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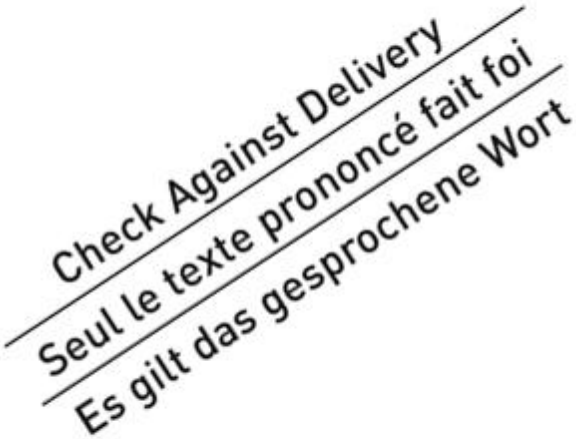
The Object of Effects



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The Object of Effects

Ladies and Gentlemen,

It is a pleasure to be here again at the CRA conference, with its useful focus on the interplay between economics and competition law. I am glad to say the discussion about economics and law is as alive as ever.

Central to this debate is the concept of effects.

But what is the *object of effects*?

In *A Portrait of the Artist as a Young Man*, James Joyce said "The object of the artist is the creation of the beautiful. What the beautiful is, is another matter."

Every time we pursue an investigation we have to decide: is this an infringement of competition law by its very nature, or should we examine possible anti-competitive effects?

In the first case we look at inherently harmful infringements. We do this by primarily focusing on the content and the objectives of the agreements or the conduct in question in order to see whether they reveal a sufficient degree of harm to competition. But we don't consider whether in fact they produce negative effects. Such infringements by their very nature are always serious, although not necessarily obvious.

The second case concerns practices that are not always harmful to competition. Whether they do harm competition depends on many

factors, related both to the particular features of the conduct itself and of the market in which it takes place. Because it all depends on circumstances, rather than on the very nature of the conduct, we need to carefully assess and demonstrate the anticompetitive effects of the conduct in question.

The question is where to draw the line. It is not always easy to decide – is a conduct inherently bad or are we required to do a careful assessment of its effects?

Two recent Court judgments have cast more light on this challenging question. They have done so in seemingly contradictory ways, at least in the view of some. For Article 101, the European Court of Justice in *Cartes Bancaires* urges caution and warns against an overenthusiastic finding of "by object" infringements. For Article 102 some claim, by contrast, that the General Court in the *Intel* judgment criticizes the effects-based approach we have been advocating in recent years, in particular in our Guidance Paper.

I find this claim overstated. Intel obviously will have consequences, but I would like to make it clear today that our effects based approach is still very much alive.

Before explaining why and going into the specific details of these two cases, let me first of all say two things.

First of all, about terminology. The words "object or effects" can be found in Article 101 of the Treaty dedicated to anticompetitive agreements. But, roughly speaking, the basic distinction between by nature and by effect infringements can also be found in abuse of dominance cases under

Article 102, even if the dichotomy is not mentioned in Article 102 itself. In particular in *Intel*, the General Court makes a distinction between certain abuses where a negative effect can be presumed (like exclusivity rebates), and, for example, price abuses where such effects have to proven.

Just as under Article 101, negative effects are presumed for a restriction by object but need to be proven in an effects based case.

And here I open a bracket.

For “by nature” conduct under both 101 and 102 the efficiency defence remains available. This possibility for parties to raise efficiency arguments also in cases of "by nature" conduct is an important difference to the way US courts have been interpreting Section 1 of the Sherman Act. This is why it is not accurate to equate the European notion of "anticompetitive by object" or "by its nature" with the notion of "per se illegal".

Bracket closed.

Now, first, I'd like to make it clear that today, for simplicity's sake, when I use the terms "by object" and by "effect" I will not only be referring just to Article 101, but also to the broader distinction between practices that are harmful in principle and by their very nature, and practices that are harmful only in particular circumstances, which we also find under Article 102.

Secondly, in this debate, there is far too much emphasis on differences between schools of thought and beliefs, differences that may even

become bigger depending on whether you speak to an economist or a lawyer.

I prefer to focus on what unites the two.

In competition enforcement, the by object method and the by effects method of determining infringements have in common that they aim to demonstrate anticompetitive behaviour, based on a theory, methodology and evidence.

About the goal, there is agreement: to make markets work better. About the method, there is debate. Fundamentally this is a debate about how to best achieve our goals.

Is it better to have clear legal rules that guide behaviour, or is it better to judge behaviour on a case by case basis, by the harm it is likely to cause? Today, I would like to argue that this dilemma is a false one, and that it is important to strike a balance.

Let me use an analogy to make this point.

In her Opinion on T-Mobile Netherlands, Advocate-General Juliane Kokott compared restrictions by object to drunk driving.[1] Drunk driving is always illegal, because all our experience tells us that it is extremely likely to cause harm. The risk of harm is sufficiently great to warrant an outright prohibition, rather than judging infringements on a case by case basis. But where there is no clear risk of harm, it is neither necessary nor efficient to have blanket prohibitions. For these situations, legal systems

[1] Case C-8/808, T-Mobile Netherlands BV and Others [2009] ECR I-04529 (Opinion of Advocate General Kokott)

have devised prohibitions that require the proof that harm has been done or was likely to occur.

A prohibition "by object" creates legal clarity. You know that if a practice falls in the category of object restrictions, you really should think twice before doing it. A company can't defend itself by arguing that there are no negative effects in a concrete case.

An effects-based legal test may establish less legal clarity and predictability; it does serve justice in its own way, because we have to prove in individual cases that certain behaviour was likely to cause harm. This means that the key question is not whether to examine effects, because we clearly often do. The question rather is in which cases the legal test requires us to do it, in which cases we are not legally required but still want to do so as a matter of priority setting, and finally how we do it.

The effects based approach

I would now like to discuss the development of the effects based approach. First, I will look at Article 101, then at Article 102, saying also a few words about Mergers and State Aid.

But first, Article 101.

The distinction between object and effect existed in embryonic form in the Coal and Steel Treaty.[2] The Treaty of Rome demanded we examine agreements and practices that have the "object or effect" of restricting

[2] Anca D Chiriţă, A Legal-Historical Review of the EU Competition Rules. *International and Comparative Law Quarterly*, 63, 281-316.

competition. The Courts especially have been the driving force in establishing the effects based approach.
It was the Court which, in *Société Technique Minière*, made clear what the phrase "object *or* effect" in the Treaty meant. It meant that, if we could not find a restriction by object, we had to look for anticompetitive effects.

But which effects had to be established by law, and how did they have to be established?

In *Société Technique Minière*, the Court also pointed out the method. We had to analyse effects on competition by applying a counterfactual analysis. What would competition have looked like, if the allegedly anti-competitive agreement under investigation had never existed?

In 1991 the Court made its seminal *Delimitis* judgment.

You may remember the story. In a typical exclusive dealing and minimum purchase agreement, the Frankfurt *Henninger* brewery had compelled pub landlord Stergios Delimitis to purchase the beer for resale in his bar exclusively from Henninger, who owned the bar, and to annually purchase at least 132 hectoliters of beer. When Mr Delimitis ended the tenancy agreement, the brewery demanded he pay back the rent, fined him for not buying enough beer, and took the money out of his deposit. To get his 6600 Deutschmarks back, Mr Delimitis took the brewery to court.

In a preliminary ruling, the ECJ ruled on the competition aspects of the case. It found that account must be taken of the conditions under which the competitive forces operate in the relevant market. In particular, it must be assessed whether there is a concrete possibility for new

competitors to penetrate the beer market despite the exclusivity agreements of the existing breweries.

Which meant a blanket ban was out of the question and potential negative effects on competition had to be established.

This is why the case had such an impact on the competition community. A seemingly serious restriction of competition like the obligation not to buy from Henninger's competitors, required the consideration of effects. We had to look at effects.

But again, how much effect had to be shown under the legal test?
An agreement with one single pub may only have insignificant effects.

Just looking at the deal with Mr Delimitis was not enough. To fully determine potential anticompetitive effects, the court argued that we had to look at the effects on competition of the entire network of agreements in the beer market.

After *Delimitis* the Courts emphasised in several other cases, also outside the area of vertical restraints,that we have to examine effects in their full economic context.

The Commission has taken these instructions by the Court very seriously. We have included them in our notices, first in the Guidelines on Vertical Restraints, then in the Horizontal Cooperation Guidelines, and in our Guidelines on Article 101(3). In short, we have made the search for effects part and parcel of our everyday work.

So, that's the situation for anti-competitive agreements under Article 101. Next I will discuss the effects based approach under Article 102.

When it comes to abuses of a dominant position under Article 102, the Court has sent a more differentiated message on effects. But here too, there is clear case law demanding an analysis of effects. In the 1991 Akzo case, the court considered certain low pricing practices only predatory, and therefore abusive, if they had the likely effect of foreclosing equally efficient competitors from the market.

A similar price cost test was endorsed by the Court of Justice for margin squeeze cases. (*Deutsche Telekom* (2010) and TeliaSonera, (2009)). In Microsoft, the General Court fully upheld the Commission's effects-based analysis in relation to both refusal to deal and tying practices.
Up till now, I have discussed how the effects-based approach can be used to determine the legality of behaviour. But it can also be used to set priorities.

Our 2009 Guidance Paper on enforcement priorities makes this clear. According to the Guidance Paper, the Commission will, as a matter of priority setting, focus on cases that are likely to have the most harmful effects for competition and, ultimately, consumers.

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Apart from Antitrust, the effects based approach is also firmly established in Merger control. When analysing mergers we have – already before the modification of the legal test, before the change from a dominance test to

a SIEC[3] test, – assessed which effects the merger is likely to have on the competitive conditions in the markets concerned.
Here again, important impulses came from the Union courts. In the cases Airtours/First Choice (2002), TetraLaval/Sidel (2002/2005) and General Electric/Honeywell (2005) the courts emphasised that the Commission must use a body of cogent and consistent evidence to demonstrate that a merger is likely to lead to a competition problem. The Commission cannot rely on merely abstract or hypothetical considerations.

In the same vein, since the 2005 State Aid Action Plan, we have been moving towards a more economic, effects-based approach when assessing the compatibility of aid measures with the Treaty. The more recent State Aid Modernisation Programme continues on that path. We will only allow "good aid" that corrects market failures. A key question is a counterfactual: "will the beneficiary undertake activities that it would not have done without the aid."

In short, the effects approach is here to stay – It has become part of our DNA.

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Intel

The Intel case is the latest instalment in a long series of cases addressing whether at all and what effects we have to show under the applicable legal tests.

[3] Significant Impediment to Effective Competition

As you know, the Court found that we had demonstrated Intel's abusive behaviour, and considered our fine of €1.06 billion appropriate. So obviously, we welcome the decision by the Court.
But this is, of course, not the only thing the Court told us.
First, it said that exclusivity rebates offered by a dominant firm – as in the case of Intel – are, absent an objective justification, abusive by their very nature. So, there is no need to establish any anti-competitive effects in each specific case because these can be presumed from the nature of the conduct.

Second, in response to an argument made by Intel, the Court noted that to appreciate foreclosure effects in rebate cases, it is not necessary to demonstrate that it is *impossible* for competitors to access the market. It is enough to show that it is *more difficult* for them to do so. Because the As Efficient Competitor Test investigates the former, the court appears to consider the test inconclusive to assess whether there is no foreclosure.
Now, the key question is: *what will we do after Intel. Which effect does the judgement have on how we apply 102 to exclusivity rebates and other types of abuses?*

We fully support the judgment of the General Court upholding our decision, and it goes without saying that we will apply the legal test that the General Court has set out for exclusivity rebates, even if the judgment is under appeal. I would like to make it clear today that we will also be applying the legal test to exclusive dealing, even if this was not mentioned by the Court. Because if exclusivity rebates are by their very nature distortive of competition, then this is even more so the case for exclusive dealing arrangements without rebates.

What room does Intel leave for considering effects – either as part of the legal test or as a means of priority setting?

First, outside the area of rebates, we will still have to determine effects in those cases where the Court itself has endorsed an effects based legal test. This concerns several types of abuse ranging from margin squeeze (TeliaSonera, Deutsche Post), refusal to deal (Microsoft) to predatory pricing (Akzo).

It also concerns the behaviour at issue in Post Denmark I, where the Court held that selective price cuts are only abusive where they cannot be matched by an equally efficient competitor.

Second, concerning rebates other than exclusivity rebates, the legal test as mentioned by the General Court in Intel requires us to consider 'all circumstances'. This clearly means that the likely effects of the rebates in question need to be examined. We can, but we are not legally required to apply a price-cost test for this, there are also other questions we could ask to determine possible harm.

Third, as you know, in Intel the Court also reminded us that dominant companies are free to come up with efficiency defences and if they do so, we have to take the possible efficiency effects into account.

Fourth, also for exclusivity rebate schemes, we will still be considering their likely anti-competitive effects *when setting priorities*. Resources are finite, we should focus them on the potentially most harmful cases. In order to decide whether a case is particularly harmful or not, we will examine the likelihood and magnitude of anticompetitive harm in the stage when we are screening cases for priority status. Apart from

examining our other usual priority considerations, we could at this screening stage, for example, ask whether it is a good use of our resources to investigate a case where the exclusivity rebate covers less than 1% of the market.

Intel has lodged an appeal against the General Court's judgment and there will be the ruling of the Court of Justice. In any event, I can assure you that we remain committed to an effects-based approach – be it at the level of priority setting or, where required, at the level of the legal and economic test for other abuses than those by nature such as exclusivity rebates.

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Cartes Bancaires

If Intel tells us "don't look for effects if you don't need to", Cartes Bancaires says "only use by object if you are pretty sure that it's there."

I assume you are all familiar with the judgment, so – if you will excuse me the pun – I will concentrate on its effects.
We draw several lessons from the case.

First, we must take particular care when we find an agreement to be a restriction by object if it does not bear an obvious resemblance to past cases where a restriction by object was established.

We also need to think twice before finding that agreements that may have a legitimate aim, such as preventing free riding, are a restriction by object.

In Cartes Bancaires, the Court confirmed the need for looking thoroughly into the legal and economic context, before concluding that a certain type or restriction is "by object". Where an agreement is clearly a horizontal price fixing cartel – to give the example of the Court – there is not really any relevant context we would need to look into. In Cartes Bancaires, the context of the agreement included both the issuing and the acquiring side of the Cartes Bancaires system, and the analysis could not be limited to just the issuing side.

If we want to demonstrate that an agreement is so bad for competition that it is "harmful by its very nature", then we must present a convincing argument based on the content, objectives and context of the agreement. This will be more demanding for new, unfamiliar types of agreement or conduct, but will be normally rather straightforward for established types of restrictions by object such as cartels.

But when showing that a restriction is by object we cannot, and should not, use evidence on the concrete effects of a certain restriction in the case at hand. The Court of Justice in Cartes Bancaires clearly faulted the General Court for having relied on effects in that case when analysing whether the agreement should be found to restrict competition *by object*. In the mind of the Court of Justice, relying on effects was the red-line that cannot be crossed when qualifying a restriction as by object.

The Cartes Bancaires judgment has only told us what to do and what not to do when analysing infringements *by object*. The Court did not tell us much what to do when it comes to infringements *by effect*. But this is pretty clear from previous case law, for instance the case John Deere, which tells us that for finding an infringement by effect under Article 101 there is no requirement to demonstrate whether and to what extent concrete effects *actually occurred*: we legally only have to show, on the

basis of a realistic counterfactual, the *likely* effects of the conduct in question.

In some cases the quantitative economic evidence can be very important. But there are certainly are also cases in which qualitative analysis can be sufficient to provide the required proof of the likely effects, just as it can be in merger cases.

Conclusion

So, to end with my initial question: what is the *object of effects*?
In a nutshell, the goal of the effects based approach is to focus our enforcement activities on the most harmful of cases. And, ultimately to ensure that markets work properly and that consumers benefit from the efficiency and productivity resulting from effective competition.
The effects based approach has been a key element of competition enforcement for many years across all our instruments, and will remain so for the foreseeable future.

Some say that the General Court in Intel *objected to effects*.
As I said, I don't think this is correct, certainly not as a general statement. There is nothing in Intel suggesting that we should not consider effects under Article 102 as a matter of general principle, nor indeed that the likely effects of an exclusivity arrangement cannot be taken into account at the stage of priority setting.

Some say that the Court of Justice in Cartes Bancaires *objected to object*.

But, once again, I do not think this is correct. In my view, the Court of Justice's main message is not that there is anything wrong with running

by object cases. It is a reminder though that we need to have a convincing story before finding one and that we cannot mix up by object and effect.

In general, in competition law enforcement, object and effects complement each other.

The over-arching lesson of these two cases, Intel and Cartes Bancaires, is that each approach should be properly applied.

It's all about finding the right balance.
To come back to the beer analogy. In Belgium they have an appropriate saying:

Une bière brassée avec savoir, se déguste avec sagesse. That seems like a good message before the festive season.

Thank you for your attention.