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Competitor agreements under EU competition law

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Ladies and Gentlemen,

Before I enter into a discussion on how we go about assessing non-cartel competitor agreements under EU competition law, I would like to set the scene by addressing a larger issue. I want to put the transatlantic twin concepts of “*per se v* rule of reason” and “restriction by object *v* by effect” into context and, to some extent, compare them.

I am doing this because, following the Supreme Court’s *Actavis* opinion¹ in June and our similar *Lundbeck* decision² a few days later, I heard a number of comments comparing these concepts and drawing conclusions from the comparison. Some of those conclusions suggested to me that there is scope for clarification. And I could not imagine a better forum to discuss this matter than Fordham.

After having made these general remarks, I will discuss three recent cases in some more detail: The *Lundbeck* reverse payment case, the *Star Alliance* case and the *e-books* investigation.

Rule of reason *v* per se

This will be familiar territory for many of you. Let me give you my personal – and distinctly European – perspective, also in view of what I will say later on in my speech.

As Justice Brandeis pointed out almost 100 years ago “every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition”³. To determine this, courts should look at the facts specific to the business, the situation before and after the constraint was put in place, and the nature of the restraints as well as their actual or probable effect.

One may summarise this stance by “everything is relevant, nothing is decisive.”

This broad approach did not lend itself easily to litigation, and in the decades that followed the Court seemingly would rely more and more on irrebuttable presumptions of anticompetitive effects based on the nature of the conduct concerned – in other words, on *per se* rules.

With the arrival of Justice Stevens to the Court, the direction seemed to change. From the late 1970s we can start to see two complementary categories of antitrust analysis emerging⁴:

¹ *Federal Trade Commission v. Actavis, Inc., et al*, 570 U.S.

² COMP/AT. 39.226.

³ *Board of Trade of Chicago v. United States*, 246 U.S. (1918).

⁴ See, for example, *National Society of Professional Engineers*, 453 U.S. (1978).

- The first category of agreements comprises those “whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality – they are illegal *per se*”.
- The second category of agreements requires an evaluation of the facts, history of and reasons for the restraint.

But at the same time, Justice Stevens brought together what seemed to be two distinct rules by stressing that in any event, “the purpose of the analysis is to form a judgment about the competitive significance for the restraint”. So effectively, Justice Stevens seemed to see Section 1 as a *continuum*, the comprehensive rule of reason being the standard and the *per se* rule but one – and exceptional – means of applying it.

I will come back to the concept of *continuum* later when discussing Article 101.

It is of course in the very nature of a *continuum* that there is something in between the two extremes of the scale. It did not take long for that intermediary enquiry - or “*middle ground*” as it was called – to take shape under the label “quick look”⁵.

Sometime later, the Court stated clearly that the categories of analysis cannot be pigeonholed into terms like “*per se*”, “quick look” or “rule of reason”⁶. “No categorical line can be drawn between them”, the Court held. Instead, what is required is a situational analysis moving along what the Court referred to as a “sliding scale”. Since then, courts have shaped – or “structured” - the rule of reason to fit the purposes of litigation, essentially assigning the burden of proof between plaintiff and defendant by means of a set of presumptions.

A few months ago, in its *Actavis* opinion, the Court for the first time applied antitrust scrutiny to payments by branded drug companies to their generic competitors. The goal of these payments was to settle patent cases and keep the generics off the market for a certain period of time. The Court declined to apply the quick look approach to reverse payments settlements and, referring to *California Dental*, held that such presumptive rules are appropriate only where “an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anti-competitive effect on consumers and markets”.

At the same time, the Court indicated that a full rule of reason assessment was not required either: while the burden of proof for showing market power and competitive harm will continue to lie with the plaintiff, the nature of the evidence needed for the discharge of that burden seems to be lighter than under the full rule of reason.

For example, on the issue of market power, the Court took the view that “the size of the payment from a branded drug manufacturer to a prospective generic is itself a strong indicator of power.” Likewise, the size of the payment is one of the indicators of

⁵The “quick look” is essentially the application of the rule of reason “in the twinkling of an eye”, as Philipp Areeda once put it.

⁶ *California Dental*, 526 U.S. (1999).

competitive harm. It is true that the Court discussed a number of potential “redeeming virtues” of such payments, but I do not find them all that numerous. Finally, referring anew to the “sliding scale in appraising reasonableness”, the Court left it to the trial courts to “structure antitrust litigation” appropriately, depending on the facts and circumstances of each case.

Object v effect

Under Article 101(1), agreements between firms which have as their object *or* their effect an appreciable restriction of competition are prohibited.

But what is a restriction of competition?

A few years ago, an Advocate-General at the Court of Justice wrote that the concept of restriction of competition is “difficult to grasp”⁷. Let me try to shed some light.

In its quest to protect rivalry among firms and so the competitive process to promote consumer welfare, the Court takes a broad approach when it comes to concerted restraints on the competitive autonomy of firms that are liable to impede the competitive outcome. As the Court likes to put it, every firm is supposed to “determine independently the policy which [it] intends to adopt on the common market. Any form of coordination which deliberately substitutes practical cooperation between undertakings for the risks of competition” is held to “patently conflict with the concept inherent in the Treaty”⁸.

The language in this phrase (“patently conflict”), reminds me of the Supreme Court’s famous label of “frontal assault on the basic policy of the Sherman Act” when rejecting the claim that the very process of competition could itself be harmful by leading to allegedly “unreasonable” prices⁹.

Given the either/or nature of the “object or effect” requirement, the first step is to consider the precise object of the agreement. Indeed, certain forms of collusion between firms “can be regarded, by their very nature, as being injurious to the proper functioning of normal competition”¹⁰. The intention of the parties is not an essential factor, but the Commission may take it into account.

In such situations, is not necessary to examine the effects on competition. Rather, it is sufficient to show that they are inherently liable to negatively affect competition, that is to say, that the restraint is capable of resulting in a distortion of competition. Agreements with such tendencies will be found to exist in particular where the restriction

⁷ Conclusions of AG Trstenjak in case C-209/07, *Competition Authority v. Beef Industry Development Society Ltd and Barry Brother (Carrigmore) Meats Ltd (“Irish Beef”)*, 4 September 2008, at point 42.

⁸ Established case-law, see recently case C-209/07, *Irish Beef*, cited above, judgment of 20 November 2008, n.y.r.

⁹ *National Society of Professional Engineers*, 435 U.S.

¹⁰ Case C-32/11, *Allianz Hungária Biztosító Zrt and Others v Gazdasági Versenyhivatal*, judgment of 14 March 2013, n.y.r. (“Allianz”).

of competition is a necessary consequence of the restraint. In such a case, the parties may not, in principle, argue that they did not intend any restriction of competition, or that their agreement also pursued a different – innocuous – aim.

In a way, it's a bit like speed limits. It is presumed – based on experience – that driving too fast is dangerous, and it is therefore prohibited. That prohibition applies irrespective of whether someone drove *safely* above the speed limit, whether the offence actually resulted in an accident or whether someone had other, perhaps even laudable motives for driving too fast. It is the mere risk of the presumed danger which triggers the offence.

Identifying the anti-competitive object of a restraint does not take place in a vacuum. It is based on the content of the provisions, the objectives and the economic and legal context of the constraint. Apart from classic restrictions like price fixing, output limitations and sharing of markets and customers, there are other, more ambivalent situations, where a contextual analysis can either cast doubt on or confirm the anti-competitive object of an agreement.

Please note that this cuts both ways:

- A restraint that at first sight looks like a restriction by object may on closer examination turn out not to be a restriction at all. For example, the Court held that selective distribution systems for high-end products tend to reduce price competition. And yet, such arrangements can actually spur competition on factors other than price, especially on quality of service, etc. If so, they do not fall under Article 101(1).
- Conversely, a restraint of which the anti-competitive nature had not been clearly determined in the past may yet turn out to have an anti-competitive object. An example would be reverse payment cases where the Commission only recently took its first decision (as I will discuss in a moment).

We need to remember: restrictions by object are serious - but not necessarily obvious.

The depth of that contextual analysis – the Court speaks of “a concrete and individual examination” - will vary according to the circumstances (not unlike the methodology set out by the Supreme Court). Its purpose is to establish whether the agreement in question is “sufficiently injurious to the proper functioning of normal competition”¹¹. Isn't there an echo of the Supreme Court's *sliding scale* approach of situating a restraint within a *continuum*?

It is only where that contextual analysis does not reveal a sufficient degree of harm to competition that actual or potential anti-competitive effects – notably on at least one of the parameters of competition such as price, output, product quality, product variety or innovation – need to be established. That – more detailed – assessment is made in comparison with the relevant counterfactual, i.e., with the situation which could have realistically occurred in the absence of the restraint.

¹¹ Case C-32/11, *Allianz*, cited above.

You will have noticed that, apart from cases like price-fixing, output limitations and the like, the line between restrictions by object and those by effect is not always bright. Reading its more recent rulings¹² one may wonder whether the Court, whilst finding a restriction by object, may not have gone rather far towards analysing the effects of the agreement when it looked at the market structure, the functioning of the market, the degree of concentration, the market power of the firms involved, etc. The US practitioners among you may recognise this tension which seems to be somewhat similar to the variance in practice among US courts in applying the quick look. While some courts focus on whether the agreement is “inherently suspect” on the basis of “economic learning and experience of the market”, others seem to equate the quick look with evidence of actual anti-competitive effects.

At this point, perhaps a question is in order: is the *continuum* approach under the Sherman Act taking hold in Article 101(1)? And if so, what impact would this have on the analysis under Article 101(3)? After all, a *sliding scale* approach – proportional to the seriousness of the restraint – under Article 101(1) would probably find its mirror image when making the balancing in Article 101(3). But I leave that for our discussion.

Two differences

Having pointed to the possible similarities between our two regimes, let me now come to two differences.

1. Different enforcement models, role of the courts and of Guidelines

As has become apparent in my brief history of the rule of reason, in the US it is the courts that play the predominant role in shaping the application of this principle.

In Europe, on the other hand, the principal impetus tends to come from the EU institutions – i.e., from the European Courts’ case-law and the Commission’s decisions and guidelines.

What I said earlier about restrictions by object and by effect has its origin in rulings of the Court. Building on the Court’s case-law, the Commission, in consultation with the national competition authorities, regularly provides general guidance, for instance the 2011 “Horizontal Guidelines” dealing with non-cartel competitor agreements. Whilst not being binding for either the courts or the competition authorities in the EU, those documents provide extensive and detailed explanation about how the Commission will assess various types of agreements and situations.

We see in the framework of the European Competition Network that national authorities do rely on such guidance. National courts then get involved when reviewing the agencies’

¹² *Irish Beef* centred on an agreement between competitors to reduce capacity in the Irish beef processing industry. The agreement involved the major players in the industry agreeing to pay those players who would voluntarily leave the industry. In return for that payment, the players leaving would agree to decommission their plants, refrain from using the associated lands for processing for a period of five years and sign a two-year non-compete clause with regard to processing anywhere in Ireland. *Allianz* was about a vertical agreement between car insurers and repairers in Hungary. The payment the car dealers received was linked with the amount of insurance they sold.

decisions, and they may make a formal request for guidance to the Court – thereby "closing the loop" and giving the Court the opportunity to rule on topical issues under the EU competition rules¹³.

2. Normative difference: Unitary assessment under Section 1, bi-polar assessment under Article 101

The second difference is one of substance, and it is a fundamental one.

Under Section 1, a restraint falling into one of the categories of business practices that "have proved to be predominantly anticompetitive" will be found to be a *per se* offence and therefore necessarily and irretrievably unlawful.

No such rule exists under EU competition law: no restraint is ever necessarily and irretrievably unlawful, and that includes restrictions by object.

The reason for this important difference is that under Article 101(1), no matter whether the restraint is by object or by effect, the contextual analysis never goes as far as balancing the anti- and pro-competitive effects. It only aims at gauging the negative consequences of the restraint for the process of competition, for which the Commission or plaintiff carries the burden of proof. In other words, the analysis under Article 101(1) deals exclusively with identifying competitive harm.

The balancing between competitive harm and redeeming virtues is made exclusively under 101(3). As you will know, that provision provides an efficiency defence in case a restriction of competition has been identified. It is the parties, or defendants, who carry the burden of proof that each of the conditions of Article 101(3) has been met. They need to bring forward sufficient and verifiable evidence that a restraint is ultimately pro-competitive and beneficial for consumers. Failure to provide such evidence leads to the agreement being void pursuant to Article 101(2).

The kind of EU rules that comes closest to US-style *per se* rules are in fact *per se* rules of legality, or what we call "safe harbours". This is the case, for example, for certain types of vertical agreements where the supplier's market share does not exceed 30 per cent. Conversely, the fact that certain particular restrictions are excluded from the scope of the safe harbour – so-called "hard-core restrictions" like fixing minimum sales prices – does not mean that they are *per se* illegal.

I sometimes hear that in practice – albeit not in law – a finding by the Commission of a restriction by object is basically the end of the story, much like a *per se* offence under Section 1.

This is incorrect.

¹³ See, for example, case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la concurrence et et Ministre de l'Économie, de l'Industrie et de l'Emploi*, judgment of 13 October 2011, n.y.r., dealing with internet sales by distributors in a selective distribution network under the Vertical Block Exemption Regulation and Guidelines.

It is true that severe restrictions of competition – such as price fixing or limiting, controlling and sharing markets – are unlikely to meet the conditions for exemption under Article 101(3) as they rarely enhance efficiencies or benefit consumers and are rarely indispensable.

Having said that, reports of the death of Article 101(3) for object restrictions have been greatly exaggerated. The first of the three cases I am going to discuss now is a good example.

The Star Alliance case

On 23 May 2013, the Commission adopted a commitment decision in the Star Alliance case. In its preliminary assessment of the cooperation between Continental, United, Lufthansa and Air Canada, the Commission took the preliminary view that their collaboration by its very nature aimed at restricting competition. After all, by working together they completely eliminated competition between themselves on key aspects of competition, such as price and capacity, and focused on the common interest and benefit of the joint venture. The whole concept of this agreement was held to “conflict patently with the concept inherent in the Treaty provisions relating to competition”, since the parties “substituted competition with full cooperation for the risk of competition”¹⁴.

But, as I said earlier, even by-object restrictions are never “*per se*” unlawful and may indeed be redeemed by cognizable efficiencies under 101(3). Indeed, in this case the parties did bring forward such efficiencies, about which I will say more later. On the basis of these efficiencies, the Commission decided not to raise concerns on the routes covered by the agreement, except for one (Frankfurt-New York).

In the two other examples I want to mention, the claimed efficiencies turned out to be insufficient to outweigh the restriction by object.

Lundbeck

On 19 June of this year – two days after the *Actavis* opinion - the Commission imposed a fine of roughly €90 million on the Danish pharmaceutical company Lundbeck and fines totalling some €50 million on several producers of generic medicines.

Citalopram is a blockbuster antidepressant and was Lundbeck’s best-selling product at the time. After Lundbeck’s basic patent for the citalopram molecule had expired, it only held a number of related process patents which provided a more limited protection. Producers of cheaper, generic versions of citalopram therefore had the possibility to enter the market. Indeed, one of them had actually started selling its own generic version of citalopram and several other producers had made serious preparations to do so.

But instead of competing, the generic producers agreed with Lundbeck in 2002 not to enter the market in return for substantial payments and other inducements from Lundbeck amounting to tens of millions of euros. The agreements gave Lundbeck the

¹⁴COMP/AT.39595, Continental/United/Lufthansa/Air Canada, at point 37, referring to case C-209/07, *Irish Beef*, cited above.

certainty that the generics producers would stay out of the market for the duration of the agreements, without giving the generic producers any guarantee of market entry thereafter. These agreements are very different from other settlements of patent disputes, in which generic companies are not simply paid off to stay out of the market.

Let me start by recalling that patent settlements agreements, like any other agreements, are subject to EU competition law. Even if the limitations included in a patent settlement agreement remain within the scope of the patent, that agreement may, under certain circumstances, have to be considered as contrary to competition law. The same is true for Section 1 of the Sherman Act.

In order to identify whether each agreement covered by the decision had by its very nature the potential to restrict competition, the Commission conducted the kind of contextual analysis I referred to earlier. In that context, the Commission looked at the following aspects:

1. Potential competition: The investigation showed that the generic producers in question had envisaged viable routes to the market. They had, for instance, considered challenging or circumventing one or more of Lundbeck's process patents. This demonstrated that the generic and the originator producers were indeed potential competitors.
2. The generic producer had committed itself in the agreement to limit, for the duration of the agreement, its independent efforts to enter the market.
3. The value transfer from the originator company substantially reduced the incentives of the generic undertaking to independently pursue its efforts to enter the European market. Indeed, it was found that the value which Lundbeck transferred took into consideration the profit or turnover the generic producer expected if it had successfully entered the market.

As you can see, this assessment took into account the economic and legal context leading up to the conclusion of the agreement, the actual content and objectives of the agreement, and each party's subjective intentions, as evidenced by the facts of the case.

The decision further took into account that Lundbeck could not have obtained the limitations on entry through enforcement of its process patents. As a matter of fact, the agreement imposed obligations on the generic producer that went beyond the rights of holders of process patents. Finally, the agreement contained no commitment from Lundbeck to refrain from infringement proceedings if the generic undertaking entered the market with generic citalopram after expiry of the agreement.

As I said before, the finding of a restriction by object under 101(1) does not close the door to an efficiency defence under 101(3). And indeed, the parties did claim efficiencies. However, the conditions of 101(3) were not met.

Incidentally, to those of you who are familiar with the Supreme Court's *Actavis* opinion, the above-mentioned factors taken into consideration by the Commission will sound familiar. Indeed, the Supreme Court looked at the same factors, in particular the size of the payment including as compared to the expected profits of the generic producer, and

the lack of any other convincing justification. In light of the complexities surrounding those elements the Supreme Court required a rule of reason analysis. It seems to me that the 466 pages of detailed factual, legal and economic analysis in the *Lundbeck* decision – both under Article 101(1) and 101(3) – do full justice to those complexities.

In conclusion, let me add the following observation. As discussed earlier, once a restriction of competition by object is established, it is not necessary to show any actual or potential anti-competitive effects of the restraint. Nevertheless, for the sake of completeness, the Commission did analyse the situation in the UK and found that one year after the restrictive agreements had come to an end and generic market entry took place, prices of generic citalopram dropped on average by 90 per cent compared to Lundbeck's previous price level.

Let me come to the third and last example:

E-books

In December 2012, the Commission adopted a commitment decision regarding the conduct of Apple and four of the five international publishers involved (Simon & Schuster, HarperCollins, Hachette and Holtzbrinck/Macmillan) with regard to the sale of e-books to consumers¹⁵. The fifth publisher – Penguin – offered the same commitments later in 2013.

In this case, the Commission took the (preliminary) view that the practice, in its economic context, had the objective of raising retail prices for e-books or prevent the emergence of lower retail prices. In other words, it was the parties' intention to raise retail prices above those offered by Amazon. By its very nature, such a practice had the potential to restrict competition.

The commitments offered included:

- the termination of agency agreements for the sale of e-books in the EEA concluded between each of the five settling publishers and Apple;
- the termination of agency agreements for the sale of e-books in the EEA concluded between each of the five settling publishers and retailers other than Apple that (i) restrict the retailer's ability to set the retail price, or to offer price discounts or promotions, or (ii) contain a price MFN clause.
- A two-year "cooling-off" period during which the five publishers shall not restrict the ability of e-book retailers to set retail prices for e-books and/or to offer discounts or promotions. The maximum discount discretion for retailers was capped at the aggregate amount of commissions that a retailer would earn over a 12-month period from the sale of e-books with the given publisher.

¹⁵ COMP/AT.39847, E-books.

- A five-year ban on retail price MFN clauses for Apple, and on retail price, wholesale and commission MFN clauses for the five publishers in all e-book agreements.

The Commission accepted these commitments because it considered that in this specific case, in particular given the fact that the market for e-books is nascent and fast-moving, the priority should be to put an end to the potential infringement and create conditions aimed at restoring the normal conditions of competition as quickly as possible.

Bill Baer has just described the DOJ's investigation of the same practice in the US. Judge Cote, in her ruling of July, held that the DOJ "had shown [...] through compelling direct and circumstantial evidence that Apple participated in and facilitated a horizontal price-fixing conspiracy. As a result, they have proven a *per se* violation of the Sherman Act." Let me confirm that we had an excellent and close collaboration with the DOJ – as we so often do. This allowed both authorities to find a global solution to the horizontal concerns identified in both jurisdictions. Indeed, on the same day (11 April 2012) that the DOJ filed its lawsuit against Apple and the five publishers along with the proposed consent decrees with three publishers (Hachette, HarperCollins and Simon & Schuster), Vice-President Almunia issued a statement confirming that DG COMP was also engaged in fruitful discussions with Apple and four publishers and on a possible settlement.

Coming to the end of my remarks, let me return to the first case I discussed with you this morning, the Star Alliance case, but let me this time relate it to the efficiency defence in Article 101(3). In fact, that decision features an innovation in the way we look at efficiencies under Article 101(3).

Efficiencies under 101(3) – a new test in Star Alliance

Indeed, in view of the specificity of the airline sector, the Commission for the first time accepted so-called "out-of-market efficiencies". These are efficiencies which are generated on the markets other than the markets where concerns were identified.

According to the standard test as set out in our Guidelines on Article 101(3), the Commission can accept efficiencies produced on other markets than the markets of concern, as long as (i) these two sets of markets are related and (ii) the groups of consumers affected by the restriction of competition and benefiting from these efficiencies are substantially the same.

The test applied in Star represents a broadening of the standard test because it does not require the parties to demonstrate that the groups of consumers travelling on the market(s) of concern and related markets are "substantially the same", in order to credit any efficiencies generated on these related (other) markets.

Instead, it is sufficient to demonstrate the commonality of consumer groups across these two sets of markets in order to credit a part of efficiencies generated on the related markets. This part of efficiencies will correspond to the efficiencies accruing to "common consumers".

In this way, just like the standard test, the broadened test does not weigh the harm to one consumer group against the benefits to another, completely unrelated, consumer

group. Let me stress that the broadened test does not replace the standard one – it only complements it. Indeed, it could be accepted in view of the specific characteristics of the aviation industry.

On the basis of the new test, the Commission's initial concerns could be dropped on five out of six routes. Only on the Frankfurt-New York route premium market, the efficiencies were found to be insufficient to compensate for the negative effects to consumers stemming from the cooperation. The parties therefore offered commitments to address competition concerns on this route.

This shows – contrary to what I sometimes hear - that the Commission is ready to review its policy under 101(3) where this is justified and appropriate.