

Guidelines on the application of Article 81(3) of the Treaty,

OJ.2004/C 101/97.

(Text with EEA relevance)

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Headings to most of the individual guidelines have been added by Valentine Korah (centred and in italics) and key words within the guidelines have been italicised to make it easier for the reader to navigate the text. Some notes are also included as footnotes.

1. Introduction

Article 81(3) exempts from Article 81(1) – direct effect

1. Article 81(3) of the Treaty sets out an exception rule, which provides a defence to undertakings against a finding of an infringement of Article 81(1) of the Treaty. Agreements, decisions of associations of undertakings and concerted practices¹ caught by Article 81(1) which satisfy the conditions of Article 81(3) are valid and enforceable, no prior decision to that effect being required.

Individual or bloc exemptions

2. Article 81(3) can be applied in *individual cases* or to *categories of agreements* and concerted practices by way of block exemption regulation. Regulation 1/2003 on the implementation of the competition rules laid down in

¹ In the following the term ‘*agreement*’ includes concerted practices and decisions of associations of undertakings.

Articles 81 and 82² does not affect the validity and legal nature of block exemption regulations. All existing block exemption regulations remain in force and agreements covered by block exemption regulations are *legally valid and enforceable even if they are restrictive* of competition within the meaning of Article 81(1)³. Such agreements can only be prohibited for the future and only upon formal withdrawal of the block exemption by the Commission or a national competition authority⁴. Block exempted agreements cannot be held invalid by national courts in the context of private litigation.

Other guidelines

3. The existing guidelines on *vertical restraints, horizontal cooperation agreements and technology transfer agreements*⁵ deal with the application of Article 81 to various types of agreements and concerted practices. The *purpose of those guidelines is to set out the Commission's view of the substantive assessment criteria applied to the various types of agreements and practices.*

These guidelines do not bind NCAs or courts

4. The present guidelines set out the Commission's interpretation of the conditions for exception contained in Article 81(3). It thereby *provides guidance on how it will apply Article 81 in individual cases.* Although not

² OJ 2003 L 1, p. 1.

³ All existing block exemption regulations and Commission notices are available on the DG Competition web site:
<http://www.europa.eu.int/comm/dgs/competition>.

⁴ See paragraph 36 below.

⁵ See Commission Notice on Guidelines on vertical restraints, OJ 2000 C 291, page 1, Commission Notice on Guidelines on the application of Article 81 of the Treaty to horizontal cooperation agreements, OJ 2001 C 3, page 2, and Commission Notice on Guidelines on the application of Article 81 of the Treaty to technology transfer agreements, not yet published.

binding on them, these guidelines also intend to give guidance to the courts and authorities of the Member States in their application of Article 81(1) and (3) of the Treaty.

Analytical framework

5. The guidelines establish *an analytical framework* for the application of Article 81(3). The purpose is to develop a methodology for the application of this Treaty provision. This methodology is based on the economic approach already introduced and developed in the guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements. The Commission will follow the present guidelines, which provide *more detailed guidance on the application of the four conditions of Article 81(3)* than the guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements, also with regard to agreements covered by those guidelines.

No mechanical application

6. The standards set forth in the present *guidelines must be applied in light of the circumstances specific to each case*. This excludes a mechanical application. Each case must be assessed on its own facts and the guidelines must be applied reasonably and flexibly.

Current case law and Commission policy

7. With regard to a number of issues, the present guidelines outline the *current state of the case law of the Court of Justice*. However, the Commission *also intends to explain its policy with regard to issues that have not been dealt with in the case law, or that are subject to interpretation*. The Commission's position, however, is *without prejudice to the case law of the Court of Justice and the Court of First Instance* concerning the interpretation of Article 81(1)

and (3), and to the interpretation that the Community Courts may give to those provisions in the future.

2. The General Framework of Article 81 EC

2.1 The Treaty provisions

Article 81(1)

8. Article 81(1) *prohibits* all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States⁶ and which have as their object or effect the prevention, restriction or distortion of competition⁷.

Article 81(3)

9. As an *exception* to this rule Article 81(3) provides that the *prohibition contained in Article 81(1) may be declared inapplicable* in case of agreements which contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits, and which do not impose restrictions which are not indispensable to the attainment of these objectives, and do not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products concerned.

Direct effect of Article 81

10. According to *Article 1(1) of Regulation 1/2003* agreements which are caught by Article 81(1) and which do not satisfy the conditions of Article 81(3)

⁶ The concept of effect on trade between Member States is dealt with in separate guidelines.

⁷ In the following the term '*restriction*' includes the prevention and distortion of competition.

are *prohibited, no prior decision to that effect being required*⁸. According to Article 1(2) of the same Regulation agreements which are caught by Article 81(1) but which satisfy the conditions of Article 81(3) are not prohibited, no prior decision to that effect being required. Such agreements are valid and enforceable from the moment that the conditions of Article 81(3) are satisfied and for as long as that remains the case.

Balancing performed only under Article 81(3)

11. The *assessment under Article 81* thus consists of two parts. The first step is to assess whether an agreement between undertakings, which is capable of affecting trade between Member States, has an anti-competitive object or actual or potential⁹ anti-competitive effects. The second step, which only becomes relevant when an agreement is found to be restrictive of competition, is to determine the pro-competitive benefits produced by that agreement and to assess whether these pro-competitive effects outweigh the anti-competitive effects. *The balancing of anti-competitive and pro-competitive effects is conducted exclusively within the framework laid down by Article 81(3)*¹⁰.

See whether agreement infringes A 81(1) before applying A 81(3)

Other guidelines

12. The assessment of any countervailing benefits under Article 81(3) necessarily requires *prior determination of the restrictive nature and impact of*

⁸ According to Article 81(2) such agreements are automatically void.

⁹ Article 81(1) prohibits both actual and potential anti-competitive effects, see e.g. Case C-7/95 P, *John Deere*, [1998] ECR I-3111, paragraph 77.

¹⁰ See Case T-65/98, *Van den Bergh Foods*, [2003] ECR II-, paragraph 107 and Case T-112/99, *Métropole télévision (M6) and others*, [2001] ECR II-2459, paragraph 74, where the Court of First Instance held that it is only in the precise framework of Article 81(3) that the pro- and anti-competitive aspects of a restriction may be weighed.

the agreement. To place Article 81(3) in its proper context it is appropriate to briefly outline the objective and principal content of the prohibition rule of Article 81(1). The Commission guidelines on vertical restraints, horizontal co-operation agreements and technology transfer agreements¹¹ contain substantial guidance on the application of Article 81(1) to various types of agreements. The present guidelines are therefore limited to recalling the basic analytical framework for applying Article 81(1).

2.2 *The prohibition rule of Article 81(1)*

2.2.1 *General remarks*

Consumer welfare and efficient allocation

13. The objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumers.

Collusion etc– Reg. 1/2003, Article 3 – primacy of Community law

14. The prohibition rule of Article 81(1) applies to restrictive agreements and concerted practices between undertakings and decisions by associations of undertakings in so far as they are capable of affecting trade between Member States. A general principle underlying Article 81(1) which is expressed in the case law of the Community Courts is that In view of this the Community Courts have defined ‘agreements’, ‘decisions’ and ‘concerted practices’ as Community law concepts which allow a distinction to be made between the unilateral conduct of an undertaking and co-ordination of behaviour or collusion between

¹¹ See note 5 above.

undertakings¹². Unilateral conduct is subject only to Article 82 of the Treaty as far as Community competition law is concerned. Moreover, the convergence rule set out in Article 3(2) of Regulation 1/2003 does not apply to unilateral conduct. This provision applies only to agreements, decisions and concerted practices, which are capable of affecting trade between Member States. Article 3(2) provides that when such agreements, decisions and concerted practices are not prohibited by Article 81, they cannot be prohibited by national competition law. Article 3 is without prejudice to the fundamental principle of primacy of Community law which entails in particular that agreements and abusive practices that are prohibited Articles 81 and 82 cannot be upheld by national law.¹³

Article 81(1) applies to coordination that substantially reduces uncertainty - actual or tacit collusion.

15. The type of co-ordination of behaviour or collusion between undertakings falling within the scope of Article 81(1) is that where at least one undertaking vis-à-vis another undertaking undertakes to adopt a certain conduct on the market or that as a result of contacts between them *uncertainty as to their conduct on the market is eliminated or at least substantially reduced*¹⁴. It follows that *co-ordination can take the form of obligations that regulate the market conduct of at least one of the parties as well as of arrangements that*

¹² See in this respect paragraph 108 of the judgment in *Anic Partecipazioni* cited in the previous note and Case C-277/87, *Sandoz Prodotti*, [1990] ECR I-45.

¹³ See in this respect e.g. Case 14/68 *Walt Wilhelm* [1969] ECR 1, and more recently Case T-203/01 *Michelin (II)* ..., paragraph 112.

¹⁴ See Joined Cases T-25/95 and others, *Cimenteries CBR*, [2000] ECR II-491, paragraphs 1849 and 1852; and Joined Cases T-202/98 and others, *British Sugar*, [2001] ECR II-2035, paragraphs 58 to 60.

influence the market conduct of at least one of the parties by causing a change in its incentives. It is not required that co-ordination is in the interest of all the undertakings concerned¹⁵. Co-ordination must also not necessarily be express. It can also be tacit. For an agreement to be capable of being regarded as having been concluded by tacit acceptance there must be an invitation from an undertaking to another undertaking, whether express or implied, to fulfil a goal jointly¹⁶. In certain circumstances an agreement may be inferred from and imputed to an ongoing commercial relationship between the parties¹⁷. However, the mere fact that a measure adopted by an undertaking falls within the context of on-going business relations is not sufficient¹⁸.

Appreciable adverse impact on competition

16. Agreements between undertakings are *caught by the prohibition rule of Article 81(1)* when they are *likely to have an appreciable adverse impact on the parameters of competition on the market, such as price, output, product quality, product variety and innovation*. Agreements can have this effect by appreciably reducing rivalry between the parties to the agreement or between them and third parties.

2.2.2 The basic principles for assessing agreements under Article 81(1)

Counterfactual - appraisal ex ante – inter- and

¹⁵ See to that effect Case C-453/99, *Courage v Crehan*, [2001] ECR I-6297, and paragraph 3444 of the judgment in *Cimenteries CBR* cited in the previous note.

¹⁶ See in this respect Joined Cases C-2/01 P and C-3/01 P, *Bundesverband der Arzneimittel-Importeure*, [2004] ECR I- , paragraph 102.

¹⁷ See e.g. Joined Cases 25/84 and 26/84, *Ford*, [1985] ECR 2725.

¹⁸ See in this respect paragraph 141 of the judgment in *Bundesverband der Arzneimittel-Importeure* cited in note 16.

intra-brand competition

17. The assessment of whether an agreement is restrictive of competition must be made *within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions*¹⁹. In making this assessment it is necessary to take account of the likely impact of the agreement on *inter-brand competition* (i.e. competition between suppliers of competing brands) and on *intra-brand competition* (i.e. competition between distributors of the same brand). Article 81(1) prohibits restrictions of both inter-brand competition and intra-brand competition²⁰.

Inter- or intra-brand competition

18. For the purpose of assessing whether an agreement or its individual parts may restrict inter-brand competition and/or intra-brand competition it needs to be considered how and to what extent the agreement affects or is likely to affect competition on the market. The following two questions provide a useful framework for making this assessment. The *first question* relates to the impact of the agreement on *inter-brand competition* while the *second question* relates to the impact of the agreement on *intra-brand competition*. As restraints may be capable of affecting both inter-brand competition and intra-brand competition at the same time, it may be necessary to analyse a restraint in light of both questions before it can be concluded whether or not competition is restricted within the meaning of Article 81(1):

Counterfactual is the hypothetical competition that would have arisen in the absence of agreement

¹⁹ See Case 56/65, *Société Technique Minière*, [1966] ECR 337, and paragraph 76 of the judgment in *John Deere*, cited in note 9.

²⁰ See in this respect e.g. Joined Cases 56/64 and 58/66, *Consten and Grundig*, [1966] ECR 429.

(1) Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1). In making this assessment it is necessary to take into account competition between the parties and competition from third parties. For instance, where two undertakings established in different Member States undertake not to sell products in each other's home markets, (potential) competition that existed prior to the agreement is restricted. Similarly, where a supplier imposes obligations on his distributors not to sell competing products and these obligations foreclose third party access to the market, actual or potential competition that would have existed in the absence of the agreement is restricted. In assessing whether the parties to an agreement are actual or potential competitors the economic and legal context must be taken into account. For instance, if due to the financial risks involved and the technical capabilities of the parties it is unlikely on the basis of objective factors that each party would be able to carry out on its own the activities covered by the agreement the parties are deemed to be non-competitors in respect of that activity²¹. It is for the parties to bring forward evidence to that effect.

Ancillary restraints

(2) *Does the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)?* If so, the agreement may be caught by Article 81(1). For instance, where a supplier restricts its distributors from competing with each other, (potential) competition that could have existed between the distributors absent the restraints is restricted. Such restrictions include resale price maintenance and territorial or customer sales restrictions between

²¹ See in this respect e.g. Commission Decision in *Elopak/Metal Box – Odin*, OJ 1990 L 209, p. 15, and in *TPS*, OJ 1999 L 90, p. 6.

distributors. *However, certain restraints may in certain cases not be caught by Article 81(1) when the restraint is objectively necessary for the existence of an agreement of that type or that nature*²². Such exclusion of the application of Article 81(1) can only be made on the basis of objective factors external to the parties themselves and not the subjective views and characteristics of the parties. The question is not whether the parties in their particular situation would not have accepted to conclude a less restrictive agreement, but whether given the nature of the agreement and the characteristics of the market a less restrictive agreement would not have been concluded by undertakings in a similar setting. *For instance, territorial restraints in an agreement between a supplier and a distributor may for a certain period of time fall outside Article 81(1), if the restraints are objectively necessary in order for the distributor to penetrate a new market*²³. *Similarly, a prohibition imposed on all distributors not to sell to certain categories of end users may not be restrictive of competition if such restraint is objectively necessary for reasons of safety or health related to the dangerous nature of the product in question.* Claims that in the absence of a restraint the supplier would have resorted to vertical integration are not sufficient. Decisions on whether or not to vertically integrate depend on a broad range of complex economic factors, a number of which are internal to the undertaking concerned.

Restrictions by object or by effect

²² See in this respect the judgment in *Société Technique Minière* cited in note 20 and Case 258/78, *Nungesser*, [1982] ECR 2015.

²³ See rule 10 in paragraph 119 of the Guidelines on vertical restraints cited in note 5 above, according to which *inter alia* passive sales restrictions – a hardcore restraint – are held to fall outside Article 81(1) for a period of 2 years when the restraint is linked to opening up new product or geographic markets.

19. In the application of the analytical framework set out in the previous paragraph it must be taken into account that *Article 81(1) distinguishes* between those agreements that have a *restriction of competition as their object* and those agreements that have a *restriction of competition as their effect*. An agreement or contractual restraint is only prohibited by Article 81(1) if its object *or effect is to restrict inter-brand competition and/or intra-brand competition*.

Distinction does not apply to Article 81(3)

20. *The distinction between restrictions by object and restrictions by effect is important. Once it has been established that an agreement has as its object the restriction of competition, there is no need to take account of its concrete effects*²⁴. In other words, for the purpose of applying Article 81(1) no actual anti-competitive effects need to be demonstrated where the agreement has a restriction of competition as its object. *Article 81(3), on the other hand, does not distinguish between agreements that restrict competition by object and agreements that restrict competition by effect*. Article 81(3) applies to all agreements that fulfil the four conditions contained therein²⁵.

Restrictions by object

21. Restrictions of competition *by object* are those that *by their very nature* have the potential of restricting competition. These are restrictions which in light of the objectives pursued by the Community competition rules have *such a high potential of negative effects on competition* that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market. *This presumption is based on the serious nature of the restriction and on experience showing that restrictions of competition by object are likely to*

²⁴ See e.g. paragraph 99 of the judgment in *Anic Partecipazioni* cited in note 12.

²⁵ See paragraph 46 below.

produce negative effects on the market and to jeopardise the objectives pursued by the Community competition rules. Restrictions by object such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources, because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.

Criteria to determine whether object anti-competitive

22. The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. *These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market²⁶. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of subjective intent on the part of the parties to restrict competition is a relevant factor but not a necessary condition.*

Hardcore restraints in block exemptions and notices

23. Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulations, guidelines and notices. Restrictions that are black listed in block exemptions or identified as hardcore restrictions in guidelines and notices are generally considered by the

²⁶ See Joined Cases 29/83 and 30/83, *CRAM and Rheinzink*, [1984] ECR 1679, paragraph 26, and Joined Cases 96/82 and others, *ANSEAU-NAVEWA*, [1983] ECR 3369, paragraphs 23-25.

Commission to constitute restrictions by object. In the case of *horizontal agreements* restrictions of competition by object include price fixing, output limitation and sharing of markets and customers²⁷. As regards *vertical agreements* the category of restrictions by object includes, in particular, fixed and minimum resale price maintenance and restrictions providing absolute territorial protection, including restrictions on passive sales²⁸.

Restrictions by effect – no presumption – appreciable

24. If an agreement is not restrictive of competition by object it must be examined whether it has *restrictive effects on competition*. Account must be taken of both *actual and potential effects*²⁹. In other words the agreement must have *likely anti-competitive effects*. In the case of restrictions of competition by effect there is *no presumption of anti-competitive effects*. For an agreement to be restrictive by effect it *must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability*³⁰. Such negative effects must be *appreciable*.

²⁷ See the Guidelines on horizontal cooperation agreements, cited in note 5, paragraph 25, and Article 5 of Commission Regulation 2658/2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements, OJ 2000 L 304, p. 3.

²⁸ See Article 4 Commission Regulation 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ 1999 L 336, p. 21, and the Guidelines on Vertical Restraints, cited in note 5, paragraph 46 *et seq.* See also Case 279/87, *Tipp-Ex*, [1990] ECR I-261, and Case T-62/98, *Volkswagen v Commission*, [2000] ECR II-2707, paragraph 178.

²⁹ See paragraph 77 of the judgment in *John Deere* cited in note 9.

³⁰ It is not sufficient in itself that the agreement restricts the freedom of action of one or more of the parties, see paragraphs 76 and 77 of the judgment in *Métropole television (M6)* cited in note 10. This is in line with the fact that the object

The prohibition rule of Article 81(1) does not apply when the identified anti-competitive effects are insignificant³¹. This test reflects the economic approach which the Commission is applying. *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*³². It is insufficient for such a finding that the market shares of the parties exceed the thresholds set out in the Commission's *de minimis* notice³³. Agreements falling within safe harbours of block exemption regulations may be caught by Article 81(1) but this is not necessarily so. Moreover, *the fact that due to the market shares of the parties, an agreement falls outside the safe harbour of a block exemption is in itself an insufficient basis for finding that the agreement is caught by Article 81(1) or that it does not fulfil the conditions of Article 81(3). Individual assessment of the likely effects produced by the agreement is required.*

Concept of market power

25. 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 and the agreement contributes to the creation, maintenance or*

of Article 81 is to protect competition on the market for the benefit of consumers.

³¹ See e.g. Case 5/69, Völk, [1969] ECR 295, paragraph 7. Guidance on the issue of appreciability can be found in the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty, OJ 2001 C, 368, page 13. The notice defines appreciability in a negative way. Agreements, which fall outside the scope of the *de minimis* notice, do not necessarily have appreciable restrictive effects. An individual assessment is required.

³² See in this respect Joined Cases T-374/94 and others, *European Night Services*, [1998] ECR II-3141.

³³ See note 32.

strengthening of that market power or allows the parties to exploit such market power. Market power is the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time. In markets with high fixed costs undertakings must price significantly above their marginal costs of production in order to ensure a competitive return on their investment. The fact that undertakings price above their marginal costs is therefore not in itself a sign that competition in the market is not functioning well and that undertakings have market power that allows them to price above the competitive level. It is when competitive constraints are insufficient to maintain prices and output at competitive levels that undertakings have market power within the meaning of Article 81(1).

Market power is question of degree

26. *The creation, maintenance or strengthening of market power can result from a restriction of competition between the parties to the agreement. It can also result from a restriction of competition between any one of the parties and third parties, e.g. because the agreement leads to foreclosure of competitors or because it raises competitors' costs, limiting their capacity to compete effectively with the contracting parties. Market power is a question of degree. The degree of market power normally required for the finding of an infringement under Article 81(1) in the case of agreements that are restrictive of competition by effect is less than the degree of market power required for a finding of dominance under Article 82.*

Appraise and define the market

27. For the purposes of analysing the restrictive effects of an agreement it is normally necessary to define the relevant market³⁴. It is normally also

³⁴ See in this respect Commission notice on the definition of the relevant

*necessary to examine and assess, inter alia, the nature of the products, the market position of the parties, the market position of competitors, the market position of buyers, the existence of potential competitors and the level of entry barriers. In some cases, however, it may be possible to show anti-competitive effects directly by analysing the conduct of the parties to the agreement on the market. It may for example be possible to ascertain that an agreement has led to price increases. The guidelines on horizontal cooperation agreements and on vertical restraints set out a detailed framework for analysing the competitive impact of various types of horizontal and vertical agreements under Article 81(1)*³⁵.

2.2.3 Ancillary restraints

28. Paragraph 18 above sets out a framework for analysing the impact of an agreement and its individual restrictions on inter-brand competition and intra-brand competition. *If on the basis of those principles it is concluded that the main transaction covered by the agreement is not restrictive of competition, it becomes relevant to examine whether individual restraints contained in the agreement are also compatible with Article 81(1) because they are ancillary to the main non-restrictive transaction.*

Directly related and necessary to main non-restrictive transaction

29. In Community competition law the concept of *ancillary restraints* covers any alleged restriction of competition which is directly related and necessary to the implementation of a main non-restrictive transaction and proportionate to it³⁶. If an agreement in its main parts, for instance a distribution

market for the purposes of Community competition law, OJ 1997 C 372, page 1.

³⁵ For the reference in the OJ see note 5.

³⁶ See paragraph 104 of the judgment in *Métropole télévision (M6) and others*, cited in note 10.

agreement or a joint venture, does not have as its object or effect the restriction of competition, then *restrictions, which are directly related to and necessary for the implementation of that transaction, also fall outside Article 81(1)*³⁷. These related restrictions are called ancillary restraints. *A restriction is directly related to the main transaction if it is subordinate to the implementation of that transaction and is inseparably linked to it.* The test of necessity implies that the restriction must be *objectively necessary* for the implementation of the main transaction and be *proportionate* to it. It follows that the ancillary restraints test is similar to the test set out in paragraph 18(2) above. However, the *ancillary restraints test applies in all cases where the main transaction is not restrictive of competition*³⁸. It is not limited to determining the impact of the agreement on intra-brand competition.

Distinguish Article 81(3) from ancillary restraints

30. The application of the ancillary restraint concept must be distinguished from the application of the defence under Article 81(3) which relates to certain economic benefits produced by restrictive agreements and which are balanced against the restrictive effects of the agreements. *The application of the ancillary restraint concept does not involve any weighing of pro-competitive and anti-competitive effects. Such balancing is reserved for Article 81(3)*³⁹.

Necessary to implement main transaction and proportionate

³⁷ See e.g. Case C-399/93, *Luttikhuis*, [1995] ECR I-4515, paragraphs 12 to 14.

³⁸ See in this respect paragraphs 118 et seq. of the *Métropole television* judgment cited in note 10.

³⁹ See paragraph 107 of the judgment in *Métropole télévision* cited in note 10.

31. The assessment of ancillary restraints is limited to determining whether, in the specific context of the main non-restrictive transaction or activity, *a particular restriction is necessary for the implementation of that transaction or activity and proportionate to it*. If on the basis of objective factors it can be concluded that without the restriction the main non-restrictive transaction would be difficult or impossible to implement, the restriction may be regarded as *objectively necessary for its implementation and proportionate to it*⁴⁰. If, for example, the main object of a franchise agreement does not restrict competition, then restrictions, which are necessary for the proper functioning of the agreement, such as obligations aimed at protecting the uniformity and reputation of the franchise system, also fall outside Article 81(1)⁴¹. Similarly, if a joint venture is not in itself restrictive of competition, then restrictions that are necessary for the functioning of the agreement are deemed to be ancillary to the main transaction and are therefore not caught by Article 81(1). *For instance in TPS*⁴² the Commission concluded that an obligation on the parties not to be involved in companies engaged in distribution and marketing of television programmes by satellite was ancillary to the creation of the joint venture during the initial phase. The restriction was therefore deemed to fall outside Article 81(1) for a period of three years. In arriving at this conclusion the Commission took account of the heavy investments and commercial risks involved in entering the market for pay-television.

2.3 *The exception rule of Article 81(3)*

⁴⁰ See e.g. Commission Decision in *Elopak/Metal Box – Odin* cited in note 22.

⁴¹ See Case 161/84, *Pronuptia*, [1986] ECR 353.

⁴² See note 22. The decision was upheld by the Court of First Instance in the judgment in *Métropole télévision (M6)* cited in note 10.

32. The assessment of restrictions by object and effect under Article 81(1) is only one side of the analysis. *The other side, which is reflected in Article 81(3), is the assessment of the positive economic effects of restrictive agreements.*

Aim of competition rules

33. The aim of the Community competition rules is to protect competition on the market as a means of *enhancing consumer welfare and of ensuring an efficient allocation of resources*. Agreements that restrict competition may at the same time have pro-competitive effects by way of efficiency gains⁴³. *Efficiencies* may create additional value by lowering the cost of producing an output, improving the quality of the product or creating a new product. *When the pro-competitive effects of an agreement outweigh its anti-competitive effects the agreement is on balance pro-competitive and compatible with the objectives of the Community competition rules. The net effect of such agreements is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals. This analytical framework is reflected in Article 81(1) and Article 81(3).* The latter provision expressly acknowledges that restrictive agreements may generate objective economic benefits so as to outweigh the negative effects of the restriction of competition⁴⁴.

Four conditions

34. The application of the exception rule of Article 81(3) is subject to *four cumulative conditions*, two positive and two negative:

⁴³ Cost savings and other gains to the parties that arise from the mere exercise of market power do not give rise to objective benefits and cannot be taken into account, cf. paragraph 49 below.

⁴⁴ See the judgment in *Consten and Grundig*, cited in note 21.

- (a) The agreement must contribute to improving the production or distribution of goods or contribute to promoting technical or economic progress,
- (b) Consumers must receive a fair share of the resulting benefits,
- (c) The restrictions must be indispensable to the attainment of these objectives, and finally
- (d) The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

When these four conditions are fulfilled the agreement enhances competition within the relevant market, because it leads the undertakings concerned to offer cheaper or better products to consumers, compensating the latter for the adverse effects of the restrictions of competition.

Individual exceptions or block exemptions

35. Article 81(3) can be applied either to individual agreements or to categories of agreements by way of a block exemption regulation. When an agreement is covered by a block exemption the parties to the restrictive agreement are relieved of their burden under Article 2 of Regulation 1/2003 of showing that their individual agreement satisfies each of the conditions of Article 81(3). They only have to prove that the restrictive agreement benefits from a block exemption. *The application of Article 81(3) to categories of agreements by way of block exemption regulation is based on the presumption that restrictive agreements that fall within their scope⁴⁵ fulfil each of the four conditions laid down in Article 81(3).*

Block exemption may be withdrawn by Commission or NCA

⁴⁵ The fact that an agreement is block exempted does not in itself indicate that the individual agreement is caught by Article 81(1).

36. If *in an individual case* the agreement is caught by Article 81(1) and the conditions of Article 81(3) are not fulfilled the *block exemption may be withdrawn*. According to Article 29(1) of Regulation 1/2003 the Commission is empowered to withdraw the benefit of a block exemption when it finds that in a particular case an agreement covered by a block exemption regulation has certain effects which are incompatible with Article 81(3) of the Treaty. Pursuant to Article 29(2) of Regulation 1/2003 a competition authority of a Member State may also withdraw the benefit of a Commission block exemption regulation in respect of its territory (or part of its territory), if this territory has all the characteristics of a distinct geographic market. In the case of withdrawal it is for the competition authorities concerned to demonstrate that the agreement infringes Article 81(1) and that it does not fulfil the conditions of Article 81(3).

Not by a court

37. The courts of the Member States have *no power to withdraw the benefit of block exemption regulations*. Moreover, in their application of block exemption regulations Member State courts may not modify their scope by extending their sphere of application to agreements not covered by the block exemption regulation in question⁴⁶. *Outside the scope of block exemption regulations Member State courts have the power to apply Article 81 in full (cf. Article 6 of Regulation 1/2003)*.

3. The application of the four conditions of Article 81(3)

4 conditions cumulative

38. The remainder of these guidelines will consider each of the four conditions of Article 81(3)⁴⁷. Given that these four conditions are cumulative⁴⁸ it is

⁴⁶ See e.g. Case C-234/89, *Delimitis*, [1991] ECR I-935, paragraph 46.

⁴⁷ Article 36(4) of Regulation 1/2003 has, *inter alia*, repealed Article 5 of

unnecessary to examine any remaining conditions once it is found that one of the conditions of Article 81(3) is not fulfilled. In individual cases it may therefore be appropriate to consider the four conditions in a different order.

Invert order of 2nd & 3rd condition

39. For the purposes of these guidelines it is considered appropriate to invert the order of the second and the third condition and *thus deal with the issue of indispensability before the issue of pass-on to consumers.* The *analysis of pass-on requires a balancing of the negative and positive effects of an agreement on consumers. This analysis should not include the effects of any restrictions, which already fail the indispensability test and which for that reason are prohibited by Article 81.*

3.1 General principles

Article 81(3) relevant only if Article 81(1) is infringed

40. Article 81(3) of the Treaty only becomes relevant when an agreement between undertakings restricts competition within the meaning of Article 81(1). In the case of non-restrictive agreements there is no need to examine any benefits generated by the agreement.

Burden of proof – nullity

41. Where in an individual case a restriction of competition within the meaning of Article 81(1) has been proven, Article 81(3) can be invoked as a defence. According to Article 2 of Regulation 1/2003 the *burden of proof under*

Regulation 1017/68 applying rules of competition to transport by rail, road and inland waterway. However, the Commission's case practice adopted under Regulation 1017/68 remains relevant for the purposes of applying Article 81(3) in the inland transport sector

⁴⁸ See paragraph 42 below.

Article 81(3) rests on the undertaking(s) invoking the benefit of the exception rule. Where the conditions of Article 81(3) are not satisfied the agreement is null and void, cf. Article 81(2). However, such automatic nullity only applies to those parts of the agreement that are incompatible with Article 81, provided that such parts are severable from the agreement as a whole⁴⁹. If only part of the agreement is null and void, it is for the applicable national law to determine the consequences thereof for the remaining part of the agreement⁵⁰.

4 conditions cumulative and exhaustive

42. According to settled case law the four conditions of Article 81(3) are *cumulative*⁵¹, i.e. they must all be fulfilled for the exception rule to be applicable. If they are not, the application of the exception rule of Article 81(3) must be refused⁵². The four conditions of Article 81(3) are also *exhaustive*. When they are met the exception is applicable and may not be made dependant on any other condition. Goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article 81(3)⁵³.

Balancing within the same market, unless . . .

⁴⁹ See the judgment in *Société Technique Minière* cited in note 20.

⁵⁰ See in this respect Case 319/82, *Kerpen & Kerpen*, [1983] ECR 4173, paragraphs 11 and 12.

⁵¹ See e.g. Case T-185/00 and others, *Métropole télévision SA (M6)*, [2002] ECR II-3805, paragraph 86, Case T-17/93, *Matra*, ECR [1994] II-595, paragraph 85; and Joined Cases 43/82 and 63/82, *VBVB and VBBB*, [1984] ECR 19, paragraph 61.

⁵² See Case T-213/00, *CMA CGM and others*, [2003] ECR II-, paragraph 226.

⁵³ See to that effect implicitly paragraph 139 of the *Matra* judgment cited in note 52, and Case 26/76, *Metro (I)*, [1977] ECR 1875, paragraph 43.

43. The assessment under Article 81(3) of benefits flowing from restrictive agreements is *in principle made within the confines of each relevant market* to which the agreement relates. The Community competition rules have as their objective the protection of competition on the market and cannot be detached from this objective. Moreover, the condition that consumers⁵⁴ must receive a fair share of the benefits implies in general that *efficiencies* generated by the restrictive agreement within a relevant market *must be sufficient to outweigh the anti-competitive effects produced by the agreement within that same relevant market*⁵⁵. Negative effects on consumers⁵⁵ in one geographic market or product market cannot normally be balanced against and compensated by positive effects for consumers in another unrelated geographic market or product market. However, *where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same*⁵⁶. Indeed, in some cases only consumers in a downstream

⁵⁴ As to the concept of consumers see paragraph 84 below where it is stated that consumers are the customers of the parties and subsequent buyers. The parties themselves are not ‘consumers’ for the purposes of Article 81(3).

⁵⁵ The test is market specific, see to that effect Case T-131/99, *Shaw*, [2002] ECR II-2023, paragraph 163, where the Court of First Instance held that the assessment under Article 81(3) had to be made within the same analytical framework as that used for assessing the restrictive effects, and Case C-360/92 P, *Publishers Association*, [1995] ECR I-23, paragraph 29, where in a case where the relevant market was wider than national the Court of Justice held that in the application of Article 81(3) it was not correct only to consider the effects on the national territory.

⁵⁶ In Case T-86/95, *Compagnie Générale Maritime and others*, [2002] ECR II-1011, paragraphs 343 to 345, the Court of First Instance held that Article 81(3) does not require that the benefits are linked to a specific market and that in appropriate cases regard must be had to benefits ‘for every other market on which

market are affected by the agreement in which case the impact of the agreement on such consumers must be assessed. This is for instance so in the case of purchasing agreements⁵⁷.

Economic context may change

44. The assessment of restrictive agreements under Article 81(3) is made within the *actual context in which they occur*⁵⁸ and on the basis of the facts existing at any given point in time. The assessment is sensitive to material changes in the facts. The exception rule of Article 81(3) applies as long as the

the agreement in question might have beneficial effects, and even, in a more general sense, for any service the quality or efficiency of which might be improved by the existence of that agreement'. Importantly, however, in this case the affected group of consumers was the same. The case concerned intermodal transport services encompassing a bundle of, *inter alia*, inland and maritime transportation provided to shipping companies across the Community. The restrictions related to inland transport services, which were held to constitute a separate market, whereas the benefits were claimed to occur in relation to maritime transport services. Both services were demanded by shippers requiring intermodal transport services between northern Europe and South-East and East Asia. The judgment in *CMA CGM*, cited in note 53 above, also concerned a situation where the agreement, while covering several distinct services, affected the same group of consumers, namely shippers of containerised cargo between northern Europe and the Far East. Under the agreement the parties fixed charges and surcharges relating to inland transport services, port services and maritime transport services. The Court of First Instance held (cf. paragraphs 226 to 228) that in the circumstances of the case there was no need to define relevant markets for the purpose of applying Article 81(3). The agreement was restrictive of competition by its very object and there were no benefits for consumers.

⁵⁷ See paragraphs 126 and 132 of the Guidelines on horizontal co-operation agreements cited in note 5 above.

⁵⁸ See the *Ford judgment* cited in note 18.

*four conditions are fulfilled and ceases to apply when that is no longer the case*⁵⁹. When applying Article 81(3) in accordance with these principles it is *necessary to take into account the initial sunk investments* made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment. *Article 81 cannot be applied without taking due account of such ex ante investment*. The *risk* facing the parties and the *sunk investment* that must be committed to implement the agreement can thus lead to the agreement falling outside Article 81(1) or fulfilling the conditions of Article 81(3), as the case may be, *for the period of time required to recoup the investment*.

Some agreements irreversible

45. In some cases the restrictive agreement is an irreversible event. Once the restrictive agreement has been implemented the *ex ante* situation cannot be re-established. In such cases the assessment must be made exclusively on the basis of the facts pertaining at the time of implementation. For instance, in the case of a research and development agreement whereby each party agrees to abandon its respective research project and pool its capabilities with those of another party, *it may from an objective point of view be technically and economically impossible to revive a project once it has been abandoned*. *The assessment of the anti-competitive and pro-competitive effects of the agreement to abandon the individual research projects must therefore be made as of the time of the completion of its implementation*. If at that point in time the agreement is compatible with Article 81, for instance because a sufficient number of third parties have competing research and development projects, the parties' agreement to abandon their individual projects remains compatible with

⁵⁹ See in this respect for example Commission Decision in *TPS*, OJ 1999 L 90, page 6. Similarly, the prohibition of Article 81(1) also only applies as long as the agreement has a restrictive object or restrictive effects.

Article 81, even if at a later point in time the third party projects fail. However, the prohibition of Article 81 may apply to other parts of the agreement in respect of which the issue of irreversibility does not arise. If for example in addition to joint research and development, the agreement provides for joint exploitation, Article 81 may apply to this part of the agreement if due to subsequent market developments the agreement becomes restrictive of competition and does not (any longer) satisfy the conditions of Article 81(3) taking due account of *ex ante* sunk investments, cf. the previous paragraph.

Any agreement may qualify under Article 81(3)

46. Article 81(3) does not exclude *a priori* certain types of agreements from its scope. As a matter of principle *all restrictive agreements that fulfil the four conditions of Article 81(3) are covered by the exception rule*⁶⁰. However, *severe restrictions of competition are unlikely to fulfil the conditions of Article 81(3)*. Such restrictions are usually black listed in block exemption regulations or identified as hardcore restrictions in Commission guidelines and notices. Agreements of this nature generally fail (at least) the two first conditions of Article 81(3). They neither create objective economic benefits⁶¹ nor do they benefit consumers⁶². For example, a horizontal agreement to fix prices limits output leading to misallocation of resources. It also transfers value from consumers to producers, since it leads to higher prices without producing any countervailing value to consumers within the relevant market. Moreover, these types of agreements generally also fail the indispensability test under the third condition⁶³.

⁶⁰ See paragraph 85 of the *Matra* judgment cited in note 52.

⁶¹ As to this requirement see paragraph 49 below.

⁶² See e.g. Case T-29/92, *Vereniging van Samenwerkende Prijsregelende Organisaties in de Bouwnijverheid (SPO)*, [1995] ECR II-289.

⁶³ See e.g. Case 258/78, *Nungesser*, [1982] ECR 2015, paragraph 77,

Purpose of Article 81

47. Any claim that restrictive agreements are justified because they *aim at ensuring fair conditions of competition on the market is by nature unfounded* and must be discarded⁶⁴. The *purpose of Article 81 is to protect effective competition by ensuring that markets remain open and competitive*. The protection of fair conditions of competition is a task for the legislator in compliance with Community law obligations⁶⁵ and not for undertakings to regulate themselves.

3.2 *First condition of Article 81(3): Efficiency gains*

3.2.1 General remarks

48. According to the first condition of Article 81(3) the restrictive agreement must contribute to improving the production or distribution of goods or to promoting technical or economic progress. The provision *refers expressly only to goods, but applies by analogy to services*.

Only objective benefits

49. It follows from the case law of the Court of Justice that only objective benefits can be taken into account⁶⁶. This means that efficiencies are not assessed from the subjective point of view of the parties⁶⁷. *Cost savings that arise from the mere exercise of market power by the parties cannot be taken*

concerning absolute territorial protection.

⁶⁴ See in this respect e.g. the judgment in *SPO* cited in note 63.

⁶⁵ National measures must, *inter alia*, comply with the Treaty rules on free movement of goods, services, persons and capital.

⁶⁶ See e.g. the judgment in *Consten and Grundig* cited in note 21.

⁶⁷ See in this respect Commission Decision in *Van den Bergh Foods*, OJ 1998 L 246, p. 1.

into account. For instance, when companies agree to fix prices or share markets they reduce output and thereby production costs. Reduced competition may also lead to lower sales and marketing expenditures. Such cost reductions are a direct consequence of a reduction in output and value. The cost reductions in question do not produce any pro-competitive effects on the market. In particular, they do not lead to the creation of value through an integration of assets and activities. They merely allow the undertakings concerned to increase their profits and are therefore irrelevant from the point of view of Article 81(3).

Efficiencies

50. The purpose of the first condition of Article 81(3) is to define the types of efficiency gains that can be taken into account and be subject to the further tests of the second and third conditions of Article 81(3). The aim of the analysis is to ascertain *what are the objective benefits created by the agreement and what is the economic importance of such efficiencies*. Given that for Article 81(3) to apply the pro-competitive effects flowing from the agreement must outweigh its anti-competitive effects, it is necessary to verify what is the link between the agreement and the claimed efficiencies and what is the value of these efficiencies.

Substantiate

51. All efficiency claims must therefore be *substantiated* so that the following can be verified:

- (a) The *nature* of the claimed efficiencies;
 - (b) The *link* between the agreement and the efficiencies;
 - (c) The *likelihood* and *magnitude* of each claimed efficiency;
- and
- (d) *How* and *when* each claimed efficiency would be achieved.

Objective efficiencies

52. Letter (a) allows the decision-maker to *verify whether the claimed efficiencies are objective* in nature, cf. paragraph 49 above.

Causal link

53. Letter (b) allows the decision-maker to *verify whether there is a sufficient causal link* between the restrictive agreement and the claimed efficiencies. This condition normally requires that the efficiencies result from the economic activity that forms the object of the agreement. Such activities may, for example, take the form of distribution, licensing of technology, joint production or joint research and development. To the extent, however, that an agreement has wider efficiency enhancing effects within the relevant market, for example because it leads to a reduction in industry wide costs, these additional benefits are also taken into account.

Causal link must be direct

54. *The causal link between the agreement and the claimed efficiencies must normally also be direct*⁶⁸. Claims based on indirect effects are *as a general rule too uncertain* and too remote to be taken into account. A direct causal link exists for instance where a technology transfer agreement allows the licensees to produce new or improved products or a distribution agreement allows products to be distributed at lower cost or valuable services to be produced. An example of indirect effect would be a case where it is claimed that a restrictive agreement allows the undertakings concerned to increase their profits, enabling them to invest more in research and development to the ultimate benefit of consumers. While there may be a link between profitability and research and development, this link is generally not sufficiently direct to be taken into account in the context of Article 81(3).

⁶⁸ See in this respect Commission Decision in *Glaxo Wellcome*, OJ 2001 L 302, page 1.

Verification and balancing

55. Letters (c) and (d) allow the decision-maker *to verify the value of the claimed efficiencies*, which in the context of the third condition of Article 81(3) must be *balanced against the anti-competitive effects of the agreement*, see paragraph 101 below. Given that Article 81(1) only applies in cases where the agreement has likely negative effects on competition and consumers (in the case of hardcore restrictions such effects are presumed) efficiency claims must be substantiated so that they can be verified. Unsubstantiated claims are rejected.

Describe and estimate the cost efficiencies and methods of achieving them

56. In the case of *claimed cost efficiencies* the undertakings invoking the benefit of Article 81(3) *must as accurately as reasonably possible calculate or estimate the value of the efficiencies and describe in detail how the amount has been computed*. They must also describe the method(s) by which the efficiencies have been or will be achieved. The data submitted must be verifiable so that there can be a *sufficient degree of certainty that the efficiencies have materialised or are likely to materialise*.

For improved products

57. In the case of *claimed efficiencies in the form of new or improved products* and other non-cost based efficiencies, the undertakings claiming the benefit of Article 81(3) *must describe and explain in detail what is the nature of the efficiencies and how and why they constitute an objective economic benefit*.

Substantiate projections

58. In cases *where the agreement has yet to be fully implemented the parties must substantiate any projections as to the date from which the efficiencies will become operational so as to have a significant positive impact in the market*.

3.2.2 The different categories of efficiencies

59. The types of efficiencies listed in Article 81(3) are broad categories which are intended to *cover all objective economic efficiencies*. There is considerable overlap between the various categories mentioned in Article 81(3) and the same agreement may give rise to several kinds of efficiencies. It is therefore not appropriate to draw clear and firm distinctions between the various categories. For the purpose of these guidelines, a distinction is made *between cost efficiencies* and efficiencies of a *qualitative nature* whereby value is created in the form of new or improved products, greater product variety etc.

Efficiencies must stem from integration of economic activities

60. In general, *efficiencies stem from an integration of economic activities* whereby undertakings combine their assets to achieve what they could not achieve as efficiently on their own or whereby they entrust another undertaking with tasks that can be performed more efficiently by that other undertaking.

Value chain – markets and hierarchies

61. The *research and development, production and distribution* process may be viewed as a value chain that can be divided into a number of stages. At each stage of this chain an undertaking must make a choice between performing the activity itself, performing it together with (an)other undertaking(s) or outsourcing the activity entirely to (an)other undertaking(s).

Both horizontal and vertical agreements may create efficiencies

62. In each case where the choice made involves cooperation on the market with another undertaking an agreement within the meaning of Article 81(1) normally needs to be concluded. These agreements can be *vertical*, as is the case where the parties operate at different levels of the value chain *or horizontal*, as is the case where the firms operate at the same level of the value chain. *Both categories of agreements may create efficiencies* by allowing the undertakings in question to perform a particular task at lower cost or with

higher added value for consumers. Such agreements *may also contain or lead to restrictions of competition* in which case the prohibition rule of Article 81(1) and the exception rule of Article 81(3) may become relevant.

The following types of efficiency not exhaustive

63. The types of efficiencies mentioned in the following are only examples and are not intended to be exhaustive.

3.2.2.1 Cost efficiencies

Dynamic efficiencies

64. Cost efficiencies flowing from agreements between undertakings can originate from a number of different sources. One very important source of cost savings is the development of *new production technologies and methods*. In general, it is when *technological leaps are made that the greatest potential for cost savings is achieved*. For instance, the introduction of the assembly line led to a very substantial reduction in the cost of producing motor vehicles.

Integration of existing assets

65. Another very important source of efficiency is synergies resulting from an integration of existing assets. When the parties to an agreement combine their respective assets they may be able to attain a cost/output configuration that would not otherwise be possible. *The combination of two existing technologies that have complementary strengths* may reduce production costs or lead to the production of a higher quality product. For instance, it may be that the production assets of firm A generate a high output per hour but require a relatively high input of raw materials per unit of output, whereas the production assets of firm B generate lower output per hour but require a relatively lower input of raw materials per unit of output. Synergies are created if by establishing a production joint venture combining the production assets of A and B the parties can attain a high(er) level of output per hour with a low(er) input of raw

materials per unit of output. Similarly, if one undertaking has optimised one part of the value chain and another undertaking has optimised another part of the value chain, the combination of their operations may lead to lower costs. Firm A may for instance have a highly automated production facility resulting in low production costs per unit whereas B has developed an efficient order processing system. The system allows production to be tailored to customer demand, ensuring timely delivery and reducing warehousing and obsolescence costs. By combining their assets A and B may be able to obtain cost reductions.

Economies of scale

66. Cost efficiencies may also result from economies of scale, i.e. declining cost per unit of output as output increases. To give an example: investment in equipment and other assets often has to be made in indivisible blocks. If an undertaking cannot fully utilise a block, its average costs will be higher than if it could do so. For instance, the cost of operating a truck is virtually the same regardless of whether it is almost empty, half-full or full. Agreements whereby undertakings combine their logistics operations may allow them to increase the load factors and reduce the number of vehicles employed. Larger scale may also allow for better division of labour leading to lower unit costs. Firms may achieve economies of scale in respect of all parts of the value chain, including research and development, production, distribution and marketing. Learning economies constitute a related type of efficiency. As experience is gained in using a particular production process or in performing particular tasks, productivity may increase because the process is made to run more efficiently or because the task is performed more quickly.

Economies of scope

67. *Economies of scope are another source of cost efficiency, which occur when firms achieve cost savings by producing different products on the basis of the same input. Such efficiencies may arise from the fact that it is possible to*

use the same components and the same facilities and personnel to produce a variety of products. Similarly, economies of scope may arise in distribution when several types of goods are distributed in the same vehicles. For instance, a producer of frozen pizzas and a producer of frozen vegetables may obtain economies of scope by jointly distributing their products. Both groups of products must be distributed in refrigerated vehicles and it is likely that there are significant overlaps in terms of customers. By combining their operations the two producers may obtain lower distribution costs per distributed unit.

Better planning of production

68. Efficiencies in the form of *cost reductions* can also follow from *agreements that allow for better planning of production*, reducing the need to hold expensive inventory and allowing for better *capacity utilisation*. Efficiencies of this nature may for example stem from the use of “*just in time*” *purchasing*, i.e. an obligation on a supplier of components to continuously supply the buyer according to its needs thereby avoiding the need for the buyer to maintain a significant stock of components which risks becoming obsolete. Cost savings may also result from agreements that allow the parties to rationalise production across their facilities.

3.2.2.2 Qualitative efficiencies

69. Agreements between undertakings may generate various efficiencies of a qualitative nature which are relevant to the application of Article 81(3). In a number of cases the *main efficiency enhancing potential of the agreement is not cost reduction; it is quality improvements* and other efficiencies of a qualitative nature. Depending on the individual case such efficiencies may therefore be of equal or greater importance than cost efficiencies.

Technical advances

70. *Technical and technological advances form an essential and dynamic part of the economy, generating significant benefits in the form of new or improved goods and services. By cooperating undertakings may be able to create efficiencies that would not have been possible without the restrictive agreement or would have been possible only with substantial delay or at higher cost. Such efficiencies constitute an important source of economic benefits covered by the first condition of Article 81(3). Agreements capable of producing efficiencies of this nature include, in particular, research and development agreements. An example would be A and B creating a joint venture for the development and, if successful, joint production of a cell-based tyre. The puncture of one cell does not affect other cells, which means that there is no risk of collapse of the tyre in the event of a puncture. The tyre is thus safer than traditional tyres. It also means that there is no immediate need to change the tyre and thus to carry a spare. Both types of efficiencies constitute objective benefits within the meaning of the first condition of Article 81(3).*

Combining complementary assets

71. In the same way that the *combination of complementary assets can give rise to cost savings*, combinations of assets may also *create synergies* that create efficiencies *of a qualitative nature*. The combination of production assets may for instance lead to the production of higher quality products or products with novel features. This may for instance be the case for licence agreements, and agreements providing for joint production of new or improved goods or services. Licence agreements may, in particular, ensure more rapid dissemination of new technology in the Community and enable the licensee(s) to make available new products or to employ new production techniques that lead to quality improvements. Joint production agreements may, in particular, allow new or improved products or services to be introduced on the market

more quickly or at lower cost⁶⁹. In the telecommunications sector, for example, cooperation agreements have been held to create efficiencies by making available more quickly new global services⁷⁰. In the banking sector cooperation agreements that made available improved facilities for making cross-border payments have also been held to create efficiencies falling within the scope of the first condition of Article 81(3)⁷¹.

Specialised distribution

72. *Distribution agreements* may also give rise to *qualitative efficiencies*. Specialised distributors, for example, may be able to provide services that are better tailored to customer needs or to provide quicker delivery or better quality assurance throughout the distribution chain⁷².

3.3 *Third condition of Article 81(3): Indispensability of the restrictions*

73. According to the third condition of Article 81(3) the restrictive agreement must not impose restrictions, which are not indispensable to the attainment of the efficiencies created by the agreement in question. This *condition implies a two-fold test*. First, the *restrictive agreement as such must be reasonably necessary in order to achieve the efficiencies*. Secondly, the *individual restrictions of competition that flow from the agreement must also be reasonably necessary for the attainment of the efficiencies*.

⁶⁹ See e.g. Commission Decision in *GEAE/P&W*, OJ 2000 L 58, page 16; in *British Interactive Broadcasting/Open*, OJ 1999 L 312, page 1; and in *Asahi/Saint Gobain*, OJ 1994 L 354, page 87.

⁷⁰ See e.g. Commission Decision in *Atlas*, OJ 1996 L 239, page 23, and in *Phoenix/Global One*, OJ 1996 L 239, page 57.

⁷¹ See e.g. Commission Decision in *Uniform Eurocheques*, OJ 1985 L 35, page 43

⁷² See e.g. Commission Decision in *Cégétel + 4*, OJ 1999 L 88, page 26.

Objective

74. In the context of the third condition of Article 81(3) the decisive factor is *whether or not the restrictive agreement and individual restrictions make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement or the restriction concerned*. The question is not whether in the absence of the restriction the agreement would not have been concluded, but *whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction*⁷³.

Least restrictive means

75. The first test contained in the third condition of Article 81(3) requires that the *efficiencies be specific to the agreement in question* in the sense that there are *no other economically practicable and less restrictive means of achieving the efficiencies*. In making this latter assessment the market conditions and business realities facing the parties to the agreement must be taken into account. *Undertakings invoking the benefit of Article 81(3) are not required to consider hypothetical or theoretical alternatives*. The Commission will not second guess the business judgment of the parties. It will *only intervene where it is reasonably clear that there are realistic and attainable alternatives*. The parties must only explain and demonstrate why such seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient.

76. It is *particularly relevant to examine whether*, having due regard to the circumstances of the individual case, the *parties could have achieved the*

⁷³ As to the former question, which may be relevant in the context of Article 81(1), see paragraph 18 above.

efficiencies by means of another less restrictive type of agreement and, if so, when they would likely be able to obtain the efficiencies. It may also be *necessary to examine whether the parties could have achieved the efficiencies on their own*. For instance, where the claimed efficiencies take the form of cost reductions resulting from economies of scale or scope the undertakings concerned must explain and substantiate why the same efficiencies would not be likely to be attained through internal growth and price competition. In making this assessment it is relevant to consider, *inter alia*, what is the *minimum efficient scale on the market concerned*. The minimum efficient scale is the level of output required to minimise average cost and exhaust economies of scale⁷⁴. The larger the minimum efficient scale compared to the current size of either of the parties to the agreement, the more likely it is that the efficiencies will be deemed to be specific to the agreement. In the case of agreements that produce substantial synergies through the combination of complementary assets and capabilities the very nature of the efficiencies give rise to a presumption that the agreement is necessary to attain them.

Example

77. These principles can be illustrated by the following hypothetical example:

A and B combine within a joint venture their respective production technologies to achieve higher output and lower raw material consumption. The joint venture is granted an exclusive licence to their respective production technologies. The parties transfer their existing production facilities to the joint venture. They also transfer key staff in order to ensure that existing learning economies can be exploited and further developed. It is estimated that these

⁷⁴ Scale economies are normally exhausted at a certain point. Thereafter average costs will stabilise and eventually rise due to, for example, capacity constraints and bottlenecks.

economies will reduce production costs by a further 5 %. The output of the joint venture is sold independently by A and B. In this case the indispensability condition necessitates an assessment of whether or not the benefits could be substantially achieved by means of a licence agreement, which would be likely to be less restrictive because A and B would continue to produce independently. In the circumstances described this is unlikely to be the case since under a licence agreement the parties would not be able to benefit in the same seamless and continued way from their respective experience in operating the two technologies, resulting in significant learning economies.

Restrictions indispensable

78. Once it is found that the agreement in question is necessary in order to produce the efficiencies, the *indispensability of each restriction of competition* flowing from the agreement must be assessed. In this context it must be assessed whether individual restrictions are reasonably necessary in order to produce the efficiencies. The *parties to the agreement must substantiate their claim* with regard to both the nature of the restriction and its intensity.

Alternative solutions

79. *A restriction is indispensable if its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise. The assessment of alternative solutions must take into account the actual and potential improvement in the field of competition by the elimination of a particular restriction or the application of a less restrictive alternative. The more restrictive the restraint the stricter the test under the third condition*⁷⁵. *Restrictions that are black listed in*

⁷⁵ See in this respect paragraphs 392 to 395 of the judgment in *Compagnie Générale Maritime* cited in note 57.

block exemption regulations or identified as hardcore restrictions in Commission guidelines and notices are unlikely to be considered indispensable.

Actual context – structure of market – avoid hold up problem

80. The assessment of indispensability is made within the *actual context* in which the agreement operates and must in particular take account of *the structure of the market*, the *economic risks* related to the agreement, and the *incentives* facing the parties. The more uncertain the success of the product covered by the agreement, the more a restriction may be required to ensure that the efficiencies will materialise. Restrictions may also be indispensable in order to align the incentives of the parties and ensure that they concentrate their efforts on the implementation of the agreement. A restriction may for instance be necessary in order *to avoid hold-up problems once a substantial sunk investment has been made by one of the parties*. Once for instance a supplier has made a substantial relationship-specific investment with a view to supplying a customer with an input, the supplier is locked into the customer. In order to avoid that *ex post* the customer exploits this dependence to obtain more favourable terms, it may be necessary to impose an obligation not to purchase the component from third parties or to purchase minimum quantities of the component from the supplier⁷⁶.

Limited duration

81. In some cases a *restriction may be indispensable only for a certain period of time*, in which case the exception of Article 81(3) only applies during that period. In making this assessment it is necessary to take *due account of the period of time required for the parties to achieve the efficiencies* justifying the

⁷⁶ See for more detail paragraph 116 of the Guidelines on Vertical Restraints cited in note 5.

application of the exception rule⁷⁷. In cases where the benefits cannot be achieved without considerable investment, account must, in particular, be taken of the period of *time required to ensure an adequate return* on such investment, see also paragraph 44 above and question 21.

Examples

82. These principles can be illustrated by the following hypothetical examples:

P produces and distributes frozen pizzas, holding 15% of the market in Member State X. Deliveries are made directly to retailers. Since most retailers have limited storage capacity, relatively frequent deliveries are required, leading to low capacity utilisation and use of relatively small vehicles. T is a wholesaler of frozen pizzas and other frozen products, delivering to most of the same customers as P. The pizza products distributed by T hold 30% of the market. T has a fleet of larger vehicles and has excess capacity. P concludes an exclusive distribution agreement with T for Member State X and undertakes to ensure that distributors in other Member States will not sell into T's territory either actively or passively. T undertakes to advertise the products, survey consumer tastes and satisfaction rates and ensure delivery to retailers of all products within 24 hours. The agreement leads to a reduction in total distribution costs of 30% as capacity is better utilised and duplication of routes is eliminated. The agreement also leads to the provision of additional services to consumers. Restrictions on passive sales are hardcore restrictions under the block exemption regulation on vertical restraints⁷⁸ and can only be considered indispensable in exceptional

⁷⁷ See Joined Cases T-374/94 and others, *European Night Services*, [1998] ECR II-3141, paragraph 230.

⁷⁸ See Commission Regulation no. 2790/1999 on the application of Article 81(3) of the Treaty on categories of vertical agreements and concerted practices, OJ 1999 L 336, page 21.

circumstances. The established market position of T and the nature of the obligations imposed on it indicate this is not an exceptional case. The ban on active selling, on the other hand, is likely to be indispensable. T is likely to have less incentive to sell and advertise the P brand, if distributors in other Member States could sell actively in Member State X and thus free ride on the efforts of T. This is particularly so, as T also distributes competing brands and thus has the possibility of pushing more of the brands that are the least exposed to free riding.

S is a producer of carbonated soft drinks, holding 40% of the market. The nearest competitor holds 20%. S concludes supply agreements with customers accounting for 25% of demand, whereby they undertake to purchase exclusively from S for 5 years. S concludes agreements with other customers accounting for 15% of demand whereby they are granted quarterly target rebates, if their purchases exceed certain individually fixed targets. S claims that the agreements allow it to predict demand more accurately and thus to better plan production, reducing raw material storage and warehousing costs and avoiding supply shortages. *Given the market position of S and the combined coverage of the restrictions, the restrictions are very unlikely to be considered indispensable. The exclusive purchasing obligation exceeds what is required to plan production and the same is true of the target rebate scheme. Predictability of demand can be achieved by less restrictive means.* S could, for example, provide incentives for customers to order large quantities at a time by offering quantity rebates or by offering a rebate to customers that place firm orders in advance for delivery on specified dates.

3.4 *Second condition of Article 81(3): Fair share for consumers*

3.4.1 General remarks

83. According to the second condition of Article 81(3) consumers must receive a fair share of the efficiencies generated by the restrictive agreement.

'Consumers' means

84. The concept of '*consumers*' encompasses *all direct or indirect users of the products* covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes which can be regarded as outside their trade or profession. In other words, consumers within the meaning of Article 81(3) are *the customers of the parties to the agreement and subsequent purchasers*. These customers can be undertakings as in the case of buyers of industrial machinery or an input for further processing or final consumers as for instance in the case of buyers of impulse ice cream or bicycles.

'Fair share' means

85. The concept of '*fair share*' implies that the *pass-on of benefits* must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition found under Article 81(1). In line with the overall objective of Article 81 to prevent anti-competitive agreements, *the net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement*⁷⁹. If such consumers are worse off following the agreement, the second condition of Article 81(3) is not fulfilled. The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers⁸⁰. When

⁷⁹ See in this respect the judgment in Consten and Grundig cited in note 21, where the Court of Justice held that the improvements within the meaning of the first condition of Article 81(3) must show appreciable objective advantages of such a character as to compensate for the disadvantages which they cause in the field of competition.

⁸⁰ It is recalled that positive and negative effects on consumers are in

that is the case consumers are not harmed by the agreement. Moreover, society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources.

Sufficient benefits over all passed on

86. It is not required that consumers receive a share of each and every efficiency gain identified under the first condition. *It suffices that sufficient benefits are passed on to compensate for the negative effects of the restrictive agreement.* In that case consumers obtain a fair share of the overall benefits⁸¹. If a restrictive agreement is likely to lead to higher prices, consumers must be fully compensated through increased quality or other benefits. If not, the second condition of Article 81(3) is not fulfilled.

Overall impact

87. The decisive factor is the overall impact on consumers of the products within the relevant market and not the impact on individual members of this group of consumers⁸². In some cases a certain *period of time* may be required before the efficiencies materialise. Until such time the agreement may have only negative effects. The fact that pass-on to the consumer occurs with a certain time lag does not in itself exclude the application of Article 81(3). However, the greater the time-lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding the pass-on.

Time value of improvement

principle balanced within each relevant market (cf. paragraph 43 above).

⁸¹ See in this respect paragraph 48 of the *Metro (I)* judgment cited in note 54.

⁸² See paragraph 163 of the judgment in *Shaw* cited in note 56.

88. In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. The value of saving 100 Euro today is greater than the value of saving the same amount a year later. A gain for consumers in the future therefore does not fully compensate for a present loss to consumers of equal nominal size. In order to allow for an appropriate comparison of a present loss to consumers with a future gain to consumers, the value of future gains must be discounted. The discount rate applied must reflect the rate of inflation, if any, and lost interest as an indication of the lower value of future gains.

Time value to consumers

89. In other cases the agreement may enable the parties to obtain the efficiencies earlier than would otherwise be possible. In such circumstances it is necessary to take account of the likely negative impact on consumers within the relevant market once this lead-time has lapsed. If through the restrictive agreement the parties obtain a strong position on the market, they may be able to charge a significantly higher price than would otherwise have been the case. For the second condition of Article 81(3) to be satisfied *the benefit to consumers of having earlier access to the products must be equally significant. This may for instance be the case where an agreement allows two tyre manufacturers to bring to market three years earlier a new substantially safer tyre but at the same time, by increasing their market power, allows them to raise prices by 5%. In such a case it is likely that having early access to a substantially improved product outweighs the price increase.*

Balance benefit against restriction of competition – sliding scale

90. The second condition of Article 81(3) incorporates a sliding scale. The greater the restriction of competition found under Article 81(1) the greater must be the efficiencies and the pass-on to consumers. This sliding scale approach implies that if the restrictive effects of an agreement are relatively limited and

the efficiencies are substantial it is likely that a fair share of the cost savings will be passed on to consumers. In such cases it is therefore normally not necessary to engage in a detailed analysis of the second condition of Article 81(3), provided that the three other conditions for the application of this provision are fulfilled.

91. If, on the other hand, the restrictive effects of the agreement are substantial and the cost savings are relatively insignificant, it is very unlikely that the second condition of Article 81(3) will be fulfilled. The impact of the restriction of competition depends on the intensity of the restriction and the degree of competition that remains following the agreement.

If the agreement has both substantial anti-competitive effects and substantial pro-competitive effects a careful analysis is required

92. *If the agreement has both substantial anti-competitive effects and substantial pro-competitive effects a careful analysis is required.* In the application of the balancing test in such cases it *must be taken into account that competition is an important long-term driver of efficiency and innovation.* Undertakings that are not subject to effective competitive constraints – such as for instance *dominant firms* – *have less incentive to maintain or build on the efficiencies.* The more substantial the impact of the agreement on competition, the more likely it is that consumers will suffer in the long run.

Analytical framework to assess pass-on

93. The following two sections describe in more detail the analytical framework for assessing consumer pass-on of efficiency gains. The first section deals with *cost efficiencies*, whereas the section that follows covers other types of efficiencies such as *new or improved products* (qualitative efficiencies). The framework, which is developed in these two sections, is particularly important

in cases where it is not immediately obvious that the competitive harms exceed the benefits to consumers or *vice versa*⁸³.

Estimate extent to which benefits passed on

94. In the application of the principles set out below the Commission will have regard to the fact that *in many cases it is difficult to accurately calculate the consumer pass-on rate and other types of consumer pass-on*. Undertakings are *only required to substantiate their claims by providing estimates and other data to the extent reasonably possible*, taking account of the circumstances of the individual case.

3.4.2 Pass-on and balancing of cost efficiencies

In many markets may restrict output to raise price or discriminate

95. *When markets, as is normally the case, are not perfectly competitive*, undertakings are able to influence the market price to a greater or lesser extent by altering their output⁸⁴. They may also be able to price discriminate amongst customers.

Cost efficiencies may increase output

96. Cost efficiencies may in some circumstances lead to increased output and lower prices for the affected consumers. *If due to cost efficiencies the undertakings in question can increase profits by expanding output, consumer pass-on may occur*. In assessing the extent to which cost efficiencies are likely

⁸³ In the following sections, for convenience the competitive harm is referred to in terms of higher prices; competitive harm could also mean lower quality, less variety or lower innovation than would otherwise have occurred.

⁸⁴ In perfectly competitive markets individual undertakings are price takers. They sell their products at the market price, which is determined by overall supply and demand. The output of the individual undertaking is so small that any individual undertaking's change in output does not affect the market price.

to be passed on to consumers and the outcome of the balancing test contained in Article 81(3) *the following factors are in particular taken into account:*

- (a) The characteristics and structure of the market,
- (b) The nature and magnitude of the efficiency gains,
- (c) The elasticity of demand, and
- (d) The magnitude of the restriction of competition.

All factors must normally be considered. Since Article 81(3) only applies in cases where competition on the market is being appreciably restricted, see paragraph 24 above, there can be no presumption that residual competition will ensure that consumers receive a fair share of the benefits. However, the degree of competition remaining on the market and the nature of this competition influences the likelihood of pass-on.

Relevant factors

97. The greater the degree of residual competition the more likely it is that individual undertakings will try to increase their sales by passing on cost efficiencies. If undertakings compete mainly on price and are not subject to significant capacity constraints, pass-on may occur relatively quickly. If competition is mainly on capacity and capacity adaptations occur with a certain time lag, pass-on will be slower. Pass-on is also likely to be slower when the market structure is conducive to tacit collusion⁸⁵. If competitors are likely to retaliate against an increase in output by one or more parties to the agreement, the incentive to increase output may be tempered, unless the competitive advantage conferred by the efficiencies is such that the undertakings concerned have an incentive to break away from the common policy adopted on the market

⁸⁵ Undertakings collude tacitly when in an oligopolistic market they are able to coordinate their action on the market without resorting to an explicit cartel agreement.

by the members of the oligopoly. In other words, the *efficiencies generated by the agreement may turn the undertakings concerned into so-called “mavericks”*⁸⁶.

Fixed or variable costs

98. The nature of the efficiency gains also plays an important role. According to economic theory *undertakings maximise their profits by selling units of output until marginal revenue equals marginal cost*. Marginal revenue is the change in total revenue resulting from selling an additional unit of output and marginal cost is the change in total cost resulting from producing that additional unit of output. It follows from this principle that as a general rule *output and pricing decisions of a profit maximising undertaking are not determined by its fixed costs* (i.e. costs that do not vary with the rate of production) *but by its variable costs* (i.e. costs that vary with the rate of production). After fixed costs are incurred and capacity is set, pricing and output decisions are determined by variable cost and demand conditions. Take for instance a situation in which two companies each produce two products on two production lines operating only at half their capacities. A specialisation agreement may allow the two undertakings to specialise in producing one of the two products and scrap their second production line for the other product. At the same time the specialisation may allow the companies to reduce variable input and stocking costs. Only the latter savings will have a direct effect on the pricing and output decisions of the undertakings, as they will influence the marginal costs of production. The scrapping by each undertaking of one of their production lines will not reduce their variable costs and will not have an impact on their production costs. It follows that *undertakings may have a direct incentive to pass on to consumers in the form of higher output and lower prices*

⁸⁶ This term refers to undertakings that constrain the pricing behaviour of other undertakings in the market who might otherwise have tacitly colluded.

efficiencies that reduce marginal costs, whereas they have no such direct incentive with regard to efficiencies that reduce fixed costs. Consumers are therefore more likely to receive a fair share of the cost efficiencies in the case of reductions in variable costs than they are in the case of reductions in fixed costs.

Elasticity of demand – pass-on rate – ability to discriminate

99. The fact that undertakings may have an incentive to pass on certain types of cost efficiencies does not imply that the pass-on rate will necessarily be 100%. *The actual pass-on rate depends on the extent to which consumers respond to changes in price, i.e. the elasticity of demand. The greater the increase in demand caused by a decrease in price, the greater the pass-on rate. This follows from the fact that the greater the additional sales caused by a price reduction due to an increase in output the more likely it is that these sales will offset the loss of revenue caused by the lower price resulting from the increase in output. In the absence of price discrimination the lowering of prices affects all units sold by the undertaking, in which case marginal revenue is less than the price obtained for the marginal product. If the undertakings concerned are able to charge different prices to different customers, i.e. price discriminate, pass-on will normally only benefit price sensitive consumers⁸⁷.*

Production cost may not equal total cost

100. It must also be taken into account that efficiency gains often do not affect the whole cost structure of the undertakings concerned. In such event the impact on the price to consumers is reduced. If for example an agreement allows the parties to reduce production costs by 6%, but production costs only

⁸⁷ The restrictive agreement may even allow the undertakings in question to charge a higher price to customers with a low elasticity of demand.

make up one third of the costs on the basis of which prices are determined, the impact on the product price is 2%, assuming that the full amount is passed-on.

Balance restriction of competition and cost efficiencies

101. Finally, and very importantly, it is necessary to balance the two opposing forces resulting from the restriction of competition and the cost efficiencies. On the one hand, any increase in market power caused by the restrictive agreement gives the undertakings concerned the ability and incentive to raise price. On the other hand, the types of cost efficiencies that are taken into account may give the undertakings concerned an incentive to reduce price, see paragraph 98 above. *The effects of these two opposing forces must be balanced against each other.* It is recalled in this regard that the *consumer pass-on condition incorporates a sliding scale*. When the agreement causes a substantial reduction in the competitive constraint facing the parties, extraordinarily large cost efficiencies are normally required for sufficient pass-on to occur.

3.4.3 Pass-on and balancing of other types of efficiencies

Qualitative efficiencies

102. Consumer pass-on can also take the form of qualitative efficiencies such as new and improved products, creating sufficient value for consumers to compensate for the anti-competitive effects of the agreement, including a price increase.

Requires value judgment – burden of proof

103. Any such assessment necessarily requires value judgment. It is difficult to assign precise values to dynamic efficiencies of this nature. However, the fundamental objective of the assessment remains the same, namely to ascertain the overall impact of the agreement on the consumers within the relevant market. *Undertakings claiming the benefit of Article 81(3)*

must substantiate that consumers obtain countervailing benefits (see in this respect paragraphs 57 and 86 above).

Improved products important source of consumer welfare

104. The availability of new and improved products constitutes an important source of consumer welfare. *As long as the increase in value stemming from such improvements exceeds any harm from a maintenance or an increase in price caused by the restrictive agreement, consumers are better off than without the agreement* and the consumer pass-on requirement of Article 81(3) is normally fulfilled. In cases where the likely effect of the agreement is to increase prices for consumers within the relevant market *it must be carefully assessed whether the claimed efficiencies create real value for consumers in that market so as to compensate for the adverse effects of the restriction of competition.*

3.5 Fourth condition of Article 81(3): No elimination of competition

Ultimate aim of A 81 is to protect competitive process

105. According to the fourth condition of Article 81(3) *the agreement must not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products concerned.* Ultimately the protection of rivalry and the competitive process is given priority over potentially pro-competitive efficiency gains which could result from restrictive agreements. The last condition of Article 81(3) recognises the fact that *rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies* in the shape of innovation. In other words, *the ultimate aim of Article 81 is to protect the competitive process.* When competition is eliminated the competitive process is brought to an end and short-term efficiency gains are outweighed by longer-term losses stemming *inter alia* from

expenditures incurred by the incumbent to maintain its position (rent seeking), misallocation of resources, reduced innovation and higher prices.

Relationship with Article 82

106. The concept in Article 81(3) of *elimination of competition in respect of a substantial part of the products concerned is an autonomous Community law concept* specific to Article 81(3)⁸⁸. However, in the application of this concept it is necessary to take account of the relationship between Article 81 and Article 82. According to settled case law the application of Article 81(3) cannot prevent the application of Article 82 of the Treaty⁸⁹. Moreover, since Articles 81 and 82 both pursue the aim of maintaining effective competition on the market, consistency requires that Article 81(3) be interpreted as precluding any application of this provision to restrictive agreements that constitute an abuse of a dominant position^{90,91}. However, not all restrictive agreements

⁸⁸ See Joined Cases T-191/98, T-212/98 and T-214/98, *Atlantic Container Line (TACA)*, [2003] ECR II-, paragraph 939, and Case T-395/94, *Atlantic Container Line*, [2002] ECR II-875, paragraph 330.

⁸⁹ See Joined Cases C-395/96 P and C-396/96 P, *Compagnie maritime belge*, [2000] ECR I-1365, paragraph 130. Similarly, the application of Article 81(3) does not prevent the application of the Treaty rules on the free movement of goods, services, persons and capital. These provisions are in certain circumstances applicable to agreements, decisions and concerted practices within the meaning of Article 81(1), see to that effect Case C-309/99, *Wouters*, [2002] ECR I-1577, paragraph 120.

⁹⁰ See in this respect Case T-51/89, *Tetra Pak (I)*, [1990] ECR II-309, and Joined Cases T-191/98, T-212/98 and T-214/98, *Atlantic Container Line (TACA)*, [2003] ECR II-, paragraph 1456.

⁹¹ This is how paragraph 135 of the Guidelines on vertical restraints and paragraphs 36, 71, 105, 134 and 155 of the Guidelines on horizontal cooperation agreements, cited in note 5, should be understood when they state that in principle

concluded by a dominant undertaking constitute an abuse of a dominant position. This is for instance the case where a dominant undertaking is party to a non-full function joint venture⁹², which is found to be restrictive of competition but at the same time involves a substantial integration of assets.

Depends on reduction in competition

107. *Whether competition is being eliminated* within the meaning of the last condition of Article 81(3) *depends on* the degree of competition existing prior to the agreement and on the impact of the restrictive agreement on competition, *i.e. the reduction in competition that the agreement brings about.* The more competition is already weakened in the market concerned, the slighter the further reduction required for competition to be eliminated within the meaning of Article 81(3). Moreover, the greater the reduction of competition caused by the agreement, the greater the likelihood that competition in respect of a substantial part of the products concerned risks being eliminated.

Realistic analysis of competitive constraints

108. The application of the last condition of Article 81(3) requires a *realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered.*

Not only market shares

restrictive agreements concluded by dominant undertakings cannot be exempted.

⁹² Full function joint ventures, i.e. joint ventures that perform on a lasting basis all the functions of an autonomous economic entity, are covered by Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, OJ 1990 L 257, p 13.

109. While *market shares are relevant*, the magnitude of remaining sources of actual competition cannot be assessed exclusively on the basis of market share. *More extensive qualitative and quantitative analysis* is normally called for. The *capacity of actual competitors to compete and their incentive to do so must be examined*. If, for example, competitors face capacity constraints or have relatively higher costs of production their competitive response will necessarily be limited.

Competition on price or innovation

110. In the assessment of the impact of the agreement on competition it is also relevant to examine its *influence on the various parameters of competition*. The last condition for exception under Article 81(3) is not fulfilled, if the agreement eliminates competition in one of its most important expressions. This is particularly the case *when an agreement eliminates price competition⁹³ or competition in respect of innovation and development of new products*.

Conduct when agreement being implemented

111. *The actual market conduct of the parties* can provide insight into the impact of the agreement. *If following the conclusion of the agreement the parties have implemented and maintained substantial price increases or engaged in other conduct indicative of the existence of a considerable degree of market power, it is an indication that the parties are not subject to any real competitive pressure and that competition has been eliminated with regard to a substantial part of the products concerned*.

Past competitive interaction

112. *Past competitive interaction* may also provide an indication of the impact of the agreement on future competitive interaction. An undertaking may be able to eliminate competition within the meaning of Article 81(3) by

⁹³ See paragraph 21 of the judgment in *Metro (I)* cited in note 54.

concluding an *agreement with a competitor that in the past has been a “maverick”*⁹⁴. Such an agreement may change the competitive incentives and capabilities of the competitor and thereby remove an important source of competition in the market.

Differentiated products

113. In cases *involving differentiated products*, i.e. products that differ in the eyes of consumers, the impact of the agreement *may depend on the competitive relationship between the products sold by the parties to the agreement*. When undertakings offer differentiated products the competitive constraint that individual products impose on each other differs according to the degree of substitutability between them. It must therefore be considered what is the *degree of substitutability between the products* offered by the parties, i.e. what is the competitive constraint that they impose on each other. The more the products of the parties to the agreement are close substitutes the greater the likely restrictive effect of the agreement. In other words, the more substitutable the products the greater the likely change brought about by the agreement in terms of restriction of competition on the market and the more likely it is that competition in respect of a substantial part of the products concerned risks being eliminated.

Actual and potential competition

114. While *sources of actual competition are usually the most important*, as they are most easily verified, sources of potential competition must also be taken into account. The *assessment of potential competition requires an analysis of barriers to entry* facing undertakings that are not already competing within the relevant market. Any assertions by the parties that there are low barriers to market entry must be supported by information identifying the

⁹⁴ See paragraph 97 above.

sources of potential competition and the parties must also substantiate why these sources constitute a real competitive pressure on the parties.

Assessment of barriers to entry

115. In the assessment of *entry barriers* and the real possibility for new entry on a significant scale, it is relevant to examine, *inter alia*, the following:

(i) The *regulatory framework* with a view to determining its impact on new entry.

(ii) The *cost of entry including sunk costs*. Sunk costs are those that cannot be recovered if the entrant subsequently exits the market. The higher the sunk costs the higher the commercial risk for potential entrants.

(iii) The *minimum efficient scale* within the industry, i.e. the rate of output where average costs are minimised. If the minimum efficient scale is large compared to the size of the market, efficient entry is likely to be more costly and risky.

(iv) The *competitive strengths of potential entrants*. Effective entry is particularly likely where potential entrants have access to at least as cost efficient technologies as the incumbents or other competitive advantages that allow them to compete effectively. When potential entrants are on the same or an inferior technological trajectory compared to the incumbents and possess no other significant competitive advantage entry is more risky and less effective.

(v) The *position of buyers and their ability to bring onto the market new sources of competition*. It is irrelevant that certain strong buyers may be able to extract more favourable conditions from the parties to the agreement than their weaker competitors⁹⁵. The presence of strong

⁹⁵ See in this respect Case T-228/97, *Irish Sugar*, [1999] ECR II-2969, paragraph 101.

buyers can only serve to counter a *prima facie* finding of elimination of competition if it is likely that the buyers in question will pave the way for effective new entry.

(vi) The *likely response of incumbents to attempted new entry*.

Incumbents may for example through past conduct have acquired a reputation of aggressive behaviour, having an impact on future entry.

(vii) The *economic outlook for the industry* may be an indicator of its longer-term attractiveness. Industries that are stagnating or in decline are less attractive candidates for entry than *industries characterised by growth*.

(viii) *Past entry on a significant scale* or the absence thereof.

Examples

116. The above principles can be illustrated by the following hypothetical examples, which are not intended to establish thresholds:

Firm A is brewer, holding 70% of the relevant market, comprising the sale of beer through cafes and other on-trade premises. Over the past 5 years A has increased its market share from 60%. There are four other competitors in the market, B, C, D and E with market shares of 10%, 10%, 5% and 5%. No new entry has occurred in the recent past and price changes implemented by A have generally been followed by competitors. A concludes agreements with 20% of the on-trade premises representing 40% of sales volumes whereby the contracting parties undertake to purchase beer only from A for a period of 5 years. The agreements raise the costs and reduce the revenues of rivals, which are foreclosed from the most attractive outlets. Given the market position of A, which has been strengthened in recent years, the absence of new entry and the already weak position of competitors it is likely that competition in the market is eliminated within the meaning of Article 81(3).

Shipping firms A, B, C, and D, holding collectively more than 70% of the relevant market, conclude an agreement whereby they agree to coordinate their schedules and their tariffs. Following the implementation of the agreement prices rise between 30% and 100%. There are four other suppliers, the largest holding about 14% of the relevant market. There has been no new entry in recent years and the parties to the agreement did not lose significant market share following the price increases. The existing competitors brought no significant new capacity to the market and no new entry occurred. In light of the market position of the parties and the absence of competitive response to their joint conduct it can reasonably be concluded that the parties to the agreement are not subject to real competitive pressures and that the agreement affords them the possibility of eliminating competition within the meaning of Article 81(3).

A is a producer of electric appliances for professional users with a market share of 65% of a relevant national market. B is a competing manufacturer with 5% market share which has developed a new type of motor that is more powerful while consuming less electricity. A and B conclude an agreement whereby they establish a production joint venture for the production of the new motor. B undertakes to grant an exclusive licence to the joint venture. The joint venture combines the new technology of B with the efficient manufacturing and quality control process of A. There is one other main competitor with 15% of the market. Another competitor with 5% market share has recently been acquired by C, a major international producer of competing electric appliances, which itself owns efficient technologies. C has thus far not been active on the market mainly due to the fact that local presence and servicing is desired by customers. Through the acquisition C gains access to the service organisation required to penetrate the market. The entry of C is likely to ensure that competition is not being eliminated.

4. Notes and Questions

Notes and questions on guidelines on the application of Article 81(3) of the Treaty

1. (Points 1 & 10). Is the direct effect of article 81(3) the most important change made by regulation 1/2003? Are decisions made after April 2004 by virtue of article 81(3) constitutive as exemptions used to be: i.e., as from a specific date the agreement became valid and remains so, unless the exemption was withdrawn.
2. (Point 2). Since the guidelines on Article 81(3) were adopted some group exemptions for specific sectors have been withdrawn or amended.
3. (Point 3). The guidelines on vertical agreements are being reconsidered because the block exemption will expire on May 1 2010.
4. (Points 4 & 7). What is the status of Commission guidelines. Has it changed since regulation 1/2003?
5. (Point 6). Can this general statement reverse the Commission's previous practice over decades?
6. (Point 10). The doctrine of direct effect was developed by the ECJ in the early years of the Coal and Steel Community. Can the Commission make it apply by secondary legislation? Why is the individual application of Article 81(1) now called an exception rather than an exemption?
7. (Point 10). Do you think that the concept of fluctuating validity may give rise to difficulties if one of the parties has relied on the validity of the agreement or a national court has done so? How can the parties plan their business?
8. (Point 11). This is often referred to as the bifurcation of Article 81.

Do you think that the two stages will be kept distinct once NCAs and national courts apply article 81(3)?

9. (Point 13). Note the prominence given to consumer welfare and allocation of resources. It used to be widely believed that competition law was intended to enable firms to enter the market of their choice without questioning whether a new entrant would be as efficient as the incumbents. Do you think that by 2004 when the notice on Article 8(3) was adopted, the Commission had come to look mainly to an efficient allocation of resources for the benefit of consumers. Since the judgment of the ECJ in *British Air* the courts and Commission have sometimes recognised Ordo Liberal views about the interest of potential entrants. See point 47 below. Are these two views consistent?
- 10.(Point 14). National Competition Authorities enforce also their national competition laws which may not conflict with those of the EC.
- 11.(Points 15, 99, 101 & 109). Note the Commission's interest not only in the ability to restrain competition, but also in incentives to do so.
12. What amounts to tacit collusion? Consider *Bayer v. Commission*, Case Book pp.7-12 above.
- 13.(Point 16). See the *de minimis* notice in Case book pp 47-53.
- 14.(Points 17 - 18) Remember the realistic counterfactual in *La Technique Miniere*, Case book pp 53-54. Explain the difference between appraisal *ex ante* and *ex post* in connection with the facts of *Grundig*. Does Guideline 18 (1) follow the Advocate General or the Court in *Consten and Grundig v. Commission*? Give reasons. Consider Guideline 18 in the light of *Métropole III*, Case book pp. 60-65. Note that most officials in the Commission have only recently

begun to think *ex ante*. It marks a revolution in their approach over the last decade.

15. (Points 19-23) What is a restriction by Object? Did the judgment of the CFI in *GlaxoSmithKline v. Commission* alter the position, (T-168/01) [2006] ECR II-2006, [2006] 5 CMLR 1623, Comment, Korah, [2007] Competition Law Journal? Consider the opinion of AG Trstenjak in *Competition Authority (Ireland) v. Beef Industry Development Society Ltd and Barry Bros (Carrigmore) Mets Ltd*, comment Okeoghene Odudu, `Restrictions of Competition by Object – What`s the Beef? [2009] Competition Law Journal 11. Is it now clear that there is a rebuttable presumption that agreements with a restrictive object infringe Article 81(1) but may very occasionally be held not to infringe?
16. (Point 22). Should a subjective intent to restrict competition be relevant under Article 81(1)?
17. (Point 23). Are all the provisions that are blacklisted in recent block exemptions `capable of restricting competition` or likely to do so? Note that in *British Airways* the ECJ uses the phrase `capable of` as synonymous with `likely to`. Should they be treated as necessarily restricting competition by object? Consider resale price maintenance. It is black listed by Article 4(a) of the block exemption for Vertical Agreements, but may avoid some free rider problems.
- 18.(Point 27). Is it enough to define the relevant market, or should it be appraised?
- 19.(Points 28, 30-31, and 80) Why is it important to consider whether a restraint is ancillary to a main non-restrictive transaction? Consider the burden and standard of proof under Article 81(1).
- 20.(Point 29). How closely linked to the main transaction must an

ancillary restraint be to escape the prohibition of article 81(1), directly, reasonably or foreseeably? Does 'directly' mean that there is no incentive to invest that may break the chain of causation? See *Pronuptia* and *European Night Services*

- 21.(Point 30). The distinction between article 81(3) and ancillary restraints may well follow from the bifurcation of article 81.
- 22.(Point 31). Does this paragraph seem formalistic to you? Why are ancillary restraints limited to the initial phase – often 3 or 5 years? Should the length permitted depend on the amount of sunk costs required and other aspects of risk?
- 23.(Points 33, 47 and question 9) Does the Commission still see the aim of the competition rules as ensuring fair competition between competitors? Should it? See Point 14 above. Is the exclusion of a particular competitor always anti competitive?
- 24.(Points 24 & 41). Consider the burden of proof under Article 81(3). It is very important, especially when benefits and detriments are not commensurate. Would it have been better if Article 81(3) did not exist, and we claimed that the restrictive effects were ancillary?
- 25.(Point 43). Contrast *Cie Generale Maritime*, [2009] Competition Law Journal p. 64)
26. (Points 44 & 78). If circumstances change and the agreement that qualified under 81(3) no longer does so, or vice versa, over which periods does the nullity apply? Can an agreement that was valid, become invalid despite intermediate judgments in national courts. Is point 46 a sufficient answer?
- 27.(Points 44 & 115(ii)) What is a sunk investment? How can a competition authority take the initial sunk cost into account, if the exception lasts only as long as the 4 conditions are fulfilled? Should the Commission look to the period actually needed to

- recoup sunk costs, or should it look to the expectations of the parties at the time they committed to make the investment?
28. (Point 45). Are you happy about dividing up an agreement, so that some provisions remain valid when others do not? Could this favour one party rather than the other?
29. (Point 46). Note that even a refusal to supply with the object of restricting parallel trade raises only a rebuttable presumption that Article 81(3) cannot be applied - *GlaxoSmithKline v. Commission*, (T-168/01) [2006] ECR II-2006.
30. (Point 46.) Why is article 81(3) applied to few agreements with hard core restrictions?
31. (Point 47). Had the Commission changed its earlier view that the purpose of competition law is to keep markets open when it drafted point 13, which is based on avoiding consumer harm?
32. (Points 49 & 50). What is meant by 'objective benefits'?
33. (Points 51(c), 56 and 64). Consider how you might establish the likelihood and magnitude of each efficiency claimed? Would it be harder in a complex transaction than a simple one?
34. (Points 55 & 56). Is the burden of proof on the parties only evidentiary? In *Microsoft* the CFI said that if the parties indicated the relevant efficiencies and produced evidence of them, it was for the Commission to show that these were outweighed by negative effects. Does this statement apply also to article 81?
35. (Points 57 & 103). Consider whether it would be easy to establish *ex ante* and in detail the nature of the efficiencies and why they confer objective benefits.
36. (Point 74). Compare points 17 and 18.
37. (Point 80). Give two examples of hold-up problems. Do they amount to free rider problems?

38. (Point 81). Should the Commission look to the period actually taken to recoup the sunk cost, or should it consider the period that seems sensible at the time of the agreement?
39. (Point 82, first example). What do you think of the sharp distinction drawn by the Commission between restrictions on active or passive sales?
40. (Point 84). Note that those buying for their own enjoyment are unlikely to be undertakings.
41. (Point 98). Why is the Commission more interested in saving marginal cost than in saving fixed costs? Remember that by the time the investment in sunk costs is made, the investor must be satisfied that it will earn sufficient profits to make them worthwhile. In which event, the ECJ has accepted that where there are significant sunk costs, exceeding variable cost is acceptable.
42. (Points 57 & 101 - 104) Do you think it would be possible in advance of the agreement to measure either the value to consumers of the efficiencies or the harm to competition? Some economists spell out the relevant trade off without ascertaining whether it is possible to quantify either amount.