



Competition Competence Report 6/ 2005

## Article 81 (3) EC-Treaty

The Commission gave up its monopoly of applying Article 81 (3), which, due to Regulation No 1/2003 is now directly applicable.<sup>1</sup> In order to facilitate the application of Article 81 (3) with respect to the “more-economics-based-approach”, the Commission has provided guidelines.<sup>2</sup> Thus companies are now required to do a self-assessment of whether an agreement that restricts competition under Article 81 (1) might benefit from an exemption under Article 81 (3). Moreover, this assessment is required if an allegation of infringing Article 81 (1) arises.

### Structure of Article 81 EC-Treaty

Any assessment under Article 81 consists of two parts. The first step is to assess under Article 81 (1) whether an agreement has an anti-competitive object or actual (or potential) anti-competitive effects. The second step, which only becomes relevant when an agreement is found to be restrictive of competition under Article 81(1), is to determine the pro-competitive benefits produced by that agreement and to assess whether these pro-competitive effects outweigh the anti-competitive effects. This kind of balancing of anti-competitive and pro-competitive effects is conducted within the framework laid down by Article 81(3). From that perspective, in Article 81 a European “structured rule of reason” is applied.

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<sup>1</sup> “Agreements, decisions and concerted practices caught by Article 81 (1) of the Treaty which satisfy the conditions of Article 81 (3) of the Treaty shall not be prohibited, no prior decision to that effect being required”. Council Regulation (EC) No 1/2003 of 16.12.2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, para 1.

<sup>2</sup> EC Commission, Communication of the Commission, Notice, Guidelines on the application of Article 81(3) of the Treaty, OJ (C) 101/97, 27.4.2004

## **Applicability of Article 81 (3)**

Any prohibition in Article 81(1) is tempered by Article 81(3). The guidelines on Article 81 (3) refer to the Commission's interpretation of the conditions for exemption contained in Article 81 (3). It thereby provides guidance on how the Commission intends to apply Article 81 in individual cases. In particular, the guidelines establish an analytical framework. The 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. However, the guidelines provide more detailed guidance on the application of the four conditions of Article 81 (3) than the other ones. The standards set forth in the guidelines have to be applied - according to the jurisprudence of the EC Courts - in light of the circumstances specific to each case. This excludes a mechanical application. Each case must be assessed on its own facts by applying the guidelines reasonably and flexibly.<sup>3</sup> The criteria of Article 81 (3) are described below in more detail.

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

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. This provision defines types of efficiency gains that can be taken into account. In addition, the further tests of the second, third and fourth conditions of Article 81 (3) have to be positive as well.

While assessing efficiency gains the nature, the likelihood and magnitude and the date of the claimed efficiency are of great importance. Furthermore, the causal link between the agreement and the efficiencies has to be demonstrated.

In general, efficiencies result from an integration of economic activities whereby assets are combined. It is essential that the efficiencies could not have been achieved alone.

The Commission's guidelines on Article 81 (3) distinguish between cost efficiencies and efficiencies of a qualitative nature which create value in the form of new or improved products. The following figure shows some different types of efficiencies that can be generated by vertical or horizontal agreements.

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<sup>3</sup> EC Commission, Guidelines on Article 81(3), paras. 4-5

**Figure 1: Type of efficiencies**

Cost efficiencies	Qualitative efficiencies	Other effects
<ul style="list-style-type: none"> <li>•Development of new production technologies</li> <li>•Synergies</li> <li>•Economies of scale</li> <li>•Economies of scope</li> <li>•Planning of production, stock optimization</li> </ul>	<ul style="list-style-type: none"> <li>•R&amp;D-Agreements</li> <li>•Licence Agreements</li> <li>•Agreements providing for joint production</li> <li>•Distribution Agreements</li> </ul>	<ul style="list-style-type: none"> <li>•Stimulation of investment incentives by vertical agreements due to elimination of free-rider &amp; hold-up-problems</li> </ul>

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

According to the second condition of Article 81 (3), consumers must receive a fair share of the efficiencies generated by the restrictive agreement. The concept of fair share implies that the pass-on of benefits must at least compensate consumers for any actual or likely negative impact. Within EC competition policy, the goal is to maximize "consumer" welfare alone. Therefore the distribution of the gains and pass-on issues are very important.<sup>4</sup>

In general, 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 practice however, cost efficiencies that lead to reductions in variable or marginal costs are more cognisable to competition authorities than reductions in fixed costs because they are more likely to result in lower consumer prices and to be achieved in the short term.

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

<sup>4</sup> D.A.Yao/T.N.Dahdouh, "Information Problems in Merger Decision Making and Their Impact on Development of an Efficiencies Defence", 62 Antitrust L.J. 2, 41-43 (1993). A provocative article argues that a pass-on requirement should be rejected for an entirely different reason. See P.L.Yde/M.G.Vita, "Merger Efficiencies: Reconsidering the "Passing-on" Requirement", 64 Antitrust L.J. 735, 740 (1996)(a prediction of economic theory that "the more competitive the relevant market, the less likely it is that merger-specific efficiencies will be reflected in the post-merger market price.")

assessment necessarily requires value judgment. The availability of new and improved products constitutes an important source of consumer welfare.

In the assessment, the following factors are taken into account<sup>5</sup>:

- Characteristics and structure of the market;
- Nature and magnitude of the efficiency gains;
- Elasticity of demand, and
- Magnitude of the restriction of competition.

The degree of competition remaining on the market and the nature of this competition influences the likelihood of pass-on.

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

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 have been the case in the absence of the agreement or the restriction concerned.<sup>6</sup> This condition implies a two-fold test.

1. First, the restrictive agreement as such must be necessary in order to achieve the efficiencies.
2. Secondly, the individual restrictions of competition that flow from the agreement must also be necessary for the attainment of the efficiencies.

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 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 have to be taken into account. Undertakings invoking the benefit of Article 81 (3) must explain and demonstrate why seemingly realistic and less restrictive alternatives to the agreement would be significantly less efficient.<sup>7</sup>

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<sup>5</sup> EC Commission, Guidelines on Article 81 (3), para. 96.

<sup>6</sup> 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.

<sup>7</sup> EC Commission, Guidelines on Article 81 (3), para. 75.

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. 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. In this context it must be assessed whether individual restrictions are reasonably necessary in order to produce the efficiencies.

### **Forth condition of Article 81 (3): No elimination of competition**

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. The application of the last condition of Article 81 (3) requires an 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. 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. Both actual and potential competition must be considered.<sup>8</sup>

### **EE&MC approach**

The EE&MC approach to assessing the conditions of Article 81 (3) consists of a broad economic analysis that is adapted to each particular case. This analysis contains an assessment of the market structure in addition to the calculation and assessment of efficiencies. Concerning the second condition i.e. the pass-on, sophisticated economic analysis is required. In this context, EE&MC examines amongst other things the cost structures (variable or fixed costs) of participants in the market.

In general, it can be concluded that an economic expert opinion facilitates the self-assessment of companies as required by EC competition law.

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<sup>8</sup> EC Commission, Guidelines on Article 81 (3), paras. 107,108.