

## Fordham IP Conference

# **EU Competition Law. From a static, form-based approach towards a dynamic approach.**

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## OUTLINE

- I. Introduction: A. 101 TFEU and Reg. 17/62
- II. Com's early Formalistic Approach: First BERs for Vertical Distribution
- III. DG Gomp. Claus-Dieter Ehlermann: the rise of an Economic Approach
- IV. Integrating Economic Thinking: Com Reg. 2790/99
- V. Evolution of Economic Approach: Current vert. BER, Reg. 330/2010
- VI. BER for Patent Licenses, Reg. 2394/84 & Com's Consultation
- VII. Implementing Reg. No 1/2003
- VIII.A. 102 TFEU: Standard Setting & Patent Thickets
- IX. Conclusion: Towards a fully-fledged dynamic approach?

## Introduction

### TFEU 101 (ex. A. 81 EC)

(1) Prohibits as incompatible with common market (internal market)

- collusion
- that may affect trade between Member States &
- have object or effect of distorting restricting or preventing competition in EU.

(2) Agreements or decisions that infringe art 101(1) shall be automatically void

- Arts 101(1) and 102 now have direct effect in courts of MS (Reg. 1/2003)
- Resulted in important agreements being illegal and void
  - In whole or in part. In part is worrying if you have paid for protection

(3) Para (1) may be declared inapplicable when a provision is indispensable to obtaining various benefits.

- “indispensable” a strong word. Usually other options exist, so seldom practicable as a defence to infringing Art 101(1)

## Regulation 17/62

- Only Com could apply art 101(3) to the agreements notified to it.
- Com inundated with notifications.
- it lacked staff to grant many individual exemptions or comfort letters and
- reacted by applying 101(3) by block exemption regulation (BER ) from 101(1) to categories of collusion to escape from the paper.

## Block Exemption Regs (BERs)

- Series of BERs have been adopted, not only for technology transfer.
- Guidelines and other soft law.
- form-based, and little attention paid to market power, efficiencies or consumer welfare.
- Advisors checked any provisions that might infringe art. 101(1) & see which, if any, were exempted by any current BER.
- Now have to carry out an economic appraisal. A task requiring much more skill.

# Com gains control over competition policy

- Early view that any restriction on conduct was a restriction of competition (Ordo Liberal theology) coupled with
- Commission's exclusive power under Reg 17 to grant individual exemptions from (Art101(1))
- So agreements might be **void and illegal in part**.
  - worrying if you had paid me for illegal territorial protection, I could not get my money back.
- Most Commission officials in the 1960s were lawyers & many were formalistic. They thought ex post:
  - **Once investment has been made, there is no need for incentives to invest.** So, dynamic approach of encouraging innovation by preventing free riding was seldom considered by Com after the innovation had taken place.

## Com's approach static

- Until 1969, all Com's formal decisions concerned allocated exclusive sales territories, supported by export restrictions.
  - Easy to rule that export bans or disincentives infringed Art 101 (*Consten & Grundig v. Com* [1966] ECR 299). Foreclosure was assessed on basis of terms of agreement not on probable effect on markets or consumers.
- Officials said:
  - Omit words like **not, only, limited to, exclusively**, etc and the agreement will not infringe art 101(1),
  - but those words were often necessary to encourage dealer to invest in marketing a brand in another MS.
    - Cost was sunk – if marketing failed, it had no other use. So investment risky.
    - Com's policy delayed integration of market.

# Integration of common market

## Ordo-liberal influence

- Often an exclusive territory followed national boundary
  - Perceived as dividing Common Market *Consten & Grundig* 1966 and Ordo Liberal interest in keeping markets open.
- A few individual contracts were exempted by Commission from 1964 under art 101(3),
  - if there were no restraints on sales between MS,
  - because of consumer interest in wider choice.

## Individual exemptions

- Meanwhile from 1972, in *Davidson*, different team of Com officials granted its first individual exemption for exclusive patent licence, on the ground that unless protected from intra brand competition licensees would not invest sufficiently in promotion of licensor's brand.
- If that were true the agreement should have been cleared as not contrary to art 101(1)!

## Com's early formalistic approach: First BERs for vertical distribution

- Pursuant to Article 101(3), Reg 67/67 exempted by category from Article 101(1) agreements for exclusive distribution or single branding or both

### Early Group Exemptions

**Reg 1983/1983** - exclusive sales territories - form-based & narrow

Exemption of

- “agreements to which **only two undertakings are party**” created problems
  - If trademark was owned independently-3 parties needed
  - Italian garages when 3<sup>rd</sup> party held government licence to trade on that land
  - Even if each agreement was between single buyer and seller and would be treated by economists as vertical.
- “whereby ...the **reseller agrees with ... the supplier “to supply certain goods for resale only to that other”** (connected or designated undertaking)”
  - Irrelevant whether market was concentrated. Furore when for reg. 1983/1983 Com proposed cap on seller's market share.

## **Art. 2 of Reg. 1983/1983**

- List of permitted restraints:
- White list abandoned in BER for vertical agreements in 1999 & later BERs, whether vertical or otherwise.
  - A big move towards a dynamic approach.
  - Less control by Commission

## **Art. 3 of Reg. 1983/1983: Black list in Reg 1983 where BER will not apply (detail omitted)**

- Exclusive territories for buyers.
  - a) Reciprocal exclusive distribution between competitors,
  - b) non-reciprocal exclusive distribution agreements between competitors unless one of them is small
  - c) users can obtain contract goods only from exclusive distributor within territory and no alternative supply from outside
  - d) one or both parties makes it difficult for users to obtain contract goods.

## Law unsatisfactory

- Little reference to economic analysis, business common sense, efficiencies or other probable benefits for consumers.
- Com, often followed by ECJ, treated any restraint of conduct as restraining competition,
  - consequently, many harmless agreements were found to infringe art 101(1) and might be void in part, and only Commission then had power to apply Art. 101(3).
    - . Back log of over 30,000 vert cs.

## Claus-Dieter Ehlermann: the rise of an Economic Approach

- Became Director General of DG Comp in late 1980s.
- He lacked staff to grant many individual exemptions but noticed that economists thought that not all restrictions on conduct restricted competition.
- So, he advocated a more economic approach, It was more important for his few staff to deal with international cartels, mergers and state aids than to exempt individual contracts
  - (only Com could apply art 101(3) – time consuming & Com lacked staff – 3 or 4 individual exemptions in most years.)
  - This exclusive competence had to go.

## New officials more sympathetic to economic thinking

- From 1989, Council enabled DG Comp to recruit more officials for merger task force.
- This gave Ehlermann chance to change thinking
  - DG Comp recruited some economists directly,
  - Other departments and Member States seconded officials to DG Comp. Many were economists or had worked with economists.
  - After 3 or 4 years in merger task force, officials were moved on to deal with policy, co-ordination & individual cases.
  - So familiarity with economics and respect for economists spread. Ground for law reform became more fertile.

## Integrating Economic Thinking: Com Reg. 2790/99

Easier to start with reform of vertical distribution agreements, because:

- Economists argued that few were anticompetitive Moreover, they could lead to greater efficiency. So they might encourage investment in brand in other MSs,
- Often vertical agreement avoided free riding of many kinds,
  - And thereby made it easier to extend business to another MS
  - Most Commission vertical cases involved distribution, so BER for vertical agreements would release more resources fast.

### **New Group exemption (BER) and guidelines for vertical agreements radically different from earlier BERs:**

- Art. 2(1): between **2 or more** undertakings,
- **Each operating for purpose of agreement, at a different level** of the production or distribution chain- Agreements between competitors largely excluded
  - Art 2(4) & Gs 26 & 27
- & relating to conditions under which parties may purchase sell or resell certain goods **or services** (vertical agreements).
  - Extended to services
  - Art 3 limited market share of supplier to 30%
  - Market share may be proxy for market power

# Reg.2790/1999      targeted      vertical agreements in economic way

- Covered distribution, franchising & agency so no longer need for separate BERs for different forms of distribution.
- Applied to agreements **not** between competitors, but could be several firms in vertical relationship.

## Reg. 2790/99, Art 4. hard core restraints

- Article 4 of Reg 2790/1999 excluded from BER
  - agreements containing specified restrictions by object (Gs 46 – 56)
  - a) resale price maintenance (Gs 47& 48)
  - b) Territorial or customer restraints on buyer with exceptions (Gs 49 – 51)
  - c) selective distribution (Gs 53 & 54)
  - d) restriction on cross supplies between distributors in selective distribution system
  - e) restriction on supplier of components selling them as spare parts to end-users, repairers etc.
- Art 3 **EXCLUDED** vertical agreements from BER when **SELLER** supplied more than 30% of market in which it sold.
  - Led to different terms in different MS, dividing EU?!

## Article 5: severable conditions

- Prevents BER applying to specific provisions:
  - restraining buyer after agreement is terminated from competing with seller
  - Boycott of specific competitor imposed on members of selective distribution system
- Rest of agreement may benefit from BER but the severable provisions will not.
  - They may not infringe 101(1).

## Gs 2000 on vert BERs

- Since 2000, in drafting BERs Com has openly considered policy using economic theory.
  - probable benefit for consumers/ inducements for investment.
  - New model for Gs. Now they give policy reasons, and do not merely assert that each provision is covered by the empowering reg.
- Radical change from earlier form-based criteria.
- **G 7, 2000**, “protection of competition is the primary objective of EC Competition policy
  - as this enhances **consumer welfare** and creates an efficient allocation of resources....”
- “The Commission will adopt an economic approach which is based on the effects on the market;
- vertical agreements have to be analysed in their legal and economic context.
- However, in the case of restriction by object as listed in article 4 of the vert BER, the Commission is not required to assess the actual effects on the market.
- Market integration is an additional goal of EC competition as it enhances competition in the community. Companies should not be allowed to recreate private barriers between MS where state barriers have been successfully abolished.”

## Gs 2000 vert. BER continued

- G3. rules out mechanical application
  - Apply standards in specific circumstances of each case.
- G.62 no presumption of illegality if agreement outside group exemption.
- Gs 103-136 framework of analysis
  - Gs 110 – 114 Negative effects with reasons
    - Foreclosure by raising barriers to entry - single branding - limited distribution – rpm group – market partitioning group
  - Gs 116-118 Positive effects
    - G116 solve free rider problems of many kinds.
- Vast change from style of earlier Gs which merely restate the provisions of the BER.
- G 115 - Looks to probable effects
  - Considers legal and economic context by cap on seller's market share

## Later BERs

- Under later BERs, where agreement may be between competitors, Cap of market share is tighter
  - eg technology transfer Reg 772/2004 (later Gs, redefined horizontal to treat relationship where one party could not have operated without the agreement or without the restriction as vertical), and horizontal cooperation reg 1217/2010
- No white list,
  - Anything not forbidden allowed if qualified as ....
  - This scheme was repeated in all BERs after 1999.
- Black list , Art 4 listed provisions that prevented application of BER to agreement,
- Art 5 prevented application of BER to the restriction - the rest enforceable if restriction severable.
  - Severability is matter for national law and its conflict of laws.
- More sensible arrangements for withdrawing BE in individual decision.

## Evolution of Economic Approach: Current vert BER, Reg 330/2010

- Not very different from reg 2790/1999:
  - but more detail in guidelines on active exports by buyer, which may be permitted despite art 4(b).
  - Art 3 of reg 330/2010 now limits vertical BER to agreements when neither seller **NOR BUYER** supplies more than 30% of market.
- Similar schemes in later BERs, where agreement may be between competitors
  - Eg joint ventures, technology licensing, market share cap may be tighter.
- Criterion of buyer's market share controversial!
  - How does supplier know product and geographic market shares of its customers in all product and geographic markets?
  - May not matter in practice if it can avoid black listed clauses which would prevent application of BER in any event.

# Current Vertical Gs, OJ 2010 C130/01.

- Not very different from those of 2000\*\*
- G 6 & 23 2010, Com. accepts that vert. restraints are seldom anticompetitive if there is sufficient inter-brand competition & no hard core restraints.
  - Modern economics more sophisticated: buyer and seller may compete with each other for consumer surplus.
- G7 2010, protection of comp is primary objective as it enhances consumer welfare & helps to integrate EU.
- Explains kinds of agreement in economic terms
- G 47 2010 black list tighter than for BER 1999 because restrictions must qualify under art. 101(3)
  - (indispensable). Usually other options that rarely infringe 101(1) TEU: eg. selective distribution
    - Since 1983, redefined in art 1(e). Criteria for appointment in selective distribution may now be quantitative if agreement within BER, but not within *Metro 1*.

## Current vert. Guidelines cont.

- Throughout, explains reasons for provisions.
- G 96, Vert. ags outside reg not presumed to be illegal provided that no hard core restrictions or excessive market share of either party.
- Com has gone back to economic analyses of the problems, within and outside the reg in guidelines to each BER. Conduct is now considered more in its economic context even under BER.
- Then possible negative (GS 100-105) and positive (Gs 106-108) effects on competition with reasons.

## RESULTS of Vert. BER

- Commission ceased to challenge many vertical agreements unless international aspects.
- It left them to National Competition Network
  - French NCA very active
- We now have had a series of chief economists supported, originally by ten, now by 30 post-doctoral economists as well as economists in charge of individual cases,
- Peer Review for major cases & art 102 etc.

## BER for Patent Licenses, Reg. 2349/84

- First BER for agreements about IP
- Was as form - based as Reg 1983/1983.
- Art 1. exempts **Patent** licences with or without **knowhow** if **only 2 undertakings are party and which include one of following obligations**

## Patent BER. Art 5 exclusion of agreements that may be horizontal

- Between members of patent pool & relating to pooled patents,
  - between competitors who hold interest in a joint venture, or one of them and joint venture relating to activities of joint venture,
  - Reciprocal licences & sales rights, where parties compete re products covered by agreement
  - plant breeders' rights,
    - Reg creating plant breeders' rights adopted only later.
- Articles 6 - 9 transitional provisions & withdrawal of BER from individual agreements

## TT (1) Article 1, Reg. 240/1996

- Art 1.1 Exempted, for limited periods,
  - territorial obligations on manufacture between licensor & licensee & between licensees,
  - an obligation on the licensee to use the licensor's mark or get up as well as to
  - limit its production of the licensed product only for use to make its own products and sell the licensed product only as an integral or replacement part etc. of its own products. Etc.
- Art 2 white list – 18 items

## TT (1), Art 3(1) to black list

- Art 3, exemption shall not apply to restrs, of prices,
- Restr. of competition in r & d, production, or use of competing products without prejudice to obligation of licensee to used its best endeavours, or right of licensor of right to terminate exclusivity and cease providing improvements,
- Export restraints
  - Etc.
- Art 4, opposition procedure

## TT2 art s 2 & 3 of Reg. 772/04

- Structure similar to TT1 and reg. 2790/99
  - The modern model BERs.
- Art 1 complex. It defines so many terms
- That the exemption in Art 2 could be short.
- Art 2 provides that **Art 101(1) shall not apply to technology transfer agreements**
  - Defined in Art 1.1.a and b
- **entered into between two undertakings**
  - Com. had no power to extend BER to multipartite agreements. It had had to wait 2 years to obtain such powers for the vert BERs
- **permitting the production of contract products.**
  - This excluded pure sales licences to which Com thought vertical BER should apply.
- **As long as IPR has not expired or kh has remained secret;**

## TT2 art 1, reg 772/2004

- Art 1.1 definitions, eg, a-b patent licensing agreement includes a kh licensing agreement, a copyright licensing agreement, a software licensing agreement etc.
- Definitions qualify article 2 and give it meaning.

## TT 2, Arts 3 - 4, market share ceiling, black list etc.

- Art 3 Market share caps.
  - 1. BER shall not apply where parties to agreement compete with each other and combined share of relevant product or technology market exceeds 20% or
  - 2. Parties do not compete and share of each of technology or product market exceeds 30%
  - 3. technology market explained.
- Art 4.1 & 2 two black lists. Where the parties compete with each other list is more extensive.
  - Does this follows economic theory?

## TT 2 Competitors Art 1.1.j

- Until Com published draft of TT2 for comment, once both parties were using the licensed technology, Com. treated them as competitors.
- This static approach was much criticised.
- Article 1.1.j now provides that the counterfactual is what would have happened without the agreement and without the restriction. G 12
- This transformed the law. The 20% combined share now seldom applies as few licensees could have competed without the licence. The other effect of the change is that the more lenient black list under article 4(2) usually applies rather than the stricter one in art. 4.1
- This change in the counterfactual has been generalised in Gs 17 - 18 on Art 81(3) of the Treaty OJ 2004, C101/99.

# TT2 Art 4.1 hard-core restraints

- **In agreements between competitors, BER does not apply to agreements that directly or indirectly have as their object:-**
  - (a) **restr. of prices downstream**
  - (b) **limitation of output except limitation of contract products imposed on licensee in non-reciprocal agreement or imposed only on one of the licensees in a reciprocal agreement**
  - (c) **allocation of markets or customers except ...**
  - (d) **restr of licensee's ability to exploit its own technology, or restriction on either party to carrying out r & d, unless that is indispensable to prevent disclosure of the licensed kh to third parties.**

# TT2, Art 4(2), black list

- **Art 4(2). Where the parties are not competing, BER shall not apply where parties' have as their object**
  - **(a) a restriction of a party's ability to determine its prices when selling products to third party without prejudice to... (G97)**
    - Like rpm in vert regs. Remember licensee makes & does not resell
  - **(b) Territorial or customer restrictions on passive sales by licensee with exceptions (Gs 98,99, 174, 180) ...**
  - **Art 4(3). if parties start to compete, para 2 with more limited scope applies and not para 1. (Gs 31 & 68)**

## Art 5. excluded obligations

- **Obligations** to which BER does not apply, but which are severable
  - a) Exclusive grant back
  - b) exclusive assignment back
  - c) no challenge
  - d) obligation not to exploit its own technology if not competing.

# TT2 Art 6 & Guidelines 2004

- **Art 6 Withdrawal of BER in individual cases (like TT1)**
  - **G2 guidance under art 101 only, not 102.**
  - **G 3 application of Gs not mechanical.**
  - **G7 no inherent conflict between IPRs and competition.**
  - **Due to expire May 1 2014. Exclusions, inclusions and transitional provisions based on a structure similar to TT1.**

# Com's consultation & 13 questions

- BER due to expire by May 1 2014. See study commissioned by Com on replacement & questions [http://ec.europa.eu/competition/consultations/2012\\_technology\\_transfer/index\\_en.html](http://ec.europa.eu/competition/consultations/2012_technology_transfer/index_en.html)
- Q 7 should scope of BER be extended, eg to trademark licensing for display on consumer goods
  - No underlying licensed technology.
- Q9 do we still need TT BER?
  - Or would guidelines with safe harbours suffice?
  - Com does not question whether need BER for multilateral licences.
  - Would require Council reg.

## Implementing Reg. No 1/2003

- Implementation of competition completely changed.
- Art 43 of **Reg 1/2003 has repealed Reg 17**, and with it the ability & need to *notify* the Commission if an individual exemption is required.
- **Art.1:-confirms the direct effect of art 101(1) and 102 TEU & no agreements infringing article 101, but qualifying under Art 101(3) shall be prohibited.**
  - **Decisions of Com, NCA or Nat Court declaratory & no longer constitutive.** Each institution applies the same criteria and they co-operate under ECN.

## Reg. 1/2003 cont.

- Article 2, burden of proof on person alleging infringement of 101(1) or 102, but on undertaking claiming benefit of 101(3).
  - Case law shows burden under 101(3) is heavy.
- Undertakings must make up their minds as to legality of particular conduct without protection of Commission decision
- Art 3 (1) NCAs or nat. Court applying national law to collusion contrary to Art 101(1) TFEC, shall also apply art. 101(1) or 102.

## **Council Reg. 1/2003 replaces Reg. 17/62**

- Art. 1(direct effect of 101(1) and (3)) results In no notification or scrutiny by Com being needed. Ehlermann's policy has succeeded!
- Agreements qualifying under Article 101(3)ceased to be prohibited even without any decision to that effect.
  - Decisions became declaratory not constitutive
  - Resources were freed to deal with more important tasks.
- National courts became able to enforce agreements under Art 101(3).
- Distribution agreements & IP licences are now dealt with by NCAs and few by Commission unless international.
- Could Com also reduce its task under article 102?

## Standard and burden of proof

- *Airtours/First Choice* OJ 2000,L93/1
- Com prohibited a merger reducing from 4 – 3 the number of firms providing long haul holidays by air
- GC reversed on appeal. (T-342/99) Para 62, to find a dom. olig. Com must establish
  - Ability of each to *monitor* the conduct of the others
  - Incentive not to depart from common policy,
  - ability of each to *retaliate* against chiselling by others.
  - *Reaction of current and future competitors & of customers.*
  - 63. Prospective analysis calls for *close examination*, in particular, *of effects on the market with convincing evidence.*
  - 64 Com has some discretion dealing with complex economic facts
- Confirmed in *Tetra Laval* (T-5/02) and
- *Schneider/Legrand* C-12/03

## A. 102 TFEU (ex. 82 EC) - Standard Setting and Patent Thickets

- Efficiencies from having common standards.
- Firm whose standard is adopted has technical advantage, its old r&d remains relevant. So firms may compete to provide leading standard, but once agreed, competition between standards ends
- may be considerable competition in selecting standard
- standard often agreed between competitors – horizontal!
- The main benefit is that consumers will all belong to a single network, or enjoy a larger variety of indirect networks
  - Consumers have greater choice within network(s) (less between networks).
  - The best standard may not be chosen. Criteria may be based on bargaining power of firms involved.
  - Government may be involved with risk of more bureaucracy.

## CSS

- Benefit of not becoming stranded on standard no longer used.
- Network effects important. If no cooperative standard, market usually ends up with a single standard.
- Initially consumers may benefit from intensive competition when markets may still tip towards a single standard. Thereafter prices may rise as consumers become locked in.
- Cooperative standard setting implies a clear trade off: It eliminates competition ex ante, but intensifies it ex post, so it is not easy to judge the balance.
- Cooperative standard setting helps consumers when the product being developed needs complementary technology owned by different firms. It would enable them to pool mutually blocking patents.
- The authorities should scrutinise side clauses which call for per-unit cross payments

# Can use of IPRs be remedied via Art 102 TFEU & SSO?

- **Rambus**
  - FTC implied term that on joining SSO the firm whose technology is chosen will grant licences to others on fair and reasonable terms.
  - In Europe used settlement procedures, and Rambus accepted to licence two specific patents on fair and reasonable terms, but we do not know whether the compulsory licences were of the important patents.

## Patent thickets

- dominant technology may be protected by more than one IPR, enabling the holder of the dominant technology to increase royalties by charging for each time each IPR is exploited.
- Com argues that this may be remedied under 102 TFEU by alleging the charges excessive, and contrary to art 102(a).
- It often uses settlement procedure, which makes appeals hard to win, because dom. technology holder accepts that its conduct abusive.

# Towards a fully-fledged dynamic approach?

**Joaquin Almunia- DG COMP- Brussels April 19 2011**

- ‘Perhaps the greatest change in antitrust enforcement over the years has been the increased focus on the economic effects of the companies’ behaviour, specifically in the field of abuse of dominance.
- Rather than looking at the form of conduct – is this an exclusive agreement ... our competition analysis then looks more carefully at the potential impact on the market of the conduct in question.’

**THANK YOU FOR YOUR ATTENTION!**

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