applied in object-based analysis. Since no inquiry is made into the actual exercise of market power, such cases will not be discussed in the chapters that follow.

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<sup>282</sup> See the discussion in Chapter 5, Section 5.4.

<sup>283</sup> See Regulation 2790/99 on vertical restraints, (supra, footnote 184); Regulation 2658/2000, on specialisation agreements (supra, footnote 237); and Regulation 2659/2000, on research and development agreements (supra, footnote 238). The same does not apply to Regulation 240/96 on technology transfer agreements, [2004] OJ L123/11.