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M E M O R A N D U M

Proposal for a new regulation on the implementation of the EU competition rules

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The European Commission issued a proposal for a new regulation on the implementation of the EU competition rules. This proposal, based on the Commission's 1999 White Paper on modernisation of the competition rules, calls for a major overhaul of the current EU competition law regime and as such is one of the most significant developments in EU competition law since the current system was created in 1962.

Chiefly, the new proposal 1) eliminates the possibility for companies to notify agreements containing restrictive provisions to the Commission for approval; 2) empowers national authorities and courts to apply fully the main EU competition law provisions in reviewing such agreements; 3) prevents the application of Member State competition laws to any restrictive agreement or abusive conduct that is capable of affecting trade between Member States; and 4) increases the investigation and enforcement powers of the Commission in competition law infringement cases, particularly cartels, among other things by allowing for searches of private homes and imposing higher financial penalties for non-compliance.

The purpose of the new proposal is to provide increased protection of competition in the EU by allocating greater responsibilities to national bodies, while relieving the Commission of much of its workload and at the same time giving it increased powers in order for it to take a more proactive and effective role in combating the more serious infringements of EU competition law.

1. Background

On 28 April 1999 the European Commission adopted a "White Paper" on modernisation of the rules implementing what are now Articles 81 and 82 of the EC Treaty (these implementing

rules are Council Regulation No 17 of 1962 and the corresponding regulations applying to the transport sector). The White Paper was thereafter reviewed by the Economic and Social Committee (which adopted an opinion on 8 December 1999) and by the European Parliament (which adopted a resolution on 18 January 2000). The Commission also received comments from each of the fifteen EU Member States, as well as a number of non-EU countries and many third parties. The Commission's newly proposed regulation for the most part retains its position from the White Paper but is intended to reflect the comments of the Parliament, the Economic and Social Committee, the Member States and various third parties.

The main features of the proposed regulation are developed below.

2. Abolition of the Notification System

Under the present EU competition law regime, which has been in effect for nearly 40 years, an agreement that contains clauses that are restrictive of competition and that are not automatically exempted by a block exemption regulation may nevertheless be exempted from the EU competition rules (specifically Article 81(1) of the Treaty) if it satisfies certain criteria under Article 81(3). However, in order to qualify for such an "individual exemption", the parties must notify their agreement to the European Commission for review.

Under the present system, once an agreement is notified, the parties to the agreement are immune from being fined until the Commission rules on the agreement. The present system, therefore, gives security to companies to enter into agreements that may contain restrictive provisions, as they can rely on the Commission to rule that the agreement is either compatible with the competition rules (in which case a positive decision or, more likely, a "comfort letter" will be issued) or incompatible (in which case a negative decision will be issued).

In addition and importantly, provided that the Commission reviews the agreement favourably, the Commission's positive ruling reduces the risk of the agreement being annulled by a national court as infringing EU competition law. Under the present system, a comfort letter is not binding on national courts, but is evidence of an agreement's legality under EU competition law.

While the present system gives parties a valued degree of legal certainty, it also results in some innocuous agreements being notified as a precautionary measure, resulting in the Commission spending much of its limited resources and time reviewing agreements that do not raise serious competition concerns. In the past ten years, nearly 60% of all cases considered by the Commission have been as a result of notifications, rather than in response to complaints or at the Commission's own initiative. Many such notifications have been of agreements which, although technically qualifying as restrictive under the EU competition rules, did not pose any serious threat to competition.

The Commission's proposed regulation would eliminate the possibility for companies to notify agreements to the Commission. It is the Commission's view that the application of the EU competition rules is by now understood sufficiently by companies and their lawyers that they should be able to determine on their own whether agreements they enter into are compatible with the EU competition rules. Therefore, under the proposed regulation, any agreement that falls within Article 81(1) and does not meet the criteria of Article 81(3) would be automatically prohibited, without any prior decision to that effect being required, and subject to immediate fines. Conversely, any agreement that falls within Article 81(1) but satisfies the criteria of Article 81(3) would be automatically valid from the perspective of EU competition law, without there being any need for a decision to this effect.

The Commission considers that abolishing the notification procedure will allow it to shift its attention toward investigating complaints and taking up cases under its own initiative. It considers that anti-competitive agreements can adequately be dealt with *ex post*, in other words after they have been implemented. This would lead to the Commission paying closer attention to the more serious infringements (e.g., price fixing, market sharing, impeding parallel trade) which, according to the Commission, are rarely notified.

3. Decentralisation of the Application of Article 81(3)

Under the present system, national authorities and courts are empowered to apply Article 81(1), which concerns restrictive agreements, as well as Article 82 on abuses of dominant market position, but they do not have the authority to apply Article 81(3), under which agreements that fall within Article 81(1) may nevertheless be found not to infringe the competition rules based on their overall positive effects on consumers. As a result of the Commission's monopoly right to apply Article 81(3), although a national competition authority is empowered to apply Article 81(1) in prohibiting an agreement, it cannot take the extra step of exempting the agreement under Article 81(3). The limitation on the application of Article 81(3) handcuffs national authorities and prompts companies that believe their agreement meets the criteria for exemption under Article 81(3) to notify their agreement to the Commission.

The Commission considers that national competition authorities are often in a better position to take action under EU competition law, as they may be more familiar with national markets and may have greater resources to carry out investigations in their territory. The proposed regulation would empower national courts and competition authorities to find agreements not to infringe Article 81(1) on the grounds that they meet the criteria of Article 81(3). Indeed, Member States would be required under the proposed regulation to give their national authorities and courts the power to apply the whole of Articles 81 and 82. In addition, the proposed regulation envisages a "network" of EU competition law

application and enforcement involving the Commission and the competition authorities, allowing for the exchange of confidential information and assistance not only between the Commission and national authorities, but also between the various national authorities.

The Commission would, however, retain various measures to ensure that the competition rules are applied uniformly throughout the Community. For example, the Commission would continue to have general exemptions for certain kinds of restrictions from application of the competition rules by issuing block exemption regulations. Currently, block exemptions exist or are in the works for various categories of agreements, including vertical agreements (e.g. supply, distribution and franchising agreements), horizontal agreements (e.g. R & D) and technology transfer agreements (e.g. patent licenses), and there are also specialised block exemptions for industries such as motor vehicles, air transport, shipping and insurance. The Commission has also vowed to increase the number of notices and guidelines it issues in order to give greater guidance on how the competition rules should be applied.

Moreover, the proposed regulation requires national competition authorities to consult the Commission on certain types of decisions it takes: prohibition decisions, decisions accepting commitments as a basis for approval of an agreement and decisions withdrawing the benefit of a block exemption. No consultation is required for rejections of complaints and decisions to take no action. The Commission would also have the power by regulation to require certain types of agreements to be registered with it. Furthermore, although it would no longer accept notifications, the Commission would retain the power to withdraw a case from a national competition authority by itself initiating proceedings (this power exists under the present system, although there is no evidence that the Commission has ever invoked it). The Commission can also discuss cases with companies where appropriate, although there is no indication of the circumstances under which such consultation might be available. Finally, under the proposed regulation, the Commission would be able on its own initiative to make oral and written submissions to national courts on issues of EU competition law. The question arises, however, whether this possibility will square with national procedural rules.

The Commission would continue to investigate possible infringements on its own initiative or based on complaints received, and would still be empowered to issue decisions requiring infringements to come to end and to impose remedies. In fact, as explained below, the Commission's powers of investigation and enforcement would be significantly strengthened under the new regulation.

4. <u>Elimination of the Application of National Competition Law on Intra-EU Matters</u>

At the same time as empowering the Member States to apply the EU competition rules in their entirety, the proposed regulation takes steps to ensure that national competition rules are never applied where EU competition law is applicable.

Under the present system, EU competition law is considered to have primacy vis-à-vis national competition law, such that national law can be applied by national competition authorities only insofar as the application of national competition law does not clearly conflict with the application of EU competition law. As a number of Member States have adopted national competition laws that mirror, or at least closely resemble, Articles 81 and 82, clear conflicts do not often occur in practice. However, in Member States whose competition rules are not identical to Articles 81 and 82, where an agreement is being reviewed under both EU competition law and national competition law(s), the possibility still exists for inconsistencies and differences in treatment of agreements between EU competition law and national competition law as well as between the competition laws of various Member States.

To remedy this problem, Article 3 of the proposed regulation provides that where a restrictive agreement or abuse of a dominant position is capable of affecting trade between Member States, EU competition law shall apply to the exclusion of national competition laws.

5. Increase of the Commission's Powers of Investigation

Under the present system, the Commission has the power to conduct surprise investigations (i.e. "dawn raids") on the premises of companies and to make written requests for information. Companies that refuse to co-operate can be fined or subjected to periodic penalty payments. However, the Commission contends that its powers to investigate and punish infringements are not broad enough to ensure adequate protection of competition.

To increase its investigative and enforcement powers, the Commission’s proposal submits that:

- rules for the granting of judicial orders to require a company to submit to an inspection should be codified;
- the Commission should be allowed to search private homes if it is suspected that business records are being kept there;
- the Commission should be allowed to seal any premises (apparently either business or private) during the inspection;
- the Commission should be allowed to ask oral questions covering the entire scope of the investigation; and

- the amounts of fines and periodic penalty payments for failure to co-operate or inadequate co-operation should be increased and based on a percentage of the company's turnover.

6. Analysis

The Commission's proposed regulation is the culmination of attempts by the Commission to shift much of the responsibility for day-to-day application of the EU competition rules to the Member States, freeing up Commission time and resources to be used in investigating more serious infringements, particularly cartels. This move is consistent with recent block exemptions and explanatory notices, one of the main purposes for which has been to reduce the number of notifications. For example, the recent vertical restraints block exemption (concerning, e.g., distribution, purchase and franchise agreements) automatically exempts from the application of the EU competition rules certain agreements that would have been notifiable under the former regime.

The chief motivation behind the proposed regulation, to decentralise the application of EU competition law, is sound. As the Commission rightly recognises, the concept of subsidiarity and the progression of an effective intra-Community competition policy is thwarted when the power to conduct a comprehensive review of everyday agreements is limited to a single supranational authority with relatively limited resources (i.e. the Commission). The Commission has acted as a parent to the Member States and their companies in the field of EU competition law enforcement for nearly forty years. There must come a time when it can get rid of or delegate some of its duties.

The question is whether that time is now. The Commission believes it is, claiming that the competition rules have finally reached a level of familiarity in the private sector that companies are able to determine for themselves whether their agreements comply with the EU competition rules. Moreover, the Commission also submits that national courts and competition authorities are sufficiently knowledgeable and experienced to apply EU competition law in full (although the Commission concedes that it may on occasion need to lend a helping hand, and the proposed regulation provides mechanisms for it to do so). Although the Commission's motivation may be sound, it would seem that the Commission may be overly optimistic in its assumption that the notification system is no longer needed and that national authorities and courts are able and willing to assume a greater role in the application and enforcement of the EU competition rules.

It is debatable whether the familiarity of EU competition law has, as the Commission contends, advanced to the point where companies are now able to determine on their own whether their agreements are compatible with the competition rules. Indeed, although largely benign agreements are sometimes notified to the Commission as a precaution against fines, in a

large number of cases the restrictions at issue may not be adequately covered by previous Commission decisions and notices to give companies guidance as to whether the restrictions are likely to be deemed permissible. Although over 90% of notifications currently result in the issuance of legally non-binding comfort letters -- not exemptions -- such comfort letters at least provide companies some assurance that it is safe for them to proceed with their agreements. With the prohibition of the notification system, companies would be required to make decisions on their own, likely without any involvement by the Commission, and would risk potentially serious fines if they enter into an agreement that the Commission later finds to be anti-competitive. As a result of the lack of legal certainty under the proposed regulation, companies would continually need to perform risk assessments on their agreements and may be discouraged in the future from entering into agreements containing provisions that, although innovative and perhaps even economically beneficial, do not very clearly fall within Article 81(3).

It also remains to be seen whether the Commission is being realistic when it speaks of uniform application of the competition rules throughout the EU. There is some concern that national courts, and to a lesser extent national competition authorities, may not always be sufficiently familiar with EU competition law to be counted on to apply it correctly and consistently. Despite almost four decades of Commission precedent, the level of knowledge of (and for that matter respect for and interest in) applying EU competition law varies considerably amongst national judges. While the level of EU law expertise at the national level is clearly much higher than it has been in the past, lawyers attempting to invoke EU competition law in national courts on occasion still face a lack of understanding or even resistance from national judges. Moreover, the exemption of Article 81(3) is not as straightforward to apply as the prohibition of Article 81(1), which courts are already empowered to apply under the present system, but often hesitate to do so. The application of Article 81(3) often requires complicated economic assessments for which not all national courts may be well-equipped.

Uniform application of the EU competition rules may become an even greater problem once the EU expands to include central and eastern European countries, some of which are only recently adjusting to a market economy and have only recently adopted competition laws of any kind. Inconsistent application of EU competition law would contribute to legal uncertainty for companies and could lead to forum shopping.

The Commission's notion of a "network" of EU competition law application and enforcement involving both the Commission and the Member States is not spelled out very clearly in the proposed regulation. For example, although the proposal calls for co-operation and co-ordination between national competition authorities, it is unclear what mechanism would be in place for determining which authority will review a given agreement. Indeed, under the proposed regulation, although a

national authority may refuse to investigate if another national authority has already initiated an investigation, it would not be required to do so. There would, therefore, remain a risk of concurrent or subsequent reviews by multiple national authorities. It is not clear to what extent the Commission would use the powers it retains to intervene in national investigations or court cases to ensure that EU competition law is being applied in a correct and uniform manner. In addition, it remains to be seen how receptive national judges will be to the Commission intervening in their cases to give guidance on how the competition issues should be decided.

Finally, it is worth noting that the proposed regulation would significantly increase the Commission's powers of investigation and enforcement in competition cases. The power to conduct searches of private homes, to seal off premises and to ask questions covering the entire scope of the investigation brings EU competition law enforcement closer to the U.S. system, where antitrust falls within the ambit of criminal law. However, the powers given to the Commission under the proposed system would still fall well short of those given to antitrust authorities under U.S. law. Fines would still only be imposed against companies -- no sanctions against individuals (either imprisonment or fines) would be possible. In addition, the right to summon persons to Brussels to answer questions, which was contemplated in the White Paper, has not reappeared in the proposed regulation.

As concerns financial penalties, the Commission's proposal keeps the maximum fine for an infringement at 10% of the company's turnover in the preceding business year. However, to give more sting to the other penalties, the Commission now proposes fines of up to 1% of a company's total turnover for supplying incorrect, incomplete or misleading information or otherwise interfering with a Commission's investigation. The Commission also proposes increasing the maximum amount of periodic penalty payments to 5% per day of the company's average daily turnover, e.g., for failing to put to an end an infringement, for failing to comply with interim measures, for failing to supply correct information or for failing to submit to an inspection.

Also worth mentioning is that an extension of the lawyer-client privilege to cover correspondence between companies and their in-house counsel has not been included in the proposed regulation. Under the current system, communication between external counsel and in-house counsel (or any other company employee) is considered privileged and cannot be seized or relied upon by the Commission in its competition law investigations. The same is true of internal company documents or notes which merely report the advice of external lawyers. In contrast, advice given to the company by its in-house counsel does not benefit from the attorney-client privilege. Although an extension of the privilege to in-house counsel has been advocated for some time by the European Parliament and actually appeared in the White Paper, it has not been included in the proposed regulation.

7. Current Status

The Commission's proposed regulation must still be adopted by the Council, after consultation with the Parliament, meaning that it may still be some time before the new regime comes into effect.