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AN EXPANDED EUROPEAN UNION

NEW COMPETITION RULES AND CHALLENGES FOR U.S. COMPANIES

by

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On May 1, 2004, the same day on which ten new member states joined the European Union, a series of regulations and guidelines went in effect in what Commissioner for Competition Mario Monti described as the most "radical reform in European competition policy" since the beginning of the European Union. *See* European Commission Competition Policy Newsletter, *The EU gets new competition powers for the 21st Century*, special edition, at 1 (2004). The reforms present a challenging mix. Businesses will welcome some changes aimed at making Commission procedures more efficient and at injecting greater economic rigor into competition policy. Other changes, such as the expanded roles for courts and enforcement authorities of the 25 member states, present greater dangers. Businesses no longer will have to pre-notify the Commission before undertaking joint arrangements, but as a consequence will risk after-the-fact litigation from the Commission, national authorities, or, increasingly, private litigants — with the possibility that an arrangement may be held invalid after it has been in effect for years.

The Commission describes the reforms as *A Pro-active Competition Policy for a Competitive Europe* (COM(2004) 293 (Apr. 20, 2004)). While the word "pro-active" suggests increased intervention, the Commission characterized its reforms as designed to standardize the application of competition law throughout the European Union, require enforcement to bear a stronger relationship to economic effects, and streamline the regulatory process. Time will tell whether the changes rationalize competition enforcement or increase regulatory intervention.

The Commission's reforms fall into two broad categories. First, new merger control regulations achieve procedural reforms, and require greater attention to efficiencies, but may also expose to challenge mergers that do not raise issues of unilateral or coordinated dominance. *See* Council Regulation 139/2004 (on the control of concentrations between undertakings), 2004 O.J. (L

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24) 1; Commission Notice, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 2004 O.J. (C 31) 5.

Second, with broader potential effects, are the antitrust modernization provisions in Regulation 1/2003 and complementary regulations and guidelines.[1] Regulation 1/2003 abrogates the long-standing notification system under which companies that planned joint activities potentially restrictive of competition had to notify the Commission of the proposed arrangements and wait for regulatory clearance. Without clearance, an agreement was not exempt from the cartel prohibition. Now, agreements that qualify for an exemption are automatically valid without formal action. In addition, national competition authorities and courts will have full power to apply the competition rules of the EC Treaty. This reform is intended in part to encourage private antitrust litigation, now relatively infrequent in Europe.

We briefly survey the changes and their likely practical effects.

Treaty Provisions Governing European Competition Law. Article 81(1) of the EC Treaty prohibits all agreements that may restrict competition, enumerating certain examples. Article 81(3), however, provides that Article 81(1) "may … be declared inapplicable" to particular transactions if the restrictions are no broader than necessary to accomplish procompetitive objectives to the benefit of consumers, and do not threaten to eliminate competition within a "substantial part" of the relevant market. Article 82 EC addresses single-firm conduct, prohibiting the abuse of a dominant position, again enumerating particular examples of forbidden conduct.

Merger Reforms. The new Merger Regulation contains procedural revisions along with one potentially significant substantive change. Although the Commission will receive a few additional weeks to review proposed deals, parties now can begin the process based on a good-faith intention to merge, rather than waiting for a binding agreement. That tactic, which adopts a successful practice under some national merger control laws, could reduce the time between agreement to review and closing. A new referral procedure will allow companies to determine more efficiently whether the Commission or member states will review a proposed merger. In addition to current economic thresholds making some mergers the exclusive responsibility of the Commission and assigning mergers mainly affecting one country to be reviewed by that member state, the new regulation provides for "one-stop" shopping with the Commission whenever a merger would have to be reviewed in three or more member states, if none of the states objects to the Commission's sole control of the investigation.

The Merger Regulation requires the Commission to give specific attention to efficiencies claimed to result from mergers under review. An additional substantive change may impede mergers in concentrated industries, however. Previously, the Commission focused on whether a merger would lead to dominance in a relevant market, either by the merged firm alone or in concert with others. The latter concept of "joint" or "collective dominance" required some showing that the post-merger firms would coordinate in some way to exercise dominance together. The new regulation

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[1] *See*, *e.g.*, Council Regulation 1/2003, 2003 OJ (L 1) 1 (implementing rules of competition); Commission Regulation 773/2004, 2004 O.J. (L 123) 18 (Commission procedures); Commission Notice on informal guidance relating to novel questions concerning Articles 81 and 82 of the EC Treaty that arise in individual cases (guidance letters), 2004 O.J. (C 101) 78; Commission Notice on cooperation within the Network of Competition Authorities, 2004 O.J. (C 101) 43; Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC, 2004 O.J. (C 101) 54; Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty, 2004 O.J. (C 101) 65; Commission Notice, Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, 2004 O.J. (C 101) 81; Commission Notice, Guidelines on the application of Article 81(3) of the Treaty, 2004 O.J. (C 101) 97.

broadens Commission's criterion to reach any resulting concentration that will "significantly impede competition." The Commission views this change as providing explicit authority to challenge any merger that could lead to a significantly less competitive market structure, regardless of the risk of dominance or coordinated effects. A "pro-active" stance toward this revised standard could provide a significant roadblock to mergers in industries that are competitive but sufficiently concentrated to be viewed as potentially "oligopolistic."

Modernization of Conduct Regulation. Over the past several years, the Commission has moved toward a guidelines-based regime providing safe harbors for a broad variety of agreements, while making clear that exemptions are not available for hardcore conduct such as price-fixing and market allocation. The Commission has issued general guidelines on both horizontal and vertical coordination agreements, while issuing other more specific block exemptions. This approach will be increasingly important as parties now have to evaluate their own conduct instead of receiving pre-clearance. As the European Union expands, the Commission also seeks to share antitrust enforcement authority with other agencies while keeping antitrust compliance manageable.

Preemption of National Competition Law. Regulation 1/2003 makes clear that national law cannot be applied to conduct that violates either Article 81 or Article 82 and may affect trade between member states. Conduct that meets the latter, jurisdictional requirement but does *not* violate European law is treated differently according to whether the conduct is collective. If the conduct does not violate Article 81, national law cannot be applied. But stricter national law *can* be applied to single-firm conduct that does not violate Article 82; for example, German antitrust law prohibits abusive behaviour by companies with superior market power that falls short of dominance. The substantive change here is modest, since European law already prevails over national law, and national competition laws rarely apply stricter rules than the Commission.

Expanded Role for National Competition Authorities and Courts — Including Private Litigants. National authorities and courts will be able to apply Articles 81 and 82 in their entirety, including the exemption power under Article 81(3) that had been the sole prerogative of the Commission. Regulation 1/2003 provides various means to foster coherent application of European competition law within this decentralized system. Not only will there be a European Competition Network of competition authorities, but agencies must exchange information and are encouraged to stay proceedings in cases involving several authorities. National courts may not reach a result contrary to that reached by any past or contemplated Commission decision addressing the same conduct.

The most important change may be the encouragement of private antitrust litigation, currently rare in Europe. Complaining parties will be able to seek relief directly from the national courts without having to wait for the outcome of an administrative proceeding. Thus, companies may have to fend off antitrust action not only from up to 26 sovereigns, but also from disgruntled competitors and others who may seek the most favorable forum to address their grievances.

Without a Pre-notification Procedure, Firms Must Reach Their Own Assessment of the Applicability of an Exemption. Before Regulation 1/2003, parties entering into an agreement that appeared on its face to implicate the prohibitions of Article 81(1) had to notify the Commission to provide a chance for regulatory intervention before the deal was consummated. Under that procedure, the Commission often would undertake a lengthy investigation before issuing a "negative clearance" or informal comfort letter.

Now, conduct that qualifies for an exemption is immediately lawful in itself, without Commission intervention or imprimatur. But the parties must judge for themselves whether they come within an exemption in Article 81(3), although the Commission has announced that, upon

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request, it may issue guidance letters to firms presenting novel issues. In the absence of a guidance letter, parties will not know for sure whether their agreements are valid — yet will face an increased risk of litigation in national courts.

Legal certainty arises only for agreements that clearly qualify for a block exemption set forth in a Commission regulation; parties will have to judge whether their facts fit. Where no block exemption applies, the parties will have to undertake the four-part Article 81(3) analysis, aided by the Commission's new guidelines. 2004 O.J. (C 101) 97. The first step of the exemption analysis examines whether the agreement confers objective efficiency gains, for example in production, distribution, or research and development. *Id.* ¶¶ 48-72. The restrictive elements of the agreement must be indispensable to gaining the efficiencies. *Id.* ¶¶ 73-82. If the same efficiencies can be achieved through means less restrictive of competition, no exemption will apply. Moreover, a "fair share" of the efficiencies must be passed on to consumers (defined as all direct or indirect users of the output of the agreement). *Id.* ¶¶ 83-104. Finally, the agreement must not eliminate competition in a substantial part of the relevant market, an assessment that requires consideration not only of the market shares of the agreeing parties but of any barriers to competitive entry. *Id.* ¶¶ 105-115. This factor generally forecloses exemptions for parties that together hold a dominant position (generally defined as a 50% market share, but sometimes even less).

Compliance Issues — Obtaining the Counterparty's Information and Protecting Against Illegality through Market-share Growth. Under the notification scheme, the parties were required to provide market information to the Commission. Parties now will need the same data in order to perform their own analysis — yet may not be eager to share that information with each other, for commercial reasons (particularly for vertical agreements) and also because of the risk that an information exchange might produce accusations of spillover collusion.

Thus, while companies may need to agree to exchange market information, they may need to screen that information so that only the competitors' outside counsel and consultants review it. Companies may seek warranties as to the comprehensiveness and accuracy of the market data needed for competition analysis. In some cases, it may be sufficient if a contractual partner certifies that its market position comes under the thresholds for a block exemption or for a safe harbour under the guidelines.

Agreements may also be required need to provide for mutual notifications of changes in market position, since a growing market share of one party or of both in combination may take the agreement beyond the scope of an exemption. Parties may want to provide for curative action if changed competitive circumstances threaten the legality of the arrangement. A right to termination would be one possibility, or a predetermined modification such as converting an exclusive licence into a non-exclusive license (with appropriate changes in compensation).

The modernized European competition system presents risk as well as promise. Increased emphasis on efficient and coordinated enforcement is welcome, as is the drive to subject enforcement activity to economic rigor. A regime in which procompetitive conduct is lawful without Commission involvement is desirable, but parties must proceed at their own risk — as they must in the United States, where there is no pre-clearance for non-merger activity, and a similar system of guidance letters provides very limited assistance. The Commission is converging toward the United States model in another, potentially less desirable way: by allocating a greater role to the 25 member states, their courts, and private antitrust litigants. As a consequence, businesses operating in Europe may have to proceed with more extensive — and expensive — legal counsel to negotiate the thicket of public and private antitrust oversight.

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