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The effects-based approach under Article 101 TFUE and its paradoxes: modernisation at war with itself?

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Introduction (i) – THE question

“It was in 1962 that EEC competition lawyers began asking themselves in earnest by what criteria a contractual restriction should be judged under Article 85(1) of the EEC Treaty. They are still asking **the question**”.

(Donald L. Holley, 1992)

Introduction (ii) - Timeline

1962: Regulation 17

1965: Consten/Gründig

1977: GTE/Sylvania

1978: Antitrust Paradox

1983: Musique Diffusion

1988: Tirole's Theory of IO

1989: Merger Regulation

1990: Skadden Brussels

1992: EU internal market

1993: Wood Pulp II

1996: Leniency notice

1997: Boeing/McDo.

1997: Vertical Green Paper

1999: Modernization WP

2002: Airtours et al.

2002: ICN

2003: Chief Economist

2004: Reg. 1/2003 in effect

The Three Dimensions of Modernisation:

1. Substantive Modernisation: “effects-based approach”
 2. Procedural Modernisation: exception system and negotiated procedures
 3. Institutional Modernisation: decentralization and network enforcement
- ⇒ Interrelated dimensions

Progressive ECJ:

- *Société Technique Minière*:
 - “The competition in question must be understood within the **actual context** in which it would occur in the absence of the agreement in dispute”;
 - “it may be doubted whether there is an interference with competition if the said agreement seems **really necessary** for the penetration of a new area by an undertaking”;
 - “it is appropriate to take into account in particular [...] **the position and importance of the grantor and the concessionaire on the market for the products concerned**”.
- *Nungesser*: the grant of an open exclusive license is **not “by its very nature”** incompatible with article [85(1)] of the Treaty (*contra* Commission)
- *Pronuptia*: **limitations on the scope of article [85(1)]** in relation to franchise agreement (if ancillary/necessary to protect identity, reputation, know-how, marketing methods, etc.)
- *Delimitis*: **effects analysis** based on foreclosure, barriers to entry and the “conditions under which competitive forces operate on the relevant market”

Growing criticisms (Hawk, 1995):

- Overly broad application of Article 101(1)
- Deficiencies in (anemic) economic analysis
- Failure to consider harm to competition in consumer welfare sense (price/output) vs reliance on “*economic freedom*” paradigm and formal categories
- Market power hardly examined

Green Paper on Vertical Restraints (Jan. 1997):

- “*a review is now necessary*”
- “*too much emphasis is put on analysis of clauses and not enough on the economic impact of the agreements*”

Green Paper on Vertical Restraints (Jan. 1997):

1. Economic **consensus**:

- Anti-competitive effects are only likely **where interbrand competition is weak** and there are barriers to entry (market power);
- Vertical restraints **cannot be considered *per se*** as having a negative or positive effect on competition or integration;
- Analysis should concentrate on the **impact on the market** rather than the form of the agreement.

2. Market integration objective as “**EU exception**”: no absolute territorial protection (ATP) – alternative source of supply must always exist (parallel/passive sales)

Vertical BER & Guidelines (Oct. 2000):

- The **protection of competition is the primary objective** of EC competition policy, as this enhances **consumer welfare** and creates an efficient allocation of resources;
- Market integration is an **additional** goal of EC competition policy;
- The Commission will adopt **an economic approach which is based on the effects on the market**; vertical agreements have to be analysed in their legal and economic context;
- [C]ompetition concerns can **only arise if there is insufficient inter-brand competition**. This will limit the scope of application of Article 81 to undertakings holding a **certain degree of market power**;
- VBER creates a **presumption of legality** for vertical agreements depending on the market share of the supplier or the buyer. No presumption of illegality for agreements falling outside the VBER;
- [V]ertical restraints **often have positive effects** [on competition] by [...] promoting non-price competition and improved quality of services.

Horizontal Cooperation Guidelines (Jan. 2001):

- **Economic criteria** such as the **market power** of the parties and other factors relating to the market structure, form a key element of the assessment of the market impact likely to be caused by a cooperation and therefore for the assessment under Article 81;
- [A]greements that have as their **object** a restriction of competition by means of **price fixing, output limitation or sharing of markets or customers** [...] are **presumed** to have negative market effects;
- Many horizontal cooperation agreements, however, do not have as their object a restriction of competition. Therefore, an **analysis of the effects** of the agreement is necessary;
- The starting point for the analysis is the position of the parties in the markets affected by the cooperation. This determines whether or not they are **likely to maintain, gain or increase market power** through the cooperation, *i.e.*, have the ability to cause **negative market effects** as to **prices, output, innovation or the variety or quality of goods and services**.

Response (iii) – Art. 81(3) Guidelines

Art. 81(3) Guidelines (April 2004):

- Methodology is based on [an] **economic approach** ;
- The assessment under Article 81 consists of **two parts**: (i) object/effect to restrict competition; (ii) balancing anti- and pro-competitive effects.
- **Counterfactual method**: does the agreement restrict actual or potential competition that would have existed without the agreement/restraint?
- The prohibition of Article 81(1) only applies where on the basis of **proper market analysis** it can be concluded that the agreement has **likely anti-competitive effects** on the market. Negative effects on competition within the relevant market are likely to occur when the parties individually or jointly **have or obtain some degree of market power**;
- The restrictive agreements may generate objective **economic benefits so as to outweigh the negative effects** of the restriction of competition;
- [Aim to determine whether the] **net effect** of such agreements is to promote [...] the **competitive process**;
- Ultimately, the protection of rivalry and the **competitive process is given priority** over potentially pro-competitive efficiency gains.

A structured “*rule of reason*” :

- 101(1) - **Commission** to establish whether the agreement has the actual or potential effect of restricting competition based on:
 - Nature/aim/context of the agreement - object or effect?
 - Object: presumption of anticompetitive effects
 - Effect: theory of harm backed by economic evidence (incl. quantitative analyses), assessment of the parties’ market power/competitive constraints
 - “Ancillarity” and “appreciability” tests
- 101(3) – **Defendant(s)** to establish whether the efficiencies resulting from the agreement can outweigh its restrictive effects based on:
 - Efficiency gains (objective benefits): nature, link, realization, likelihood, magnitude, timing (incl. empirical data and facts)
 - Efficiencies must benefit consumers
 - Restrictions must be (reasonably) indispensable to achieve the efficiencies
 - At the margin, however, competition trumps efficiencies

Before/after modernization:

- **Before** substantive modernization:
 - Formal/theoretical approach (principles, intuitions)
 - Structure/economic freedom (limitation on the parties' freedom of action)
 - Internal (contract) outlook
 - Restrictions to be justified (lenient)
 - Reactive
 - **After** substantive modernization:
 - Economic/empirical approach (context, incentives)
 - Process/consumer welfare (market power)
 - External (market) outlook
 - Balancing costs/benefits – net effect (strict)
 - Proactive
- ⇒ Address **type I and II errors** (e.g., MIF and O2)

Paradoxes of modernization:

- Drop in enforcement (beyond cartels)
- Increased reliance on general presumptions/abstract guidance (BERs and guidelines)
- Conservative ECJ:
 - “Article 81 EC aims to protect not only the interests of competitors or of consumers, but **also the structure of the market** and, in so doing, competition as such” (Glaxo, T-Mobile, BIDS)
 - Agreements aimed at prohibiting or limiting parallel trade have as their object the prevention of competition
 - Emphasis on the independence of market actors
- More demanding approach
- **THE paradox?**

Before/after modernization:

- **Before** modernization, using “*Consten/Grundig*” as a proxy:
 - Article [101] pursues the aim of **market integration**;
 - The principle of **freedom of competition** concerns the various stages and manifestations of competition;
 - [T]he **absence in the contested decision of any analysis of the effects of the agreement on competition between similar products of different makes** does not, of itself, constitute a defect in the decision;
 - The efforts of the dealer are stimulated by **competition between distributors of products of the same make**;
 - **No further considerations**, whether of **economic data** (...) or [otherwise], and **no possible favourable effects** of the agreement in other respects, can in any way lead, in the face of the abovementioned restrictions, to a different solution under article 85(1).

Before/after modernization:

- **After** modernization, using the 2010 Guidelines as a proxy:
 - [C]ompetition concerns can only arise if there is insufficient competition at one or more levels of trade, that is, if there is **some degree of market power** at the level of the supplier or the buyer or at both levels;
 - **Vertical restraints are generally less harmful than horizontal restraints** and may provide substantial scope for efficiencies;
 - Assessing vertical restraints is **also important** in the context of the wider objective of achieving an integrated internal market;
 - Provided that they do **not contain hardcore [object] restrictions** of competition, the BER creates a **presumption of legality** for vertical agreements depending on the market share of the supplier/buyer;
 - **Counterfactual** approach: ex-ante/ex-post comparison;
 - Vertical agreements often have the **potential to help realise efficiencies**, but **presumption** that hardcore restrictions are unlikely to fulfill the conditions of 101(3).

Paradoxes of modernization:

- No/limited enforcement (EU since 2005/national level in spite of exceptions, *e.g.*, France);
- Regulated by **self-assessment** based on VBER/Guidelines;
- **All** vertical infringement cases involved **parallel trade/ATP** issues and were treated as **object** restrictions (9/9):
 - Commission: attempts to quantify impact of object restriction (Peugeot);
 - GC (vs ECJ): attempt to link parallel trade, object and consumer prices (Glaxo, T-Mobile) and to allow for the justification of object restrictions;
 - ECJ conservative approach:
 - No need to take account of effects if object restriction (“by nature”);
 - Limitations on parallel trade/internet sales/ATP are object restrictions (Glaxo, Pierre Fabre, Premier League), even if justifiable in theory (vs Vertical Guidelines and Decisions, *e.g.*, Glaxo).

Before/after modernization:

- **Before** modernization, using “GM/Carlsberg” (1984) as a proxy:
 - Low threshold to fall within the scope of Article 101(1) – limitation on **economic freedom** of the parties:
 - *“The obligation upon GM to purchase each year from Carlsberg a very large volume of lager beers is restrictive of competition because it prevents GM from producing this volume itself or purchasing it from other producers, possibly on more favourable terms. The obligation upon Carlsberg to supply GM with all its requirements of Carlsberg beers is also restrictive of competition because it deprives Carlsberg of control over more than half of its present output which would otherwise be able to sell to other breweries or on the free market through its agencies...The Agreement therefore falls within the scope of Article 85(1).”*
 - Market structure and position of parties relevant under 101(3) only;
 - **Loose efficiency claims**: best use of production capacity, rationalize distribution and *“the Agreement ensures that supplies of the beers there are more plentiful, fresher and also cheaper”*.

Before/after modernization:

- **After** modernization, using the 2011 Guidelines as a proxy:
 - **Economic criteria** such as the **market power** of the parties and other factors relating to the **market structure** are key to the analysis;
 - Object: anti-competitive object to be determined in view of the content of the agreement, the objectives it seeks to attain, and the economic and legal context of which it forms part.
 - Effect (to be substantiated with empirical evidence – *Morgan Stanley*):
 - Theory of harm to competition enabling the parties to **raise prices or reduce output, product quality, product variety or innovation**;
 - **Counterfactual** approach: ex-ante/ex-post comparison;
 - Restriction of competition unlikely if **limited market power**.
 - 101(3) as an **efficiency defense** – burden on the undertaking(s) to substantiate efficiency claims with empirical evidence (*MasterCard*).

Paradoxes of modernization:

- Enforcement (beyond cartels) limited but alive.
- Occasional recurring references to economic freedom/market independence (*Visa II*, *BIDS*, Guidelines).
- **8/9** infringement decisions framed in “object” terms:
 - Strict approach (GdF/Enel/ENI, CISAC);
 - Contextual approach to “object” (ONP, Ordre des architectes);
 - Object but still effects (MasterCard, CB, E.ON-GdF).
- ECJ judgments framed in strict “object” terms (*BIDS*, *T-Mobile*).
- More demanding approach: decision costs and rebuttal costs (*MasterCard*).

Consequences of modernization:

- **Narrower application** of 101(1) TFUE:
 - Theory of **harm to competition** in (flexible) consumer welfare terms: increase in prices, reduction in output, choice, quality, innovation;
 - Substantiated by **empirical evidence/facts**;
 - **Market power** requirement.
- **Stricter assessment of efficiency** claims under 101(3) TFUE.
- ECJ (not GC) turns from progressive to conservative actor.
- **Limited enforcement activity** (since 2005: 5 infringement and 10 commitments decisions).

Paradoxes of modernization:

- Increased reliance on **abstract guidance** (BER and guidelines).
- The “**object paradox**”:
 - **17/18** infringement decisions framed in “object” terms (+ cartels);
 - All ECJ cases involved infringements by object (incl. reversal – Glaxo);
 - Effects-based approach shifts focus on **what is an “object restriction”**?
 - Presumption of anticompetitive effects - on what grounds?
 - Economic consensus beyond “cartels” (industry-wide price-fixing/market-sharing agreements)?
 - Rooted in “nature” or “aim, context, conduct” – **back to form/pseudo-effects**?
 - Market power?
 - Why rely on “object” label when evidence of “effects”?

Paradoxes of modernization:

- The “object paradox” & the “justification conundrum”:
 - “81(3)” Guidelines: Article 101(3) does **not distinguish** between agreements that restrict competition by object and by effect;
 - Vertical guidelines: Where a hardcore restriction is included in an agreement, [...] it is **presumed that the agreement is unlikely to fulfill the conditions of Article 101(3)**;
 - Commission: object restrictions are “**in principle**” **not eligible** for exemption under 101(3) (Glaxo, E.ON/GdF, ONP);
 - ECJ: object restrictions **in theory** open to justification;
 - **No precedent** of 101(3) success, let alone in object cases.
- ⇒ **“Quick look” at efficiency claims? Bias in 101 enforcement? Object as starting point? System failure?**

Impact of procedural framework on substance:

- From prior notification to **exception system**:
 - Notification obligation encouraged form/category-based treatment;
 - Broad/unsophisticated analysis of 101(1) justified by monopoly on 101(3) assessment;
 - Self-assessment: requires effects-based approach/guidance for reasons of legal certainty.
- Majority of infringement decisions result from **notification backlog** – impact of targeted enforcement on effects-based approach?
- Impact of an **integrated agency system** with limited judicial review on the credibility of the effects-based approach?
- **Impact of negotiated procedures** on incentives to conduct effects-based analysis (and on broad definition of “object” restriction)?

Impact of institutional design on substance:

- Impact of the **global antitrust epistemic community** on the development/design of the effects-based approach?
 - Decentralization, consistency and effects-based approach: **economics as common language**?
 - Network enforcement and effects-based approach: a **blended approach** of (harm to) competition?
 - **EU-wide impact** of antitrust decisions/policy?
- ⇒ **Effects-based approach or effects-based process?**

Annex 1 – Art. 101 TFUE

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal 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 parties, 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.

Art. 101 TFUE enforcement statistics:

Since 1/1/2000

Excluding hardcore cartels

- Infringements decisions: **18** (10 since Regulation 1/2003)
- Commitment decisions: 10
⇒ 14 horizontal + 14 vertical

Negative clearance: 6

Exemption decisions: 18

Rejections of complaints: 9

No formal decision: 150+ (closed or still pending)