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Council of the European Union Adopts New Procedural Regulation for Non-Merger Competition Cases

On 16 December 2002, the Council of the European Union adopted the "Modernization" Regulation (the "Regulation"). The Regulation replaces the 40-year old Regulation 17,[1] which created the basic procedural framework for all EU competition cases outside the merger area. The Regulation will enter into force on 1 May 2004, the same day when ten new countries will join the European Union. It will radically change the way competition law is applied in non-merger cases.[2] In particular, the Regulation:

- **abolishes the existing notification system and replaces it with a system of self-assessment by the companies concerned;**
- **provides for the decentralization of competition law enforcement, giving a far more important role to national competition authorities and national courts;**
- **establishes a network of national competition authorities ("NCAs"); and**
- **strengthens the Commission's enforcement powers, in particular for cartel cases.**

These changes will have critical implications for conduct falling under Articles 81 and 82 EC (the EU analogue to Sections 1 and 2 of the US Sherman Act respectively) that are extremely significant for the international business community:

- ***Cooperation between companies.*** **The abolition of the notification system may cause significant legal uncertainty for certain agreements that are facially restrictive but may well be subject to exemptions under Article 81 (*e.g.*, production joint ventures). It remains to be seen whether the degree of certainty the notification system provided can be achieved by informal approaches to the Commission or to those national authorities (and courts) likely to be dealing with a case.**
- ***Cartel enforcement.*** **The Commission's increased enforcement powers and the dynamics of the leniency application process are likely to give the Commission a more, rather than less, prominent role in prosecuting cartels that reach beyond a single Member State.**
- ***Article 82 enforcement.*** **While abuses of a dominant position have as a legal matter always been subject to decentralized enforcement, it seems likely that**

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1 Regulation No. 17/62, 1962 JO 13/204, as amended.

2 For the Commission's recent proposals in the merger area, see WCP Bulletin of 12 December 2002.

most of the important Article 82 cases will continue to be handled by the Commission, whose enforcement activity in this area will be strengthened by the possibility of imposing structural remedies.

The Regulation leaves open several issues that are key to the proper functioning of the network of NCAs, such as the interplay between the Regulation and national procedural rules, and the role of national courts. The Commission, in close cooperation with the Member States, is due to adopt several implementing measures over the next few months that will hopefully provide more clarity about how the system will function in practice.

I. Background

Forty years ago, Regulation No 17/62 created a requirement that all restrictive agreements be notified to the Commission, and gave the Commission exclusive power to exempt those agreements under Article 81(3) EC (formerly Article 85(3)). Restrictive agreements that are not notified have in principle been void and unenforceable, and their implementation has subjected the parties to possible fines.

Calls for reform are almost as old as the system itself. While the Commission has for a long time maintained that its exclusive power to apply Article 81(3) EC is necessary for the uniform application of the competition rules throughout the Community, it has also recognized that certain features, in particular the centralization of notifications in Brussels, have made the system almost unworkable. The large number of notifications has placed a considerable burden on the Commission without contributing materially to the detection of serious infringements. At times, companies have used the notification process merely to suspend or delay investigations undertaken at national level.

In April 1999, the Commission published a White Paper on the "Modernization of the rules implementing Articles 81 and 82 of the EC Treaty," which proposed the abolition of the notification system as well as decentralized enforcement of the EU competition rules. After broad consultation, the modernization process has now culminated in the adoption of the Regulation by the Council.

II. Impact on restrictive agreements capable of exemption

The impact of the abolition of the notification system and decentralization of enforcement will be felt most prominently in borderline cases where conduct is neither clearly legal nor illegal. As described below, the principle of self-assessment is complicated by the fact that the parties must predict which agency or agencies are likely to make the assessment. Also, the abolition of the notification system raises important questions: (i) whether parties will, in practice, be precluded from gaining more or less authoritative *ex-ante* guidance from the agencies and (ii) how decentralized enforcement will affect parties as a practical matter.

Self-assessment. In Article 1(2), the Regulation allows parties to a facially restrictive agreement to directly apply Article 81(3) EC, without having to seek a prior Commission exemption decision finding "redeeming virtues" of their agreement (such as the creation of efficiencies). The new system is thus similar to the "rule of reason" analysis in the US under Section 1 of the Sherman Act. Notification of agreements for the purposes of obtaining an exemption decision is no longer required – or indeed possible. When entering into facially

restrictive agreements, companies must now assess themselves whether the conditions for an exemption are met.

- ***Importance of identifying the decision-making agency.*** Self-assessment is not a new problem – under the old system of Regulation 17, companies have routinely made judgment calls in deciding whether to notify agreements. Nor does self-assessment raise insoluble problems, given the existing system of block exemption regulations (which will remain in place), and the increasing body of case law and interpretative guidelines. However, the decentralized enforcement that is the other principal aspect of the Regulation introduces a new element of uncertainty, namely which agency (or national court) would assess whether the conditions of Article 81(3) are satisfied. In theory, for any one case this could be the Commission, the competition authorities of any one of 25 Member States, or any court in any one of those Member States. The identity of the agencies that will likely be called upon to make the assessment matters because the application of the broad criteria of Article 81(3) EC inevitably involves substantial discretion, and NCAs' practices still differ markedly in key respects, such as sectoral expertise, the assessment of economic expert evidence, and the degree of reliance on competitors' complaints.

- ***Principles of case allocation under the Regulation.*** The Regulation is remarkably silent on the issue of case allocation, which was a major point of disagreement between the Member States and the Commission. A Joint Statement of the Council and the Commission that was issued in December 2002 contains only relatively general principles. For example, it provides that the Commission will usually be best placed to deal with cases that (i) affect more than three Member States, (ii) are closely linked to other Community provisions that may be exclusively or more effectively applied by the Commission, or (iii) require the adoption of a Commission decision to develop its competition policy in the Community interest. Otherwise, the relevant factors for determining which NCA will be solely or principally responsible for the handling of the case are (i) the place where the main anti-competitive effects are felt; and (ii) which authority is better able to deal with the case, based on its ability and authority to gather evidence, bring the infringement to an end, and apply effective sanctions. While, to further consistent application of the EC competition rules, the Commission remains empowered to "relieve" an NCA from the EC competition aspects of a case and deal with those aspects itself, it remains to be seen how important that power will be in practice. The Joint Statement provides that the Commission will exercise this power only in a limited number of situations, such as when members of the network dealing with the same case envisage conflicting decisions, or when members may adopt a decision that is "obviously in conflict with consolidated case law".

Means of obtaining a degree of *ex-ante* certainty after abolition of the notification system. Whatever the disadvantages of the present notification system, businesses operating in Europe have come to rely on the degree of assurance it provides that their important joint ventures, cooperation or distribution arrangements will not later be challenged or penalized under Community competition law. By contrast, companies operating in the US rely mainly on the advice of their antitrust lawyers, supplemented in relatively infrequent instances by the US agencies' " business review" or "advisory opinion" procedures.

In light of the new uncertainties for European business that arise from the new Regulation and its reliance on self-assessment, it can be expected that for important transactions, companies will continue to seek some comfort through whatever kind of formal or informal *ex-ante*

processes the Commission or NCAs make available. Depending on how the practice evolves under the Regulation, it is conceivable that businesses may be able to obtain some useful guidance or assurance from the agencies even after the abolition of the notification system:

- ***Positive decisions under Article 10 of the Regulation.*** This provision gives the Commission the power to make a "finding of inapplicability" of Articles 81 and 82 EC to a given agreement or conduct. However, the Regulation provides that the Commission shall do so *on its own initiative* and when there is a *Community public interest* requiring it to do so. While this does not exclude the possibility of voluntary requests for Article 10 clearance, it seems clear that the Commission will only adopt such decisions in exceptional circumstances, *e.g.*, to provide guidance concerning new types of agreements or practices and address issues that have not been settled by existing case law or administrative practice.

- ***Commitment decisions under Article 9 of the Regulation.*** Where the Commission intends to adopt a negative decision and the parties offer commitments, the Commission may by decision make those commitments binding on the parties. Depending on how the Commission intends to apply this provision, companies may be able to voluntarily "notify" agreements that do not meet the requirements of Article 81(3) EC, with the aim of negotiating a solution with the Commission that could then be the subject of a commitment decision.

- ***Informal guidance by the Commission.*** The last recital of the Regulation asserts that the Commission retains the power to issue informal guidance to parties in cases that "give rise to genuine uncertainty because they present novel or unresolved questions." In a Statement that is part of the Council minutes, the Commission indicates willingness to issue a notice setting out the circumstances under which "guidance in the form of written opinions" could be provided. This means that the Commission may well adopt a procedure similar to that of the DOJ Antitrust Division's practice of issuing public Business Review Letters that, in appropriate cases, explain why the Division sees no reason to challenge a proposed practice.

- ***Applications to national authorities.*** The Regulation does not preclude the possibility that national authorities could issue informal guidance in response to voluntary "notifications" they receive from parties. However, in practical terms, informal guidance by a national authority will be of limited value if it does not have the backing of the full NCA network. Article 5 of the Regulation seems to preclude formal "stand-alone" positive decisions by a NCA on the applicability of Articles 81 and 82 EC, but NCAs are free (and can be expected) to apply their own national competition rules; the NCA would also make a statement as to the compatibility of an agreement with the Community competition rules.

- ***Applications to national courts.*** Last, it is conceivable that companies could seek to enlist national courts in obtaining a finding that their agreements are compatible with Article 81 EC. While in most Member States courts generally are reluctant to issue abstract "advisory" opinions, it is not unprecedented (for example, in cases involving references to the Court of Justice for a preliminary ruling) for companies to "create" a controversy before a national court with the very aim of bringing early clarification to important legal issues.

Practical issues arising from decentralization. The move from a centralized notification system to a decentralized one based largely on complaints and informal notifications raises a host of practical issues, few of which are addressed by the Regulation. For example:

- ***Interplay between the Regulation and national competition rules.*** Unlike the initial Commission proposal, Article 3 of the Regulation does not prevent the concurrent application of Community and national competition laws. Instead, it merely requires that where NCAs apply national competition rules to agreements falling under Article 81 EC, they must also apply the latter provision and must not prohibit agreements that qualify for exemption under the criteria of Article 81(3) EC. Despite the Commission's protestations to the contrary, this compromise solution risks a "re-nationalization" of competition law in the Community. National *procedural* rules, including national notification requirements, seem to remain unaffected. Moreover, limiting the pre-emption of national law to *prohibition* decisions arguably does not prevent NCAs from approving an agreement subject to stricter conditions than would be possible under Article 81 EC. Most importantly, the application of national competition rules is not subject to any kind of effective control by the Commission and the rest of the network. Even the Commission's "claw-back" powers under Article 11(6) do not prevent the NCA from continuing to apply its national competition rules. Rather, the Commission would be forced to bring a cumbersome infringement action against a Member State under Article 226 EC if that Member State were to apply national competition law in violation of Article 3.

- ***Forum shopping.*** As noted above, the lack of clear rules on case allocation potentially allows for forum shopping both by parties to the agreement in question and by complainants. Complainants in particular will try to target those competition authorities that are most likely to aggressively pursue the case, while the parties to the agreement will try to neutralize such attempts by lobbying for a case allocation that favors them. Moreover, it is unclear to what extent allocation decisions by administrative agencies within the network may be subject to collateral attack in national courts, which might allow parties to an agreement to create delay (and continue with their agreement as long as possible) or allow complainants to subject the parties to protracted expense and uncertainty.

- ***Protection of confidential information within the network.*** Articles 11 and 12 of the Regulation provide for an almost limitless flow of information between and among the NCAs and the Commission, including highly confidential business information and the identity of complainants that have requested anonymity. The free flow of information will undoubtedly increase the chance that such information may be revealed due to differences in national transparency legislation, different rules on access to files, or even deliberate leaks where national interests (such as the interest of national champions) are at stake. Moreover, although in theory the "information exchanged shall only be used […] in respect of the subject-matter for which it was collected by the transmitting authority", the existence of a virtual central database throughout the network will make it very difficult for companies to prove that specific information was collected in violation of these principles. Moreover, nothing prevents one NCA from using the data collected by another to issue an identical information request to the NCA that initially uncovered the data, thus circumventing the restriction. Companies will have to be vigilant in tracking the flow among the competition authorities of information and documents they have provided or that have been seized from them.

III. Consequences for cartel enforcement

In the area of cartel enforcement, the Regulation is likely to enhance the Commission's already prominent role rather than leading to a greater involvement of national authorities. The Regulation strengthens the Commission's enforcement powers, and several factors suggest that the Commission will continue to be the focal point for cartel cases going beyond national boundaries, both for leniency applications (when a party voluntarily reports wrongdoing) and investigations begun at the authority's own initiative.

- **Increased enforcement powers by the Commission.** The Regulation will give the Commission several new investigatory powers that are primarily relevant for cartel investigations. During an unannounced search, known as a "dawn raid", Commission officials will now be entitled to ask representatives of the company concerned for explanations of any facts or documents relating to the subject-matter of the investigation, and to record the answers for use as evidence. Moreover, the Commission will have the right to search the private homes of directors, managers and other staff of the company concerned to find evidence of anticompetitive conduct if there is a *"reasonable suspicion"* that books or other records related to the business and to the subject-matter of the inspection are being kept there. Further, the Commission has the right to interview any natural or legal person who consents to be interviewed for the purpose of collecting information relating to the subject-matter of the investigation. (This last provision eliminates existing uncertainty over the Commission's ability to rely on oral evidence.) Except for questioning in the course of a dawn raid, however, the Commission still has no power to compel oral testimony.

- **Continued central role of Commission in international cartel investigations.** One of the Commission's principal arguments for abolishing the notification system and decentralizing enforcement is that it needs to free its resources to focus more on prosecuting international "hard core" cartels. While it is unclear whether the new system will lead to a net reduction of the Commission's workload, it can nevertheless be expected that the Commission will continue to play a pre-eminent role in any cartel investigation that extends beyond the borders of one Member State:

    - ***Commission's leniency program.*** Leniency applications have been in recent years – and will likely continue to be – one of the principal drivers of the Commission's cartel investigations. While leniency programs in the Member States still remain largely untested, the Commission has proven in several cases that it is willing to grant complete immunity from fines for companies that are the first to provide material evidence to the Commission, while at same time increasing the overall level of fines and thus the price of non-cooperation. As a result, the vast majority of leniency applications in cross-border cartel cases will be directed to the Commission in the first instance. Once the Commission has committed to grant immunity, it is hard to see how the case could then be transferred to a national authority which would not be bound by the Commission's commitment.

    - ***Logistical capabilities for international cartel investigations.*** The Commission has extensive experience carrying out simultaneous dawn raids in several countries on short notice, a crucial element of effective cartel enforcement. Particularly given the Commission's new enforcement powers, it is

difficult to see how a joint investigation by NCAs could be equally effective, even with very good coordination among the national authorities.

IV. Consequences for the application of Article 82 EC

Abusive conduct by a dominant company is seemingly an ideal area for decentralized enforcement, because such conduct will normally originate in a single country, *i.e*., the home country of the dominant firm. Nevertheless, it is unclear at this stage whether there will indeed be substantial movement towards decentralized enforcement of Article 82:

- ***Enforcement powers by the Commission, including new powers to order structural remedies.*** The Regulation gives the Commission new powers to impose structural remedies where "there is no equally effective behavioral remedy or where any equally effective behavioral remedy would be more burdensome for the undertaking concerned". For example, this might involve the legal separation of the dominant firm's business activities in essential facilities or monopoly leveraging cases. This power, which has long been available to US courts and was used (for example) to restructure the US telecommunications industry in the 1980s, is a potentially far-reaching addition to the Commission's arsenal.

  In addition, as noted above, the Regulation gives the Commission new enforcement powers that are available, not only in cartel cases, but also in obtaining information from dominant undertakings.

- ***Policy dimension of Article 82 cases.*** The case law under Article 82 is not as well developed as in other areas of EU competition law, meaning that Article 82 cases often raise novel and difficult issues. Moreover, they frequently arise in newly liberalized sectors where former state monopolies still hold a very strong market position. Consequently, they will often fall into one of the categories of cases for which the Commission is primarily responsible according to the general rules for case allocation within the network (see the discussion of *Principles of Case Allocation* above).

- ***Concerns about vigorous enforcement.*** Complainants may often argue forcefully that the Commission, rather than a national authority, will be best placed for effectively enforcing competition rules against a dominant company. This could be an issue, for example, if the complainant is located in another Member State and the dominant company is wholly or partially state-owned or there are other reasons to believe that the national authority may be less vigorous in its enforcement than the Commission would be.

V. Transitional measures and legislative program

Until the Regulation enters into force on 1 May 2004, the Commission will take the following transitional measures and embark on an ambitious legislative program in conjunction with the Member States:

Transitional measures. The following measures are designed to ease the transition to the new regime:

- ***Existing exemption decisions.*** Commission decisions adopted under Article 81(3) before the date of application of the new Regulation will remain valid until the expiration date of those decisions.

- ***Pending notifications.*** As of May 2004, pending notifications will lapse, even though it is expected that the Commission will make use of the informal guidance that the Regulation foresees for cases that have a Community interest or raise novel issues. The commission reportedly intends to set a "priority list" for incoming notifications, with some notifications leading to formal exemption decisions, others to informal guidance in the form of comfort letters, and others simply lapsing without any reply from the Commission as of May 2004.

Legislative program. To provide guidance both to companies and to national competition authorities, many of which have little experience in applying EC competition rules, the Commission currently foresees adopting legislative measures, mostly in the form of Notices, in the areas listed below:

- the concept of *"effect on trade*,*"* which is of central importance in defining Member States' ability to apply national competition law even where it conflicts with the principles of Article 81;

- cooperation between the Commission and NCAs and cooperation between the Commission and national courts;

- application of Article 81(3);

- use of structural remedies and commitments;

- form, content and other details of complaints;

- practical arrangements for exchanges of information and consultations within the network; and

- practical arrangements for Commission hearings of parties and complainants.

These measures will become the arena for debate over key issues raised but not resolved in the Regulation itself.

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