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The object / effect conundrum after Cartes Bancaires

GCLC Lunch-Talk

Brussels, 24 November 2014

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Outline

1. The object/effect dichotomy and conundrum
2. Background of the Cartes Bancaires case
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   - GC judgment
   - AG opinion
3. The ECJ judgment: main findings and reasoning
4. Assessment of the ruling and Implications for future cases?
5. Concluding remarks

1. The object/effect dichotomy (i)

- The by object/effects dichotomy and implications is well known and has been summarized in the ECJ's **case law** (cited in C-32/11, Allianz Hungaria)
  - To be caught by the prohibition laid down in Article 101(1) TFEU, an agreement must have 'as [its] object **or** effect the prevention, restriction or distortion of competition...
  - Commission does not need to examine the effects of an agreement if it establishes to the required standard its anti-competitive object
  - "Where, however, the analysis of the content of the agreement **does not reveal a sufficient degree of harm to competition**, the effects of the agreement should then be considered"

1. The object/effect dichotomy (ii)

- The distinction between 'infringements by object' and by effect' arises from the fact that certain forms of collusion between undertakings can be regarded, **by their very nature**, as being injurious to the proper functioning of normal competition. [This is based on experience and prior assessment of negative effects]
- Case law has set the standard or Legal criteria to apply in order to determine whether an agreement involves a restriction of competition 'by object':
  - Regard must be had to the **content** of its provisions, its **objectives** and the **economic and legal context** of which it forms a part
  - When determining that **context,** it is also appropriate to take into consideration the **nature** of the goods or services affected, as well as the **real conditions of the functioning and structure of the market or markets** in question

1. The object/effect conundrum (i)

- If we know the legal criteria to determine the “by object” restriction why are we talking of conundrum?
- A “Conundrum”?: “*A logical postulation that evades resolution, an intricate and difficult problem*”
- Maybe not a conundrum but case law is ambiguous and not easy to interpret. There was room for clarification: e.g.
  - When to conclude that an agreement is sufficiently injurious to competition?
  - What do in case of doubt re “by object”? restrictive notion or not?
  - How to determine if an agreement is by its very nature injurious to proper functioning of normal competition?
  - What are the important aspects or factors to consider? complexity? is “by object” option appropriate for complex settings like two-sided and platform markets?

1. The object/effect conundrum (ii)

- To which extent is it required to dig on the economic context (and the real conditions of the functioning and structure of the market)?

  Allianz Hungaria seems to impose such thorough analysis, which goes very close to an effects assessment:

  > 48 "[…]. In order to determine the likelihood of such a result that court should in particular take into consideration the structure of that market, the existence of alternative distribution channels and their respective importance and the market power of the companies concerned"

- 11.09.2014 was a good day: two important rulings with much welcome guidance
  - CB ruling: "by object" restriction
  - Master Card ruling: restriction "by effects"

1. Why any clarification of the dichotomy is important?

- It is important to clarify the difference because
  - Proving "by object restriction":
    - Requires less work
    - Spares the need to prove the "appreciability requirement" (Expedia)
    - And spares need to establish restrictive effects (more difficult since requires determining the counterfactual: actual context in which competition would occur in the absence of the agreement in dispute)
  - Therefore Commission seems to prefer to use the "by object" option to apply Art.101 TFEU
- Art. 2 of Reg 1/2003 imposes on Commission (and NCAs) the burden to prove that Art. 101 (1) applies in the first place,
  - But Commission has full control of the process: it decides if Art.101(1) conditions are met and when burden of proof shifts under 101(3)).
  - Shift has decisive importance: efficiencies under 101(3) very rarely met

2. Background: GCB a very successful Payment System

- **Groupement des Cartes Bancaires**: Payment System created in 1984 in France by the main banks
  - Interoperability of the systems for payment and withdrawal by bank cards ('CB cards') issued by its members.
  - Interoperability enables a CB card issued by any CB member to be used by its customers to make payments to all traders/merchants CB affiliated and/or to make withdrawals from all automatic teller machines (ATMs) of all members
- Main French Payment System, very successful thanks to heavy investments over 20 years by founders and high merchant penetration
- Open system: all new members accepted 150 + members

2. Background: Unbalance between use and investment and Free riding issue

- Newcomers (large retailers and on line banks) interested mostly on issuing side (massive issuing of cards at very low price)
- Free riding issue, impact on investment to continue improve the system and expand on the merchant and ATMs side
- Internal discussions, economic and legal assessment on new rules to balance use and investment on issuing and acquiring:
- Notification to Commission in 2002 under Reg 17 of new rules on membership and pricing

2. Background: New membership and functioning rules

- ('MERFA') ('Mechanism for Regulating the Acquiring Function') to encourage members that are issuers more than acquirers to:
  - Either expand their acquisition activities
  - Or to pay a fee to those that invest more on acquiring new merchants, to take account financially of their efforts to development of CB.
- A reform of the membership fee
- An additional fee per active CB card issued in the three years following membership or revival of issuing activity by dormant members

2. Background: 2002 Notification, Dawn raids, first SO and hearing

- In 2002 Notification to Commission under Reg 17
- Dawn raids in Groupement and main founding banks
- First SO in 2004:
  - "Secret anti-competitive agreement' which had the 'object of generally limiting competition between the banks party to the agreement and to restrict competition, in a concerted manner, of new entrants (in particular large retailers, online banks and foreign banks) on the market for the issue of [CB cards]"
  - Notification made with the aim of concealing the real content of the anti-competitive agreement
  - Intended to render the notification ineffective and to impose a fine on the addressees of that statement of objections.
- Hearing in December 2004: Hearing Officer final statement: **il faut tout recommencer à nouveau**!

2. Background: Second SO and Final Decision in 2007

- Internal checks and balances and Second SO in 2006:
  - From a cartel to a decision by an association of undertakings establishing a series of pricing measures with an anti-competitive object or effect
  - Only one addressee: the Groupement des Cartes Bancaires
  - No threat of fine
- Second hearing November 2006
- Discussions on possible commitments under art. 9
- Final decision (Art. 7) Oct 2007

2. The Decision

- Art. 101(1) applies to the measures
  - A decision by an association of undertakings
  - With an anti-competitive object
    - Evident from the actual formulas envisaged in measures.
    - Reflects the genuine objectives of notified measures
    - Stated by main members in the course of their preparation
  - And with the effect of restricting competition
    - A reduction in issuing plans of new entrants and the prevention of a Cards price reduction for CB cards
- Conditions of Article 101(3) EC are not satisfied
- Injunction to stop and to refrain from adopting any measure or behaviour having an identical or similar object or effect'

2. The General Court ruling

- Appeal in 2007 by Groupement des cartes bancaires, supported by 3 founding banks (BNP Paribas, BPCE, and Société Générale)
- Ruling in November 2012 (5 years later…)
- GC Dismisses appeal and confirms Commission's view that:
  - Object of measures was the restriction of competition in that they hinder the competition of new entrants on the market for the issue of payment cards in France, and that
  - Anti-competitive object stemmed from the very calculation formulas which were provided for the measures at issue.
- GC finds that the notion of infringement "by object" should not be given a strict interpretation (non exhaustive list in 101(1)) a) to e)
- No review of the effects assessment under 101(1) of the Decision

2. Advocate General Opinion (Nils Wahl)

- AG Wahl showed serious doubts on GC ruling and Commission case already at hearing
- Very interesting and influential Opinion
  - 101(1) shows that the public enforcement goal is avoiding an appreciable restrictive effect or impact of an agreement on competition
  - Two ways to meet that goal
    - Case by case analysis of actual and potential restrictive effects.
    - Standardised approach ("by object"). Presumptions of harm to competition based on experience obtained through economic analysis (easier to apply)
  - Standardised approach has a number of advantages (predictability, legal certainty, deterrence and procedural gains) but only if recourse to the concept of restriction "by object" is clearly defined

3. The ECJ ruling: the principles for “by object” standard

- Reminds the well established case law on how to apply the prohibition laid down in Article 101(1) TFEU and on the requirements of the “by object” standard (LTM, BIDS, Allianz Hungária)
- Finds that GC failed to properly apply that case law and was wrong on defining the relevant legal criteria in order to assess whether there was a restriction of competition by ‘object’

3. Two main Errors in law

- ECJ clarifies two very important aspects in finding the errors in law:
  - First: that **the essential legal criterion** for ascertaining a restriction of competition 'by object' is the finding that such coordination **reveals in itself a sufficient degree of harm to competition (57)**
  - Second: that the concept of restriction of competition 'by object' requires a **restrictive interpretation.**

    "The concept of restriction of competition by 'object' can be applied **only** to certain types of coordination between undertakings which reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects, otherwise the Commission would be exempted from the obligation to prove the actual effects on the market of **agreements which are in no way established to be**, by their very nature, harmful to the proper functioning of normal competition "**(58)**

3. Error in Law resulted in wrong application of the standard

- Although the GC set out the reasons why the measures at issue, in view of their formulas, **are capable** of restricting competition, **it in no way explained** — contrary to the requirements of the case-law — **in what respect** that restriction of competition reveals a sufficient degree of harm in order to be characterised as a restriction 'by object' **(69)**

3. Two sided markets nature an context: need of consistency in the judgment

- The ECJ puts the focus on the **nature** of the measures and their **context** (pricing measures in a payment system, two-sided markets) and **underlines the lack of consistency in the GC and Commission's findings**:
  - The GC acknowledged that the Groupement is active in the payment systems market, and that there were 'interactions' between the issuing and acquisition activities of a payment system and 'indirect network effects'
  - And that the formulas for those measures sought to establish a certain ratio between the issuing and acquisition activities.
  - It had agreed that combatting free-riding in the CB system was a legitimate objective
- In such circumstances measures aiming at rebalancing the system cannot be regarded as being, by its very nature, harmful to the proper functioning of normal competition

3. “By object” test requires focus on context, beyond relevant market

- Another error in law was to held that the analysis of the requirements of balance between issuing and acquisition activities could not be carried out in the context of Article 81(1) EC on the ground that the relevant market was not that of payment systems in France but the market, situated downstream for the issue of payment cards
- “The General Court confused the issue of the definition of the relevant market and that of the context which must be taken into account in order to ascertain whether the content of an agreement or a decision by an association of undertakings reveals the existence of a restriction of competition ‘by object’ within the meaning of Article 81(1)” **(77)**
- Context to consider goes beyond relevant market to include other related markets when appropriate

3. The degree of analysis required is relevant to determine a restriction "by object"

- The degree of analysis required to consider the economic and legal context shows lack of restriction "by object". Very important finding in points 81 and 82.

  > 82 " It must therefore be found that, while purporting to examine, […], the 'options' left open to the members of the Grouping by the measures at issue […] the General Court **in fact assessed the potential effects** of those measures, analysing the difficulties for the banks of developing acquisition activity on the basis of market data, statements made by certain banks and documents seized during the inspections, and thereby **indicating itself** that the measures at issue cannot be considered 'by their very nature' harmful to the proper functioning of normal competition

- Very important since, as AG said, in prior recent case law ECJ seemed to imply that consideration of context is similar to a genuine examination of the potential effects of the measures at issue. (GlaxoSmithKline and even more clearly, Allianz Hungária)

3. ECJ sends strong message on obligation to ensure full and thorough judicial review (89-91)

- The errors in law indicate "a general failure of analysis by the General Court and therefore reveal the lack of a full and detailed examination of the arguments of the appellant and of the parties which sought the annulment of the decision at issue"
- The General Court failed to fulfil its obligation to observe the standard of review required under the case-law

4. What is new ?

1. The concept of restriction of competition by 'object' must be interpreted '**restrictively**' (**58**)
2. To meet the standard of proof the **essential legal criterion** to prove is that the coordination reveals "*in itself a sufficient degree of harm to competition*". (**57**) Not sufficient to find that the agreement has the potential to have a negative impact on competition. (contrary to T-Mobile, 31)
3. In two-sided markets **interactions between the two sides** are a relevant aspect to consider**.** The economic and legal context is a wider concept than relevant market, at least in two-sided markets
4. The **degree of analysis** required to consider the economic and legal context is relevant in the standard of proof of "by object restriction": a need of thorough analysis shows that "by object" standard is not suitable.

4. Why Cartes Bancaires is important?

1. Clarifies the need for a restrictive interpretation of the restriction "by object" notion. Therefore, if an arrangement is novel or happens in a complex economic setting (network industry- two side market) "by object" analysis is not suitable because it requires careful examination of its effects within its economic context and market circumstances
2. The legal test for "by object" seems now clear: while economic and legal context must be considered it has to be possible to prove sufficient degree of harm to competition without having to dig or examine the actual impact of the coordination on competition. If it is not possible, the more demanding effects standard is required
3. This ruling seems to nuance, if not revisit, the finding in Allianz Hungaria (47-49) requiring an almost de facto effects analysis in order to determine a restriction "by object"

4. Is this really important in practice today? (i)

- Certainly important in theory:
  - Legal certainty is key and Art. 101 TFEU is applied by EU, NCAs and national courts
  - By object may lead to application of 101 (1) even below the minimis cases?
    - After Expedia ruling it is clear that any ‘by object’ restriction will be deemed to appreciably restrict competition and thus infringe Art. 101 TFEU, unless justified under Art. 101(3) TFEU.
    - Therefore now it is more relevant than ever to clearly define the exact scope for by object restrictions, also as guidelines for NCAs and national Courts

4. Is this really important in practice today? (ii)

- But not so obvious impact on current enforcement practice in Brussels
  - Nowadays Commission prefers art 9 proceedings
  - a setting where prima facie finding of 101(1) application is less a requirement:
    - preliminary assessments are not SO, more blurred and open-ended. No real article 101(1) by object or effect analysis: "*Competition concerns are raised*…"
    - same in final art 9 decisions (no indication on whether competition concerns was a by object or by effect restriction)
  - negotiation under the threat of Art.7 and fines.

- Maybe different at NCA level, although in many MS settlements are also in fashion

4. Implications for future cases

- Probably no need to modify Commission guidelines on horizontal cooperation and on the application of Art. 101(3)
- So what needs to be changed? the Commission's application of the test: what it did in CB was clearly wrong
- What impact on ongoing and future grey zone cases (not hardcore restrictions)?
  - Two-sided markets and Network and platform industries
  - Airlines alliances?
  - Liner Shipping case and maritime conferences?
  - Pay for delay?
- For the Commission to decide how to apply the now confirmed restrictive notion of restriction "by object"

5. Concluding remarks (i)

- CB ruling helps defining the boundaries between «by object» and «by effect». Restrictive notion of “by object” is now confirmed
- But this is more back to basics than a real change
  - The legal principle in the case law has always been to assess the effects except in clear-cut cases where sufficient harm has been proven by experience
  - After all, Art. 101(1) is about prohibiting conduct with an appreciable restrictive impact/effect on competition. If doubt for lack of experience it has to be proved…
- It is also common sense and good judgment: “by object” test is not suitable for agreements involving complex measures like pricing rules in two-sided markets. Effects analysis is needed

5. Concluding remarks (ii)

- Commission has a key role now in deciding how to interpret CB ruling and how to apply it to other novel cases and types of agreements that have not been established to be, by their very nature, harmful to competition
- It seems natural that Commission will have to change and focus on the assessment of the restriction by effects condition
- But probably less relevant in practice in an Art. 9 driven enforcement era
- More need of regular economic analysis
- Strong message of ECJ to GC on importance of quality and thoroughness of judicial review of Commission decisions and the evidence on which it bases its findings. Message applies also to the Commission
- Not sure the conundrum is solved for ever (Lundbeck is pending)