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THE CAUSES OF DIVERGENCE BETWEEN LAW AND ECONOMICS IN EUROPEAN COMPETITION POLICY

STEPHEN BRIAN RANALOW

2006

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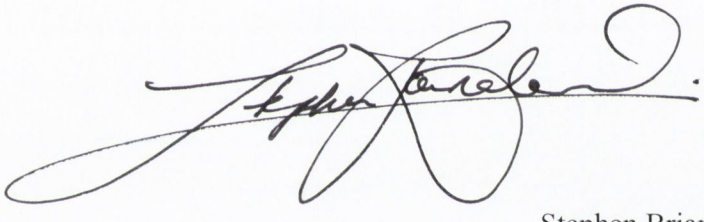

Stephen Brian Ranalow

Dublin, June 2006

SUMMARY

This work is an examination of the causes of divergence between the competition law of the European Communities, specifically Articles 81 and 82 of the E.C. Treaty and the regulation of mergers, and the microeconomic treatment of competition and industrial organisation.

It is based on an analysis of the jurisprudential explanations of the objectives of Community competition law, Luhmann's theory of autopoiesis on the interaction of the legal system with other social systems, the philosophy of the methodology of economics, the Chicago School's critique of judicial antitrust policy and a detailed case study of the treatment of tacit collusion in both Community law and the microeconomics literature.

The thesis proposed is that the argument that divergence is the result of judicially endorsed non-economic competition law objectives is unsubstantiated; that much of what is described as divergence misidentifies the clash between a given legal decision and one of possibly many economic arguments, as divergence from economics as a whole; and that while there is a more authentic form of divergence, it is the result of the impossibility of adapting certain abstract economic theories into a form that can be utilised by a legal system operating under practical constraints (in particular, the need for evidence based on proven facts rather than assumptions, and the requirement for some basic level of certainty as to the legality of a given action), rather than the outcome of any deliberate relegation by the courts of economic policy concerns. In short, Community competition law only truly departs from its objective of protecting 'competition' in the economic sense where it lacks the conceptual tools to accept a particular economic idea into the legal sphere.

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Most of all I would like to thank my parents for their endless support and encouragement, without which I would not have attempted or completed this thesis: un padre para cien hijos y no cien hijos para un padre. This work is dedicated to them.

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INTRODUCTION

Developing an Understanding of Divergence

Of all the areas of legal study, competition law is perhaps the most dependent upon another non-legal discipline. It often appears that economic theory permeates every aspect of antitrust litigation. Economists are employed to gather econometric data and to provide expert testimony on theoretic models and explanations; the force of legal arguments frequently hinges on the successful advocacy of economic concepts; while legal rules are overtly espoused in terms displaying a high degree of technical economic literacy. Such is the level of interaction between the disciplines that some commentators have (not without controversy) suggested that competition law is merely "a branch of applied economics".[1] Even without adopting such an extreme position, it is impossible not to acknowledge that in the realm of competition law economic thinking is central to both considerations of fact and of law.

Despite this intense interaction, however, there remains a divergence between what is competition *law* and what is competition *economics*. On a superficial level this separation is obvious: the language, methods and systems of lawyers are clearly different from those of economists. More substantively, there are incidences where the approach of the courts differs from that advocated by groups of economists. The criticism that a particular decision is in some way 'uneconomic' is one repeated often in competition law literature; indeed, these

[1] R. Posner, *The Problematics of Moral and Legal Theory*, (London: Belknap Press of Harvard University Press, 1999), p. 229. *See also* A. Neale and D. Goyder, *The Antitrust Laws of the United States of America: A Study of Competition Enforced by Law*, (Cambridge: Cambridge University Press, 3rd Edition, 1980), p. 441: "An important contribution to the assumptions and motives underlying antitrust is undoubtedly made by economics and economists, and it is tempting (and common) to regard the antitrust policy simply as a kind of economic engineering project."

prescriptive cries of themselves reveal a distinction between what law is and what economic thinking believes it ought to be.

The issue of divergence is significant because it touches on those questions at the heart of competition law. Is competition law primarily driven by economic reasoning? How does the law select between competing economic theories? Is there a limit to the role of economic argument? Are there restrictions on the legal system's own ability to adopt the methodology of economics? An appreciation of divergence helps open the way for an understanding of the jurisprudence of antitrust. This thesis will explain this divergence. It will examine why there are differences between economic thinking and the legal rules of European Community antitrust law, and in doing so it will set out a framework for describing the interaction of these two separate but complexly interwoven disciplines.

It will be argued that law and economics behave as separate social systems, with the law taking economic concepts as its primary consideration in competition law cases, but evaluating them in its own terms. In this sense the law accepts an economic concept of what is meant by competition and the efficiency aims of antitrust policy (in contrast with other socio-political or formalistic meanings that might be ascribed); while at the same time requiring the economic issues to be explained and arbitrated upon in an arena governed by the law's methodology, understanding and ultimate power of arbitration. It is this dichotomy of systems that creates the scope for divergence; specifically, divergence is the manifestation of the law's autonomy from economic arguments.

On one hand this takes the form of what is termed 'rhetorical divergence', that is the endorsement by the courts of one economic concept over another based on a judicial preference for the values underlying the selected model. It is into this category of divergence that much of the economic criticism of the law fits, including those critiques of European competition law with a Chicago School orientation. Divergence in these cases is described as merely rhetorical because the legal system has accepted an economic concept, albeit one that some economic proponents may consider inferior to the alternatives. This acceptance marks a convergence of the law with the broader economic methodology, if not with the particular application of that methodology

suggested by a given school of thought. Central to this idea of being aligned with the economic methodology whilst simultaneously being rhetorically divergent from certain economic theories, is an understanding that the methodology of economics is a framework within which a whole raft of differing moral or ethical valuations can be internalised. Differing sets of opening judgments may therefore result in differing propositions, all of which can be described as 'economic'. In the European context the occurrence of rhetorical divergence shows a tendency by the courts to favour both economic models valuing short term increases in competition over the longer term promotion of the competitive process, and ones that are less likely to treat rationality as a readily identifiable certainty. This in turn suggests a judicial predilection for systems of rules that are more likely to require positive acts of compliance by forbidding events with a realistic probability of occurring – in other words, rules that are capable of being broken. This revealed preference is one of the underlying 'normative functions' which both characterises and maintains the law as an independent social system.

There is also a second and, it is submitted, more authentic form of divergence, the study of which is the main concern of this thesis. Here the law's autonomy is expressed not simply by the rejection of one economic account in favour of another, but by the wholesale rejection of *all* economic accounts on a particular subject because of the incompatibility of some aspect of the economic methodology with that of the law. At its core, this 'methodological rejection' reflects an inability to assimilate certain economic concepts into the legal dialogue. Methodological rejection should not be misunderstood as judicial ignorance of economic matters or some other failure of comprehension by the legal system. Rather, it is the incommensurability of certain economic ideas because of the limited and inherited structures of the legal system; to use a linguistic analogy, it is not that law does not understand the language of economics, it is that no translation of the economic concept exists. The occurrence of methodological rejection is examined by reference to a detailed case study of tacit collusion, a topic for which the development of a compelling legal treatment has proven elusive. Based on this study two causes of methodological rejection can be identified. First, while the law is willing to rely on the methodology of economics to decide whether a particular act in specified

circumstances is anti-competitive, the legal system's own evidential methodology prohibits economic rationality alone from being construed as proof that the act in question has in fact occurred. The second cause is the principle of legal certainty, by which it is meant that individuals can only be found in breach of legal rules where they have taken conscious decisions which can be externally verified as such. It will be argued that, taken together, these two additional normative functions provide a compelling explanation for the divergence of the economic and legal treatments of tacit collusion, and by extension for methodological rejection in general.

The central argument of this thesis, therefore, is that divergence is the assertion of the law's independence from the discipline of economics; a discipline that nevertheless performs a primary role in forming the law's concept of competition policy. The legal system demonstrates its sovereignty by acting as the selector of competing economic ideas through the process of rhetorical divergence; while at the same time it is beholden to its own systemic limitations which occasionally compel the methodological rejection of some aspects of, what ultimately remains, an alien economic discipline. It is only in this last regard that divergence can properly be said to occur.

Layout of the Thesis

This work is divided into three parts. Part I examines how the dichotomy of the legal and economic systems provides a framework for studying divergence and locating the role of economics within the legal reasoning of the European courts. Chapter one sets out how an economic understanding of competition has been central to the judicial construction of Articles 81 and 82 of the E.C. Treaty to the extent that economics is the primary social consideration in the courts' determination of antitrust disputes. In the main, conventional accounts of divergence based on the portrayal of the law as either a formalistic mechanism devoid of economic reasoning or an instrument for pursuing non-economic socio-political interpretations of the ideal of competition (such as those citing market integration, market plurality or other fair-competition objectives) do not hold-up once the case-law is scrutinised. It is argued, therefore, that a compelling explanation of divergence must account for the law's patently

economic approach, that is, for the large-scale acceptance of economic concepts into the legal system.

Chapter two proposes a systems theory of law as an appropriate mechanism for understanding divergence, in particular relying on Luhmann's concept of autopoiesis. Autopoiesis describes the interaction of the legal system with societal environmental events as a process of adaptation and evolution whereby external elements are input and absorbed into law only to the extent that the legal methodology is capable of making these cognitive adjustments. The autonomy of the legal system is thus maintained although its environment (in this case the arguments provided by the economic system) is dictated to it, because it is the legal system's own normative structure which will determine how it reacts to these arguments. Under this analysis divergence emerges as either the selection by the legal system from amongst alternative economic arguments (that is, rhetorical divergence), or as the rejection of all economic arguments on a particular issue because of the unacceptability of some part of the economic methodology to the law's normative structure (that is, methodological rejection). Driving both forms of divergence are the law's normative functions, by which it is meant those aspects of the legal system which remain closed to influences from other social systems. This systems model of interaction is evident in a number of court decisions demonstrating that the law remains the arbiter of both the worth of economic concepts and their acceptance into the legal forum. The development of competition law is thus characterised by a dynamic interaction of law and economics. Economic arguments are tested by the legal standard, with succeeding arguments being accepted as the basis for a legal rule. Using its normative functions the law evaluates the economic arguments presented to it; arguments which are then accepted into the legal structure forming part of its normative functions which will be used to analyse economic concepts presented in the future. It is in identifying how these normative functions select between economic concepts or cause the rejection of entire aspects of the economic methodology that an appreciation of the reasons for divergence may be developed.

Part II examines the issue of rhetorical divergence. Chapter three describes how the various methodological tenets underlying economic systems of thought operate as conceptual structures within which a range of moral and

ethical decisions may be taken. Thus value decisions inform the selection of the relevant criteria of efficiency measurement, rationality assumptions and phenomenon isolation. The existence of numerous models based on scientifically irrefutable judgements arising within a single economic methodology creates the basis whereby the law may adopt one economic approach while simultaneously being deemed to be following an uneconomic course of action by other economic proponents.

Chapter four examines some of the discordances between the Chicago School's approach to antitrust and that of the Community courts on various issues, and argues that the courts' position in each case is based on an alternative value selection within the economic methodology, thereby revealing any observations of legal-economic deviation as mere rhetorical divergence. It is also argued in this chapter that the selection of economic arguments by the courts demonstrates a consistent preference for values which favour competition rules that tend to push price towards marginal cost in the short term and that this might be indicative of a legal normative function which promotes rules that involve some role for court-based enforcement instead of those which suggest that, left to its own devices, the unregulated market will ensure the maximisation of efficiency.

Part III turns to the issue of methodological rejection. Chapter five sets out the difference between methodological rejection and rhetorical divergence and proposes an empirical test for detecting the former. The suggested method for identifying methodological rejection involves identifying the non-equivalent treatment in the legal sphere of phenomena having identical economic effects. The objective of this test is to identify divergence without referencing different value judgements. Thus the issue is not whether the legal system deems a particular action harmful (and hence illegal) while an economic argument suggests the contrary, but instead, that the legal system divides and ascribes different labels of legality or illegality to behaviour which the economic system regards as having an identical effect, thereby demonstrating that independent of the economic view of whether the single phenomenon is harmful or not, an inconsistency between the legal and economic positions arises.

Chapters six, seven and eight contain a case study of the economic and legal treatments of tacit collusion with a view to exploring the operation of

methodological rejection. In chapter six it is argued that in economic theory tacit collusion is relatively unimportant as a stand alone concept and that there is a general economic equivalence of all types of collusion regardless of their descriptive label. Chapter seven undertakes a detailed examination of the case-law of the Community courts and Commission and proposes that there is a general legal rule against the prohibition of tacit collusion, which results in the segregated legal treatment of tacit and express collusion. Several exceptions to this principle, 'special cases', are noted as arising in a small number of decisions, espousing principles potentially broad enough to capture within the concept of a concerted practice tacit collusion arising through vertical arrangements, post-cartel behaviour and by the actions of fringe market players where express collusion is occurring elsewhere in the same market. The treatment of tacit collusion in the context of the special case of information exchange and under the auspices of the Article 82 concept of joint dominance is also examined, although it is submitted that their role in the regulation of this type of behaviour may be limited. The principle implement for addressing tacit collusion, it is suggested, is the prospective analysis used in the evaluation of concentrations under the merger regulation. Comparing the legal and economic approaches to tacit collusion reveals the general failure of Community competition law to address the equivalence granted by economic theory to tacit and express collusion, and hence indicates methodological rejection that goes beyond mere differences of value selection taking place within the economic paradigm. Chapter eight discusses the causes of this divergence and suggests two normative functions of the legal system which dictate both the limits of transplantation of economic ideas into the legal context, namely the legal approach to evidence (and the role it is willing to ascribe to economics within this evidential process) and the issue of certainty. Finally, chapter nine returns to the issue of value selection in economics – this time in the context of rhetorical rejection – and argues that although it is possible to further expand the definition of what is economic so as to include the divergence between law and economics described in this thesis as the coalescence of the law with a broader conception of efficiency, such a critique inevitably leads to an unnecessarily nihilistic outcome avoided by the acceptance of some objectively identifiable body of legal and economic source material.

Research Method

The principle research approach in this thesis is a textual analysis of the case law of the Community courts – the Court of Justice of the European Communities (referred to throughout as the E.C.J.) and the Court of First Instance (C.F.I.) – and the decisions of the European Commission. This adopts, in essence, Langdell's case-orientated model of legal study; that is, the examination of legal decisions with a view to understanding the legal principles that emerge from judicial opinions over time.[2] There is, perhaps, a risk – given the subject matter – that such an approach owes too much to the Anglophonic common law tradition and ignores the civil law's focus on academically developed legal principles as an indication as to the legal position on a given issue, which undoubtedly has had an influence on the development of Community law.[3] Nevertheless, the extent to which the Community courts have developed their own *acquis*, the ever more detailed reasoning of both court decisions and the opinions of the advocates general, combined with the frequency, indeed predominance, of reliance by the courts on its own established precedent, justify the adopted method of textual analysis.

The Euro-centric approach has been selected for a number of reasons. First, relatively little work has been done in the European context on the divergence of judicial decisions from economic theory. Second, the development of European antitrust has followed a sufficiently independent path from that of the United States to justify the study of the European law-economics divide as a separate phenomenon. The European courts have shown themselves somewhat less prone to dramatic shifts in economic ideology compared to the Supreme Court,[4] although whether this is due to the shorter history of antitrust in Europe

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[2] On Langdell's approach *see* N. Mercuro and S. Medema, *Economics and the Law: From Posner to Post-Modernism*, (Princeton (N.J.): Princeton University Press, 1997), p. 7 *et seq.*

[3] *See generally* K. Zweigert and H. Kötz, *Introduction to Comparative Law*, T. Weir (trans.), (Oxford: Clarendon Press, 3rd Edition, 1998), pp. 256 *et seq.*

[4] *See generally* J. Flynn and J. Ponsoldt, "Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of the Neoclassical Economic Analysis in the Resolution of Antitrust Disputes", (1987) 62 *N.Y.U.L. Rev.* 1125, 1128-1129.

or other more deeply rooted academic or institutional reasons is unclear. Consequently, the story of divergence in the U.S. requires several period specific accounts which are not so acutely necessary for an equivalent European examination. In addition, the E.C.J. and the C.F.I. have been somewhat more consistent in applying a recognisably economic approach to competition law, whereas the U.S. courts have intermittently (particularly during the early years of the Sherman Act and later in the Warren court) put forward a policy-weighting approach[5] reliant on concepts of Jeffersonian market plurality and common law "reasonableness". Again this raises the issue of a multiplicity of period-specific U.S. studies, but more significantly, it casts the issue of American divergence as a slightly different problem. In Europe the issue is why an economic approach to the law sometimes appears to achieve uneconomic results; whereas in the U.S. there is an additional ancillary question: how do the courts decide in the first place whether to admit arguments based on economic theory as the basis for antitrust law over those promoting a different policy aim? Moreover, there are quite clearly trans-Atlantic doctrinal divisions on the issue of what amounts to anticompetitive effects for a range of phenomena, which raises the spectre of separate empirical analyses of the case law for each jurisdiction. Taking these issues together, it is submitted that while it is feasible to study the divergence of law and economics in European and American jurisprudence together, examining one in isolation greatly increases the ability to concentrate on the jurisdiction-specific characteristics of divergence in that case.

The analysis of methodological rejection focuses primarily on the single case study of tacit collusion. There are two main reasons why this narrow focus has been chosen. First, it is critical that an empirical examination of the concept of methodological divergence be as exhaustive as is practical because even a single case of successfully transplanting an economic concept into law on a particular issue that otherwise appears from the case-law to be untransferable requires a reassessment, or at least a more robust appraisal, of the normative functions being observed. This is borne out, for example, in the requirement for the normative functions observed in Part III to take account of the legal treatment of tacit collusion through the merger regulation, Article 82 joint

[5] This is discussed further in chapter one *infra*.

dominance and the possibility of the 'special cases' under Article 81. Some measure of exhaustiveness thus protects from the study becoming selectively anecdotal. Secondly, it is also highly desirable that the subject areas selected for study consist of a relatively large number of cases as this reduces the danger of drawing implications from exemplary cases which have not been subject to the scrutiny of repeated judicial consideration. Taking these two considerations into account, a preliminary review of the case law of the European courts was undertaken to find some examples which displayed some divergences between the legal position and economic theory which did not, *prima facie* at least, indicate rhetorical divergence. On this basis, three areas in particular suggested themselves: tacit collusion, the role of market definition, and excessive pricing as an abuse of dominance. Of these, tacit collusion has been selected in part because of the volume of decided cases on the issue and the courts' use of potentially non-economic distinctions which makes it suitable for examination under the test developed in chapter five to identify methodological rejection distinctly from rhetorical divergence. More simply, tacit collusion suggests itself because it has posed one of the most intractable conundrums to have been visited upon by the European courts. Having said this, brief reference is made in chapter eight on the extent to which the findings flowing from the case study of tacit collusion are applicable to other potential sources of methodological rejection.

A study of the divergence of law and economics by its nature necessitates much discussion of theoretical economics. This thesis remains, however, a jurisprudential examination of the law-economics interface, with the submitted arguments and primary focus of discussion being of a legal nature. In so far as economic issues are addressed, it is not pretended that this is from anything other than a 'lawyer's-eye view'. The approach used in the discussion of economics in this thesis is modelled on that employed generally in the competition law literature. Consequently, no suggestions are made as to how economic concepts should be developed and an effort has been made to discuss those technical aspects of economics that do arise in the explanatory tradition of Posner, Coase, Bork, and Suffrin and Jones, amongst others, rather than by reference to formal proofs and mathematical equations.

PART I

THE NATURE OF DIVERGENCE

CHAPTER ONE

LOCATING ECONOMICS WITHIN COMPETITION LAW

Challenging the 'Non-Economic' Explanation of Divergence

There exists an account of divergence which is sufficiently prevalent that it might be described as the orthodox view. It takes a number of different guises, and has been expressed by many different lawyers (and a handful of economists too) in a myriad of ways, but in essence each variety can be reduced to the same core principle: competition law differs from competition economics because on occasion the legal definition of the term 'competition' draws on meanings and policy concerns unconnected to the microeconomic concept of the same name. This non-economic explanation of divergence takes three forms.

First, is where the courts are described as implementing a "formalistic prohibitory"[1] model of antitrust where the protection of competition manifests itself not as the examination of the economic effects of a particular action, but by the determination of whether the conduct in question matches one of the list of activities pre-ordained as anti-competitive.

Second, is the view that the Community concept of competition is informed by a number of different policy aims, including, on one hand, the promotion of economic concerns of efficiency, and on the other a raft of non-economic socio-political objectives, such as the maintenance of market plurality; the restriction of the social power of corporate entities; the promotion of fairness; and, most importantly of all, the creation of a single integrated European market. Inevitably, the argument goes, competition law is required to

[1] I borrow the term from Sufrin and Jones; A. Jones and B. Sufrin, *E.C. Competition Law: Text, Cases, and Materials*, (Oxford: Oxford University Press, 2001), p. 35. The same concept is alternatively described by Whish as "formalism and technical conundra"; R. Whish, *Competition Law*, (London: Butterworths, 3rd Edition, 1993), p. 123.

serve "two masters",[2] an economic and a non-economic one, in circumstances where the diverging "policy objectives ... produce differing prescriptions, necessitating a choice between them".[3] It is in these situations that divergence can be observed.

Third, is the description of divergence as the result of judicial ineptitude in applying economic analysis to legal issues. The court-delivered view of competition in these cases is, to some extent, economically illiterate and marks the creation of a legal concept of competition unintentionally divorced from that of economic theory.

Each of these non-economic accounts, it is submitted, fails to withstand a close examination of the case-law from which they are derived. Not only is economics a primary consideration for the courts in most competition law cases, but it is *the* operative mode of thinking in defining what are anti-competitive practices both in general and in those cases allegedly indicating the ascendancy of a non-economic approach. With no basis in the express language of the courts, the non-economic accounts are revealed as somewhat inaccurate simplifications. The core function of economic thinking within the jurisprudence of the Community courts requires a more robust analysis of divergence than one grounded on the argument that the judicial concept of competition is non-economic. A compelling account of divergence must, therefore, account for the fundamentally 'economic' nature of Community competition law.

This chapter commences with a generalised examination of the central role of economic reasoning in the development of the competition rules of Articles 81 and 82 of the E.C. Treaty. It then turns to an examination of the authorities backing up each of the three non-economic accounts of antitrust analysis, arguing that in each instance an economic concept of competition is evident as the central strand of the courts' reasoning. Finally, the consequences for the study of divergence of the avowedly economic approach evident in the

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[2] A. Jones and B. Sufrin, *op. cit.*, p. 32: "E.C. competition law serves two masters, the 'competition' one and (even more demanding) the imperative of single market integration. The second goal has sometimes dictated the entire development of the law...".

[3] P. Craig and G de Búrca, *E.U. Law: Text, Cases, and Materials*, (Oxford: Oxford University Press, 1998), p. 891.

case-law is discussed, and an outline of the elements that a compelling description of divergence must contain is proposed.

The Central Role of Economic Concepts in Community Antitrust

The case law of the Community courts[4] demonstrates a high level of fluency with the terminology and concepts of the economic study of industrial organisation. Significant parts of the courts' decisions are given over to comparing the economic arguments presented by the disputing parties and rationalising the judicial decision in similar terms, and the economic vernacular of 'monopoly', 'oligopoly' and 'competition' underscore much of the courts' application of Articles 81 and 82. This choice of phraseology is more than a superficial use of the jargon of economics: it reflects a legal approach focussed on the efficiency effects of the behaviour of commercial actors.

The development of the principles of Article 81 illustrates the placing of an economic-effects based concept at the fore of competition law analysis. From the earliest competition cases the E.C.J. quickly established that the question of whether an agreement between undertakings was anticompetitive depended on its actual or potential impact on the market in question. The basic test, first formulated by the court in *Technique Minière*[5] and repeated many times since, is posed as a simple question of market effect: what would the market situation be if the agreement in question never existed?[6] The answer is provided by carrying

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[4] By which it is meant the European Court of Justice and the Court of First Instance.

[5] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.M.B.H.* [1966] E.C.R. 235, [1966] C.M.L.R. 357.

[6] *Ibid.*, 250 (E.C.R.), 375 (C.M.L.R.): "The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute." *See also*: Case 31/80, *L'Oréal N.V. and l'Oréal S.A. v. De Nieuwe A.M.C.K. P.V.B.A.* [1980] E.C.R. 3775, [1981] C.M.L.R. 235, para. 19: "in order to decide whether an agreement is to be considered as prohibited by reason of the distortion of competition which is its object or its effect, it is necessary to consider the competition within the actual context in which it would occur in the absence of the agreement in dispute."; Case 31/85, *E.T.A. Fabriques d'Ebauches S.A. v. D.K. Investment S.A. and others* [1985] E.C.R. 3933, [1986] 2 C.M.L.R. 674, para. 11: "The restriction of the guarantee to products sold through authorised dealers must be viewed in that context and must be appraised by reference to the distortion of competition which is its object or

out an examination of the structure of the market in issue with a view to establishing the degree of competition faced by the competitors engaged in the behaviour in question.[7] This includes an analysis of the market share of the undertakings and their competitors;[8] the impact of the behaviour on the ability of the co-operating parties to compete vis-à-vis each other;[9] the presence of

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effect. As the Court stated in its judgments in [Case 99/79, *Lancôme v. Etos* [1980] E.C.R. 2511, [1981] 2 C.M.L.R. 164] and [*L'Oréal*] it is necessary to consider competition within the actual context in which it would occur in the absence of the agreement or clause in dispute."; Case 42/84, *Remia B.V., Verenigde Bedrijven Nutricia N.V. and another v. Commission* [1985] E.C.R. 2545, [1987] 1 C.M.L.R. 1, para. 18: "In order to determine whether or not such clauses come within the prohibition in Article [81](1), it is necessary to examine what would be the state of competition if those clauses did not exist."

[7] This is a compulsory part of the Article 81(1) analysis: Cases T-68, 77-78/89, *Re Italian Flat Glass: Societá Italiano Vetro S.p.A. v. Commission* [1992] E.C.R. II-1403, [1992] 5 C.M.L.R. 302, para. 159: "The Court cannot agree with the Commission's view that an analysis of the market would have been superfluous. The Court considers, on the contrary, that the appropriate definition of the market in question is a necessary precondition of any judgment concerning allegedly anti-competitive behaviour."

[8] *See* Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.M.B.H.* [1966] E.C.R. 235, 250, [1966] C.M.L.R. 357, 376: "[T]o judge whether a contract containing a clause 'granting an exclusive right of sale' should be regarded as prohibited by reason of its object or its effect, it is necessary to take into account, in particular, the nature and the quantity, whether limited or not, of the products which are the object of the agreement, the position and size of the grantor and concessionaire on the market for the products concerned, the isolated nature of the agreement in question or, on the contrary, its position in a series of agreements, the severity of the clauses aiming at protecting the exclusive right or, on the contrary, the possibilities left for other commercial currents upon the same products by means of re-exports and parallel imports."; Cases T-68, 77-78/89, *Re Italian Flat Glass: Societá Italiano Vetro S.p.A. v. Commission* [1992] E.C.R. II-1403, [1992] 5 C.M.L.R. 302, paras. 161-171, where it was held that assessments of the market share of the allegedly colluding parties and of imports into the relevant product market must be accurately calculated.

[9] *See* Cases T-374-375, 384, 388/94, *European Night Services and others v. Commission* [1998] E.C.R. II-3141, [1998] 5 C.M.L.R. 718, para. 137: "It must also be stressed that the examination of conditions of competition is based not only on existing competition between undertakings already present on the relevant market but also on potential competition, in order to ascertain whether, in the light of the structure of the market and the economic and legal context within which it functions, there are real concrete possibilities for the undertakings concerned to compete among themselves or for a new competitor to penetrate the relevant market and compete with the undertakings already established." Citations omitted.

existing barriers blocking new entrants;[10] and the creation of new barriers to entry from the impugned conduct.[11] Each of these constituent inquiries focuses, ultimately, on the extent to which competitors will contribute to continued low or falling prices,[12] or continued high or improving product quality.[13] In short, it

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[10] *See* Case C-234/89, *Delimitis v. Henninger Bräu A.G.* [1991] E.C.R. I-935, [1992] 5 C.M.L.R. 210, para. 22: "[I]t is necessary to know not only the number and the size of producers present on the market, but also the degree of saturation of that market and customer fidelity to existing brands, for it is generally more difficult to penetrate a saturated market in which customers are loyal to a small number of large producers than a market in full expansion in which a large number of small producers are operating without any strong brand names."; [10] Cases T-374-375, 384 and 388/94, *European Night Services and others v. Commission* [1998] E.C.R. II-3141, [1998] 5 C.M.L.R. 718, para. 137, quoted *supra* fn. 9.

[11] *See* Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.M.B.H.* [1966] E.C.R. 235, 357, [1966] C.M.L.R. 357, 376, quoted *supra* fn. 8; Cases T-374-375, 384 and 388/94, *European Night Services and others v. Commission* [1998] E.C.R. II-3141, [1998] 5 C.M.L.R. 718, paras. 149-160: where the creation of privileged access to the market for railway infrastructure resulting from a joint venture by several undertaking was examined; Case C-234/89, *Delimitis v. Henninger Bräu A.G.* [1991] E.C.R. I-935, [1992] 5 C.M.L.R. 210, paras. 24 and 27: "If ... [an] examination reveals that it is difficult to gain access to the relevant market, it is necessary to assess the extent to which the agreements entered into by the brewery in question contribute to the cumulative effect produced in that respect by the totality of the similar contracts found on that market.... [T]he agreement in question must make a significant contribution to the sealing-off effect brought about by the totality of those agreements in their economic and legal context. The extent of the contributions made by the individual agreement depends on the position of the contracting parties in the relevant market and on the duration of the agreement."

[12] *See* Cases 48-57/69, *I.C.I. and others v. Commission* [1972] E.C.R. 619, [1972] C.M.L.R. 557, para. 115: "The function of competition, in relation to prices, is to maintain prices at the lowest possible level...."

[13] *See* Case 26/76, *Metro S.B.-Grossmärkte Gmb.H. & Co. K.G. and Verband des S.B.-Grosshandels e.V. v. Commission and Saba (No. 1)* [1977] E.C.R. 1875, [1978] C.M.L.R. 1, para. 21, where the court acknowledged the significance of measures aimed at maintaining competition between brands on the grounds of service quality as well as price: "[A]lthough price competition is so important that it can never be eliminated, it does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded.... [T]he desire to preserve, in the interests of consumers, the possibility of the continued existence of this channel of distribution in conjunction with new methods of distribution based on a different type of competition policy, forms one of the objectives which may be pursued without necessarily falling under the prohibition contained in Article [81](1) ....

is an investigation of the impact on consumer utility, and by implication, on allocative efficiency.

The courts' treatment of the abuse of dominance concept under Article 82 demonstrates a similar efficiency-orientated approach. As a mandatory prerequisite for a finding of dominance the law requires a substantiated economic definition of the relevant product market[14] and proof that the undertakings under scrutiny possess market power sufficient to effect price increases without fear that the reactions of competitors or customers will impact negatively on their revenues.[15] Thus, examinations of a product's price elasticities of demand and supply,[16] and the cross elasticity of demand with other

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This argument is strengthened if, in addition, such conditions promote improved competition inasmuch as it relates to factors other than prices."

[14] *See* Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] 1 C.M.L.R. 429, para. 11: "The opportunities for competition under Article [82] of the Treaty must be considered having regard to the particular features of the product in question and with reference to a clearly defined geographic area in which it is marketed and where the conditions of competition are sufficiently homogeneous for the effect of the economic power of the undertaking concerned to be able to be evaluated."; Case 322/81, *Nederlandsche Bander-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 37, quoted *infra* fn. 16; Case 6/72, *Europemballange Corp. & Contintental Can Co. Ltd. v. Commission* [1973] E.C.R. 215, [1975] C.M.L.R. 199, paras. 32-33, quoted *infra* fn. 16.

[15] *See* Case 85/76, *Hoffmann-La Roche & Co. A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, paras. 38-39: "The dominant position thus referred to relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of its consumers. Such a position ... enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not act to its detriment". *See also* similar statements in: Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] 1 C.M.L.R. 429, para. 65; Case 322/81, *Nederlandsche Bander-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 30.

[16] *See* Case 102/77, *Hoffmann-La Roche & Co. A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, para. 28: "The concept of the relevant market in fact implies that there can be effective competition between the products which form part of it and this presupposes that there is a sufficient degree of interchangeability between all the products forming part of the same market insofar as a specific use of such products is concerned."; Case 322/81, *Nederlandsche*

products,[17] as well as the identification of industry barriers to entry,[18] monopolistic pricing[19] or behaviour characteristic of a profit maximising monopolist,[20] have all become an accepted part of the judicial analysis. The *sine*

Bander-Industrie Michelin v. Commission [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 37: "[F]or the purposes of investigating the possibly dominant position of an undertaking on a given market, the possibilities of competition must be judged in the context of the market comprising the totality of the products which, with respect to their characteristics, are particularly suitable for satisfying constant needs and are only to a limited extent interchangeable with other products."; Case 6/72, *Europemballange Corp. & Contintental Can Co. Ltd. v. Commission* [1973] E.C.R. 215, [1975] C.M.L.R. 199, paras. 32-33: "In considering the dominant position ... the delimitation of the market concerned is of crucial importance, for the possibilities of competition can only be considered in the light of the characteristics of the products in question, which reveal them to be particularly suited to satisfying a constant demand and interchangeable with other products only to a small extent."; *ibid.*, para. 36, where the issue of supply side substitutability was examined: "it can be assumed that the products in question have a special market only if they can be individualised not only by the mere fact that they are used for packaging certain products but also by special production characteristics which give them a specific suitability for this purpose. Accordingly, a dominant position in the market for light metal containers for canned meat and fish cannot be decisive in so far as it is not proved that competitors in other fields in the market for light metal containers cannot, by a mere adaptation, enter this market with sufficient strength to form a serious counterweight."

[17] Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 28, where the court examined the cross-elasticity of demand of bananas against grapes and peaches.

[18] See Case 238/87, *A.B. Volvo v. Erik Veng* [1988] E.C.R. 612, [1989] 4 C.M.L.R. 122, where sole access to the after-market in spare parts was considered to be a barrier entry; Case 30/87, *Corrine Bodson v. Pompes Funèbres des Régions Libérées* [1988] E.C.R. 2479, [1989] 4 C.M.L.R. 984, where an exclusive statutory concession was held to be a barrier to entry; Case 322/81, *Nederlandsche Bander-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 58, where the requirement for an established sales network was considered a barrier to entry.

[19] Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 91, where the ability of the undertaking to obtain premium prices was deemed relevant to the determination of market power. *See* also Commission Decision 87/500/E.E.C., *B.B.I./Boosey & Hawkes* [1987] O.J. L286/34, [1998] 4 C.M.L.R. 67, para. 18, where the Commission employed a similar analysis.

[20] See Case 85/76, *Hoffman-la Roche & Co. A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, para. 48, where the maintenance of idle capacity was held to be a factor indicating output at a level higher than average cost; Case 27/76, *United Brands Co. and United*

qua non of legality under Article 82 becomes, therefore, a question of the degree to which an undertaking is capable of reducing the consumer surplus.

That the central concern of community competition law is economic efficiency, consumer welfare and allocative efficiency has become increasingly recognised by the Commission. In its *Thirty-Second Report on Competition Policy*[21] the Commission asserted that "[o]ne of the main purposes of European competition policy is to promote the interests of consumers, that is, to ensure that consumers benefit from the wealth generated by the European economy".[22] An even more robust proposition of the place of economic thinking within competition law has been advocated by the Commission in its various guidelines on the application of Article 81. In these, it appears, that the status of the efficiency-maximising objective of the law has been promoted from being one of possibly several principle objects, to being the law's over-riding purpose. Thus, in its guidelines on vertical restraints[23] it is stated that:

> The protection of competition is the primary objective of E.C. competition policy, as this enhances consumer welfare and creates an efficient allocation of resources. In applying the E.C. competition rules, 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.[24]

Brands Continental B.V. v. Commission [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 121, where the ability of the firm to operate independently of competitive concerns was considered; Commission Decision 88/133/E.E.C., *Eurofix-Bauco/Hilti* [1988] O.J. L65/19, [1989] 4 C.M.L.R. 677, para. 71, where the Commission similarly concluded that the behaviour displayed was inconsitant with that of an undertaking engaged in a competitive market.

[21] *Thirty-Second Report on Competition Policy, 2002*, (Luxembourg: Office for the Official Publications of the European Communities, 2003).

[22] *Ibid.*, p. 20.

[23] Commission Notice 2000/C 291/01, Guidelines on Vertical Restraints [2000] O.J. C291/1.

[24] *Ibid.*, para. 2(7).

The recently produced guidelines on Article 81(3)[25] contain a similarly general statement on the goals and methodology of competition law. Without qualification, we are informed that "[t]he aim of the Community competition rules is to protect competition on the markets as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources";[26] while the framework for achieving this, within the context of Article 81(3) at least, "is based on an economic approach".[27]

What emerges from this brief outline of the key principles of competition law is that as a general rule the courts have delineated which activities are deemed illegal under Articles 81 and 82 by reference to the principles of industrial organisation. More specifically, an economic analysis (of some description) of the impact on consumer welfare of the impugned action has been pivotal to the courts' determination of its legality. This point is relatively uncontroversial, as Jones and Sufrin point out, "[t]here seems to be consensus that competition law should be adopted and applied in pursuit of economic efficiency".[28] But this same consensus also holds that there are instances where the central role of economics in the courts' reasoning is displaced; circumstances where the delineation of legality is informed by non-economic concerns. In this light, the acknowledgement of the central role of economics emerges only as a general principle: one that holds true in the majority of cases, but, crucially, not in all of them. For there remains, the argument goes, a category of decisions which stand as monuments to a divergence of law and economics founded on the judicial relegation of efficiency-based reasoning beneath other, more important concerns.[29] It is to the validity of these assertions that this chapter now turns.

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[25] Commission Notice 2004/C 101/08, Guidelines on the Application of Article 81(3) of the Treaty [2004] O.J. C101/97.

[26] *Ibid.*, para. 33.

[27] *Ibid.*, para. 5.

[28] A. Jones and B. Sufrin, *op. cit.*, p. 17.

[29] *See* for example: P. Craig and G. de Búrca, *op. cit.*, pp. 891-892 : "A number of differing objectives may lay at the heart of competition policy, not all of which are compatible. One object is to enhance efficiency, in the sense of maximizing consumer welfare and achieving the optimal allocation of resources. ...Efficiency is not the only goal of competition law. A second objective may be to protect consumers and smaller firms from large aggregations of economic power.... A third objective of E.C. competition law is to help in the creation of a single European market,

The Rejection of a Formalistic Prohibitory Approach

A formalistic prohibitory approach to competition law is the antithesis of an effects-based form of analysis. The legality of conduct is determined by its formal characterisation, that is a description of its factual appearance rather than an assessment of its impact from an economic or other socio-political perspective. The quintessence of a formalistic prohibitory approach is a list of prescribed actions which the judicial authority applies to individual cases by straightforward factual analogy, and without regard for the economic considerations which may have informed the drawing up of the list in the first place. An example of this system in action is the United Kingdom's now repealed restrictive trade practices legislation which set out a technical list of contractual clauses considered anticompetitive, including those setting prices, production quantities, terms of sale, methods of production and limitations on permitted customers.[30] Advocates for a formalistic prohibitory approach on both sides of the Atlantic point to its non-economic approach as a major attribute; with courts' relieved from engaging in issues of economic theory and the policy-making function that would appear inevitably to accompany an effects-focused method.[31] Of course, the formalistic prohibitory approach is not without its

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and to prevent this aspiration from being frustrated by the activities of private undertakings."; A. Jones and B. Sufrin, *op. cit.*, p. 34: "[C]ompetition policy is concerned with efficiency and the allocation of resources, although its interaction with other Community policies means that efficiency in the neo-classical sense cannot be seen as the sole goal of the law.... Rather, competition policy is seen as part of the overall scheme of Community policies."

[30] Restrictive Trade Practices Act 1976, section 6(1), repealed by Competition Act 1998. See R. Galinsky, "The Resolution of Conflicts between U.K. and Community Law", [1994] 15(1) *E.C.L.R.* 16; A. Jones and B. Sufrin, *op. cit.*, pp. 35-36; R. Whish, *op. cit.*, p. 123.

[31] *See* T. Arthur, "Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act", (1986) 74 *Cal. L. Rev.* 263, 318: "If the Sherman Act is as lacking in substance as the conventional wisdom holds, a unitary, operational section 1 standard can only result from a common judicial view on microeconomic policy questions. But this is not possible in a pluralistic society."; A. Neale and D. Goyder, *The Antitrust Laws of the United States of America: A Study of Competition Enforced by Law*, (Cambridge: Cambridge University Press, 3rd Edition, 1980), p. 497, commenting on the pre-Chicago *per se* rules in U.S. antitrust: "The American judges have had good reason for their view that the confrontation of economic experts

drawbacks. The policy goal of protecting the efficiency-promoting effects of competition is not particularly amenable to being abstracted into a handful of definitively culpable acts. The economic effect of every action depends to some lesser or greater degree on the surrounding circumstances, and consequently, each formalistic prohibitory prescription runs the risk of being over-inclusive, under-inclusive, or both – as Galinsky, commenting on the operation of the repealed British legislation, put it: "agreements which are 'harmless' in competition terms may be 'caught' by the [Restrictive Trade Practices Act 1976] whereas truly anti-competitive agreements ... may escape its ambit".[32] Ultimately, the blindness of such a mechanical judicial approach to policy-concerns may extensively undermine the legislative intent.

In general, as was concluded in the previous section, the fundamental principles of Community competition law, with their attention to the individual economic circumstances of each case, eschew the formalistic prohibitory approach. There is, however, one aspect of the antitrust *acquis*, which appears *prima facie* to have some formalistic elements, namely the doctrine of anticompetitive objects under Article 81(1).

Article 81(1) prohibits those agreements, concerted practices and decisions by associations of undertakings "which have as their *object or effect* the prevention, restriction or distortion of competition."[33] In *Technique Minière* the E.C.J. alluded to the fact that the italicised words were "not cumulative but alternative requirements".[34] Shortly afterwards, the *Consten and Grundig*[35] decision determined that once an anticompetitive object was attributed to an agreement, the requirement to examine its effects became "superfluous".[36]

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of both sides of the case would not lead to clear and easily applicable decisions. Hence they have restricted themselves to facts about the existence of collusion and of restrictive market and have left it at that."

[32] R. Galinsky, *loc.cit.*, 16.

[33] Emphasis added.

[34] [1966] E.C.R. 235, 249, [1966] C.M.L.R. 357, 375.

[35] Cases 56, 58/64, *Establissements Consten S.A. and Grundig-Verkaufs-G.m.b.H. v. Commission* [1966] E.C.R. 299, [1966] C.M.L.R. 418.

[36] *Ibid.*, 342 (E.C.R.), 473 (C.M.L.R.): "[F]or the purpose of applying Article [81](1), it is superfluous to take account of the concrete effects of an agreement once it appears that it has the object of restricting, preventing or distorting competition."

Together, these decisions established that the Treaty provision contained, effectively, two separate prohibitions: one on behaviour having an anticompetitive object; and another on behaviour with an anticompetitive effect. This principle has since been repeated by the Community courts on many occasions, and several classes of conduct, including horizontal price-fixing, quota setting, and market-partitioning, are now recognised as forming a "hard-core" of actions deemed by their very nature to have an anticompetitive object.[37]

It is tempting to view the anticompetitive object rule as a formalistic prohibitory one: certain forms of conduct are placed on the hard-core infringement list and deemed anticompetitive without the need to examine their efficiency effects. Such an interpretation, however, is both unnecessarily stark and ignores an important subtlety. There is an important distinction to be made between waiving the requirement to examine the actual effects of a particular action on the market in question and waiving an efficiency-based assessment of the impact of that behaviour. What the anticompetitive object doctrine allows is for the courts to delineate the efficiency effects of certain conduct in the abstract, without the need to prove that those effects have actually occurred on the market. Finding behaviour to have an anticompetitive object thus becomes a process of determining whether its negative efficiency effects are inevitable, in which case the actual market effects need not be proven. Where a detrimental impact on efficiency does not flow from the behaviour as a matter of course, the "effects" element of Article 81 comes into play relying on an empirical analysis of proven real-market effects to determine the issue.

Support for this reading of the anticompetitive object doctrine is evident in the two seminal cases on the subject. The *Technique Minière* decision explains the object analysis as an evaluation of the challenged behaviour's "effect on competition" within the relevant market's "economic context", but without the necessity of an empirical examination to prove "competition has in fact been prevented" – something which is left to the "effects" element of the

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[37] *See* Case 41/69, *A.C.F. Chemiefarma N.V. v. Commission* [1970] E.C.R. 661, 696; Case 123/83, *B.N.I.C. v. Clair* [1984] E.C.R. 391, 399, [1985] 2 C.M.L.R. 430, 445; Case C-234/89, *Delimitis v. Henninger Bräu A.G.* [1991] E.C.R. I-935, [1992] 5 C.M.L.R. 210, para. 13.

Article 81 prohibition.[38] Likewise, in *Consten and Grundig* the court's finding that a parallel import restriction amounted to an anticompetitive object was accompanied by the economic conclusion that contractual parallel import restrictions had adverse consequences on the level of intra-brand competition.[39] Thus, the court was not referring to the efficiency-characterisation of the agreement when it stated that an effects analysis was superfluous; instead, it was taking aim at the argument that price, cost and demand data for the various markets under consideration should be required in every case, even when the court had concluded that the effect of the parties' conduct could not be anything other than anticompetitive.[40] It is also important to remember that the E.C.J. in

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[38] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.m.b.H.* [1966] E.C.R. 235, 249, [1966] C.M.L.R. 357, 375: "The fact that these are not cumulative but alternative requirements, indicated by the conjunction 'or', leads first to the need to consider the precise purpose of the agreement, in the economic context in which it is to be applied. This interference with competition referred to in Article [81](1) must result from all or some of the clauses of the agreement itself. Where, however, an analysis of the said clauses does not reveal the effect on competition to be sufficiently deleterious, the consequences of the agreement should then be considered and for it to be caught by the prohibition it is then necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent."

[39] Cases 56, 58/64, *Establissements Consten S.A. and Grundig-Verkaufs-G.m.b.H. v. Commission* [1966] E.C.R. 299, 343, [1966] C.M.L.R. 418, 474: "In addition, in so far as the efforts of producers to individualise their brands in the eyes of the consumer succeed, the effectiveness of competition between producers tends to diminish. Because of the considerable impact of the distribution costs on the total returns, it seems important that competition between traders should also be stimulated. The efforts of the trader are stimulated by competition between distributors of products of the same brand. Since the agreement thus aims at insulating the French market for Grundig products and maintaining artificially, for products of a very widespread brand, separate national markets within the Community, it is therefore such as to distort competition in the Common Market. Therefore it was proper for the attacked decision to consider that the agreement constitutes a breach of Article [81](1); and any further considerations, whether of economic data (price differences between France and Germany, representative character of the type of apparatus envisaged, level of costs borne by Consten) or of the accuracy of criteria upon which the Commission based itself in its comparisons between the situation of the French and German markets, as well as any favourable effects of the agreement in other respects, can in no way lead, in the presence of the above-mentioned restrictions, to a different solution within the framework of Article [81](1)."

[40] *Ibid.*

Consten and Grundig described the "effects" limb of Article 81 as a reference to "concrete effects".[41] Given the reasoning employed by the court, it becomes clear that that the word "concrete" is a synonym for the empirically proven market impact of a particular event – a quite separate issue from the question of anticipated efficiency effects of an undertaking's behaviour.

This distinction between the efficiency-effects (which forms part of the anticompetitive object analysis) and concrete effects (meaning empirical proof) is brought out clearly in a number of subsequent judgments. In *Miller*[42] the E.C.J. described an anticompetitive object as a demonstration that an act was capable of having an effect damaging to competition.[43] The effect element of Article 81 is then left as a question of whether the market-damaging effects in fact occurred. In this case, the economic analysis carried out by the Commission of the relevant market structure was deemed sufficient to demonstrate that the impugned agreement had the capacity to damage competition.[44] Here, as in *Consten and Grundig* and *Technique Minière*, settling for evidence of an anticompetitive object is not used as an excuse to avoid the necessity of an economic justification. Similarly, in *Rolled Zinc*[45] the court's examination of the object of an agreement containing export restrictions reflected not on the form of these clauses or the intention of the parties, but on their unavoidable consequence of enforcing an apparent market-partitioning cartel.[46] In this role

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[41] *Ibid.*, 342 (E.C.R.), 473 (C.M.L.R.), quoted supra fn. 36.

[42] Case 19/77, *Miller International Schallplatten G.m.b.H. v. Commission* [1978] E.C.R. 131, [1978] 2 C.M.L.R. 334.

[43] *Ibid.*, para. 15: "In prohibiting agreements which may affect trade between member-States and which have as their object or effect the restriction of competition Article 85 (1) of the Treaty does not require proof that such agreements have in fact appreciably affected such trade, which would moreover be difficult in the majority of cases to establish for legal purposes, but merely requires that it be established that such agreements are capable of having that effect. The Commission, basing its assessment on Miller's position on the market, its scale of production, ascertainable exports and price policy, has provided appropriate proof that in fact there was a danger that trade between member-States would be appreciably affected."

[44] *Ibid.*

[45] [1984] E.C.R. 1679, [1985] 1 C.M.L.R. 688.

[46] *Ibid.*, paras. 26-28: "In order to determine whether an agreement has as its object the restriction of competition, it is not necessary to inquire which of the two contracting parties took the initiative in inserting any particular clause or to verify that the parties had a common intent at

the object element of Article 81 is a mechanism for squeezing conduct that inescapably has a capacity to produce efficiency-harming effects without the need to separately prove what is in any event considered inevitable.

The characterisation of the concept of an anticompetitive object as being intrinsically linked to an efficiency effects analysis also emerges from a number of cases considering the issue of whether a concerted practice, as opposed to an agreement, could be construed as having an anticompetitive object. The question faced by the courts was how behaviour which manifested itself purely as market conduct without any evidence of a written agreement could be conceived other than through the effects limb of Article 81. The initial view, apparent in the advisory opinions of Gand A.G. in *Chemiefarma*[47] and Mayras A.G. in *Sugar*,[48] was that the conduct and effect were, in the case of a concerted practices, inseparable, and as such, a concerted practice having an anticompetitive object

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the time when the agreement was concluded. It is rather a question of examining the aims pursued by the agreement as such, in the light of the economic context in which the agreement is to be applied. ...Schiltz obtained the same sheets from Asturienne and Rheinzink by leading them to believe that the sheets were to be re-exported to the Middle East and in particular to Egypt. The prices charged by the two producers were, however, almost identical to, or very close to, those which the same producers charged for their sales intended for the Belgian market. In those circumstances, the conclusion cannot be avoided that the export clauses were essentially designed to prevent the re-export of the goods to the country of production so as to maintain a system of dual prices and restrict competition within the common market."

[47] Case 41/69, *A.C.F. Chemiefarma N.V. v. Commission* [1970] E.C.R. 661, 714-715, *per* Gand A.G.: "[F]or the purposes of the application of Article [81] there is no need to take account of the concrete effects of an agreement when it has as its object the prevention, restriction or distortion of competition. It is no doubt otherwise in the case of a concerted practice which, according to the prevailing view, presupposes that the agreement is actually carried out so that it is necessary to establish the actual conduct of the undertakings concerned and the existence of such conduct and a prearranged plan."

[48] Cases 40-48, 50, 54-56, 111, 113-114/73, *Suiker Unie and others v. Commission* [1975] E.C.R. 1663, [1976] 1 C.M.L.R. 295, 322, *per* Mayras A.G.: "[P]rovided that the existence of an agreement is established and that its object is to produce an adverse effect on competition in the common market, it falls within the scope of the prohibition laid down by Article [81](1), without it being necessary to ascertain whether it has in fact had any effect on competition. A concerted practice, on the contrary, cannot be entirely severed, owing to its very nature, from the effects which it has on the conditions of competition, since it must become apparent from the behaviour of the undertakings concerned."

alone was an impossibility. What is of interest about this conclusion for the present discussion is how it delineates the object-effect interface. On one hand, it serves to narrow the operation of the anticompetitive object examination; restricting it to the identification of behaviour which from its written form alone demonstrates a capacity to produce efficiency-damaging effects. On the other hand, it expands the effects analysis to include the search for *each* of three elements: the occurrence of conduct (being conduct not taking the form of an agreement); the anticompetitive character of that conduct (that is its efficiency effects); and the empirical evidence of the anticompetitive effects being demonstrated in the market data. This view of the anticompetitive objects doctrine comes close to being a formalistic prohibitory one; close, but not quite identical because some scope for an efficiency effects based analysis remains once the initial formal condition that the conduct take the shape of a contractual clause is satisfied.

It is not a perspective, however, that has withstood the subsequent scrutiny of the Community courts. In *Anic*[49] the E.C.J. was faced with evidence that the appellant polypropylene producer had taken part in price-fixing meetings, but without any accompanying price data to illustrate that the price-fixing intention had been effective.[50] The court was effectively faced with three options. First, follow the implications of the Gand/Mayras line of thought, in which case the indicted behaviour would escape through a lacuna – being neither in the form of an agreement (a prerequisite for having for having an anticompetitive object) nor satisfying the triple burden of conduct, efficiency-effect and proven market effect, of the anticompetitive effect analysis. Secondly, it could leave the Gand/Mayras view of the anticompetitive object intact, including its formalistic elements, but rephrase the effects limb removing the requirement to separately prove concrete market effects – something that Mayras A.G. himself had contemplated in the course of his *Dyestuffs* opinion.[51] The

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[49] Case C-49/92P, *Commission v. Anic Partecipazioni S.p.A.* [2001] 4 C.M.L.R. 602.

[50] *Ibid.*, paras. 93-94.

[51] Cases 48-57/69, *I.C.I. and others v. Commission* [1972] E.C.R. 619, 683, [1972] C.M.L.R. 557, 586, *per* Mayras A.G.: "I have already given you to understand that my opinion is not very far removed from that from that expressed in those words [of Gand A.G. in *Chemiefarma*]. Would it be possible to go further and to take into consideration not the result, the actual effect

third option was to dump the formalistic interpretation of the Gand/Mayras object limb; with the analysis of an anticompetitive object centring on an abstraction of the examined behaviour's efficiency-effects rather than the particular form of the colluders' anticompetitive understanding, and with the effects limb remaining as an examination only of the proven actual-fact market effects – that is, the "concrete effects" envisaged in *Technique Minière*, *Consten and Grundig*, *Miller*, and *Rolled Zinc*. It was this last option which the E.C.J. chose and in so doing closed off the possibility of a formalistic prohibitory analysis within Article 81. The search for anticompetitive objects of Article 81 was deemed to be independent of the form of the conduct under scrutiny; all that mattered was that its efficiency effects could be determined without recourse to empirical "concrete" market proof:

> [A]s in the case of agreements between undertakings and decisions by associations of undertakings, concerted practices are prohibited, regardless of their effect, when they have an anti-competitive object.
>
> Next, although the concept of a concerted practice presupposes conduct of the participating undertakings on the market, it does not necessarily imply that the conduct should produce the concrete effect of restricting, preventing or distorting competition.[52]

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of the practice, but also its potential effect? There can be no doubt that it would seem curious for a concerted practice which has not had any material effect on the competitive situation, despite the intention of the participants and because of circumstances beyond their control, to escape the application of Article [81]. I should be tempted to say that in such a case merely to attempt or initiate execution would be enough to justify the application of Article [81](1)."

[52] Case C-49/92P, *Commission v. Anic Partecipazioni S.p.A.* [2001] 4 C.M.L.R. 602, paras. 123-134. *See also* Case T-141/94, *Thyssen Stahl A.G. v. Commission* [1999] 4 C.M.L.R. 810, paras. 268-272, where, a few months before the *Anic* decision, the C.F.I. came to a similar conclusion when dealing with the analogous Article 65(1) of the E.C.S.C. Treaty: "The Court considers that this prohibition [the Article 65(1) prohibition] applies to any concerted practice which 'tends' or 'is likely' to affect adversely normal competition, without it being necessary to prove, for the purpose of finding that an infringement has been committed, that there has been an actual and specific effect on competition. In its judgment in [Case 2/56, *Geitling and others v. High Authority* [1957 & 58] E.C.R. 3.] the Court of Justice indicated, moreover, that, in order to reach the finding that an agreement distorts or restricts competition, it is not necessary to examine its practical effects, since that finding emerges *in abstracto* from Article 65(1)."; Case 172/80,

In arguing against a formalistic prohibitory reading of the anticompetitive object doctrine it must be conceded that there are instances where the efficiency-effects element of the analysis is, to say the least, thin. As has been mentioned above, the anticompetitive object doctrine has been used to classify certain conduct as hard-core, which in some cases has been relied upon by the courts to conclude that the evidence of the behaviour *ipso facto* indicates an anticompetitive result without the need for a separate efficiency-effects analysis. It would be wrong to infer from this, for a number of reasons, that the existence of hard-core rules undermines the central efficiency-effects focus of the courts.

First, some conduct – including horizontal price-fixing, quota setting, and market-partitioning – is inseparable from the efficiency damaging effect, and in these cases to carry out a separate efficiency effects analysis would be an unnecessary and somewhat artificial over-conceptualisation of the issues involved.

In addition, a finding of hard-core conduct without an explicit efficiency-effects analysis may simply reflect that such an analysis has already been sufficiently established in the prior case-law of the courts. The efficiency-effects analysis within the object limb of Article 81 is, after all, an abstraction of the inevitability of a particular outcome in a given set of circumstances. As such, it is hardly unreasonable for courts to rely directly on prior assessments where the degree of abstraction is sufficient to cover the present case. This 'learning-by-experience' view of hard-core infringements is reflected in the Commission's characterisation of hard-core acts as giving rise to a presumption of anticompetitive effect born from past observation:

Gerhard Züchner v. Bayerische Vereinsbank [1981] E.C.R. 2021, [1982] 1 C.M.L.R. 313, para. 320, *per* Slynn A.G., where the advocate general, nearly 18 years before *Anic*, seemed to allow for the possibility of a concerted practice having an anticompetitive object under Article 81(1), albeit the advocate general's comments in this regard were somewhat perfunctory, and no consideration was given to the position previously adopted by Gand and Mayras A.GG.: "Even if the object of the concerted practice is not to prevent, restrict or distort competition, it certainly could have that effect (so long as it was a significant or material effect) by making the price charged for the services offered independent of purely economic factors…".

> This presumption is based on the serious nature of the restriction and on experience showing that restrictions on competition by object are likely to produce negative effects on the market and to jeopardise the objectives pursued by the Community competition rules.[53]

The Commission's reference here to a "presumption" of anticompetitive effect arising from hard-core conduct also serves to highlight another point. Ultimately, the Community courts' prior findings of a malign efficiency impact in specified circumstances are subject to revision in each new case. While the efficiency-effects examination of the anticompetitive object doctrine may not always be expressly carried out by the court, the fact that the court may call upon such an analysis at any time indicates, at least, a silent approval of the precedent economic analysis. As such, an efficiency analysis looms even where it is not obviously present. This ultimate recourse to an efficiency analysis, even for such obviously hard-core breaches as horizontal price-fixing, was recognised by Judge Vesterdorf, acting as advocate general, in *Polypropylene*:[54]

> According to the traditional view, and in particular the view underlying Article [81](1)(a) and (b) of the Treaty, pricing agreements or production agreements are harmful to competition. What happens, however, should it transpire that pricing agreements cannot normally be used to defy market forces, or if this was impossible in this very case? What happens,

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[53] Commission Notice 2004/C 101/08, Guidelines on the Application of Article 81(3) of the Treaty [2004] O.J. C101/97, para. 21.

[54] [1991] E.C.R. II-869. Combined Opinion for Case T-1/89, *Rhône-Poulenc S.A. v. Commission*; Case T-2/89, *Petrofina S.A. v. Commission*; Case T-3/89, *Atochem S.A. v. Commission*; Case T-4/89, *B.A.S.F. S.A. v. Commission*; Case T-6/89, *Enichem Anic S.p.A. v. Commission*; Case T-7/89, *Hercules Chemicals N.V. v. Commission*; Case T-8/89, *D.S.M. N.V. v. Commission*; Case T-9/89, *Hüls A.G. v. Commission*; Case T-10/89, *Hoechst A.G. v. Commission*; Case T-11/89, *Shell International Chemical Company Ltd. v. Commission*; Case T-12/89, *Solvay & Cie. S.A. v. Commission*; Case T-13/89, *Imperial Chemical Industries Plc. v. Commission*; Case T-14/89, *Montedipe S.A. v. Commission*; Case T-15/89, *Chemie Linz A.G. v. Commission*.

therefore, if either in general or in specific cases pricing agreements are, or were, inapt as a means?

If that were the case, it would undoubtedly provide cause for raising fundamental questions about competition law. An applicant seeking to get off the hook by using such arguments, which appear to be real substantial innovations in the field of competition law, must, however, produce particularly cogent evidence to substantiate his theories.

In my view, it would at least have to be possible to demonstrate that amongst academic writers on economic matters there was a consensus of opinion that the market could never be affected by the means which parties seek to bring to bear.[55]

Should any hard-core rule nevertheless materialise into a rigid efficiency-blind rule within Article 81(1), there remains the final safety net of Article 81(3). The E.C.J. and the C.F.I. in *Binon*,[56] *European Night Services*,[57] and – most emphatically – in *Matra Hachette*[58] have unambiguously asserted that there is no

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[55] *Ibid.*, 948.

[56] Case 243/83, *S.A. Binon et Cie. v. S.A. Agence et Messageries de la Presse* [1985] E.C.R. 2015, [1985] 3 C.M.L.R. 800, paras. 44-47, where the E.C.J. allowed for the possibility that a restrictive distribution system deemed to have an anticompetitive object under Article 81(1) could be exempted by the Commission unde Article 81(3).

[57] Cases T-374-375, 384, 388/94, *European Night Services and others v. Commission* [1998] E.C.R. II-3141, [1998] 5 C.M.L.R. 718, para. 136: "[I]t must be borne in mind that in assessing an agreement under Article [81](1) of the Treaty, account should be taken of the actual conditions in which it functions, in particular the economic context in which the undertakings operate, the products or services covered by the agreement and the actual structure of the market concerned, unless it is an agreement containing obvious restrictions of competition such as price-fixing, market-sharing or the control of outlets. In the latter case, such restrictions may be weighed against their claimed pro-competitive effects only in the context of Article [81](3) of the Treaty, with a view to granting an exemption from the prohibition in Article [81](1)."

[58] Case T-17/93, *Matra Hachette S.A. v Commission* [1994] E.C.R. II-595, para. 85: "[T]he Court considers that, in principle, no anti-competitive practice can exist which, whatever the extent of its effects on a given market, cannot be exempted, provided that all the conditions laid down in Article [81](3) of the Treaty are satisfied and the practice in question has been properly notified to the Commission."

conduct which having been adjudged to have an anticompetitive object under Article 81(1) cannot then be redeemed after an efficiency-effects examination under Article 81(3). The impetus of this finding for an effects-driven approach to Community competition law is all the greater in the wake of Regulation 1/2003[59] insofar as it opens up the vista of a unified 81(1)-81(3) analysis.[60]

Of course, the review of a hard-core rule – whether under the auspices of Article 81(1) or 81(3) – may still be a practical improbability, but the possibility alone is significant: it signifies that the status of any hard-core rule as an operational formalism relies entirely on the continued credibility of its underlying economic justification. In short, the final arbiter of the status of any undertaking's behaviour is its likely effect on competition.[61]

The Case of Non-Economic Socio-Political Objectives

In common with reasoning based on economic analysis, a model of judicial antitrust reasoning based on non-economic socio-political objectives is effects-orientated and avoids the rigidity of the formalistic prohibitory approach. Its distinction from the economic approach is that the effects are measured against the attainment of a policy goal other than the maximisation of efficiency.[62] An example of a socio-political competition law system is the old common law

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[59] Council Regulation 1/2003, on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, [2003] O.J. L1/1.

[60] *Ibid.*, art. 1(2).

[61] Block exemptions should not be considered as formalisms as they do not operate to identify specific actions as illegal – a failure to come under the provisions of one of the block exemptions will not of itself render the action illegal. Instead the block exemptions are better characterised as a qualitative or quantitative *de minimis* procedural devices, and even then the *de minimis* immunity cannot be availed of if its impact on competition is sufficiently deleterious notwithstanding its formal compliance with the terms of the exception; see Council Regulation 1/2003, on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty; [2003] O.J. L1/1, art. 29(1).

[62] Bork defines such systems as "political", while Posner classifies them as "populism"; R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, (New York: Free Press, 2nd Edition, 1993), p. 72 *et seq.*; R. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 2nd Edition, 2001), pp. 23-24.

relating to restraints of trade as it was prior to – and, to a lesser extent, as it was immediately after – the introduction of the first antitrust statutes. Here, the test of an agreement in restraint of trade was its 'reasonableness', or otherwise – by which it was meant the degree of its impact on the future freedom to contract; while the test of the legality of a combination was its impact on the trading possibilities of third parties.[63] This approach located a policy-weighting decision (balancing the respective rights and interests of parties *inter se* and social policy as a whole) within the familiar legal conventions of fairness and reasonableness. The Warren Court's interpretation of U.S. merger rules in the 1960's is an even more overt illustration of non-economic socio-political reasoning. Thus, in *Brown Shoe*[64] Chief Justice Warren, delivering the majority opinion, expressly relegated the efficiency benefits of the merger in question (in the form of lower consumer prices and greater variety of products) behind concerns for the protection of small businesses and the maintenance of market plurality.[65]

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[63] *See generally* G. Amato, *Antitrust and the Bounds of Power: The Dilemma of Liberal Democracy in the History of the Free Market*, (Oxford: Hart, 1997), pp. 8-14; H. Hovenkamp, "The Sherman Act and the Classical Theory of Competition", (1989) 74 *Iowa L. Rev.* 1019; M. Handler, *Trade Regulation: Cases and Materials*, (Brooklyn: Foundation Press, 1960), p. 104 *et seq.*

[64] *Brown Shoe Co. v. U.S.* 370 U.S. 294 (1962).

[65] *Ibid.*, 333, *per* Chief Justice Warren: "[N]ot only must we consider the probable effects of the merger upon the economics of the particular markets affected but also we must consider its probable effects upon the economic way of life sought to be preserved by Congress. Congress was desirous of preventing the formation of further oligopolies with their attendant adverse effects upon local control of industry and upon small business. Where an industry was composed of numerous independent units, Congress appeared anxious to preserve this structure."; *ibid.*, 344, *per* Chief Justice Warren: "[A] strong, national chain of stores can insulate selected outlets from the vagaries of competition in particular locations and that ... large chains can set and alter styles in footwear to an extent that renders the independents unable to maintain competitive inventories. A third significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. ...It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these

It is important to emphasise that rejecting a non-economic objective for competition law should not be equated with declaring the supremacy of competition law over the legal implementation of other policy objectives. It is well accepted that the jurisdiction of the competition provisions of the Treaty are subject to certain limits. Some of these boundaries are set out in the Treaty itself, such as Article 36's pronouncement that Articles 81 and 82 shall only apply to the agricultural sector to the extent permitted by the Council.[66] Other limits have been recognized by the courts in cases such as *Albany*,[67] where the E.C.J. held that Article 81 was not applicable to collectively negotiated labour agreements, thereby yielding the application of the competition provisions to Community employment policy and rights of association.[68] In each of these instances the internal workings of competition law are unaffected; instead what is rejected is the application of the competition law system in its totality to certain sectors and problems. The issue of how antitrust rules are themselves reasoned, whether on a formalistic prohibitory, efficiency-effects or non-economic objective basis, is a

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competing considerations in favor of decentralization. We must give effect to that decision." Citations omitted. *See* G. Amato, *op. cit.*, p. 18; R. Bork, *op. cit.*, pp. 198-216.

[66] E.C. Treaty, art. 36: "The provisions of the Chapter relating to rules on competition shall apply to production of and trade in agricultural products only to the extent determined by the Council within the framework of Article 37(2) and (3) and in accordance with the procedure laid down therein, account being taken of the objectives set out in Article 33."; Case 139/79, *Maizena G.m.b.H. v. Council* [1980] E.C.R. 3393, para. 23: "[Article 36] recognizes the precedence the agricultural policy has over the aims of the Treaty in relation to competition and the power of the Council to decide how far the rules on competition should apply to the agricultural sector." See generally P. Roth (ed.), *Bellamy & Child: European Community Law of Competition*, (London: Sweet & Maxwell, 5th Edition, 2001), paras. 18-001 *et seq.*

[67] Case C-67/96, *Albany International B.V. v. Stichting Bedrijfspensioenfonds Textielindustrie* [1999] E.C.R. I-5751, [2000] 4 C.M.L.R. 446.

[68] *Ibid.*, paras. 59-60: "It is beyond question that certain restrictions of competition are inherent in collective agreements between organisations representing employers and workers. However, the social policy objectives pursued by such agreements would be seriously undermined if management and labour were subject to Article [81](1) of the Treaty when seeking jointly to adopt measures to improve conditions of work and employment. It therefore follows from an interpretation of the provisions of the Treaty as a whole which is both effective and consistent that agreements concluded in the context of collective negotiations between management and labour in pursuit of such objectives must, by virtue of their nature and purpose, be regarded as falling outside the scope of Article [81](1) of the Treaty."

separate consideration. Rejecting a socio-political analysis of competition rules does not affect the subsidiarity, or otherwise, of those rules vis-à-vis others implementing different policies; rather, to paraphrase Amato, it challenges the extent to which non-efficiency policy concerns corrode the antitrust machinery from within.[69]

Similarly one should be careful not to confuse the rejection of non-economic objectives as an operative part of competition law, with the fact that such objectives undoubtedly exist as part of the background political antitrust objectives. Full employment, economic liberty and a peaceful and integrated international community can probably be identified as some of the motivations for introducing a Community competition policy; however, this is not to say that these concerns are permissible considerations in the application of competition law. Kobayashi uses an analogy to the role of the physician to explain this distinction between operative and background objectives: on one hand doctors may diagnose and cure the patient using their abilities and available resources; but while "many doctors hope that by curing a patient, that patient will be able to work effectively, creatively, and happily", ensuring these outcomes is not within their gift.[70]

In the Community law context, non-economic, or to be more precise, non-efficiency orientated policy goals are often cited as informing the courts' view of whether a given behaviour should be branded as anticompetitive. The most celebrated of these alternative objectives is the so-called 'market integration imperative': an understanding that the courts will reject an efficiency-promoting rule where it collides with the promotion of cross-border trade.[71] Other non-economic policy objectives have also been read by commentators into the judgments of the Community courts at one time or

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[69] G. Amato, *op. cit.*, p. 62.

[70] Quoted in "Panel Discussion: Competition Policy Objectives", in C. Ehlermann and L. Laudati (eds.), *European Competition Law Annual 1997: The Objectives of Competition Policy*, (Oxford: Hart Publishing, 1998), p. 21. *See also* A. Schaub, "Working Paper VIII", in C. Ehlermann and L. Laudati (eds.), *op. cit.*, p. 124.

[71] *See* V. Korah, "E.E.C. Competition Policy: Legal Form or Economic Efficiency", [1996] *Current Legal Problems* 85, 91: "In competition cases, however, integration has been elevated by the Commission and the Court to a goal in itself, more important than efficiency."

another. Broadly, and, it is hoped, without making too great a sacrifice to expediency, these can be divided into: descriptions of cases which are mentioned as instances of fairness or market plurality reasoning; and accounts attributing the courts' approach to competition as encompassing an industrial policy of employment protection. Taken together, these non-economic socio-political approaches indicate a legal understanding of competition quite separate from the efficiency-promoting one of economic thinking. As far as the divergence of law and economics is concerned they point to a straightforward explanation: within the 'big top' of competition law, the policy of maximising efficiency is not the only, or even the best, way of determining what constitutes anticompetitive conduct. What a closer study of these cases reveals, however, is that each of these explanations has little or no foundation in the case-law upon which it seeks to rely.

Socio-Political Objectives I: The Market Integration Imperative

The touchstone of the market integration imperative is usually cited as the *Consten and Grundig* decision.[72] The case concerned an agreement for the exclusive distribution by Consten of Grundig electrical consumer goods into France from Germany, which was accompanied by Grundig's undertaking to prohibit its German distributors from carrying out imports into the French market, and a grant to Consten of a right to register Grundig's brand name under French trade mark law. The combined effect of these provisions was to seal off the French market from parallel imports of Grundig goods through unauthorised channels. The applicants contended that this level of protection was necessary to foster a new brand in a market where, at the time of the original agreement, it had an insignificant presence. Moreover, it was argued that even after the success of Consten in establishing a market for Grundig goods in France there remained a high level of inter-brand competition between the various producers of electrical consumer goods. In its analysis the Commission had failed to challenge this assertion or undertake any worthwhile economic examination of the market, the level of inter-brand competition or of the agreement's actual

[72] G. Amato, *op. cit.*, p. 49.

economic effect on market price and output levels. Nevertheless, the E.C.J. upheld the Commission's decision concluding that:

> No further considerations, whether of economic data ... or of the correctness of the criteria upon which the Commission relied in its comparisons between the situations of the French and German markets, and no possible favourable effects of the agreement in other respects, can in any way lead, in the face of the above mentioned restrictions to a different solution under Article [81](1).[73]

Amato argues that this rejection of the inter-brand argument by the court is one "inconceivable" to a system of competition law centred on efficiency concerns, and reflects the operation of a different concept of competition, one based on "another principle, a higher one in 1966, that of market integration" which served to over-rule what would otherwise have been the outcome if efficiency reasoning alone had been employed.[74] It is submitted, however, that it is more convincing to read *Consten and Grundig* not as a rejection of an economic approach, but as an instance of efficiency reasoning prioritising short term price reductions from intra-brand competition over dynamic longer term considerations of market entry.

For a start, it should be clarified that when the E.C.J. refused to entertain arguments based on the "possible favourable effects" of the agreement it was asserting that once the agreement had been found to have an anticompetitive object there was no need to examine its empirical effects. As has been discussed during the examination of the formalistic-prohibitory approach, the refusal to apply the "effects" limb of Article 81 is an indication that an abstract efficiency-effects analysis has already occurred under the "object" part of the prohibition. The "effects" deemed unimportant in *Consten and Grundig* are, therefore, only the "concrete" ones in the form of visible market data.[75] In truth, the E.C.J. gave much consideration to the general efficiency effects of restrictions on intra-brand

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[73] [1966] E.C.R. 299, 343, [1966] C.M.L.R. 418, 474.

[74] G. Amato, *op. cit.*, pp. 48-49. Amato refers to the outcome as being inconceivable in the Chicago-influenced decision-making of modern U.S. antitrust.

[75] [1966] E.C.R. 299, 342, [1966] C.M.L.R. 418, 473, quoted *supra* fn. 36.

competition before coming to its conclusion that the agreement had an anticompetitive object. Early on in its judgement the court argued that restrictions on intra-brand competition could not be deemed *per se* legal since they could have an economically harmful effect on competition. The applicants' argument that a vertically integrated undertaking was economically identical to two separate legal entities operating at different levels of the economy linked by an exclusivity agreement was rejected by the court on the grounds that their efficiencies would not necessarily be equivalent[76] and that there could be a resulting "unjustified advantage at the expense of the consumer or user".[77] Later, as the court directly addressed the issue of whether the agreement had an anticompetitive object, reduced substitutability, higher consumer prices and lower distribution efficiency were specifically identified as economic harms which could arise from the agreement's intra-brand restrictions.[78] The court also considered on its merits an efficiency based free-rider argument (that parallel

[76] *Ibid.*, 340 (E.C.R.), 470 (C.M.L.R.): "These situations are distinct in law and, moreover, need to be assessed differently, since two marketing organizations, one of which is integrated into the manufacturer's undertaking whilst the other is not, may not necessarily have the same efficiency. ...It does not thereby follow, however, that the contractual situation based on an agreement between a manufacturing and a distributing undertaking is rendered legally acceptable by a simple process of economic analogy – which is in any case incomplete and in contradiction with the said Article [81]."

[77] *Ibid.*, 340-341 (E.C.R.), 470 (C.M.L.R.): "Competition may be distorted within the meaning of Article [81](1) not only by agreements which limit competition which might take place between one of them and third parties. For this purpose, it is irrelevant whether the parties to the agreement are or are not on a footing of equality as regards their position and function in the economy. This applies all the more, since, by such an agreement, the parties might seek, by preventing or limiting the competition of third parties in respect of the products, to create or guarantee for their benefit an unjustified advantage at the expense of the consumer or use, contrary to the general aims of Article [81]."

[78] *Ibid.*, 343 (E.C.R.), 474 (C.M.L.R.): "The situation as ascertained above results in the isolation of the french market and makes it possible to charge for the products in question prices which are sheltered from all effective competition. In addition, the more producers succeed in their efforts to render their own makes of product individually distinct in the eyes of the consumer, the more the effectiveness of competition between producers tends to diminish. Because of the considerable impact of distribution costs on the aggregate cost price, it seems important that competition between dealers should also be stimulated. The efforts of the dealer are stimulated by competition between distributors of products of the same make."

importers would avail of Consten's investment in advertising of the Grundig brand and its free service guarantee), and rejected it as factually unproven.[79] Overall, *Consten and Grundig* reads quite satisfactorily as a decision based on a coherent efficiency-based argument against certain types of intra-brand restrictions without the need to imply into the judgment an efficiency-rejecting line of market integrationist thought for which there is scant support in the actual language of the court.[80]

To be fair to Amato, he readily concedes that the over-riding of efficiency arguments by market integrationist reasoning alleged to underpin *Consten and Grundig* is apparent only as an "implicit" principle.[81] If such an implicit principle does exist, one would expect two conclusions to follow. First, an efficiency analysis that revealed the competitive benefits of a parallel import prohibition would never be allowed to prevail by the courts because this would ignore the supremacy of the market integration policy. Secondly, in the absence of a parallel import prohibition the efficiency benefits of intra-brand restrictions on inter-brand trade would be acknowledged and permitted under Article 81(1)

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[79] *Ibid.*, 349 (E.C.R.), 478 (C.M.L.R.): "As regards the free guarantee service, the Decision states that a purchaser can normally enforce his right to such a guarantee only against his supplier and subject to conditions agreed with him. The applicant parties do not seriously dispute that statement. The fears concerning the damage which might result for the reputation of Grundig products from an inadequate service do not, in the circumstances, appear justified. In fact, U.N.E.F., the main competitor of Consten, although it began selling Grundig products in France later than Consten and while having had to bear not inconsiderable risks, nevertheless supplies a free guarantee and after-sales services against remuneration upon conditions which, taken as a whole, do not seem to have harmed the reputation of the Grundig name. Moreover, nothing prevents the applicants from informing consumers, through adequate publicity, of the nature of the services and any other advantages which may be offered by the official distribution network for Grundig products. It is thus not correct that the publicity carried out by Consten must benefit parallel importers to the same extent."

[80] An almost identical approach to that used in *Consten and Grunidg* is evident in the subsequent *Tepea* decision. Once again a parallel import prohibition (this time of a "dustbuster" product produced in the United Kingdom and distributed in the Netherlands) was found to be contrary to Article 81 on the grounds of the protection of intra-brand competition rather than any ostensible protection of the market integration imperative; Case 28/77, *Tepea B.V. v. Commission* [1978] E.C.R. 1391, [1978] 3 C.M.L.R. 392, *espec.* paras. 56-57.

[81] G. Amato, *op. cit*, pp. 48-49.

since it is only the over-riding integrationist concern that prevents such efficiency arguments from prevailing. The subsequent case-law of the Community courts, however, demonstrates that neither of these conclusions can been sustained.

The first conclusion is rebutted by the Article 234 reference case of *Coditel II*,[82] where the E.C.J. examined the exclusive distribution rights granted to a Belgian film distributor for a French production, which the distributor sought to enforce against a cable television service that had relayed a German station's broadcast of the film. Reischl A.G. concluded that on efficiency grounds the restriction of intra-brand competition in this case was justified since without it it was unlikely that the film would have been picked up by a large-scale film distributor.[83] More significantly he concluded that it was "immaterial" that upholding the agreement on these grounds "*ipso facto* leads to the exclusion of 'parallel imports'";[84] in other words, an integration imperative would not over-rule efficiency reasoning. The E.C.J. endorsed the advocate general's opinion, reiterating the negative impact on market access (and hence on consumer welfare) that an insistence on intra-brand competition in this case would entail,[85] and acknowledging that in these circumstances the existence of a parallel import prohibition was not a sufficient condition for an agreement to be deemed to have an anticompetitive object.[86] *Coditel II* is therefore impossible to

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[82] Case 262/81, *Coditel S.A. and others v. Cine Vog Films S.A. and others (No. 2)* [1982] E.C.R. 3381, [1983] 1 C.M.L.R. 49.

[83] *Ibid.*, 62 (C.M.L.R.), *per* Reischl A.G.: "[I]t has been pointed out that films are often made with the financial participation of distributors. This, of course, does not happen without a certain safeguard against risks. A distributor will only be prepared to pay a lump-sum advance to finance a film if in return he is granted an exclusive exhibition right for a particular market. If this possibility were excluded, the production of films would largely cease, the market would become impoverished and as a result competition would diminish."

[84] *Ibid.*, 63 (C.M.L.R.), *per* Reischl A.G.

[85] *Ibid.*, para. 16: "[T]he characteristic features of the cinematograph industry and markets in the Community, particularly those relating to dubbing or subtitling for audiences belonging to different language groups, to the possibilities of television broadcasting, and to the system for financing film production in Europe, show that a licence for exclusive exhibition is not in itself likely to prevent, restrict or distort competition."

[86] *Ibid.*, para. 15: "The mere fact that the proprietor of a film copyright has granted to a single licensee the exclusive right to exhibit the film in the territory of a member-State, and therefore to

reconcile with the view that the Community courts' intra-brand analysis is a façade for the supremacy of market integration reasoning. On the contrary, it demonstrates unambiguously that an efficiency analysis is both capable of approving restrictions on intra-brand competition on economic grounds and defending such a finding even where it results in market segregation.

The rejection of the second conclusion is evident in the E.C.J.'s *Pronuptia*[87] judgment. Here the court examined a franchising agreement that provided *inter alia* that the franchisee could not sell outside of his assigned contract area, while the franchisor undertook not to grant any other franchises within that same territory. The key fact here is that the assigned contract areas consisted of individual cities (Hamburg, Oldenburg and Hanover) within a single national market (Germany). As such, there was no issue of the impact of the agreement on cross-border economic integration. It is therefore significant that the E.C.J., even when relieved of the apparent market integration imperative, opted to follow an efficiency analysis which deemed intra-brand competition worth protecting. As in *Consten and Grundig* the court commenced its analysis by dismissing the economic analogy to a single vertically integrated undertaking,[88] and concluded by condemning the territorial restrictions on the grounds that they eradicated intra-brand price competition without creating any tangible efficiency balancing benefits for the creation and maintenance of brand reputation, or the protection of intellectual property.[89] Crucially, in reaching this

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prohibit its diffusion by others, for a specified period, is not sufficient however for a finding that such a contract must be considered as the object, means or consequence of an agreement, decision or concerted practice prohibited by the Treaty."

[87] Case 161/84, *Pronuptia de Paris G.m.b.H. v. Pronuptia de Paris Irmgard Schillgallis* [1986] E.C.R. 353, [1986] 1 C.M.L.R. 414.

[88] *Ibid.*, para. 10: "The contracts in question are characterised by territorial protection given to the franchisee. They cannot be assimilated to agreements with commercial agents, given that unlike the latter franchisees act in their own name and on their own account and shoulder the marketing risks."

[89] *Ibid.*, paras. 23-24: "It should on the other hand be stressed that, far from being necessary for the protection of the know-how provided or for the preservation of the identity and reputation of the network, certain clauses.... The attention of the national court should, in this regard, be drawn to the clause which requires the franchisee to sell the merchandise covered by the agreement only at the location designated in the contract. This clause prohibits the franchisee

conclusion the court declined to follow Verloren Van Themaat A.G.'s interpretation of *Consten and Grundig* as establishing a *per se* rule governing parallel imports separate from the general rule for the evaluation of intra-brand restraints.[90] Instead, *Consten and Grundig* is simply accepted as authority for a single rule of efficiency-based intra-brand analysis.[91] Once again, as with the *Coditel II* decision, *Pronuptia* provides confirmation, if confirmation were needed, that the court's intra-brand analysis stands independently of concerns of market integration.

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from opening a second shop. Its real significance emerges if one juxtaposes it to the undertaking by the franchisor to the franchisee, to ensure to him exclusivity of use of the licensed mark in a given territory. In order to honour the promise thus made to a franchisee the franchisor must not only refrain from establishing itself in the territory but must also secure undertakings from the other franchisees not to open another shop outside their own. The juxtaposition of clauses of this type results in a kind of market partitioning between the franchisor and the franchisees or among the franchisees and thus restricts competition within the network. As follows from the judgment in [*Consten and Grundig*], this type of restriction constitutes a restriction on competition in the sense of Article [81](1), since it concerns a mark that is already widely known."

[90] *Ibid.*, 435 (C.M.L.R.), *per* Verloren Van Themaat A.G.: "Article [81](1) of the EEC Treaty is applicable to franchise agreements such as those concluded between the parties in this case in so far as *inter alia*: ... (c) the agreements prevent or restrict, or are intended to prevent or restrict, parallel imports of the products covered by the contract into the contract territory or exports of those products by the franchisee to other member-States, or (d) the agreements result – in particular through the establishment of local or regional monopolies for the products covered by the contract, through royalty provisions and contractual provisions or concerted practices with regard to the setting of prices and on account of the absence of effective competition from similar products – in the setting of unreasonably high retail prices, that is to say, prices which could not be charged if effective competition existed, even allowing for the superior quality of the products covered by the contract. ... I have made it clear that criteria (c) and (d) are to be regarded as alternative criteria. In accordance with the judgments of the Court [referring to *Consten and Grundig* and *Nungesser* discussed earlier in the advocate general's opinion: *ibid.*, 434 (C.M.L.R.), *per* Verloren Van Themaat A.G.], criterion (c) places the emphasis on the absolute territorial protection of national markets, which cannot fail to result in significant restriction of horizontal competition unless the market shares involved are negligible. In criterion (d), on the other hand, the accent is placed on the prevention of monopolistic price increases, which as a rule will only be possible where the party concerned has a substantial share of the relevant local or regional markets and where there is no downward influence on prices as a result of other means of distribution for similar products."

[91] *Ibid.*, para. 24, quoted *supra* fn. 89.

The same approach is visible in the Article 82 context in Jacobs A.G.'s recent *Syfiat*[92] advisory opinion. The case concerned a refusal to supply by GlaxoSmithKline to certain Greek wholesale pharmaceutical distributors with the acknowledged aim of preventing the re-export of these products from Greece to other Member States where the market price for the products was considerably higher. Jacobs A.G. confirmed that there was no *per se* rule against parallel import restrictions,[93] although the efficiency characteristics of such measures – named as the reduction of intra-brand competition and higher consumer prices – meant that in most cases they would be considered to be anticompetitive.[94] In the advocate general's opinion, however, the efficiency effects of GlaxoSmithKline's actions placed it within the exceptional class and the parallel import ban was held not to be anti-competitive. Jacobs A.G. accepted that the regulatory price controls on pharmaceuticals in force in some countries effectively meant that these cheaper markets were generating returns for GlaxoSmithKline which if extended across the Community-wide market would not justify its capital investment in research and development; effectively

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[92] Case C-53/03, *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and others v. GlaxoSmithKline A.E.V.E.* [2005] 5 C.M.L.R. 1. The E.C.J. did not consider the issue of the parallel import restriction, finding as a preliminary matter that the court did not have jurisdiction to hear the reference from the Greek competition authority.

[93] *Ibid.*, para. 69, *per* Jacobs A.G.: "[A] dominant pharmaceutical undertaking which restricts the supply of its products does not necessarily abuse its dominant position within the meaning of Article 82 E.C. merely because of its intention thereby to limit parallel trade."

[94] *Ibid.*, para. 71, *per* Jacobs A.G.: "I consider it plausible, as the Commission submits, that an intention to limit parallel trade should be one of the circumstances which will ordinarily render abusive a refusal of supply on the part of a dominant undertaking. Such conduct is normally aimed at removing a source of competition from the dominant undertaking on the market in the Member State of import. Even assuming that a sufficient effect on competition could not in all cases be shown, an additional argument can be made in support of such a conclusion on the basis of the market-partitioning object of the conduct at issue."; *ibid.*, para. 74, *per* Jacobs A.G.: "In most cases, the benefits of parallel trade are clear: such trade promotes intra-brand competition, reducing prices in the State of import to the benefit of consumers there."; *ibid.*, para. 96, *per* Jacobs A.G.: "Ordinarily, the benefits of parallel trade are felt by those who are able to buy products at a lower price on the market for which the trade is destined."

the more expensive markets were subsidising the cheaper ones.[95] If the parallel import restricting behaviour was to be prohibited one of two efficiency damaging results would follow: a reduced overall output following the ending or delaying of supplies to the domestic consumers in the cheaper price-controlled markets;[96] or a reduction in the market optimal level of research and development investment.[97] The *Syfiat* advisory opinion thus ties together all the strands of the rejection of a market integration imperative. On one hand, it reflects the approaches in *Pronuptia* and *Consten and Grundig* by confirming that the anticompetitive characterisation of parallel import restrictions has a solid basis in efficiency reasoning without the need to concoct an additional rule of cross-border integration. At the same time, it restates in absolute terms the *Coditel II*-style finding that there is no *per se* market integration imperative capable of withstanding an efficiency argument to the contrary.

A discussion of the role of the market integration imperative could not be complete without mentioning the 'jewel in the crown' of the supposed market

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[95] *Ibid.*, para. 89, *per* Jacobs A.G.: "The decision whether to invest in developing a new pharmaceutical product will obviously depend in part upon whether the producer expects to be able to make sufficient profits to recoup the cost of investment. Once the investment is made, however, that cost is sunk. It is therefore rational for an undertaking to supply its products on any market where the price is fixed above variable cost. The mere fact that a product is marketed on a given market at a given price does not mean that a pharmaceuticals undertaking could recoup its total costs if that price were generalised across the whole of the Community."

[96] *Ibid.*, *per* Jacobs A.G., para. 91: "There would clearly be an incentive for such undertakings not to market products which might win for them a dominant position in Member States in which prices are fixed at a low level. As discussed above, the legal and moral obligations upon undertakings might render it difficult for them to withdraw products already marketed in those States. More credibly, they might delay the launch of new products in those States. The levels of output and consumer welfare generated by some pharmaceutical products would therefore fall within the Community."

[97] *Ibid.*, para. 93, *per* Jacobs A.G.: "If low-price Member States were able to resist the pressure for price rises, and pharmaceuticals undertakings did not withdraw or delay products, the revenue generated by products in respect of which dominance was found would be cut. The incentive for a pharmaceutical undertaking to invest in research and development would to that extent be reduced, given the lower returns which such an undertaking could expect to enjoy during the period of its patent protection."

integration imperative: *Maize Seeds*.[98] The case, which it should be noted predates *Coditel II*, *Pronuptia* and *Syfiat*, examined the distribution agreement between Nungesser, a German distributor, and I.N.R.A., a French state-agency which had developed a new variety of maize seed. Two elements of the contract were in contention, both with ostensibly the same aim of assisting Nungesser in the difficult task of penetrating the conservative German maize market with a new product. On one hand, I.N.R.A. agreed that Nungesser would be the only distributor on the German market which it would supply directly (referred to in the judgment as the "open exclusive licence"). In addition, I.N.R.A. undertook to do "everything in its power" to prevent parallel imports into the German market by its distributors in its other markets. Despite the common goal of these two clauses, the E.C.J. dealt with each differently. The open exclusive licence, the court held, had no harmful efficiency effects due to the fact that it was a prerequisite for entering the German market (without the protection of which, the court found, no distributor would assume the risks involved).[99] The same efficiency justification was not afforded, however, to the parallel import ban which was deemed to have an anticompetitive object.[100] Given the court's first

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[98] Case 258/78, *Nungesser K.G. and Kurt Eisele v. Commission* [1982] E.C.R. 2015, [1983] 1 C.M.L.R. 278.

[99] *Ibid.*, paras. 57-58: "[T]he case of a licence of breeders' rights over hybrid maize seeds newly developed in one member-State, an undertaking established in another member-State which was not certain that it would not encounter competition from other licensees for the territory granted to it, or from the owner of the right himself, might be deterred from accepting the risk of cultivating and marketing that product; such a result would be damaging to the dissemination of a new technology and would prejudice competition in the Community between the new product and similar existing products. Having regard to the specific nature of the products in question, the Court concludes that, in a case such as the present, the grant of an open exclusive licence, that is to say a licence which does not affect the position of third parties such as parallel importers and licensees for other territories, is not in itself incompatible with Article [81](1) of the Treaty."

[100] *Ibid.*, paras. 61, 64: "The Court has consistently held (see [*Consten and Grundig*] that absolute territorial protection granted to a licensee in order to enable parallel imports to be controlled and prevented results in the artificial maintenance of separate national markets, contrary to the Treaty. ... It is clear from the documents in the case that the contracts in question were indeed intended to restrict competition from third parties on the German market." Citations omitted.

conclusion, it is fair to ask how the second was reached other than by the use of a market integration principle to trump an efficiency argument which the court itself had apparently accepted.[101]

One answer that is apparent from the court's Article 81(3) analysis is that although the two contractual clauses shared an objective, their effects on competition were of a materially different degree. Thus, while protection from competition by another German distributor directly supplied in large quantities by I.N.L.A. may have been a necessary condition for market entry, the parallel import ban went "beyond what it is indispensable for the improvement of production or distribution"[102] – perhaps, one might speculate, because of the smaller scale on which parallel imports were likely to occur compared to a directly supplied competitor.

Even if it is conceded that the interpretation of *Maize Seeds* as adopting an internally-consistent approach in its efficiency analysis reads too much into the decision, it does not necessarily follow that the case marks a triumph of market integration reasoning over economic concerns. The question to be asked is: does the reasoning of *Maize Seeds* become any more convincing when the promotion of cross-border market activity is accepted as its guiding concern? If it is accepted that on efficiency grounds the parallel import ban was just as much a prerequisite for the penetration of the German market as the open exclusive licence, then it is difficult to comprehend how prohibiting the former would aid the over-reaching aim of further market integration since in these circumstances no significant entry onto the German market would occur, and hence no market-

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[101] *See* V. Korah, *loc. cit.*, 99-99: "I cannot reconcile the two parts of the judgment save on the basis that the judges were divided and compromised on the basis of a formalistic decision, or that some or all of the judges were not prepared to permit an export ban even if such a ban was necessary to enable the seed to be skid at all in the Federal Republic. Any restriction leading to absolute territorial protection is condemned without thought." Citations Ommitted.

[102] *Ibid.*, para. 77: "As it is a question of seeds intended to be used by a large number of farmers for the production of maize, which is an important product for human and animal foodstuffs, absolute territorial protection manifestly goes beyond what is indispensable for the improvement of production or distribution or the promotion of technical progress, as is demonstrated in particular in the present case by the prohibition, agreed to by both parties to the agreement, of any parallel imports of I.N.R.A. maize seeds into Germany even if those seeds were bred by I.N.R.A. itself and marketed in France."

integration of any variety – whether in the form of direct imports or parallel imports free-riding on the groundwork by Nungesser – would arise. Consequently, to the extent that *Maize Seeds* is irreconcilable with an efficiency-approach it would also appear to be less than satisfactory from the market integrationist viewpoint. Perhaps the best conclusion to be drawn from the case is not that it marks the sacrifice of an economic approach to the higher objectives of the Treaty, but that it is simply an incoherent decision.

This analysis of *Maize Seeds* raises a wider point about the credibility of attributing to the aim of market integration the divergence of competition law from an economic approach. Just as it is difficult to envisage within the facts of *Maize Seeds* circumstances where an efficiency maximising outcome would not also have been the market integration optimum, it is similarly hard to conceive of any situation where the two objectives would not be aligned.[103] If a particular restriction is construed as a necessary incentive for market entry in the first place, and that market entry occurs across a Community border, then it would appear to automatically follow that the restriction is a prerequisite also for the cross-border trade to occur. One might conclude that the often repeated statements by the courts that the Treaty's antitrust provisions are the means to the end of market integration should be taken at face value as an indication of two complementary aims,[104] rather than as the revelation of some supreme efficiency-rejecting legal principle.

Indeed, the linear 'means-ends' relationship between competition and market integration itself should be questioned given that the ultimate aim of market integration, after all, is to serve a still greater objective: the promotion of "economic and social progress and a high level of employment"[105] – one that

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[103] Neven makes a similar point, speaking in the context of the market plurality objective in general, that the "Community's market integration objective does not necessarily promote market integration! ...[T]he absence of territorial restraints for the sake of market integration might have the effect of deterring the distribution of commodities across Member States"; D. Neven, "Working Paper VII", in C. Ehlermann and L. Laudati (eds.), *op. cit.*, p. 117.

[104] *See* P. Roth (ed.), *op. cit.*, para. 1-075: "Community competition law has two basic and complementary aims: the promotion of a competitive market economy and the prevention of barriers to integration of the single market."

[105] Treaty on European Union, art. 2.

would appear to be pursued as well by an efficiency promoting aim directly, as through a competition policy with an intermediary market integration justification. An endorsement of this view is apparent in some of the Commission's recent pronouncements. As has been mentioned,[106] the Commission's vertical restraints guidelines refer to an efficiency-focussed concept of competition law as the "primary objective" of Article 81, while the goal of market integration is referred to as a secondary "additional goal".[107] The guidelines on the application of Article 81(3) take a similar tack, with market integration described as serving the "ends" of "enhancing consumer welfare and of ensuring an efficiency allocation of resources".[108] Ultimately, the issue of whether the relationship between the two objectives is circular or linear is unimportant; the basic point is that in addition to there being little evidence in the case-law of a divergence from an economic approach founded on market-integration reasoning, there appears to be little scope for such a divergence occurring even in theory.

Socio Political Objectives II: The Preservation of Market Plurality

A competition law system which has an objective of market plurality is one that seeks to maintain a certain minimum number of competitors within each given product market. It is an aim that will often result in decisions being made along the same lines as under an efficiency focussed approach: in many cases preventing acts of market concentration may be the most effective way of ensuring price competition and, at least in the short term, greater efficiency. There will also be instances, however, where rules promoting the most efficient result will conflict with those aimed at preserving, above all else, the continued presence on the market of rival undertakings, even where this means protecting

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[106] *See supra* p. 20.

[107] [2000] O.J. C291/1, para. 2(7), additional extract quoted *supra* p. 20.

[108] [2004] O.J. C101/97, para. 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 resource throughout the Community for the benefit of consumers."

those rivals that are less efficient. The key characteristic of the market plurality objective, therefore, is that it preserves competition first and foremost as a market structure rather than as an efficiency creating market process, with legal rights being created for competitors that cannot be justified on the grounds of maximising consumer welfare.

The arguments for following such an approach in the application of Articles 81 and 82 rest on the view that Community competition law is built on the theoretical foundations of the Freiburg 'ordoliberal' school of antitrust analysis. The ordoliberal viewpoint, expounded in the English language mainly by Gerber, sets out two complimentary objectives for antitrust.[109] First, competition laws should seek to prevent the creation of monolithic economic entities capable of wielding a political power proportionate to their economic dominance.[110] Second, is a European application of the Jeffersonian economic ideal; that is, the dispersal of economic power through a large number of small and medium enterprises should be valued in its own right as a means of ensuring individual economic liberty.[111] Although the ordoliberal view came to prominence primarily as an economic recipe for rebuilding Germany in the 1950s, embedded within it is a belief that the promotion of economic efficiency has its limits. The competitive process left unchecked is seen as self-destructive, with the less efficient being weeded out until ultimately only the fittest survives as a monopoly.[112] Underpinning ordoliberalism is an adherence to the idea of 'ruinous competition' and a deep-seated suspicion of the unbridled market process; views that compel a construction of competition law where an efficiency-focussed analysis must on occasion be rejected so that market plurality might be maintained.

There is little doubt that the ordoliberal objectives were influential in helping the earliest Member State competition laws develop. What is less

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[109] *See* D. Gerber, "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the 'New' Europe", (1994) 42 *Am. J. Comp. L.* 25; D. Gerber, "Law and the Abuse of Economic Power in Europe", (1987) 62 *Tul. L. Rev.* 57. *See also* G. Amato, *op. cit.*, pp. 39-45.

[110] D. Gerber, "Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the 'New' Europe", *loc. cit.*, 36-37.

[111] *Ibid.*, 37.

[112] *Ibid.*, 38, 52.

apparent is that this approach has been applied by the Community courts to the exclusion of an efficiency analysis. Gerber points to the early Article 82 cases of *Commercial Solvents*,[113] *United Brands*,[114] *Hoffmann-La Roche*[115] and *Michelin*[116] as instances of the Freiburger school of thought in action,[117] but none of these decisions, it is submitted, indicates the pre-eminence of ordoliberal arguments over efficiency based ones.

In *Commercial Solvents* the E.C.J. decided that the refusal by Istituto Chemioterapico to supply aminobuthanol to Zoja for processing into ethambutol shortly after Istituto Chemioterapico had entered the ethambutol market was an abuse of a dominant position. The court's explanation of why this behaviour constituted an abuse was phrased purely in terms of the behaviour's impact in removing a competitor from the marketplace.[118] Gerber interprets this conclusion as authority for the proposition that "the actual elimination of a competitor through acquisition *could* constitute abuse",[119] and hence the central purpose of Article 82 is the preservation of markets with multiple competitors as an objective in its own right.[120] Gerber's argument is technically accurate – the elimination of a competitor "could" be used to infer an abuse of dominance – but it is nevertheless misleading in so far as it suggests an exclusively ordoliberal approach. It is important to emphasise the circumstances in which

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[113] Cases 6-7/73, *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v. Commission* [1974] E.C.R. 223, [1974] 1 C.M.L.R. 309.

[114] Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] C.M.L.R. 429.

[115] Case 85/76, *Hoffmann-La Roche & Co. A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211.

[116] Case 322/81, *Nederlandsche Banden-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282.

[117] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, 89 *et seq.*

[118] [1974] E.C.R. 223, [1974] 1 C.M.L.R. 309, para. 25: "[A]n undertaking which has a dominant position in the market in raw materials and which, with the object of reserving such raw material for manufacturing its own derivatives, refuses to supply a customer, which is itself a manufacturer of these derivatives, and therefore risks eliminating all competition on the part of this customer, is abusing its dominant position within the meaning of Article [82]."

[119] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, 91. Emphasis added.

[120] *Ibid.*

the court held that the refusal to supply "could" constitute an abuse. In particular, the court paid particular attention to the fact that Zoja was a major player in the ethambutol market, and its elimination would have a bearing on the level of concentration in the market, and conceivably on its overall efficiency of output.[121] As such, all that can be said with confidence about *Commercial Solvents* is that the considerations of market structure effects are important; to what ends they are important – whether ordoliberal or efficiency protecting – is left unanswered.

In *United Brands* the E.C.J. addressed a number of practices by a fruit importer and held *inter alia* that the importer's refusal to supply the 'Chiquita' brand of bananas to a Danish distributor who had promoted the rival 'Dole' mark constituted an abuse of dominance. Gerber highlights two aspects of the court's analysis in support of his ordoliberal interpretation; first, the court's statement that a dominant undertaking "cannot stop supplying a long standing customer who abides by regular commercial practice, if the orders placed by this customer are in no way out of the ordinary"[122] – a statement which Gerber describes as a "general rule";[123] and second, the court's finding that the refusal to sell "amounted to a serious interference with the independence of small and medium-sized firms in their commercial relations with the undertaking in a dominant position",[124] which Gerber identifies as establishing a principle against the unfair coercion smaller undertakings.[125] As with his analysis of *Commercial Solvents*, Gerber's arguments depend on unduly selective extracts from the court's judgment. The "general rule" apparently espoused by the court is predicated by the statement that it applies where the dominant undertaking's

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[121] [1974] E.C.R. 223, [1974] 1 C.M.L.R. 309, para. 25: "[A]n undertaking being in a dominant position as regards the production of raw material and therefore able to control the supply to manufacturers of derivatives cannot, just because it decides to start manufacturing these derivatives (in competition with its former customers), act in such a way as to eliminate their competition which, in the case in question, would have amounted to eliminating one of the principal manufacturers of ethambutol in the Common Market."

[122] [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 182.

[123] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, 92.

[124] [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 193.

[125] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, 93.

refusal is "for the purpose of marketing a product".[126] What constitutes such "marketing" is explained later in the judgment when the court cites as an instance of this activity the implementation by an undertaking of policies designed to deter competing importers from gaining a larger foothold in the market by creating credible disincentives for distributors tempted to stock the competing brands.[127] Consequently, in so far as the judgment does contain a general principle it is that for a refusal of supply to be abusive there must be evidence that the transaction has been declined not because it is individually unprofitable (and therefore inefficient), but because there is a broader "marketing" rationale for preventing market entry at the importer's level of production. It is only once the E.C.J. has laid out this concern for the efficiency of competition on the supply side (that is amongst the importers) resulting from United Brands' marketing action, that it refers to there being an interference with the independence of smaller undertakings. Placed in this context, the court's statement on the importance of distributor independence highlighted by Gerber is stated as much for its beneficial efficiency effect of preserving new market entry by new importers, as for any inherent value in maintaining the liberty of small firms to choose their suppliers.

Amongst the issues examined by the E.C.J. in *Hoffman-La Roche* were the rebate arrangements in a number of vitamin supply contracts. Hoffman-La Roche had committed itself to providing customers with two types of rebate: first, loyalty rebates payable once a certain percentage of a buyer's needs were purchased regardless of the volumes of the orders; and secondly, trigger rebates whereby once certain order thresholds were passed (again calculated as a percentage of the relevant customer's needs) the rebate was calculated on the entire amount ordered and not just on the post-threshold quantity.[128] The court found these arrangements to be an abuse on the grounds that they were "designed to deprive the purchaser of or restrict his possible choices of sources

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[126] [1978] E.C.R. 207, [1978] C.M.L.R. 429, para. 182.

[127] *Ibid.*, para. 192: "In fact [United Brands] could not be unaware of the fact that by acting in this way it would discourage its other ripener/distributors from supporting the advertising of other brand names and that the deterrent effect of the sanction imposed on one of them would make its position of strength on the relevant market that much more effective."

[128] [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, para. 87.

of supply and to deny other producers access to the market".[129] Gerber states that this finding is based on the principles of "transactional equivalency and of dependency", by which he means (albeit without stating so in as many words) the rights of entities with little market power to supplies on an equal footing with their (*i.e.* the supplied firms') competitiors.[130] This interpretation, however, does not even withstand *prima facie* scrutiny of the judicial statement cited as supporting it. In *Hoffman-La Roche* the E.C.J. was primarily concerned with the impact of the rebates on excluding competitors from entering into the vitamin supply level of the market,[131] rather than at the vitamin purchaser level(s) of the market – as is implied by Gerber. The court's reasoning implies a clear efficiency concern regarding the rebates; specifically, rival vitamin producers with cheaper per unit prices but operating on a smaller scale of production would be restricted from entering the market because the rebate structure ensured that new entry could only occur at the same scale of production as Hoffman-La Roche.[132] There is a parallel here between these rebates and the "marketing" policies in *United Brands*: both are effective strategies for restricting market entry by more efficient firms. Overall, it is difficult to read any type of small firm protection into the judgment, indeed, Reischl A.G. in his advisory opinion on the case expressly rejected the notion of an abuse of dominance rule based on weighting of the rights of the various parties.[133]

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[129] *Ibid.*, para. 89: "The fidelity rebate, unlike quantity rebates exclusively linked with the volume of purchases from the producer concerned, is designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers".

[130] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, *Ibid.*, 96.

[131] [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, para. 90: "they are not based on an economic transaction which justifies this burden or benefit but are designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market. The fidelity rebate ... is designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers."

[132] *See* the comments of Reischl A.G. in this regard; *ibid.*, 248 (C.M.L.R.), *per* Reischl A.G.: "If a purchaser receives rebates on the basis of his total supplies (total turnover rebate), on the understanding that he obtains the whole or a large part of his supply from the party granting the rebate, a competitor can obtain the order only if his offer compensates for the loss of the rebate."

[133] *Ibid.*, 246 (C.M.L.R.), *per* Reischl A.G.: "[I]t must be admitted that in [Case 127/73, *Belgische Radio en Televisie v. SABAM* [1974] E.C.R. 313, [1974] 2 C.M.L.R. 295] the idea of a weighing of the interests involved is indeed suggested. In addition, it is true that such

The last of the cases relied on by Gerber is the *Michelin* judgment where the E.C.J. examined a target rebate system very similar in nature to the loyalty rebates used in *Hoffman-La Roche*. Gerber's focus, once again, is on the court's assertion that the rebate mechanism impinged on a tyre purchaser's "freedom to choose his source or supply"[134] and the court's rejection of Michelin's argument that it was operating at a superior scale of efficiency;[135] thereby implying an approach to Article 82 driven by the preservation of market participants.[136] Gerber's argument does not accord with a full reading of *Michelin*, which reveals a judicial approach directly concerned with the efficiency effects of strategic behaviour on the producer level of the market. Indeed, the E.C.J.'s analysis of the efficiency effects of the rebates is much more explicit than that used in *Hoffman-La Roche*. The court stressed that the rebates enabled Michelin to maintain market share (and prevent new entry) despite offering a higher unit price than its potential competitors because no other firm could match its scale of production within a reasonable time-frame.[137] It was against this backdrop

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considerations are also mentioned by writers. It may, however, be doubted whether this may be regarded as an established legal view of Article [82]" Citations omitted.

[134] [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 73.

[135] *Ibid.*, para. 8: "Such a situation is calculated to prevent dealers from being able to select freely at any time in the light of the market situation the most favourable of the offers made by the various competitors and to change supplier without suffering any appreciable economic disadvantage. It thus limits the dealers' choice of supplier and makes access to the market more difficult for competitors. Neither the wish to sell more nor the wish to spread production more evenly can justify such a restriction of the customer's freedom of choice and independence. The position of dependence in which dealers find themselves and which is created by the discount system in question, is not therefore based on any countervailing advantage which may be economically justified."

[136] D. Gerber, "Law and the Abuse of Economic Power in Europe", *loc. cit.*, *Ibid.*, 97.

[137] [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, para. 82: "If a competitor wished to offer a dealer a competitive inducement for placing an order, especially at the end of the year, it had to take into account the absolute value of Michelin N.V.'s annual target discount and fix its own discount at a percentage which, when related to the dealer's lesser quantity of purchases from that competitor, was very high. Despite the apparently low percentage of Michelin N.V.'s discount, it was therefore very difficult for its competitors to offset the benefits or losses resulting for dealers from attaining or failing to attain Michelin N.V.'s targets, as the case might be."

that the court rejected Michelin's efficiency of scale arguments, not – as Gerber implies – because all efficiency of scale arguments in general are irrelevant in the face of market plurality concerns, but because Michelin was attempting to pass off the expansion of its individual output as evidence of the expansion of output (and therefore efficiency) of the market as a whole. Thus, when the court included a statement at the end of its efficiency analysis regarding the rights of buyers to select their supplier, what is spoken of is not an immutable 'right' in the constitutional sense, but a means for ensuring efficiency in given instances. In so far as the right is a statement of ordoliberal intent, it is one dependent on a co-existing efficiency justification; that is to say the court did not promote market plurality for its own sake, but because in the circumstances of this case it was considered to reflect the most efficienct outcome.

More recently the courts have confronted one of the core elements of ordoliberalism, the concept of ruinous competition, and expunged it from the *acquis* of Articles 81 and 82. In *S.P.O.*[138] the C.F.I. examined the defence mounted by a Dutch building contractors' trade association in regard to its rules on pre-tender reporting, in particular the requirements placed on members to fix certain elements of the transaction costs associated with the tendered projects. The association had argued that to require contractors to compete on this element of contract price would reveal the "structural weaknesses of supply against demand",[139] in other words, it would require a fall in prices and a reduction in the number of viable contractors. The court's response to this argument was unequivocal:

> [I]t is impossible to distinguish between normal competition and ruinous competition. Potentially, any competition is ruinous for the least efficient undertakings. That is why, by taking action to counteract what they regard as ruinous competition, the applicants necessarily restrict competition and therefore deprive consumers of its benefits.[140]

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[138] Case T-29/92, *Vereniging van Samenwerkende Prijsregelende Organisaties in de Bouwnijverheid and others v. Commission* [1995] E.C.R. II-289.

[139] *Ibid.*, para. 268.

[140] *Ibid.*, para. 294.

This statement amounts to a complete rejection of the idea that Community competition law may follow an ordoliberal objective at the expense of efficiency and the maximisation of consumer welfare. According to the C.F.I., competition is to be understood as a process and not a market structure: the vigour of an efficient market cannot be interpreted itself to be anticompetitive. [141] The issue of an ordoliberal divergence from efficiency reasoning, therefore, does not arise because there are no points where concerns for market plurality will be allowed to depart from efficiency concerns.[142]

A similarly reasoned assertion, this time in the context of Article 82, was made in the *Oscar Bronner*[143] reference case. Here an Austrian daily newspaper

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[141] A parallel can be drawn here with the U.S. Supreme Court decision in *National Society of Professional Engineers v. U.S.* 435 U.S. 679, 98 S.Ct. 1355 (1978) where a consulting engineers' trade association's prohibition on members submitting tender bids containing a fee estimate (ostensibly on the grounds that it ensured health and safety standards were not sacrificed in the interests of cutting costs) was dismissed by Justice Stevens in the following terms: "The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers. Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad."; *ibid.*, (S. Ct.) 1367.

[142] The E.C.J.'s judgment in *Pioneer* was, to some extent, a forerunner to the approach used by the court in *S.P.O.* in rejecting arguments based on ruinous competition, albeit without advancing anything approaching the same unequivocal statement of principle. In *Pioneer* the court refused to examine an argument that actions taken to prevent parallel imports were justified as acts of legitimate economic self-protection against cheaper goods on the preliminary grounds that the adverse effect of the parallel imports on the survival of the impinging undertaking had not as a matter of fact been proven; Case 100-103/80, *Musique Diffusion Française and others v. Commission* [1983] 3 C.M.L.R. 221, paras. 89-91. In his advisory opinion in the same case Slynn A.G. doubted if such a defence existed even in principle: *ibid.*, 304, *per* Slynn A.G.: "[T]he Court's decisions on the 'state of necessity' do not establish, as I see it, a principle whereby a trader is entitled to act in a manner which would otherwise amount to a breach of Article [81] of the E.E.C.. Treaty, in order to protect itself against the damaging effects of competitors whose action is lawful." The C.F.I. did not refer to *Pioneer* in its *S.P.O.* decicion.

[143] Case C-7/97, *Oscar Bronner G.m.b.H. & Co. K.G. v. Mediaprint Zeitungs und Zeitschriftenverlag G.m.b.H. & Co. K.G. and others* [1998] E.C.R. I-7791, [1999] 4 C.M.L.R. 112.

publisher with under 4% market share sought access to the home-delivery distribution system of the market leader, Mediaprint. Oscar Bronner argued that because of the efficiencies which Mediaprint had achieved in the home-delivery sector it was impossible to enter this section of the newspaper market unless it was given access to its rival's developed distribution network. If this was a play to the perceived market plurality sentiments of the court, then it was one that backfired badly as first the advocate general and then the E.C.J. applied the cold logic of an efficiency analysis blind to the interests of smaller less efficient firms. "[T]he primary purpose of Article [82]", declared Slynn A.G. was "to prevent distortion of competition – and in particular to safeguard the interests of consumers – rather than to protect the position of particular competitors".[144] Likewise, the E.C.J. favoured an abuse of dominance concept with maximisation of consumer welfare unrestricted by concerns for the survival of less efficient rivals. Thus it held that a firm which could not compete with its rivals by reason alone of its own inefficiencies of scale did not enjoy a right of access to the better developed resources of more established undertakings.[145] No mention is made of the 'rights-speak' (so conspicuously highlighted by Gerber in the earlier case-law) of transactional equivalence or the independence of small firms – and correctly so; the function of these rights is inextricably linked to the prevention of strategic behaviour excluding the expansion of more efficient firms. If the strategy employed serves only to stunt less efficient competitors, as in *Oscar Bronner*, then Gerber's competitor rights become redundant. *Oscar Bronner* is

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[144] *Ibid.*, para. 58, *per* Slynn A.G.

[145] *Ibid.*, paras. 44-46: "[I]t does not appear that there are any technical, legal or even economic obstacles capable of making it impossible, or even unreasonably difficult, for any other publishers of daily newspapers to establish, alone or in co-operation with other publishers, its own nationwide home-delivery scheme and use it to distribute its own daily newspapers. It should be emphasised in that respect that, in order to demonstrate that the creation of such a system is not a realistic potential alternative and that access to the existing system is therefore indispensable, it is not enough to argue that it is not economically viable by reason of the small circulation of the daily newspaper or newspapers to be distributed. For such access to be capable of being regarded as indispensable, it would be necessary at the very least to establish ... that it is not economically viable to create a second home-delivery scheme for the distribution of daily newspapers with a circulation comparable to that of the daily newspapers distributed by the existing scheme."

therefore entirely consistent with the earlier Article 82 cases, with the language of competitor rights being revealed as nothing more than the description of actions which facilitate efficient market outcomes.

Overall, the explanation of divergence from economic thinking as the result of an ordoliberal hierarchy of objectives lacks compelling judicial support. To the extent that there is a concern for market plurality evident is the case-law it is one that emerges only when it complements the efficiency evaluation of the particular circumstances. Otherwise, where market plurality is at odds with the maximisation of consumer welfare, the only hierarchical relationship is the one focussed on the primacy of the economic objective.

Socio-Political Objectives III: Promoting Employment

Citing the promotion of higher levels of employment as an antitrust objective would appear to be a particularly European phenomenon and one that tends to be ignored in the American accounts of non-economic socio-political competition policy objectives. Perhaps this is because the argument that competition law protects small entrepreneurs carries considerably less weight in the European context where, particularly in the larger continental economies, there tends to be a significant level of distrust of the profit motive and market capitalism in general. Instead, a different means for arousing popular support for competition law is needed and an appeal must be made to the providers of labour that competition policy is, if not clearly beneficial, at least not prejudicial to their interests.[146] It is easy to envisage how a competition policy encompassing an

[146] The need for competition law to be advocated to the general public in the form of 'populist' arguments can be seem as a necessary step to building the support required to establish a system of competition law, even one that is based on purely efficiency focused criteria; thus, as Jenny has commented in the context of the establishment of competition law in developing countries: "[T]he immediate goal of competition policy in these countries appears to be to contribute to the emergence of economic opportunities and entrepreneurship in a context in which more attention must be paid to establishing the political acceptance of a market economy (and therefore taking into consideration the populist goals of competition policy)"; F. Jenny, "Report of the General Rapporteur of Session One", in C. Ehlermann and L. Laudati (eds.), *op. cit.*, p. 35. The existence of such methods for 'selling' competition policy to the public should not be equated with the operational objective used by the courts when applying the law, as Khemani has commented:

employment objective might clash with efficiency-based decision-making. Market outcomes that maximise employment might entail an inefficient use of those labour resources. Nor, in fact, is there a need for any direct negative correlation between the levels of employment and the efficiency of an outcome in order for a divergence between an employment focussed approach and efficiency reasoning to arise; a particular outcome may lead to market inefficiencies independently of considerations of the efficient use of labour and then be separately justified on the basis that it increases employment levels. This potential absence of any correlation serves to illustrate that the promotion of employment *per se* has no meaningful semantic claim to the label of 'competition' in the way that the market integration and market plurality objectives do. As such, an antitrust system which takes into account considerations of employment is, in truth, better described as industrial or social policy.

The argument that Community competition law takes into account considerations of employment is grounded principally on four decisions:[147] *Metro I*,[148] *Remia*,[149] *Yves Aubert*[150] and *Ford/Volkswagen*.[151] In none of these cases, however, do employment concerns form part of the central reasoning that decided the case, nor do these judgments come close to espousing anything approaching a general principle of the applicability of employment concerns to the determination of competition cases at the expense of efficiency reasoning.

"The political gloss that is often linked with competition in order to make it saleable should not be confused with the objectives. Competition legislation is frequently unpopular; to get the legislation passed, it is frequently necessary to attach a political gloss"; quoted in "Panel Discussion: Competition Policy Objectives", in C. Ehlermann and L. Laudati (eds.), *op. cit.*, pp. 17-18.

[147] *See* P. Roth (ed.), *op. cit.*; G. Amato, *op. cit.*, pp. 59-63.

[148] Case 26/76, *Metro S.B.-Grossmärkte Gmb.H. & Co. K.G. and Verband des S.B.-Grosshandels e.V. v. Commission and Saba (No. 1)* [1977] E.C.R. 1875, [1978] 2 C.M.L.R. 1.

[149] Case 42/84, *Remia B.V., Verenigde Bedrijven Nutricia N.V. and another v. Commission* [1985] E.C.R. 2545, [1987] 1 C.M.L.R. 1.

[150] Case 136/86, *Bureau National Interprofessionnel du Cognac v. Yves Aubert* [1987] E.C.R. 4789, [1988] 4 C.M.L.R. 331.

[151] Commission Decision 93/49/E.E.C., *Ford/Volkswagen* [1993] O.J. L20/14.

In *Metro I* the E.C.J in considering whether an exclusive distribution system was justified under Article 81(3) made a somewhat cryptic reference to the effect of these distribution systems as "a stabilising factor with regard to the provision of employment which, since it improves the general conditions of production, especially when the market conditions are unfavourable"[152] could be taken into account as part of the competition analysis. A very similar form of words was used again by the E.C.J. in *Remia* – this time in the context of an examination of non-compete obligations following a demerger.[153] Certainly these statements envisage a role for arguments based on the effect on employment, but crucially this role is linked into the impact of employment on the "general conditions of production". It is at least as likely, therefore, that the importance of a stable workforce is stressed by the court in these two cases for its impact on the efficient functioning of individual undertakings as for its importance as a goal in its own right. In *Metro I* this interpretation of stability of employment as a criterion of efficiency is supported by the fact that the court's consideration of the employment issue forms part of its analysis of the overall stabilising effects of the exclusive distribution system which facilitated market entry and inter-brand competition.[154] Likewise, in *Remia* the question of

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[152] [1977] E.C.R. 1875, [1978] C.M.L.R. 1, para. 43.

[153] [1985] E.C.R. 2545, [1987] 1 C.M.L.R. 1, para. 42: "In connection with the argument to the effect that the survival of the undertaking and the preservation of jobs are only possible if the non-competition clause applies for a period of ten years, it must indeed be admitted that, as the Court held in [*Metro I*], the provision of employment comes within the framework of the objectives to which reference may be had pursuant to Article [81](3) because it improves the general conditions of production, especially when market conditions are unfavourable."

[154] [1977] E.C.R. 1875, [1978] 2 C.M.L.R. 1, para. 43: "[T]he conclusion of supply contracts for six months taking account of the probable growth of the market should make it possible to ensure both a certain stability in the supply of the relevant products, which should allow the requirements of persons obtaining supplies from the wholesaler to be more fully satisfied, and, since such supply contracts are of relatively short duration, a certain flexibility, enabling production to be adapted to the changing requirements of the market. Thus a more regular distribution is ensured, to the benefit both of the producer, who takes his share of the planned expansion of the market in the relevant product, of the wholesaler, whose supplies are secured, and, finally, of the undertakings which obtain supplies from the wholesaler, in that the variety of available products is increased. Another improvement in distribution is provided under the

employment is addressed as part of the court's analysis of the risk-factors faced by the newly demerged undertaking which might be reduced by the non-compete clause, and which would ultimately determine the period of time for which such a clause could be deemed necessary in order to facilitate market entry.[155]

The reference to considerations of employment in *Yves Aubert* is more fleeting. Here B.N.I.C., a vineyard owners and wine producers representative association, sought to defend its quota system by arguing that the practice secured a stable livelihood for 63,000 "wine growers" and 9,000 employees. The E.C.J. rejected the argument, but conceded that it would have been admissible under an application to the Commission under Article 81(3).[156] This is a far cry, however, from concluding that satisfaction of an employment criterion alone would be grounds for granting an Article 81(3) exemption; acknowledging the admissibility of an argument is one thing, to make the jump to saying that the facts grounding such an argument are *per se* grounds for a legal finding is quite a separate matter. *Yves Aubert* does little more than set out the principle that would later me more robustly expounded in *Polypropylene*, *Binon*, *European*

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clause in the co-operation agreement obliging Saba to compensate wholesalers for service performed under guarantee and to supply spare parts necessary for repairs under guarantee."

[155] [1985] E.C.R. 2545, [1987] 1 C.M.L.R. 1, para. 42: "[T]he Commission gave an adequate answer to the applicants' arguments in the contested decision, particularly in paragraph 31 in which it explains the specific reasons for which it considered a period of four years to be sufficient to enable Remia to secure its position in the market against competition from Luycks. Furthermore, and irrespective of this, the Commission stated in paragraph 27 that if, despite having been protected by a non-competition clause for the minimum necessary period, an undertaking proves to be no longer viable, that fact is not sufficient to justify an extension of the duration of that clause."

[156] [1987] E.C.R. 4789, [1988] 4 C.M.L.R. 331. paras. 20-21: "The B.N.I.C. also contends that the provisions adopted cannot be incompatible with Article [81](1) because they aim to remedy a situation characterised by stagnation in sales and increasing stocks of cognac brandies, by securing an economic balance in the region where 63,000 wine growers and approximately 9,000 employees in dealing firms make a living from the business of wine growing. In this connection it should be observed that these circumstances could have been invoked by the B.N.I.C. in support of an application to the Commission for Article [81](1) to be declared inapplicable pursuant to paragraph (3) of the same Article. However, an application for this purpose has not been submitted to the Commission."

Night Services and *Matra Hachette*[157] – namely, that there is no set of circumstances that by their formal character alone can be construed as being anticompetitive. Where *Yves Aubert* differs from these later cases is that it fails to elucidate that, once admitted, the method to be used for weighing the value of an argument is an efficiency analysis. The silence of the court in this regard prevents once from placing *Yves Aubert* squarely in the same category as the other cases, but at the same time it also points away from the conclusion that it is a case espousing employment centred reasoning.

Perhaps the most cited[158] instance of the supposed presence of an employment criterion within Article 81 is the Commission's *Ford/Volkswagen* decision which examined a joint venture between the two car manufacturers to establish a new production facility for 'M.P.V.s' in an economically underdeveloped area of Protugal, and in the course of which the following statement was made:

> In the assessment of this case, the Commission also takes note of the fact that the project constitutes the largest ever single foreign investment in Portugal. It is estimated to lead, *inter alia*, to the creation of about 5,000 jobs and indirectly create up to another 10,000 jobs, as well as attracting other investment in the supply industry. It therefore contributes to the promotion of the harmonious development of the Community and the reduction of regional disparities which is one of the basic aims of the Treaty. It also furthers European market integration by linking Portugal more closely to the Community through one of its important industries. This would not be enough to make an exemption possible unless the conditions of Article [81](3) were fulfilled, but it is an element which the Commission has taken into account.[159]

When this decision is read as a whole it is difficult to see how the employment consideration can be seen as an operative element of the decision.

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[157] *See* p. 32 *supra*.

[158] *See* G. Amato, *op. cit.*, pp. 59-62; P. Roth (ed.), *op. cit.*

[159] [1993] O.J. L20/14, para. 36.

The Commission spent most of its Article 81(3) analysis putting forward the view that the chief economic impact of the joint venture was to allow for new market entry that would not have been feasible if Ford and Volkswagen had each acted alone.[160] Thus the Commission acknowledged the efficiencies that would be gained by sharing know-how between the two producers;[161] the capacity and resource insufficiencies of each car-maker taken in isolation;[162] and the fact that, based on projected sales, neither company acting alone would sell enough units to justify producing at the minimum scale of efficiency.[163] It was only after this examination of the efficiency circumstances of the case, that the Commission added its comment on the issue of the positive employment impact. Significantly, when an incumbent producer in the M.P.V. market challenged this Commission decision before the C.F.I. in *Matra Hachette*, it was this interpretation of the Commission decision, as one based fundamentally on the efficiency attributes of the joint venture independent of the Commission's aside on the issue of employment and regional policy, that found favour with the court.[164]

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[160] *Ibid.*, para. 29: "The partners, each acting on its own, could not develop and produce the M.P.V. in the same conditions so rapidly and efficiently in Portugal as their cooperation will enable them to do."

[161] *Ibid.*, para. 30: "The cooperation, furthermore, enables the partners to complement each other as to their engineering personnel and technical expertise, as such a project requires a considerable amount of skilled manpower. For this purpose, Ford will, *inter alia*, make manufacturing engineering staff available while V.W. is able to sufficiently provide skilled product engineering staff. This will allow the partners to concentrate on certain tasks and thus to operate more efficiently."

[162] *Ibid.*: "Neither partner has currently a sufficient capacity at its disposal for a production of the size projected for their J.V. on the basis of the concept described above."

[163] *Ibid.*, para. 31: "Taking into account the investment required by either company for separate development and production of an M.P.V. as well as the unit production necessary for profitability, it could not be expected that the companies, acting on their own, would achieve a reasonable return in view of their anticipated sales and with regard to the low volume of the M.P.V. segment in comparison with other market segments."

[164] [1994] E.C.R. II-595, para. 107: "[I]t is only in relation to paragraphs 24 to 26 of the [Commission] Decision that the merits of the applicant's arguments should be considered. Consequently, certain arguments put forward by Matra, which do not relate to the Commission's appraisal at that stage of the examination of the application made to it, are irrelevant. That is

Taking these four cases together, it is fair to conclude that the evidence for the existence of a line of reasoning promoting employment as the goal of competition is unconvincing. At best, considerations of employment can be described as a populist drum occasionally beaten as an accompaniment to the courts' established efficiency reasoning.

Accounting for 'Bad' Economics

Whereas the accounts of the divergence of competition law from efficiency reasoning based on the existence of a formalistic prohibitory approach or non-economic socio-political objectives both attribute to the courts a deliberate, even nuanced, policy of rejecting economic thinking, the last of the non-economic explanations which we will examine is the unintentional result of the judiciary's limited grounding in the study of economics. This view holds that judges attempt to apply efficiency reasoning but occasionally fail in this task simply because they have not fully grasped the concepts in issue.

Easterbrook, writing before he himself was appointed to the U.S. federal court of appeal, has suggested that since most legal analysis is based on reasoning by analogy, when courts are required to address economic arguments they are called upon to act in manner for which "neither law school, legal practice nor the usual pre-judicial career provides the necessary skills".[165] This perspective, however, rests on a stereotypical description of the analytical processes of legal reasoning. According to Easterbrook, "[n]o number of analogies will help a judge to determine whether a business practice reduces output and thus raises price in violation of the antitrust laws".[166] No doubt this might be the case, but it is hardly a unique attribute of competition law that strict reasoning by analogy does not produce easy answers. The determination of what constitutes negligence in the realm of tort law, and reasonableness during the course of judicial review, are but two obvious examples of every-day legal

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true, in particular, of the argument concerning the contribution to 'social' progress and the contribution to regional progress (matters not dealt with in the Decision) as part of the analysis of the project's contribution to technical or economic progress".

[165] F. Easterbrook, "The Court and the Economic System", (1984) 98 *Harv. L. Rev.* 4, 7-8.

[166] *Ibid.*, 7.

processes considered par for the judicial mind which require reasoning based on abstract principle rather than simple analogy. In each case, the legal standard of reasonableness performs a function not dissimilar to the efficiency criterion by providing a core framework within which any combination of factual circumstances, regardless of complexity, can be accommodated. Of course, there is a considerable grey area between reasoning by analogy and reasoning from principles and, assuming that the quantification of such a nebulous incremental scale was possible, one might argue that the processes involved in everyday legal argument are closer to the 'analogy' end of the spectrum, and economic argument is closer to the 'principle' side. But far from bolstering Easterbrook's perspective, the idea of such a spectrum serves to underline the difficulty in maintaining separate fixed categories of reasoning depending on their 'analogous' or 'principled' nature. As such, in so far as Easterbrook attempts to argue that there is some pathological inability on the part of the legal mindset to understand basic economic concepts, he misrepresents the inevitable (and unremarkable) lack of familiarity of the courts with new arguments and factual circumstances as a methodological chasm between legal and economic reasoning.

While there may be no pathological inability for legal thinking to absorb economic ideas, there are undoubtedly instances where the courts simply get the economics of a decision wrong. The number of such cases should not be overstated. There is a tendency in the wake of the Chicago School's rigorous economic analysis of antitrust policy to classify their conclusions as economic, and everything else as, at best, second-rate economic reasoning and at worse as uneconomic "populism".[167] Much of the criticism of the E.C.J.'s economic conclusions, including those in relation to barriers to entry and abuses of dominance inconsistent with rational behaviour, are based on the Chicago School's preferences for long term temporal valuations and selection of opening assumptions.[168] The scope for different value judgments to be taken *within* the economic methodology allows for the development of multiple alternative

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[167] See R. Posner, *op. cit.*, pp. 23-24: "The noneconomic objections are various, but 'populism' is a reasonable umbrella term, as all are based on a hostility toward wealth and power and a suspicion of capitalism but a suspicion that falls short of an endorsement of socialism."

[168] *See* the discussion on the definition of rhetorical divergence in chapters three and four *infra*..

economic perspectives as to what is the most efficient outcome for the same set of circumstances. This is a theme that will be returned to in part II, because the process of how different economic values are formed and how the courts select between them is fundamental to understanding the interaction of the legal and economic systems. The point of immediate relevance is that accusations of 'bad' economic reasoning should be filtered so as to distinguish between, on one hand, criticisms highlighting judicial misunderstanding of economic concepts, and on the other, those that espouse a competing economic viewpoint based on a different set of value decisions. It is only the former of these types of criticism that properly describe instances of divergence arising from judicial misunderstanding. One such case might be *Maize Seeds* which, as discussed in this chapter,[169] is difficult (although not impossible) to reconcile with any coherent economic argument. But while there are cases that do come within this category, their number, it is submitted, is relatively insignificant as a proportion of the total number of Community competition law decisions. As has been argued in this chapter and will be argued again in chapter four with regard to the Chicago-style criticism of Community competition law, many claimed instances of poor economic reasoning are in fact based on sound efficiency criteria, albeit importing value decisions that may not necessarily accord with those of some economists.

Divergence and the Central Role of Economics

The Community courts have placed the efficiency rationale at the heart of their approach to competition law. The precepts of Articles 81 and 82 are built on economic foundations, and while it might be said that Community competition policy has a wide range of ultimate political objectives, at the operative level of judicial reasoning the process of rule formation is informed by a single, or at least a singularly pervasive, object of efficiency maximisation. If the divergence between law and economics in Community competition policy cannot be explained by the formalism of the legal method, the prevalence of alternative policy objectives or widespread judicial ineptitude, a new story of divergence

[169] *See supra* p. 46 *et seq.*

must be told. The challenge is to account for the divergence of law and economics within a legal system that has accepted the economic objective of efficiency and adopted many of the tools of economic analysis.

What this task requires is a reappraisal of the concept of divergence. By acknowledging the central role of economics within the law the possibility of relying on the easy answers to the question of why divergence occurs is closed off. If the formalistic prohibitory approach, the various non-economic objectives and bad economics are not substantiated in the Community judgments, then it follows that their explanatory power is redundant.

Even more fundamental than the requirement to find a new answer to the question of divergence, the question itself must be revaluated. The deconstruction of the various non-economic principles said to be operating within competition law decisions in this chapter has demonstrated that what is presented as a non-economic approach can be more readily interpreted as expressly applying the conceptual structures of efficiency-reasoning. In essence, the reason why each of the examined accounts for divergence is unsatisfactory is because the case law does not support the conclusion that any divergence has occurred. The implication here is that, as a corollary to denying the explanation, the incidence of the phenomena is rubbed out. It is tempting, perhaps, to see this as leading to a paradox; how can there be divergence from the economic system when that system plays a central role within the legal process. Instinctively, such a conclusion of paradox is unsatisfactory; lawyers and economists alike 'know' that economics is not law, just as law is not economics – but clearly something more tangible than mere intuition is called for.

What a compelling account of divergence must do, therefore, is map out both where and how distinctions between the legal and economic systems arise given the acceptance of core aspects of economic reasoning within the law's structures. It is to the construction of this new edifice of divergence that we turn in the next chapter.

CHAPTER TWO

MODELLING DIVERGENCE

Establishing the What and How of Divergence

Up to this point this thesis has argued that what is often claimed to be divergence cannot be described as such, and consequently cannot be used as the basis from which to explain its occurrence. In short, the focus has been on the deconstruction of prevailing concepts of divergence. As with any argument of deconstruction, there automatically follows a more difficult question: if the preconceived notion does not explain the concept, then what does? This chapter sets out to answer this question by proposing a new structure for understanding divergence.

Perhaps the best place to start is with the simple question: what is divergence? As a basic definition, divergence can be said to be that which arises when the courts adopt a rule regarding the legality of a particular type of market behaviour where the microeconomic literature holds that such a rule is not justified. It is clear even from this straightforward meaning that the concept of divergence depends on the juxtaposition of two systems. Each of these has its own meanings, standards and processes of reasoning; elements which might be collectively described as that system's methodology. If there is such a thing as the phenomenon of divergence, it can only be assumed that each of these systems has an ability to determine its methodology autonomously, or at least independently from some of the influences exerted by the other system; only where there is some level of self-determined conceptual control can a system reject external suggestions. The idea of divergence, therefore, presupposes autonomy; indeed, divergence is the manifestation of a system's autonomy. Establishing how divergence arises requires the identification of these autonomous functions. The challenge laid down in chapter one was to account

for this autonomy in circumstances where one of the systems, the legal one, has readily accepted much of the theory and mode of thinking of the other. What this level of acceptance makes clear is that a framework for understanding divergence must also be a framework for understanding the entire process of interaction between the legal and economic systems – one that addresses both the manner in which economic ideas are integrated into legal thinking and the limits of such conceptual inter-change.

This chapter is set out in two parts. First, it is necessary to establish some theoretical foundations for determining how distinct social systems interact and absorb elements of each other while still retaining their own autonomy. The model for understanding these operations, it is suggested, is Luhmann's theory of autopoiesis, which accounts for the independence-interaction dichotomy by proposing systems with their own closed but evolving methodologies which determine the extent to which external elements can be internalised into a system's structure. In essence this theory states that while the legal system may accept whole-heartedly elements of other systems, it does so on its own terms and subject always to the limits imposed by the conceptual constraints of its own methodology.

The second part of this chapter narrows its focus to the specific application of the theory of autopoiesis to the operations of competition law, examining first the process of autopoietic interaction between the methodology of the Community courts and economics, and subsequently how this interaction results in divergence through two processes; on one hand as rhetorical divergence, whereby the law's power of selection between competing economic theories manifests itself as the divergence from some parts only of the microeconomic literature; and on the other, as methodological rejection, whereby the legal system's own functions are inherently incapable of absorbing certain aspects of economic thinking.

The Theory of Autopoiesis

The term autopoiesis, which translates as "self-changing", was first scientifically used by Maturana to describe the adaptation of biological systems to

environmental events.[1] As habitat changes arise individual biological actors will respond, but they are limited in their choice of responses to those which are physiologically available to them. Environmental impacts will elicit responses, but the range of these possible responses is determined by the inherited range of operations which the biological actor is capable of undertaking – the actor responds to external pressures, but always "on its own terms".[2] To take a simple example, in the midst of storm a dog may hide, howl or run, but it cannot sprout wings and fly away. This concept is equally valid for groups of actors as for the individual. On the macro level, biological actors of common parentage with similar physiological capabilities will have similar inherited responses; thus entire systems, whether at the species, genus or even the ecological level, can be seen to have a common response to environmental events. It is therefore possible to think in terms of systems without sacrificing the consideration of the atomised actor; indeed, it is this ability to locate the individual within the system that allows one to account for the adaptation of the system to the environment without disregarding the physiological limitations of the actors. Over time, environmental pressures will be reflected in the operations of the system through the evolutionary process. Those individuals within the system more physiologically adept at performing the response will thrive and their characteristics will become prevalent through the system, improving the range of inherited responses available to the system when identified as a whole. The response operation, however, always remains the self-created product of the biological system, and to the extent that the range of operations available to the system are observed to change over time in response to environmental pressure, it is because the constituency of the system has become dominated by those with the inherited operations best suited to the new circumstances. Returning to the dogs caught in the storm, if only those with the instinct to run survive, then it will be their progeny alone, with their common quick-footed inheritance, that will come to define the traits of all of their kind. In essence biological

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[1] H. Maturana, *Autopoiesis and Cognition: The Realization of the Living*, (London: Reidl, 1982 [1970]). *See also* H. Maturana, "Autopoisesis", in M. Zeleny (ed.), *Autopoiesis: A Theory of Living Organisation*, (New York: North Holland, 1981).

[2] A. Jacobson, "Autopoietic Law: The New Science of Niklas Luhmann", (1989) 97 *Michigan Law Review* 1647, 1660.

autopoieisis is a description of the mechanics of response selection within Darwin's process of evolution which takes into account the role of the individual actor in system-wide change.[3]

Jacobson illustrates the nature of the autopoietic system by describing its alternative – the "allopoietic system" where change is brought about only by elements outside of the system. Such as system is not restricted in its choice of responses by its inherited elements, and as such there is no unifying element of the system as it passes between incarnations. Jacobson's image of the allopoietic system is that of the machine which "changes when its elements change [and] cannot resist change in its operations by transforming its elements".[4]

The perception of law as an autopoietic system is largely the work of Niklas Luhmann.[5] For Luhmann, the range of responses of the law to any given event is confined to those created from the pre-existing methodology of the legal system.[6] This methodology is the inherited element of the system – the equivalent of the physiological realm of possible responses in a biological system. The new factual situations presenting themselves for judicial arbitration are the environmental changes to which the law must respond, with the law's response always being fashioned from conventions of legal reasoning. As with biological systems, the legal system's response to the new circumstance results in the promotion of certain elements of the inherited methodology leading to the evolution of the system as a whole. Thus legal material is ceaselessly generated

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[3] *See generally* E. Mayr, *The Growth of Biological Thought: Diversity, Evolution and Inheritance* (Cambridge (Ma.): Belknap Press, 1982), pp. 251-298.

[4] A. Jacobson, *loc. cit.*, 1660.

[5] On Luhmann's theory and the related work of Teubner *see* N. Luhmann, "Operational Closure and Structural Coupling – the Differentiation of the Legal System", (1992) 13 *Cardoza L. Rev.* 1419; N. Luhmann, "Unity of the Legal System", in G. Teubner (ed.), *Autopoietic Law: A New Approach to Law and Society*, (Berlin: Walter de Gruyter, 1988); G. Teubner, "How the Law Thinks", (1989) 23 *L.S. Rev.* 728; J. Pribán and D. Nelken (eds.), *Law's New Boundaries: The Consequences of Legal Autopoiesis*, (Aldershot: Ashgate Dartmouth, 2001). For a general introduction *see* M. Freeman, *Lloyd's Introduction to Jurisprudence*, (London: Sweet & Maxwell, 7th Edition, 2001), pp. 700-702; J. Penner, D. Schiff and R. Nobles (eds.), *Introduction to Jurisprudence and Legal Theory*, (London: Butterworths LexisNexis, 2002), pp. 897-954.

[6] N. Luhmann, "Unity of the Legal System", *loc. cit.*, p. 14: The legal system constitutes "elements of which it consists through the elements of which it consists".

from legal material. This is no mere statement of the doctrine of precedent, however. The inherited element of the system is not the precise point of law to be followed, rather it is the use of legal reasoning and the contribution of the individual judgement to this methodology. Certainly, precedent is part of this methodology, but so are the exceptions to this doctrine and the other traditions of reasoning – such as the evaluation of evidence, the conventions of presentation, the values of objectivity, logic and certainty – which together comprise the process of legal thinking.

In Luhmann's terminology, the legal system is normatively closed but cognitively open.[7] Environmental factors are considered and responded to but always through the internalisation of the issue into terms understandable and acceptable to the legal methodology – communication only take place within the legal system when made in the form of legal statements. The process by which the environmental elements result in changes to the system through the promotion of certain inherent elements of legal methodology is referred to by Luhmann as "structural coupling".[8] Structural coupling provides a map to the inter-relationship of the legal system with other elements of society. It presents the law as autonomous in the sense that its responses to events are all made within the bounds of its existing methodology. But although autonomous, this normative methodology is neither static nor host to a homogeneity of response. An event will occur, and the law will rejoin by selecting a response from those permitted to it by its methodology. Rules and reasoning drawn from the body of legal reasoning determine the case, and in turn that individual case will be drawn upon as part of the *corpus* of the law's methodology to be used in the adjudication of future occurrences. There is more to the autopoietic autonomy of the law, however, than this ceaseless procession of selection followed by absorption followed again by selection. Just as in our biological example the dogs may be caught in a storm so severe that their only resort for survival is to sprout wings and fly or carry out some other physiologically impossible action, there must be conceivable circumstances where the legal methodology's finite

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[7] *Ibid.*, p. 15: "[C]losure consist in the fact that all operations always reproduce the system".

[8] N. Luhmann, "Operational Closure and Structural Coupling – the Differentiation of the Legal System", *loc. cit.*, 1433.

inheritance holds out no action of response. In these circumstances, whereas the only canine recourse is to perish, the only legal one is to fail to respond to an event for which no equivalence can be found within the bounds of legal meaning. Divergence is the distance between the ideal response to the event and the actual failure of the system to address the circumstances in its own terms.

The theory of autopoiesis has been criticised on a number of grounds. Citing the policy *volte face* of the U.S. Supreme Court in relation to education segregation and abortion, Freeman argues that since legal systems adjust dynamically to allow for new values as well as new facts, it cannot be regarded as normatively closed:

> [T]hese changes reflect the normative adaptability of the legal system to normative changes in society. The legal system is open to facts but these are values. We could dress them up as facts but then in what sense would the system be closed?[9]

Freeman's interpretation of the normative element of the autopoietic system as containing only values and the cognitive element processing only facts misunderstands Luhmann's concept. All environmental pressures, whether moral or factual in nature are cognitively passed through the structural coupling. Normative closure is not a reference to a legal system having uniform or immovable positions on the moral issues of the day, instead it refers to the process of legal thinking which deals with these changes. Judicial revisions may arise and case law may be distinguished, but this is always done using the tools of the legal methodology. As Luhmann makes clear: "changes in the moral environment do not cause normative adjustments in the system, because it remains an intra-system choice whether or not the changes should be made."[10] Freeman's criticism also misconstrues normative closure as normative stasis and thereby overlooks the role of structural coupling in developing a system's normative content. Each exercise of the legal methodology to a particular

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[9] M. Freeman, *op. cit.*, p. 702.

[10] N. Luhmann, "Operational Closure and Structural Coupling – the Differentiation of the Legal System", *loc. cit.*, 1433.

cognitive value change alters that methodology by promoting those parts of legal methodology equipped to process such changes. There is no doubting that the law responds to value changes, but equally these actions are discernible from the responses of other social systems to change. Autopoiesis is ultimately a framework theory that accounts for normative changes without sacrificing the unity of the legal system.[11] Freeman states that this rebuttal results in a formalism that is too high a price to pay to preserve a theory, but this complaint appears to be little more than the lament of the theoretician removed from all semblance of empirical observation. So long as some elements of legal methodology can be identified as operating on a normative level, then Luhmann's autopoiesis escapes the allegation of formalism.

This requirement of observability leads us to consider a second criticism put forward by Harris. If law is a self-contained system of communication then there is "no question of measuring law's effectiveness against anything external to itself".[12] Following this view, evaluation and observation of the normative functions of the legal system is impossible without using the methodology of that system. As with Freeman's critique, Harris's comments seem to misunderstand the role of structural coupling. The legal system interacts with other social phenomena on a cognitive level and in turn its normative functions develop in the manner permitted by the system's inherited methodology: autopoiesis in no way envisages the hermetic sealing of the legal system from the rest of society. Harris's real criticism would appear to be that the observation of the existence of an autopoietic structure itself is an action occurring within the cognitive level of the legal system.[13] It is difficult to see how this is the case. Theorisation of law may have many conventions in common with judicial arbitration, but this does not mean that it shares an identical normative methodology. The observation of the legal system may be beholden to the norms of a system of academic examination, but the fact that the observer is not without subjective values is hardly a problem particular to autopoietic theory,

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[11] *See* J. Pribán and D. Nelken, "Introduction", in J. Pribán and D. Nelken (eds.), *op. cit.*, p. 6; J. Clam, "The Specific Autopoiesis of Law: Between Derivative Autonomy and Generalised Paradox", in J. Pribán and D. Nelken (eds.), *op. cit.*, p. 48.

[12] J. Harris, *Legal Philosophies*, (London: Butterworths, 2nd Edition, 1997), p. 251.

[13] For a similarly nihilistic perspective *see* A. Jacobson, *loc. cit.*, 1658-1659.

nor indeed is it a problem at all if some level of inter-subjective comparison and the presence of some absolutes of existence are accepted.[14]

Freeman also briefly alludes to a third criticism: if all legal systems are autopoietic then how did the first legal system emerge? Consequently, "[u]nless the first legal system was not autopoietic or not a legal system ... it seems it must have had its source in the extra-legal environment, whether this was religion, morality or power."[15] Uncertainty as to the origins of a legal system, however, are no more damaging to autopoietic theory in law than in biology. In biology, as different actors within a system select different responses based on their inherited range so separate species develop. The lack of any conclusive explanation for the creation of the universe or the development of life does not undermine the existence of present day autopoietic systems. Likewise in law, whether its origin is the result of a 'year zero' creation or the gradual development as sub-system of some other social function does not deprive it of its autopoietic content. What sets the system in motion is irrelevant for determining the mechanics of its current dynamic existence; legal theory needs a description of origin no more so than biology requires astrophysical or theological foundations.[16]

Jacobson picks up on the idea of law as a sub-system of the general social system to articulate another criticism of Luhmann's autopoiesis. Since law operates within society it must contain elements of the other sub-systems of that society, such as economics and politics. These elements of the legal system, argues Jacobson, would tend to use the methodologies of the other sub-systems of society and are hence beholden to normative elements outside of the control of the legal system. Thus "[e]ven a highly differentiated legal system cannot

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[14] King criticises Harris on similar grounds stating that "Harris, however, ...offers no solution to this post-modern predicament, unless it is his own version of legal reasoning and his own undoubted intelligence"; M. King, "The Construction and Demolition of the Luhmann Heresy", in J. Pribán and D. Nelken (eds.), *op. cit.*, p. 128.

[15] M. Freeman, *op. cit.*, p. 703.

[16] Pribán and Nelken offer an argument supporting the origin of the legal system within autopoiesis theory, with the very process of self-referentiality of the legal system being the result of the normative inheritance of what came before, until normative closure is possible once a critical mass of self-referencing material has been reached; J. Pribán and D. Nelken, *loc. cit.*, p. 5.

obviously maintain the absolute control over production and reproduction over the legal code that autopoiesis requires" and even if it could the actions of the legal system would have inevitable implications for the normative development of the wider social system of which it forms part.[17] This criticism is not without its problems. Those elements of the legal system concerning other sub-systems must first be translated into the methodology of the legal system if they are to be normatively addressed. The legal system's responses to the cognitive pressures of economics and politics are formed using the law's methodology alone. To the extent that these responses have an economic or political effect is irrelevant to the autonomy of the legal methodology save in so far as the selected response promotes some aspect of that methodology above another. The other social sub-systems will in turn treat the legal responses as cognitive elements, translating them into their own methodologies for response. Collectively all are part of the same general societal system but this does not deprive the individual sub-systems of their autonomous character. For the individual biological actor, being part of a wider sub-system or systems does not expand the range of choices available to it beyond those which it has physiologically inherited, notwithstanding the fact that the external environmental pressures may have an identical distant parentage to that actor. Similarly for each individual legal decision, the fact that the particular event to which it is reacting may be rooted in a normative system derived from the common parent of the general social system in no way expands or diminishes the range of choices which the legal methodology presents. The concept of norm evolution through structural coupling means that systems may have common parentage and yet be presently equipped with different normative methodologies. To some degree Jacobson pre-empts this rebuttal by stating that the boundaries of each component sub-system are so fluid as to make the observer's characterisation of separate subsystems one freighted with "normative consequences".[18] As Jacobson acknowledges, however, this is an empirical observation – either the distinct normative elements of the system can be described and observed or they cannot. As with Freeman's allegation of formalism, the response to this criticism lies in

[17] A. Jacobsen, *loc. cit.*, 1676.

[18] *Ibid.*, 1677-1681.

describing those aspects of the law's methodology which are demonstrably inherent and autonomous.

Ultimately the worth of autopoiesis depends on the ability to identify the characteristic constants of law's methodology which inform legal decisions in a manner distinct from the methodologies of other societal sub-systems. The failure to do so results in autopoiesis' normative functions remaining vague, existing only as an ever-malleable definition of the unstated informing values behind every legal reaction to cognitive social value changes.[19] For autopoiesis to avoid becoming, to borrow Freeman's description, a mere "metaphor", a demonstration of divergence of the legal system's values from the cognitive representations made to it is necessary.[20] Even then, autopoiesis does not present a complete jurisprudential theory, no more than it provides a grand theory of scientific unity in the biological sphere. To be such a theory would require a full explanation of origin, and of the full spectrum of social pressures which force the system to make choices and which ultimately determine the system's survival. What it does amount to, however, is a robust tool for analysing and explaining judicial decisions and doctrinal development over time, and in particular for identifying the legal system's methodological limitations in accepting economic propositions.

Autopoietic Interaction and Divergence in Competition Law

The core of the notion of a system, and consequently the theory of autopoiesis as a theory of system interaction and divergence, resides in the autonomy of that system. As has been discussed, the concept of normative closure is an

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[19] *See* for an example of this argument R. Cotterel, "Representation of Law's Autonomy in Autopoiesis Theory", in J. Pribán and D. Nelken (eds.), *op. cit.*, p. 92.

[20] The criticism that a theory is mere metaphor is undermined when the comparison is being made not for the purposes of coincidental explanatory example, but because of a common underlying communality of all the intelligent systems in question – be they biological of social. *See* J. Clam, *loc. cit.*, p. 47, for an argument along these lines in the specific context or autopoiesis; and on the use of metaphors more generally in the course of philosophical argument *see* D. McCloskey, "The Rhetoric of Economics", (1983) 21 *Journal of Economic Literature* 481, reprinted in D. Hausman (ed.), *The Philosophy of Economics: An Anthology*, (Cambridge: Cambridge University Press, 2nd Edition, 1994), p. 424.

expression of this independence, as is the divergence that this closure results in when a system is unable to interface with an external event on its own terms.

The existence of this autonomy is evident in the system of Community competition law, specifically in its interaction with the external element of the microeconomic system. On one level the fact of this autonomy is intuitive to all lawyers and economists; the standards of proof, methods of reasoning, even the superficial modes of presentation are particular to each system – 'everyone' knows that competition law is not the same as competition economics. Behind this intuition lie very real assertions by the courts of this methodological independence. The *modus operandi* of the courts demonstrates that economic arguments are merely submissions for judicial consideration, and not mandates for a particular legal outcome. Although this treatment of economic arguments by the courts is apparent throughout the case-law, it is relatively seldom stated in express terms. Perhaps the clearest such statement is contained in Judge Vesterdorf's *Polypropylene*[21] opinion. Here, while acknowledging the central role of economic analysis, the acting advocate general refused to examine the applicant's economic evidence that the attempted price fixing in question had no actual adverse effects on efficiency. Instead he concluded that, regardless of its veracity, the defendant's economic conclusion was fundamentally inconsistent with the legal application of Article 81, and in doing so he categorically stated the independence of legal analysis from economic conclusions:

> Economic analyses often make up an important part of the evidence in competition cases and can be of great value to the Court in understanding the relevant economic context. It is thus important to obtain information about how an oligopolistic market might react in different circumstances. But – and this is the important point – the findings of economic experts cannot take the place of legal assessment and adjudication. Thus, when Professor Albach [the defendant's economic expert] makes his observations about what target prices might be in an economic context, it must be emphasized that his views are not, and cannot form, a legal assessment. Even if it were to be found that there were no significant

[21] [1991] E.C.R. II-869.

effects on the market, that does not prove that no agreement was reached or that no exchange of information took place with a view to regulating prices. It is for the Court to consider what is prohibited under Article [81](1) and the evidence for the commitment of prohibited acts, and not for economic theorists.

On the basis of an overall assessment of the evidence, the Court must therefore consider whether what took place constitutes prohibited conduct, even if the expression 'target prices' from the point of view of economic experts might conceivably mean something other than unanimity on the prices which all should strive to obtain.[22]

What becomes apparent from Judge Versterdorf's opinion is that while economic analysis plays an important and accepted role in the decision-making of the Community courts, it remains an external element to be judged against the criteria selected by the legal system. When competition law issues arise for judicial determination the role of economics is of central concern, but it is suggestive only and not determinative of the legal finding.

Acknowledging this autonomy opens the way for an autopoietic analysis of the interaction of competition law and competition economics. Ostensibly this process of interaction takes the form of court selecting between various competing economic arguments and endorsing one as the basis for its judgment, a decision which will then form part of the *acquis* of the courts when determining future competition law issues. This process of selection and interaction is an instance of structural coupling in action. When a court examines a given form of economic behaviour for the first time, it assesses which of the competing economic arguments it should adopt as the foundation of the legal rule. A decision will be made by the court based on its methodology; this will be the 'best' legal response, both in so far as the limitations of the inherited legal methodology will allow, and because it is the legal system itself that defines what is 'best' in the circumstances. Once the issue is decided, the economic argument accepted in this initial case comes to the fore within the legal methodology – that is, the prioritisation of the established principle now

[22] *Ibid.*, para. 957.

forms part of the inherited *corpus* that the law will draw upon to determine future disputes. As new cases come along, the application of the court's legal methodology to decide between the economic arguments in question will itself have an increasingly economic aspect. This is not because the economic reasoning is displacing the law's autonomy, rather the earlier economic selections by the court in the initial case are now reflected in the legal standard. The process is a never-ending refinement of legally accepted economic principles generated from earlier legally accepted economic principles.

Although semantically this process may be described as the selection of external elements from the economic system and their internalisation into the legal one, in autopoietic terms the selection is between different aspects of the legal methodology which allow for the use of external arguments. Thus the arguments for, say, an economic approach to competition law or for a formalistic one are each made within law's conventions, each drawing on separate aspects of the legal methodology – the equivalent of the canine choice between its own inherent responses of howling or hiding. When the law 'selects' an economic approach over a formalistic one, or one economic argument over another, it is weighing two different options inherently available to it within its internal mode of operation. Of itself, the fact that the methodology of the law allows for the universality (or at least a vast number) of external concepts to be presented as legal arguments is not particularly enlightening. Instead, the significant normative function is the process by which the system evaluates and promotes different aspects of its own methodology; that is, the one that dictates which economic arguments succeed before the courts and which fail.

This normative operation of selection can be illustrated by taking a couple of examples from the case-law. A pronounced instance of the initial weighting of and selection between economic arguments arises in the E.C.J.'s *A.K.Z.O.*[23] decision where the court determined for the first time the scope of predatory pricing behaviour which could constitute as an abuse of dominance under Article 82. Here the court examined two approaches for determining the economic definition of price fixing: first, Areeda and Turner's argument that

[23] Case C-62/86, *A.K.Z.O. Chemie B.V. v. Commission* [1991] E.C.R. 3359, [1993] 5 C.M.L.R. 215.

only pricing below average variable costs should be considered as predatory;[24] and second, a two-tiered rule which accepted both the Areeda and Turner test and added a supplemental rule covering prices above average variable cost but below average total cost which provided protection to equally efficient firms (*i.e.* those with the same average total costs as the predator) but which had a smaller 'war-chest' with which to survive the predation.[25] What is significant for present purposes is not that it opted for the latter approach, but that in doing so it set out unequivocally its criterion for selection. The court stated early in its analysis that its treatment of predatory pricing would have to be consistent with the identifier of legality under Article 82, namely, that the dominant firm was engaged in "normal competition in products or services on the basis of the transaction of commercial operations",[26] a category of behaviour that did not include competition "using methods other than those which come within the scope of competition on the basis of quality".[27] How the court determines which argument should be promoted as the correct outcome depends on which precise answer fits best with the existing methodology, that is, the general principle of what constitutes "normal competition". The selected outcome will be a refinement of the methodology – *i.e.* a principle for detailing what "normal competition" means when dealing with predatory pricing – which will be applied in the determination of future problems.

If *A.K.Z.O.* is an example of an initial autopoietic selection of principle, the *Polypropylene* opinion demonstrates the subsequent application of an element of the legal methodology already promoted in an earlier judgment. Here Judge Vesterdorf's refusal to even examine the applicant's arguments that the attempted price fixing was not economically harmful reflected the earlier promotion by the Community courts not only of the principle that price fixing was anticompetitive, but also the principle that the court's prior *acquis* should normally be subsequently obeyed. By the time of the *Polypropylene* decision the

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[24] [1991] E.C.R. 3359, [1993] 5 C.M.L.R. 215, paras. 70-71. *See* P. Areeda and D. Turner, "Predatory Pricing and the Related Practices Under Section 2 of the Sherman Act", (1975) 88 *Harv. L. Rev.* 697.

[25] [1991] E.C.R. 3359, [1993] 5 C.M.L.R. 215, para. 72.

[26] *Ibid.*, para. 69.

[27] *Ibid.*, para. 70.

opportunity for making arguments relating to the harm or otherwise caused by price fixing had already passed, since the rule against price-fixing had by now established a position of pre-eminence within the *acquis*. Consequently, the acting advocate general felt free to dispense with the need to examine the appellant's argument since the legal methodology available to the court, as moulded by its prior selections and resulting refinements, meant that the role for meaningful economic argument in the present case was confined to presentations that the impugned activity was not price fixing, rather than whether or not price fixing should be considered illegal.

Both these cases demonstrate instances of legally accepted economic principles being promoted within the legal system, and subsequently refined by ensuing decisions. If this process is back-extrapolated we arrive at a point where the competing arguments presented to the court did not all encapsulate an economic approach to the application of competition law. At some stage in the development of a competition law system of jurisprudence a choice is made by the courts as to what the operational objectives of the law are to be, and consequently whether the subsequent development of legal principles is to have an orientation towards aims of efficiency, formalistic certainty or some other non-economic objective. In the Community context, it is apparent from the early decisions, such as the *Consten and Grundig*[28] and *Technique Minière*[29] cases examined in chapter one, that there was a seamless endorsement of efficiency reasoning by the courts. One might hypothesise that the selection of this approach reflected the established legal canons of certainty, respect for legislative intent, and the avoidance of establishing principles that would require the courts to adopt decisions of a political nature not traditionally made within the judicial jurisdiction – as well as the established legal willingness to accept new factual arguments regardless of their originating field of study. That this selection occurred without manifest discussion within the text of the judgments does not undermine the proposition that it in fact occurred; the proof of its occurrence is in the established *acquis* of the court locating efficiency reasoning

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[28] Cases 56, 58/64, *Establissements Consten S.A. and Grundig-Verkaufs-G.m.b.H. v. Commission* [1966] E.C.R. 299, [1966] C.M.L.R. 418.

[29] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm* [1966] E.C.R. 235, [1966] C.M.L.R. 357, 375.

as the principal concept for arbitrating antitrust disputes and for the interpretation of Articles 81 and 82.

The importance of this analysis of the development of Community compeition law as arising from a process of structural coupling is that it explains how economic efficiency can be both the primary consideration of the courts in framing its decisions while at the same time the possibility of divergence, and by implication the autonomy of the legal system from economic modes of thought, remains. Autopoiesis provides two explanations as to why divergence occurs, both of which are consistent with the central role of economics within competition law reasoning.

Once the legal system has promoted within its methodology the application of economic efficiency as the objective of competition law, the selecting and arbitrating role of the legal system does not cease. In part this is because there is an absence of uniformity as to what constitutes the 'correct' economic analysis for a given set of circumstances. The power to determine which of several competing economic interpretations is selected remains a normative function of the legal system. There is no divergence here in the autopoietic sense, since there is consistency with one part, at least, of the economic system; that is, with the economic argument that has been made in the legal forum and selected as reflecting the legal approach consistent with the established legal understanding of what is the correct outcome in the circumstances. It is true to say, however, that there is a deviation from a part, perhaps a significant part, of the microeconomic literature. In this sense, such an event can be described as rhetorical divergence: it adopts a position consistent with the economic approach, but given the heterogenity of the economic system and its internal debates, it will nevertheless be invariably described in some quarters as being divergent. This class of divergence presupposes, of course, that it is possible to have more than one economic argument on the same issue that can properly be said to be 'correct' in economic terms.

More fundamentally, the legal system retains the ultimate ability to reject all of the economic arguments on a particular issue. Even the most respected academic consensus in the economic literature can never be regarded as a statement of the law because only the legal system can bring such concepts within its own system by conferring an economic argument with a legal

meaning. Where the legal methodology has developed such as to place efficiency reasoning at the core of judicial decision making, and to reject other non-economic objectives as grounds for generating competition judgments, an outcome where the law follows a line of reasoning irreconcilable with the conclusions of the economic system represents a failure to transcribe an economic concept into the realm of legal meaning. Such a rejection represents the ultimate normative closure of the legal system, in other words, there are some economic concepts that the law cannot implement notwithstanding its acceptance of efficiency reasoning and its rejection of alternative competition law goals. This form of divergence is autopoeitic divergence in the truest sense. Here there is simply no response available to the particular environmental event within the universe of possible legal actions because the inherited legal methodology is unable to frame a solution in terms which adequately address the encountered problem; where the system can only hide, howl or run, the circumstances require it to fly. This type of divergence can referred to as 'methodological rejection' since it is manifested by the adoption of a legal decision which is irreconcilable with every microeconomic argument, not because the legal system is endorsing a non-economic competition objective, but because the inherited legal methodology does not allow for the economic problem, as well as the economic solutions posited, to be understood. In this regard it differs from rhetorical divergence since it represents a situation where law's normative informing elements are incapable or unwilling to recognise or implement responses suggested not only by a given economic theory, but by the economic methodology in general. Methodological rejection thus raises the spectre of competition policy problems beyond the realms of judicial solution.

Underlying both these forms of divergence are the normative functions of the legal system. It is a normative function which determines why certain economic arguments are preferred above others in the case of rhetorical divergence, and why certain economic concepts cannot be digested into legal solutions leading to methodological rejection. Although it is tempting to cite these normative functions as alternative competition law objectives in their own right, ultimately such a description would be misleading. Normative functions operate on a different plane to the operational objectives of competition law; they are not rivals to the central position of efficiency reasoning in the sense that

the formalistic prohibitory approach or the non-economic socio-political objectives are; rather they inform the role in which economic reasoning has been cast within the law's methodology, and, in the case of methodological rejection, the limits of this role. The conceptions of divergence based on autopoietic theory therefore allow for the maintenance of the centrality of efficiency reasoning during the courts' application of competition law: divergence emerges as the operation of the law's selection between different aspects of efficiency reasoning (in the case of rhetorical divergence) or the encountering of economic problems for which no equivalence of meaning can be found within the legal methodology (in the case of methodological rejection). In either event, the primary role of economic thinking as the legal system's selected mode for deciding competition law cases remains intact.

Using autopoiesis as a framework of study presents the normative functions of the legal system as the causes of divergence. Explaining divergence involves identifying these functions in a tangible manner. Specifically, what is the element of the Community competition law system which drives the courts' system of preferences for certain economic arguments over others and causes rhetorical divergence, and what are the legal system's limitations which prevent certain economic concepts making the leap into legal decision-making thereby leading to methodological rejection? It is to addressing these issues, and examining in more depth instances of each types of divergence, that parts II and III of this thesis turn.

PART II

RHETORICAL DIVERGENCE

CHAPTER THREE

THE PERMISSIBLE SPECTRUM OF 'CORRECT' ECONOMICS

Rhetorical Divergence and the Heterogeneity of 'Correct' Economics

The concept of rhetorical divergence rests on there being multiple 'correct' economic arguments for a given situation; one of which is taken and promoted by the legal system, and at least one alternative that is held out in the critical literature as the superior analysis which, the critics believe, the court should have followed in the circumstances. In order for the court's selected reasoning to be merely rhetorically divergent from the economic methodology it must be possible for there to be several, perhaps contradictory, economic arguments in a given case, each of which can properly be described as being coherently grounded in the methodology of economics. This economic multiplicity is readily observed within the processes of the court – as Forrester has commented, "[w]hen one goes to hearings at the European Commission or the Court, one can find Nobel scientists on each side of the table, one proving with beautiful charts and diagrams the precise diametric opposite of what the other has argued."[1] This appearance sits uncomfortably with the law's usual demands of scientific evidence and indeed with the self-perception of the economics profession itself – that within a series of conflicting statements only one can be demonstrated as the scientifically true outcome, with the remainder being discrepancies, *i.e.* divergences from proper economics. Nevertheless, it will be argued in this chapter that such a multiplicity of opposing arguments, each being economically valid, can be asserted within the confines of economic thought because of the

[1] Quoted in "Panel Discussion: Competition Policy Objectives", in C. Ehlermann and L. Laudati (eds.), *European Competition Law Annual 1997: The Objectives of Competition Law*, (Oxford: Hart Publishing, 1998), p. 16.

array of value judgments which can be accommodated within the major tenets of economics. It is this potential to select between positions that are potentially irreproachable *inter se* that creates the scope for Community competition law to claim to be economic while simultaneously being derided as uneconomic by elements of antitrust academia. In short, the possibility of different value judgments being taken within economics demonstrates how rhetorical divergence may arise.

The first part of this chapter examines how value judgments can be accepted within the scientific methodology of economics, examining both the tradition of denying the role of ethical considerations and how this view is reconcilable with the post-modernist understanding of Popper's falsification criterion for scientific legitimacy. The remaining sections discuss the points at which value decisions are made in proposing economic arguments within the three framework methodologies of economics, namely, the metric of efficiency, the rationality function and the *ceteris paribus* principle. The chapter closes with an overview of the discrete required value judgments that emerge from this analysis and which are of primary concern to economic argument within competition law.

The Scope for Value Judgments in Microeconomics

There is a well-established reluctance on the part of the economics profession to acknowledge that value judgments underlie any aspect of their methodology. This tradition can be traced back to the rationalisation of economics as a branch of the sciences rather than philosophy that is often said to have originated with Ricardo and which blossomed with the expansion of mathematical economics at the turn of the last century.[2] If economics was, to use Robbins' classic

[2] On the rise of mathematical abstraction in economics *see* H. Demsetz, *Economic, Legal, and Political Dimensions of Competition*, (Amsterdam, New York and Oxford: North-Holland Publishing Co., 1982), p. 4 *et seq.*; J. High, "Split Personality: A Brief History of Competition in Economic Theory", in J. High (ed.), *Competition*, (Northampton (Ma.) and Cheltenham: Edward Elgar, 2001), p. xi *et seq.* This has been referred to by some commentators as the "Ricardan vice"; *see* J. Schumpeter, *History of Economic Analysis*, (New York: Oxford University Press, 1954), pp. 472-473.

definition, to be the "science which studies human behaviour as a relationship between ends and scarce means that have alternative resources",[3] then any aspersions of normative engagement would have to be refuted – or at least carefully concealed. Thus, Liefmann, writing in 1915, took the view that any value judgements must necessarily take place outside of the economic dialogue:

> [I]t must be stated that according to modern principles of science, economics has the character of a science only so long as it refrains from expressing judgements. These must always be based on some ideal which is beyond the bounds of economic consideration; and upon this basis, no propositions of general application, such as science demands, are possible.[4]

This tendency is one that has continued into present-day economic attitudes. The perception of economics as a sphere for empirical proof and disproof, and theories subject to testing and refutation free from the messy considerations of ethics and morality reflects a stern adherence to the view that, to use the words of one economist, "the problem is not that there is a left and right and centre of economics, but that there is bad economics and good economics".[5]

At the heart of this tendency to deny value judgments is a belief in the rigid distinction between 'is' and 'ought' statements, often referred to as "Hume's guillotine".[6] 'Is' statements are those facts that are materially demonstrable, that is those points of reference which can be held out as definitively false or true and agreed on an inter-personal level as such.[7] In contrast, an 'ought' statement is an evaluation: "it approves or disapproves, it

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[3] L. Robbins, *The Nature and Significance of Economic Science*, (London: Macmillian, 1962), p. 16.

[4] R. Liefmann, "Monopoly or Competition as the Basis of a Government Trust Policy", (1915) 19 *Quarterly Journal of Economics* 308, 311.

[5] D. Neven quoted in "Panel Discussion: Competition Policy Objectives", *loc. cit.*, p. 17.

[6] Named after David Hume, and first coined by Black; *see* M. Blaug, *The Methodology of Economics or How Economists Explain*, (Cambridge: Cambridge University Press, 2nd Edition, 1992), p. 113; M. Black, *Margins of Precision: Essays in Logic and Language*, (Ithaca: Cornell University Press, 1970), p. 24.

[7] M. Blaug, *op. cit.*, p. 113.

praises or condemns, it extols or deplores – and we can only employ arguments to persuade others to accepts it";[8] in other words it is a rational argument which a rational person may nevertheless refuse to countenance. Scherer suggests that the unwillingness of economists to engage in the 'ought' debates which value judgments entail is an indication that their scientific methods of thinking are poorly adapted for examining value-laden issues:

> Economists, including myself, are more like plumbers than philosophers. We have a box of analytical tools with which we can address a wide array of problems. We accept without much thought the law of supply and demand (our equivalent to the law of gravity for plumbers) and the different calculus telling how firms maximize profits and markets adjust to shocks (our analogue to the plumber's equations of fluid motion). When someone tells us that water flows naturally uphill, or that it *should* flow uphill if the world were properly ordered, we are inclined to change the subject rather than debate the point.[9]

Antitrust economics as practiced before the Community and U.S. courts has a particularly strong interest in this ritual of denial. Much has been invested in rejecting the alternative non-economic interpretations of the operative objectives of competition law on the grounds that they require nebulous determinations of a political nature; something which is said to stand in marked contrasted to the cool rational factuality of the efficiency standard. As Jacobs has pointed out, even where there are seismic differences of opinion between participants in an antitrust debate, there is a shared reluctance to ostensibly

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[8] *Ibid.*; *see also* on the role of argument in shaping and changing value judgments T. Hutchison, *'Positive' Economics and Policy Objectives*, (London: Allen & Unwin, 1964), chap. 2, reprinted in B. Caldwell (ed.), *The Philosophy and Methodology of Economics*, (Aldershot: Edward Elgar, 1993), vol. ii, p. 25, p. 53.

[9] F. Scherer, "Antitrust: Ideology or Economics?", (1991) 5 *Critical Review* 497, 498. Emphasis original. *See also* F. Scherer, "Efficiency, Fairness, and the Early Contributions of the Economists to the Antitrust Debate", (1990) 29 *Washburn Law Journal* 243, 254, reprinted in F. Scherer (ed.), *Competition Policy, Domestic and International*, (Cheltenham and Northampton (Ma.): Edward Elgar, 2000), p. 15.

discuss the existence of value-differences which might reopen the communally settled issue of the legitimacy of the centrality of economic reasoning within the strictures of the competition law.[10]

Value judgments, however, are not only capable of being accommodated within the economic framework – they are unavoidable. First, it is important to point out that no single fact can be definitively proven from another since to do so would require the process of inductive reasoning to be replaced with an absolute and complete knowledge of all things.[11] Thus, the statement that one has only ever seen white swans, does not allow one to conclude that all swans are white.[12] This is the inductive fallacy: a true premise can lead to a false conclusion because, as Blaug puts it, there is no guarantee that what we have so far experienced will prove to be universally the case.[13] Popper's solution to this problem was to shift the focus of scientific factual proof from the quest for verification to the process of falsification.[14] Taking this perspective it is still impossible to state a universal conclusion based on a limited observation, but what can be said is that the posited conclusion that all swans are white is the best one until evidence to the contrary, say the discovery of a black swan, is established. The truth or otherwise of a particular statement is thus demonstrated in the potential for it to be shown to be definitively false. This is Popper's criterion for a scientific statement: induction is manageable so long as it is non-demonstrative with its inter-personal acceptability proven by the potential for the statement to be proven to be false.

The role of value judgments within this process comes to the fore when the limits of falsification are considered. On one hand is the problem posed by

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[10] M. Jacobs, "An Essay on the Normative Foundations of Antitrust Economics", (1995) 74 *N.C. L. Rev.* 219, 261.

[11] The following analysis is drawn principally from M. Blaug, *op. cit.*; B. Caldwell (ed.), *op. cit.*; D. Redman, *Economics and the Philosophy of Science*, (Oxford: Oxford University Press, 1991); D. Hausman (ed.), *The Philosophy of Economics: An Anthology*, (Cambridge: Cambridge University Press, 2nd Edition, 1994).

[12] This swan analogy was first used by John Stuart Mill to describe the imbalance between deduction and induction; *see* M. Blaug, *op. cit.*, p. 13.

[13] *Ibid.*

[14] K. Popper, *The Poverty of Historicism*, (London: Routledge & Kegan Paul, 1957).

the Duhem-Quine thesis.[15] This criticises falsificationism on the basis that any scientific hypothesis relies on a testing observation, which then requires that this observation can be examined in isolation from all other phenomenon. In turn this necessitates a whole series of ancillary hypotheses to create the conditions of isolation. The impossibility of falsification arises because the deviation of the tested result from that predicted by the theory can always be blamed on the conditions of one of the ancillary hypotheses not being met in the tested conditions; this is a difficulty that Popper himself acknowledged:

> no conclusive disproof of a theory can ever be produced; for it is always possible to say that the experimental results are not reliable or that the discrepancies which are asserted to exist between the experimental result and the theory are only apparent and ... will disappear with the advance of our understanding.[16]

Overcoming the Duhem-Quine problem requires a distinction to be made between falsificationism and, as Blaug describes it, naïve falsification. With the naïve variety the Duhem-Quine thesis is unavoidable; scientific statements become unflasifiable because the propagator of the theory places no limitation on the grounds upon which it may be defended. Inherent within Popper's concept, however, is the idea that such immunising stratagems may not be employed. Instead there must be conceivable grounds on which the theory can be said to have been falsified, notwithstanding the requirement for ancillary hypothesis to be put in place for the treatment of the phenomenon in isolation. Determining what these boundary elements are and when they have been breached will in large part indicate whether the theory is falsifiable. If many contrary empirical indications to the theory are blamed on the failure for the factual circumstances to meet the ancillary hypotheses, then the currency of the theory being tested will diminish. In contrast, if the ancillary hypotheses are seldom blamed for negative outcomes and many empirical results confirm the

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[15] *See generally* D. McCloskey, "The Rhetoric of Economics", (1983) 21 *Journal of Economic Literature* 481, reprinted in D. Hausman (ed.), *op. cit.*, pp. 395, 402 *et seq.*; M. Blaug, *op. cit.*, p. 18 *et seq.*

[16] K. Popper, *op. cit.*, p. 50, quoted in M. Blaug, *op. cit.*, p. 18.

theory, the theory can be said to be "well-corroborated".[17] There is no clear division between the point when a theory moves from being unfalsifiable to being well-corroborated, but there is a sliding scale along which one moves between science and non-science. What this demonstrates is that the value-fact delineation of Hume's guillotine is not absolute. While at one end of the spectrum there are facts with which a rational person cannot disagree, and at the other are values in the guise of internally coherent statements with which a rational person may disagree, there exists an awkward middle ground where rational people will disagree without acknowledging the value judgment inherent in their respective arguments. Fundamentally, the determination of whether the defence of a scientific statement is justified or employs an immunising stratagem relies on an evaluation as to what the credible levels of required phenomenon isolation in a given instance should be. The point when a satisfactorily falsifiable theory becomes mere dogma depends on the extent to which the assertion resonates with its intended audience as being a scientific one; a process which is as likely to draw upon inter-subjective value judgments as brute facts.

The premise of the Duhem-Quine thesis, that scientific concepts be examined in isolation, also forces the entry of value judgments into Popper's falsificationism in another way. A concept is studied in reliance on certain elements taken as accepted (that is, the ancillary hypotheses) either as to the nature of the problem or the presentation of the solution. This is, as has been discussed, fundamental to the operation of induction as an alternative to universal deductive explanation. Every scientific endeavour thus has a point of departure and of termination beyond which further enquiry is not made. Repeated delving beyond this point leads to a multitude of investigations of ever more fundamental questions until a complete unified explanation is reached. In the economic context, Friedman describes the issue as one of avoiding the trap of infinite regression:

> The problem that bothers me about cause is that it almost invariably leads into a problem of infinite regress. There is no such thing as *the*

[17] *See* M. Blaug, *op. cit.*, p. 24.

> cause of anything. In a way, it's the same problem as the problem that bothers me about people who talk about theory versus facts. As you probably know I've always thought the best definition I could give of the difference between a theory and a fact is that a fact is a theory that we take for granted for present purposes. But there's no such thing as *a fact*. There's a way of looking at some facts and that's really a theory. But to go back, once you start talking about cause – money is the cause of inflation. Well then, what caused the money? And there's no stopping. ...People are always trying to get to ultimate causes. I think it's a foolish search.[18]

Friedman's solution to infinite regression is highly pragmatic; the stopping point is determined simply by the purpose of the investigation and convenience.[19] Von Mises takes an alternative, much more philosophical view drawing on the so-called *Verstehen* doctrine whereby the basis of inquiry is delved from fundamental internally accepted truths created from intuition and empathy rather than empirical demonstration.[20] However these points are selected, they unavoidably result in a value judgment. They represent an agreed decision as to the point beyond which further regressive questions will not be asked (why are people assumed to be rational actors?), and consequently they are the scintilla from which enquiries as to what is or is not falsifiable commence (if a firm is rational, what facts will prove that the given action of a firm is consistent with that predicted by the theory?). This, in essence, reflects Lakatos' concept of paradigms of study with a hard-core of empirically irrefutable beliefs around

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[18] Quoted in an interview with Hammon, reproduced in full in J. Hammon, "An Interview with Milton Friedman on Methodology", (1992) 10 *Research in the History of Economic Thought and Methodology*, reprinted in B. Caldwell, *The Philosophy and Methodology of Economics* (Aldershot: Edward Elgar, 1993), vol. i, p. 216. *See also* M. Friedman, "The Methodology of Positive Economics", in M. Friedman (ed.), *Essays in Positive Economics*, (Chicago: University of Chicago Press, 1966), p. 3.

[19] J. Hammon, *loc. cit.*, p. 216: "The stopping point has to be based on the purpose of your investigation, on convenience and so on."

[20] *See* L. Von Mises, *Human Action: A Treatise on Economics*, (London: William Hodge, (1978) [1949]); M. Blaug, *op. cit.*, p. 86.

which refutable elements are expanded.[21] As with the solution to the Duhem-Quine thesis, the validity of these points depends on inter-subjective endorsement. This requires a double-value judgement: the determination as to what the boundaries of regressive consideration are held to be are decided by what the participants consider to be beyond the scope of scientific adjudication. In other words, it is a value-judgement as to what constitutes value-judgments.

It is apparent from this discussion that value judgments can operate within the scientific conception of economics on two planes; first, in delineating what are unacceptable immunising stratagems; and second, in determining the limits of regressive analysis. Depending on the value judgments selected, therefore, it is possible for multiple correct outcomes to arise within the domain of economics, each premised on a distinct set of opening or defending value assertions leading to diverging economic conclusions, and every one of which is internally coherent and fundamentally scientific. Economics, as with any other science, is therefore a framework within which there are successive agreements and disagreements as to value judgments (where there is no correct answer), as much as with facts. Understanding where these value judgments are made requires a more detailed examination of some of the methodological elements of microeconomics.

Value Judgments in Economics I: The Metric of Efficiency

The concept of efficiency can be described as the economist's yardstick. Put most simply the efficiency methodology involves the comparison of societal utility before and after a specific event. The greater this utility, the greater the efficiency. The measure of utility is likewise assessed by a relative analysis; the utility of an economic actor is deemed to be increased where the same level of resources previously employed by the actor yields a greater amount of the desired product after the event, enabling the actor to either consume more of that product or to consume the same amount and apply his surplus of resources to

[21] *See* I. Lakatos, *Philosophical Papers: The Methodology of Scientific Research Programmes*, J. Worall and G. Currie (eds.), (Cambridge: Cambridge University Press, 1978), pp. 69, 116-117; M. Blaug, *op. cit.*, pp. 33-37; S. Keen, *Debunking Economics: The Naked Emperor of the Social Sciences*, (Annandale (N.S.W.): Pluto Press Australia, 2001), p. 155 *et seq.*

acquiring other products. In such a situation, assuming that the actor is rational, he will increase his utility by satisfying some of his previously unrequited demands.[22] Put colloquially, the relative measurement of utility is an examination of whether the individual gets 'more bang for his buck'.

The challenge of the efficiency methodology is to measure changes to total societal utility. If societal utility is treated as the sum of individual utilities, then determining efficiency would simply involve a comparison of the total expended resources to output ratio before and after the event. Since the start of the twentieth century, however, economists have usually qualified the societal calculus model of efficiency with the 'Pareto condition'.[23] This holds that an outcome will only be regarded as more efficient if it improves the utility enjoyed by some individuals without reducing that of anyone else. Efficiency so declared must therefore take into account both individual and total societal welfare. Rather conveniently, conventional microeconomics presents a model which satisfies both the Pareto condition and indicates the optimal point of total

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[22] The fundamental concept of utility in modern economics is as a subjective value, a position first put forward by Liefmann: "utility and cost are not to be understood in the sense accepted by prevailing theory, which I term quantitative-materialistic, as a quantity of goods, but of consisting as sensations of pleasure and pain, and the yield is not a quantity of goods, but is purely psychical [sic.], a surplus of the former over the latter. It can hardly be overemphasized that all fundamental economic concepts are valuation concepts, and that valuation in terms of money turns not on the quantity of money, but upon the individual's valuation of that quantity. To bring about the largest possible return, *i.e.*, the largest possible surplus of pleasurable sensations, is the aim of all economic activity. Whether this object is attained, whether there is the most complete satisfaction of all wants, is a question which depends obviously upon the subjective estimates of the individuals regarding the goods offered. Upon that point no general theorems can be laid down, and hence strictly scientific, theoretical investigation seems to break down at the very first fundamental question – when is complete satisfaction of wants present?"; R. Liefmann, *loc. cit.*, 312.

[23] *See* V. Pareto, *Manual of Political Economy*, A. Schwier and A. Page (trans.), (London: Macmillan, 1972 [1909]); C. Veljanovski, "The New Law-and-Economics: A Research Review", in A. Ogus and C. Veljanovski (eds.), *Readings in the Economics of Law and Regulation*, (Oxford: Claredon Press, 1984), pp. 19-21; H. Varian, *Intermediate Microeconomics: A Modern Approach*, (New York and London: W.W. Norton & Co., 2nd Edition, 1990), pp. 15-16.

societal efficiency when measured using a simple net social utility calculation.[24] This is the concept of allocative efficiency, with optimal allocative efficiency being achieved when the resources expended by the consumer are equal to the marginal cost of production of the object in question. It represents the point when no further consumer utility gains may be achieved without a proportionately larger reduction in producer utility, and *vice versa*; hence it signifies the optimisation of net social utility. If prices increase from this level, the producer would improve his utility at the expense of the consumers now forced to pay the higher price; however, the producer gain would be less than the consumer loss because there would be some element of untransferred utility. This 'deadweight loss' comprises of the utility forgone by consumers unwilling to purchase at the new higher price who were willing to buy at the allocative optimal.[25]

While the Pareto conditions and allocative efficiency are attempts to immunise efficiency determinations from normative evaluations,[26] there are at least three types of value judgments that remain inherent within the metric of efficiency.

First, optimal allocative efficiency can only be regarded as satisfying the Pareto condition in the sense that it matches up every consumer willing to purchase with every producer willing to sell. The scenario of a market where there has been a super-normal level of profit, (*i.e.* the revenue received by the producer is in excess of his average cost of production) and hence where a shift towards optimal allocative efficiency will harm the producer's utility (in the sense that there will be a transfer in utility from producers to consumers) is overlooked. One way around this is the development of Kaldor-Hicks efficiency

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[24] *See* T. Calvani, "Consumer Welfare is Prime Objective of Antitrust", (1984) 7 *Legal Times* 14, reprinted in T. Calvani and J. Siegfried (eds.), *Economic Analysis and Antitrust Law*, (New York: Little, Brown & Co., 2nd Edition, 1988); H. Varian, *op. cit.*, pp. 15-16, 489-495; R. Bork, "Legislative Intent and the Policy of the Sherman Act", (1966) 9 *Journal of Law and Economics* 7, 11-12, 16;

[25] For a concise formal analysis *see* R. Posner, *Antitrust Law,* (Chicago: University of Chicago Press, 2nd Edition, 2001), pp. 287-308.

[26] *See* F. Scherer, "Efficiency, Fairness and the Early Contributions of the Economists to the Antitrust Debate", *loc. cit.*, 248.

which modifies the Pareto condition to permit these net total social utility gains, notwithstanding the fact that they leave certain individuals worse off, provided the harmed individuals can in principle be compensated by transfers of the net utility gain.[27] Ultimately, this leads to the conclusion that the measure of efficiency represented by the allocative efficiency model is synonymous with a measure of utility focussing solely on net societal utility gain, with transfers of utility as between individual actors being discounted by the hypothetical possibility of compensation which might or might not accord with the level of subjective utility lost by the harmed individual. The obvious difficulty here is that the compensatory transfer need never actually occur in order for Kaldor-Hicks efficiency to arise since to prescribe such a payment would, of itself, be a value judgement. As such it is a measure of potential rather than actual preservation of individual utility.[28] Indeed as Mercuro and Medema point out, the very act of *not* advocating a Kaldor-Hicks mandated transfer payment comes "perilously close" to itself being a value judgment in favour of the *status quo*.[29]

More troubling is the introduction of objective utility in the guise of the transfer mechanism. Allocative efficiency relies on individuals having different levels of utility in the same resource so that scarce resources are allocated only to those having the highest utility in that resource as measured by the price they are willing to pay.[30] Subjective utility is therefore a fundamental premise of allocative efficiency, and any attempt to supplement the negative effects of a movement towards the allocative optimum on individual utility through a mechanism of objective utility transfer will never directly address the harm done. This is not to say that the allocative optimum as a measure of efficiency should be discarded, rather that it should be characterised as a measurement of net societal utility and that its ability to satisfy the Pareto condition is at best

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[27] *See* C. Veljanovski, *loc. cit.*, p. 20.

[28] *Ibid*, p. 21.

[29] N. Mercuro and S. Medema, *Economics and the Law: From Posner to Post-Modernism*, (Princeton (N.J.): Princeton University Press, 1997), p. 20.

[30] This is an observation first made by Hutchison; T. Hutchison, *The Significance and Basic Postulates of Economic Theory*, (New York: Augustus M. Kelly, 1938 [1965]), pp. 138-139. *See also* S. Keen, *op. cit.*, pp. 138139.

imperfect.[31] Consequently, the use of allocative efficiency as the measure of economic efficiency is grounded on a value judgement: the aggregate gain of society will always be greater than the losses of the few. In semantic terms it is possible to juxtapose this type of evaluation against the alternative of focussing on the maximisation of the utility of a smaller sub-set of society, be they consumers or producers. On closer scrutiny, however, an evaluation based on net societal gain is itself a value judgment in favour of the particular section of society that benefits from the utility transfers flowing from a shift towards the allocative optimal outcome. Given the improbability of output ever being greater than the allocative optimum (since producers would simply cease to produce where price falls below average cost) a shift towards the allocative optimum invariably means an increase in output; thus, establishing allocative efficiency as the desired metric is, more likely than not, a value judgment preferring consumer utility. Ultimately, to paraphrase Samuels, there is no independent measure of the most efficient outcome.[32] Instead, to avoid the pointlessness of regressive analysis a value decision must be made as to whose perspective on efficiency is taken as the point of departure for making scientific economic statements.

The second area for considering value judgments in the context of efficiency relates to the 'second-best problem'. This theory states that movements in price and quantity of a given industry towards the allocative optimum level for that sector will only be guaranteed to result in a net societal efficiency gain where every sector in the rest of the economy is operating at their particular allocative optimal levels. To take an example of two industries both using different amounts of the same resource, if a price-fixing cartel forms in the

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[31] As has been indicated, allocative efficiency may still be regarded as Pareto efficient in two limited circumstances: first, where the market was always priced at marginal cost and hence there is no utility transfer from the producer arising from shifts from a previous position of price being above marginal cost; and second, where the individual actors are only conceived in their capacity as consumers.

[32] W. Samuels, "Maximisation of Wealth as Justice: An Essay on Posnerian Law and Economics as Policy Analysis", (1981) 60 *Texas L. Rev.* 147, 155, quoted in N. Mercuro and S. Medema, *op. cit.*, p. 119. *See also* F. Machlup, "Positive and Normative Economics: An Analysis of Ideas", in A. Lowe (ed.), *Economic Means and Social Ends: Essays in Political Economics*, (Englewood Cliffs (N.J.): Prentice-Hall, 1969), p. 99, pp. 121-122.

first industry which results in a lower output and lower demand for the resource, there may be a fall in price of this resource resulting in decreasing costs, and consequently price, in the second industry to a degree that leads to an overall utility gain for consumers in the second industry greater than the deadweight loss inflicted by the first industry's cartel.[33] Thus, while reducing price towards marginal cost in every sector is the 'first-best' method of maximising societal utility, where it is possible to reduce price towards cost in some sectors only the 'second-best' net utility outcome may, in some circumstances, be to leave the moveable prices at their original level.

Despite its potential, the second-best problem has had relatively little impact on the study of industrial organisation. It has been dismissed by some commentators as only a theoretically possibility, with the likelihood of a real-life occurrence being described as at best "rare".[34] The greater crime of the theory is that it is beyond practical scientific observation, a position best explained by Bork in the context of the courts' ability to analyse second-best evidence:

> In order to take into account second-best's caution in a price-fixing case, for example, the court would first have to measure the gap between price and marginal cost – in itself an all but impossible task. Next, the court would have to inquire whether there existed divergences between marginal cost and price in any industry making substitutes for or complements of the products produced by the cartel, or in any industry to and from which resources might move if the cartel were outlawed, and whether such divergences in any such industry would probably be increased or lessened by outlawing the price agreement. Finally, the

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[33] *See* C. Hansen, "A Second-Best Antitrust in General Equilibrium: A Special Case", (1999) 63 *Economic Letters* 193; H. Hovenkamp, "Distributive Justice and the Antitrust Laws", (1982) 51 *Geo. Wash. L. Rev.* 1.

[34] R. Schmalensee, *The Control of Natural Monopolies*, (Lexington Ma.: Heath, 1979), pp. 30-31. *See also* R. Posner, *op. cit.*, p. 13, fn. 5; R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, (New York: The Free Press, 2nd Edition, 1993), pp. 113-114; F. Easterbrook, "Workable Antitrust Policy", (1986) 84 *Mich. L. Rev.* 1696, 1704: "The difference between 'always' and 'almost always' is unimportant in antitrust whether it cuts against or for a practice. Rules that do well on average are the best courts can produce and apply."

> court would have to judge whether the new equilibrium, across all affected industries, would be better or worse for consumers than the present equilibrium. The objection is not merely that every price fixing case would take ten or fifteen years to try, but that the task itself is beyond the capacity of any court or of any other institution.[35]

This 'unobservability' is not just a problem from the empirical analysis perspective. By stating that the determination of the net efficiency effects of a single industry requires an examination of every sector of the economy, the second-best problem becomes a head-on challenge to the premise that useful economic analysis may be undertaken by examining phenomena in isolation. The second-best problem presents a vista of infinite regression; the solution is to make a series of value judgments as to what constitute the reasonable boundaries of enquiry through determining what is pragmatic (to follow Friedman's approach), what can be internally validated (in line with the *Verstehen* doctrine), or – if one were to be really honest – which societal group's efficiency is of primary concern.

The third type of value judgment necessitated in using the metric of efficiency is temporal in nature. A given allocative optimum will only equate to the point of total highest social utility for one period in time of uncertain but finite duration. In this single static period total societal utility will be increased as price falls to marginal cost. If, however, for any given market a producer commences operations with a lower level of cost (due to, say, improved technology), then total societal utility will be improved if the new price is below the price in the first period regardless of the fact that the price in the first period may have been at marginal cost while the price in the second period is above the second period's level of marginal cost. Consequently, although the deadweight losses in the second period may be greater than those in the first, there has been a net social utility gain, as Schumpeter puts it:

> A system – any system, economic or other – that at *every* given point of time fully utilises its possibilities to the best advantage may yet in the

[35] R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 114.

> long run be inferior to a system that does so at *no* given point in time, because the latter's failure to do so may be a condition for the level or speed of long-run performance.... [S]ince we are dealing with an organic process, analysis of what happens in any particular part of it – say, in an individual concern or industry – may indeed clarify details of mechanism but is inconclusive beyond that. Every piece of business strategy acquires its true significance only against the backdrop of that process and within the situation created by it. It must be seen in its role in the perennial gale of creative destruction; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull.[36]

This concept of efficiency gain from dynamic change[37] brings with it further complications. With the period to be examined cast as an open ended variable a decision must be made determining the cut-off point after which efficiency gains will not be considered. For the early dynamic theorists such as Schumpeter, it was "a matter of indifference whether competition in the ordinary sense function[ed] more or less promptly",[38] thus the cut-off point was set at infinity. In contrast, economists from the structure-conduct-performance school of thought place greater emphasis on the damage inflicted on consumers during the time it takes for a dynamic shift to occur, thereby displaying a lack of confidence in the ability of the market to improve net utility within a socially

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[36] J. Schumpeter, "The Process of Creative Destruction", in J. Schumpeter, *Capitalism, Socialism and Democracy*, (London and New York: Routledge, 1993 [1943]), pp. 82-83, reprinted in J. High (ed.), *op. cit.*, p. 335 *et seq.*

[37] Schumpeter and Hayek are credited with being the first academics to clearly develop the concept, although the idea of dynamic competition and efficiency change through market cost structure realignment appears throughout the classical writings of Smith, Ricardo and Marshall; *see* G. Stigler, "Perfect Competition, Historically Contemplated", (1957) 65 *Journal of Political Science* 1, 1-14; M. Machovec, *Perfect Competition and the Transformation of Economics*, (London and New York: Routledge, 1995), pp. 1, 4; P. McNulty, "A Note on the History of Perfect Competition", (1967) 75 *Journal of Political Economy* 395, 387; F. Hayek, "The Meaning of Competition", in F. Hayek, *Individualism and Economic Order*, (Chicago and London: University of Chicago Press, 1948), pp. 92-106, reprinted in J. High (ed.), *op. cit.*, p. 341 *et seq.*; J. Schumpeter, *op. cit.*

[38] J. Schumpeter, *op. cit.*, p. 84.

acceptable period.[39] Determining the relevant period is a value judgement based on weighting the interests of current consumers against those of future consumers. If the period is too short, actions pushing price towards marginal cost will reduce the incentive of producers to innovate towards the next dynamic shift, given their knowledge that once the shift occurs any super-normal profits are likely to be reduced more rapidly towards cost than would otherwise be the case. If the cut-off point is too distant, we ignore Keynes' famous quip that "[i]n the long run we are all dead"[40] – and the utility of current society is subjugated to the gains of the denizens of the future.[41] Ratios, equations and discounting methods may all be applied to help decide the issue, perhaps similar to those applied in the realm of intergenerational environmental ethics such as Wenz's 5% *per annum* discount rate of future utility.[42] There is little point in scientifically arguing why a particular point has been chosen; although, it is clearly indispensable that some temporal limits are selected to avoid the creation of the immunising stratagem whereby every empirical refutation of a theory is dismissed as having relied on the 'wrong' period of measurement. Inevitably, whatever method is used will depend on a value judgement.

Taken together the three classes of value judgment necessitated by the metric efficiency comprise the who and when of economic concern. The selection of allocative efficiency, even with the Kaldor-Hicks condition satisfied, or of some other alternative, is based on the identification of the grouping whose utility is considered important. Likewise, determining how many contiguous industries should be examined in response to the second-best problem is a judgment of what body of economic actors the utility effects of a

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[39] *See* S. Martin, *Industrial Economics, Economic Analysis and Public Policy*, (New Jersey: Prentice Hall, 2nd Edition, 1993), pp. 144-145; R. Nelson, "Comments on a Paper by Posner", (1979) 127 *Univ. Penn. L. Rev.* 949.

[40] J. Keynes, "A Tract on Monetary Reform", in J. Keynes, *The Collected Works of John Maynard Keynes*, (London: Macmillan, 1971), vol. iv.

[41] *See also* F. Machlup, *op. cit.*, p. 123 *et seq.*; P. Schoemaker, "The Quest for Optimality: A Positive or Heuristic of Science", (1991) 14 *Behavioural and Brain Sciences* 205, 207-208, reprinted in B. Caldwell, *op. cit.*, vol. ii, p. 260.

[42] S. Wenz, *Environmental Justice*, (New York: State University of New York Press, 1988), p. 244. On intergenerational methods in the environmental field in general *see* J. Alder and D. Wilkinson, *Environmental Law and Ethics*, (London: Macmillan Press, 1999).

given event are deemed worth considering. The issue of temporal values makes an equivalent selection on the intergenerational plane. Each of these value judgments represents a point of departure and termination for economic enquiry. They are the opening premises from which falsifiable statements can be generated; while looking into why each of these opening selections is made moves the enquiry into the realm of the unfalsifiable. In a sense, they represent the scientifically least objectionable value judgments.

Value Judgments in Economics II: The Rationality Function

The presumption of rationality – that is, the reaction of economic actors to any given event will be to maximise their utility –is an indispensable element of the economic methodology. Its function is computational and generative;[43] a series of opening considerations are stated and then put into motion by the presumption that, unless stated as one of the opening considerations, all subsequent events will be the result of behavioural units acting to maximise their self interest in the selected circumstances. Without rationality inductive reasoning in economics would be impossible as there would be no basis for arguing that the given set of opening considerations would lead to any particular predicted outcome; as Easterbrook succinctly puts it, "if you assume people are not rational ... then you may as well give up trying to influence their behaviour".[44] The presumption of rationality acts as a break on infinite regression by marking one of the points beyond which no further economic enquiry is required. Once again one may select between *Verstehen* type explanations or simple pragmatism as to why no further investigation is necessary, but fundamentally it comes down to the fact that alternative generative tools would place economics too far beyond the scientific pale.

There are two types of value judgments that remain to be made within the methodology of the rationality function. The first of these is the selection of

[43] I borrow the term 'generative' from Melitz: J. Melitz, "Friedman and Machlup on the Significance of Testing Economic Assumptions", (1965) 73 *Journal of Political Economy* 37, 42.

[44] F. Easterbrook, *loc. cit.*, 1709. *See also* M. Jacobs, "The New Sophistication of Antitrust", (1994) 79 *Minn. L. Rev.* 1, 4-6.

a metric of rationality. The metric must be representational of objective utility maximisation since an individually subjective metric would obviously fail to be generative other than for the particular individual. The most frequently used form of the rationality presumption when examining industrial organisation is the presumption of profit maximisation. It is not inconceivable, however, that other utility maximisation functions, based on the maximisation of recreational time, revenues or social power might be chosen as the rationality function. Even where wealth maximisation is the chosen criterion, value judgments remain to be made in the form of limitations as to what actions by economic actors will be considered to be satisfying the assumption in the described circumstances. This is necessary because there is the potential for an immunising stratagem to manifest itself where all conceivable actions are defined as consistent with the selected rationality programme. Precisely when this line is breached is not objectively testable. Some economists will readily push the limits of what can be explained by economics behaviour. For example, in their celebrated article, "De Gustibus Non Est Disputandum", Stigler and Becker argued *inter alia* that in addition to an increase in consumer demand following a fall in price of a particular good, the wealth maximisation function could also be used to justify demand remaining static following an identical fall on the basis that consumer inertia could be explained as the action of rational consumers factoring in the costs of searching for new cheaper products and realising that their existing consumption habit was a more efficient way with which to deal with price changes.[45] For other commentators such as Leff, however, this type of reasoning crosses the Popperian threshold of falsification:

> [S]ince people are rationally self-interested, what they *do* shows what they value, and their willingness to pay for what they value is proof of their rational self-interest. Nothing merely empirical could get in the way of such a structure because it is definitional.[46]

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[45] G. Stigler and G. Becker, "De Gustibus Non Est Disputandum" (1977) 67 *American Economic Review* 76, 81-83.

[46] A. Leff, "Economic Analysis of Law: Some Realism about Nominalism", (1974) 60 *Virginia L. Rev.* 451, 453. Emphasis original. *See also* J. Hirshleifer, "The Expanding Domain of Economics", (1985) 75 *American Economic Review* 53, 54.

What this type of disagreement boils down to is a difference of opinion as to how broadly the descriptive net of rationality can be reasonably cast before becoming unfalsifiable.

The second type of value judgment concerns whether the subject-economic actor is described within the rationality mechanism. One choice is for the firm's behaviour to be taken as a given, that is as an opening event, with the consequences of that event modelled using the presumption of rationality. Alternatively, the firm's behaviour may be considered as one of the outcomes to be predicted, in which case it will form part of the rationality assumption. The decision as to where the economic actor is located may lead to significant predictive variations. For example, where a firm has decided to refuse to supply a competing undertaking in a downstream market, taking the firm's motives and internal rationality as unknown may allow the conclusion that the firm's actions are intended to leverage its dominant position into the downstream market. In contrast, if the firm's operations are located within the rationality function, it will be presumed that, as a rational actor, it will already be exercising whatever monopoly power it has over the downstream subsidiary without the need to use the refusal to supply as a method for extracting further monopoly profits. Each selection depends on a different valuation as to where the break on infinite regress should be placed (should the subject-actor's internal rationality be presumed or not?), and as to what constitutes an immunising strategy (does inferring subject-actor rationality close the possibility of falsifiable conclusions?).

Ultimately, both of these types of value judgment are reducible to a single issue: what constitutes rational behaviour? There can be no categorical answer to such a question any more than one can state definitively what is worthy or useless behaviour. The best that can be said is that rationality depends on what is deemed convenient or internally logical; the determination of which is so inherently disputable that it seems inevitable that differences as to what the presumption of rational behaviour can be used to imply will remain irreconcilable.

Value Judgments in Economics III: The *Ceteris Paribus* Principle

The presumption of *ceteris paribus*, or other things remaining equal, permits the analysis of the effects of one or more selected phenomena in isolation from all others. As has been examined above, the use of such a concept of insulation is essential to the process of inductive reasoning since otherwise all observation would be reduced to atomistic statements. Demsetz attributes the first use of this methodology of abstraction to Adam Smith, and rightly states that its adoption marked the point when economics adopted the mantle of a disciplined study.[47] Clearly not all economic events can be explained simultaneously and one is permitted to extrapolate interfering circumstances in much the same way as friction can be discounted in the study of the laws of motion. Against this necessity for the *ceteris paribus* condition must be weighed the risk of creating unfalsifiable hypothesis; indeed, the use of this isolating principle can be cast as the archetypical immunizing stratagem. Thus one can posit that, say, a fall in price will increase demand, *ceteris paribus*, and if this result fails to empirically materialise seek recourse in the initial qualification: price *would* have fallen had income remained constant, unexpected disrupting circumstances not occurred, or if the wrong type of leaf had not fallen on the tracks – in fact, taking the argument it its extreme, price actually *has* fallen, it is just difficult to observe through all the economic causing the price increase. It is easy to see how very quickly the vociferous defence of an economic theory can become, to use Shoemaker's term, merely "postdictive".[48]

What the *ceteris paribus* methodology requires, therefore, is the making of "an artful choice between phenomena to be explained and phenomena to be abstracted from".[49] This artful choice involves grouping together those phenomena which have significant mutual effects, such that they cannot justifiably be examined independently. For example, an examination of the impact of the increase in energy prices for the cost curve of a firm may be of limited use if it assumes that the price of all the non-energy inputs of that firm remain constant, *i.e.* that the cost curves of the suppliers of the non-energy

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[47] H. Demsetz, *Economic, Legal and Political Dimensions of Competition*, (Amsterdam, New York and Oxford: North-Holland Publishing Co., 1982), p. 6.

[48] P. Schoemaker, *loc. cit.*, 207.

[49] H. Demsetz, *loc. cit.*, p. 6.

inputs are unaffected by the energy price rise. Varying even only slightly the assumptions which are included in the model may have very significant effects on the model's outcomes; to borrow a phrase from chaos theory, models of industrial organisation display a "sensitive dependence on initial conditions".[50]

The value judgments raised by the use of *ceteris paribus* presumption are in essence the same as those that flow from the second-best problem in the context of measuring efficiency, and the determination of the range of outcomes that can be justified within a rationality construct: in a world of apparently infinite possibilities, an evaluation must be made as to when a model of limited complexity will be deemed by empirical observation to be too limited.

Five Paths to Rhetorical Divergence

It is apparent from the analysis in this chapter that value judgments do take place within the methodology of economics; in fact, they are inescapable. Fundamentally all economic analysis depends on the following five evaluations being made and for which it impossible to say that there are correct or incorrect conclusions:

(i) What is the grouping with whose utility we are centrally concerned?

(ii) Over what time period is efficiency to be measured?

(iii) What will not be considered as rational behaviour?

(iv) Are the subject-economic actors assumed to behave rationally?

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[50] This is also referred to as the "butterfly effect"; *see* J. Gleick, *Chaos: Making a New Science*, (London: Random House and Vintage, 1998), pp. 11-31. *See also* for a legal perspective on this issue J. Faull and A. Nikpay (eds.), *The E.C. Law of Competition*, (Oxford: Oxford University Press, 1999), para. 1.03: "Economic theories and economic models are built on and around assumptions. These assumptions by definition do not cover (all) real world situations. In addition, when the assumptions are changed the outcomes of the models may look strikingly different, changing for example the price from a monopoly level to a competitive price level. It is for these reasons that economics may often not be able to give a clear and definite answer on what will happen in a market...."

(v) To what extent can empirical observations deviating from the theory be reasonably explained away?

Answering these questions entails making evaluations which may lead to economic statements which are irreconcilable with others based on alternative value decisions. Regardless of such divisions, all such judgments must be admitted as economic since they each take place within the confines permitted by the methodology of economics. In fact, to say that these determinations are merely permitted is to understate their role; they are unavoidable because no economic modelling is possible until they are addressed whether by express or implicit means.

Where the proponents of one value assertion decry the contradictory economic models predicated on another set of value of judgments as 'uneconomic', what is being described is merely an instance of rhetorical divergence since one set of value judgments made within the economic methodology is as valid – as 'economic' – in objective terms as the next. The scope for different value judgments being made within the economic paradigm creates the fractured conditions necessary for economic conclusions to be simultaneously economic and divergent from other arguments made using the same broad methodology. As far as the legal system is concerned, rhetorical divergence occurs where one such conflicting economic approach is promoted by the courts in the face of opposition from at least one element of the economics profession.

This is not to say that there is no scope for describing some outcomes as being 'bad economics'. Rather the point is that the proof or otherwise of economic theories must occur within a similar grouping of opening value assertions; otherwise the debate should be addressed in ethical rather than scientific terms,[51] or at least a combination of the two. Thus a court that determines that the relevant time period for measuring the harmful effects of particular action may be derided by a critic placing a greater value on creating

[51] For an example of the argument that value judgments in economics should be expressly stated at the outset *see* O. Lange, "The Scope and Method of Economics", in D. Kamerschen (ed.), *Readings in Microeconomics*, (Cleveland (Oh.): World, 1967); and also discussed in M. Blaug, *op. cit.*, p. 129, fn. 43; T. Hutchison, *'Positive' Economics and Policy Objectives*, *op. cit.*, p. 75.

incentives for longer term efficiency gains, while at the same time remaining aligned to an economic position, albeit one utilising values different from those employed in the critic's economic analysis. Nevertheless, the court's view could be shown to be manifestly incorrect if its economic conclusions were shown to be invalid even accepting the time-frame or other value assertions selected.

The idea of rhetorical divergence arising presupposes not only that there is a variety of value judgments leading to differing conclusions, but that there is a single master-economic methodology that acts as a 'big tent' within which all the competing acts of value judgment can still be described as part of the same circus. It is, after all, necessary that there is some element of communality between competing modes of thought if their divergences are to be classed as 'rhetorical'. The shared elements discussed in this chapter – the metric of efficiency, the rationality function and the *ceteris paribus* principle – are the three tenets which serve as the launch-pad for making value judgments and from there developing economic models. To be described as an economic theory, therefore, requires the use of reasoning employing a metric of efficiency, a presumption of rationality and some notion of *ceteris paribus*. If 'bad' economics can be said to mark the internal boundaries of what constitutes economics, then the required use of these defining methodologies marks the outer limits. Arguments based on concepts beyond these leave the realm of rhetorical divergence and enter that of methodological rejection.

CHAPTER FOUR

RHETORICAL DIVERGENCE AND THE COMMUNITY COURTS

Rhetorical Divergence in Action

The abstract concept of rhetorical divergence was explained in the last chapter as the result of an autonomous legal system selecting a particular set of value judgments which, although disputed by certain elements of the economic profession, may nevertheless be justified as being consistent with the core tenets of economic methodology. This chapter switches the focus from the abstract to the observed by examining two questions: where has rhetorical divergence occurred in the Community context and what is the normative function driving the legal system's value selections?

In answering the first question, the distinctions between the principles advocated by the Chicago School of antitrust criticism and those adopted by the Community courts stand out as the most important incidences of rhetorical divergence. Regardless of one's opinion of it, the Chicago School – from its rumbling beginnings in the 1950s, to the revolution it sparked in U.S. judicial reasoning in the late 1970s and 1980s and its continued dominance there today – stands out as one of the most unified, rigorously argued and internally coherent schools of thought to have impacted on practical jurisprudence in modern times.[1] Although its arguments were, and continue to be, aimed primarily at U.S. law, the Community legal system is well versed in the Chicagoans' various arguments, with most, if not all, having been submitted at some stage or other before the Community courts. Nevertheless, on a number of important issues

[1] This is a view shared by both critics and proponents of the Chicago School alike; *see* M. Jacobs, "An Essay on the Normative Foundations of Antitrust Economics", (1995) 74 *N.C .L. Rev.* 219, 220.

European law remains almost untouched by, and consequently at odds with, the Chicago approach. This, it is argued, is due to a number of fundamental differences in value judgments taken by the two differing strands of competition law analysis on the issues of temporal period, rationality and the perspective of what should be considered as *ceteris paribus*.

The second question is examined by surmising that the common thread running through all the value judgments by the Community courts is that they all lead to the inclusion of a greater number of activities within the prohibitions of Articles 81 and 82 than would be the case if the Chicago values were accepted. This clear trend indicates a consistent normative function by the courts which, it is submitted, is the manifestation of the legal system's predilection for Community rules that require positive actions of compliance.

Europe versus Chicago: An Instance of Rhetorical Divergence

The foundation of the Chicago School is usually credited to Aaron Director, an economist who taught part of the antitrust course at the University of Chicago Law School from the late 1940s on. Although Director himself published relatively little, his students and their contemporaries – amongst them Stigler, Becker, Posner and Bork – became the chief proponents of what would later be called the Chicago School of antitrust analysis.[2] Of course, the Chicago School was not purely a Chicago phenomenon, as Bork comments: "[t]he intellectual substance of the Chicago School came not only to be shared but further shaped by persons who had no connection with the University of Chicago".[3] The intellectual roots of the school can also be said to predate Director, and the Chicagoans followed in the tradition of Knight, Hayek, Schumpeter and, before them, the neoclassical English mathematical economists, all of whom stood in

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[2] For an account of the origins of the Chicago School *see* R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, (New York: The Free Press, 2nd Edition, 1993); N. Mercuro and S. Medema, *Economics and the Law: From Posner to Post-Modernism*, (Princeton (N.J.): Princeton University Press, 1997), p. 51 *et seq.*; R. Posner, "The Chicago School of Antitrust Analysis", (1979) 127 *Univ. Penn. L. Rev.* 925; S. Webber Waller, "The Language of Law and the Language of Business", (2001) 52 *Case Res. L. Rev.* 283.

[3] R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. xi.

marked contrast to the Harvard School and its emphasis on industry-specific empiricism inspired by turn-of-the-century German economists, and which would in turn evolve into the 'structure-conduct-performance' method of analysis.[4]

At the risk of some over-simplification, the Chicago critique can be viewed as comprising of two core propositions.[5] The first of these is the suggestion that monopolies are not synonymous with harmful efficiency effects and in many instances will be indicative of the fact that there are no other firms capable of bettering the price or consumer utility satisfied by the monopolist's product due to the potential rivals' relative inefficiency of costs or innovation. In these circumstances the monopolist's price might or might not be at the theoretical monopoly-profit maximising level (the risk of enticing new entrants may force the monopolist to settle for less than the monopoly rent) but it will always be below the price in a market comprising of its less efficient rivals.

The origins of this proposition can be found in the work of the dynamic market theorists of the 1940s and 1950s. In the context of the debate on the merits of central planning over market competition, Hayek suggested that one of the failings of the former was that it assumed the existence of perfect knowledge on the part of the planning committee.[6] Knowledge, argued Hayek,[7] as

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[4] On the pre-war development of the antitrust schools of thought *see* H. Hovenkamp, "The Antitrust Movement and the Rise of Industrial Organization", (1989) 68 *Tex. L. Rev.* 105; G. Stigler, "Perfect Competition, Historically Contemplated", (1957) 65 *Journal of Political Science* 1.

[5] For more detailed accounts of the various propositions of the Chicago School *see* R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*; R. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 2nd Edition, 2001); R. Posner, "The Chicago School of Antitrust Analysis", *loc. cit.*; H. Hovenkamp, "Antitrust Policy After Chicago", (1985) *Univ. Mich. L. Rev.* 213, 226-269; P. Gerhart, "The Supreme Court and Antitrust Analysis: The Near Triumph of the Chicago School", (1982) 10 *Supreme Court Review* 319; S. Weber Wallace, *loc. cit.*

[6] *See* J. High, "Split Personality: A Brief History of Competition in Economic Theory", in J. High (ed.), *Competition*, (Northampton (Ma.) and Cheltenham: Edward Elgar, 2001), p. xxxviii.

[7] F. Hayek, "The Meaning of Competition", in F. Hayek, *Individualism and Economic Order*, (Chicago and London: University of Chicago Press, 1948), reprinted in J. High (ed.), *op. cit.*, pp. 92-106.

subsequently did Schumpeter,[8] was the outcome of the process of competition since it was only through the trial and error of participating in the market that, on one hand, firms establish what are their most efficient methods of production and, on the other, consumers determine how to maximise their utility. Demand and supply curves thus exist in a constant state of flux, being formed and updated as individual firms test their innovations against demand and consumers in turn try new ways to maximise their utility, including the satisfaction of utility through the meeting of demands which they may not have realised they had until a new supply was offered. Since market knowledge is an ever-changing intangible as well as being the product of the sum of many subjective individual decisions, perfect market knowledge is unlikely to reside in any one body as a matter of logistical possibility. Moreover, such a concept of perfection carries with it a connotation of stasis which runs in direct contradiction to the idea of competition as the dynamic mechanism for discovering and testing knowledge. It was this last point in particular that enabled the dynamic theorists to reject the aspirational value of the perfect competition model. Improvements in efficiency through competition meant the superseding of existing products and cost structures with new ones, rather than increasing the number of producers operating under current conditions.[9] In other words, there was no need to insist on the driving of price towards marginal cost if there was an incentive to establish a new structure with both greater super-normal profits for the innovator and increased utility for the consumer. Thus the existence of a single dominant firm in an industry far from indicating the failure of the competitive process was evidence of its dynamic nature at work.

One of the assumptions behind this concept of dynamic competition is the absence of barriers to entry in the relevant market, since their presence would undermine any claim that the sole incumbent had gained or maintained its position through superior efficiency. It is in explaining this aspect of the theory

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[8] J. Schumpeter, "The Process of Creative Destruction", in J. Schumpeter, *Capitalism, Socialism and Democracy*, (London and New York: Routledge, 1993 [1943]), reprinted in J. High (ed.), *op. cit.*, pp. 81-86.

[9] Although fitting more comfortably under the categorisation as a Chicagoan than a dynamic theorist, this element of dynamic theory analysis is also evident in Stigler's work; G. Stigler, "Perfect Competition, Historically Contemplated", *loc. cit.*, 14-15.

that the contribution of the Chicago School comes to the fore. Before Chicago the prevailing view was that of the structure-conduct-performance paradigm, which *inter alia* posited that economies of scale, product differentiation and access to capital all acted as bars to competition because they operated as obstacles to participation in the market.[10] In contrast, the Chicagoans defined a barrier to entry more narrowly as "a condition that imposes higher long-run costs of production on a new entrant than are borne by the firms already in the market".[11] A barrier would, therefore, only arise where the new entrant would have to incur a cost which had not previously been suffered by the incumbent. Thus efficiencies of scale were dismissed as nothing other than the observation that the monopolist has attained a level of efficiency which potential rivals were either incapable of matching or could match if they put in place a level of investment which the incumbent had already committed. Likewise, the existence of product differentiation to a degree that frustrates new firms from gaining market share merely indicates the greater efficiency of the monopolist's good in satisfying consumer demand – with the monopolist being just as susceptible to a shift in taste towards a new entrant's product. Nor could access to capital be considered a barrier, since the incumbent has already made the capital investment now required of the new rival, whether it be in the form of plant, advertising and brand investment, personnel or working capital. A new entrant might not have the same resources initially as the incumbent, but it does have access to the capital markets where, assuming the new firm is targeting a juicy monopoly market ripe for greater efficiencies, there should be no shortage of investors seeking a share of the potential returns. As Bork points out, this does not require that capital markets operate perfectly, instead all that is needed is for investors to prefer higher returns to lower ones and for the imperfections of the capital market to be as likely to refuse a good bargain as engage in bad one.[12]

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[10] Bain's analysis of barriers to entry is typical of this view: J. Bain, *Barriers to New Competition: Their Character and Consequences in Manufacturing Industries*, (Cambridge (Ma.): Harvard University Press, 1965 [1965]).

[11] R. Posner, *Antitrust Law*, *op. cit.*, 74. *See also* G. Stigler, *The Organization of Industry*, (New York: Irwin, 1968), p. 67; R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 310 *et seq.*; R. Posner, "The Chicago School of Antitrust Analysis", *loc. cit.*

[12] R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, pp. 322-333.

The only harmful barriers to entry from the Chicago perspective are those which raise rivals costs' without affecting the incumbent proportionately (of which there would appear to be few) or else those artificial barriers arising from legislation or other government regulation.

The second Chicago proposition is that a firm will not leverage its harmful monopoly in one market to create a second monopoly since this would be irrational, futile or both.[13] Taking the lack of rationality first, a firm which enjoyed a monopolistic position in an upstream market has no incentive to create another monopoly for itself in a downstream market through starving its downstream competitors of supply or acquiring them all in a process of vertical integration because it already has the power to extract the monopoly level of profit available from the prospective downstream monopoly through increased pricing at the upstream level.[14] This is explained by the fact that the where there are several component industries involved in satisfying a single end consumer demand all the industries are limited in the level of monopoly profit that can be gained at their level of production because the total monopoly profits extracted for the aggregating industries cannot exceed the monopoly price of the end product. At any stage along the supply chain a monopolist may extract the total sum of this monopoly profit by raising his price to the level where the costs of all the downstream industries in purchasing the monopoly good plus their additional processing costs of production approaches the end monopoly price thus yielding no further super-normal profits. Of course, the monopolist is only able to take this course of action so long as it is itself not subject to an upstream monopolist carrying out such a policy and thereby depriving the downstream monopolist from increasing his margin further because of the end consumer price constraint. It is for this reason that the upstream monopolist would have

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[13] *See generally* R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 225 *et seq.*; R. Posner, *Antitrust Law*, *op. cit.*, p. 223 *et seq.*

[14] The following analysis draws from: D. Reiffen and A. Kleit, "Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly", (1990) 33 *Journal of Law and Economics* 419, at 419-420; R. Bork, "Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception", (1954) 22 *Univ. Chi. L. Rev.* 157; R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 225 *et seq. See also* R. Posner, *Antitrust Law*, *op. cit.*, pp. 223-229.

little to gain in extending his monopoly to other levels of production unless a monopoly in the downstream market would be a more efficienct scale of production or if greater efficiency could be obtained through combining upstream and downstream operations,[15] events which would not leave the end price any higher than was the case before the integration.

A similar line of reasoning is employed by the Chicago School to question the benefits of prohibiting 'tie-ins' whereby an upstream monopolist attempts to link the sale of a complementary product in a non-monopolised market with the monopolised one – such as in the classic example of the photocopier producing monopolist tying his sales with lengthy maintenance or paper supply contracts.[16] The rational consumer, argue the Chicagoans, would recognise the principle and secondary[17] goods as a combined product for satisfying a single demand, such as in the case of our example, the provision of a single product of photocopying facilities. Gaining a monopoly in the complementary market would not result in an increase in the monopoly rent for the two markets combined given that the total combined monopoly profit for the end consumer good could have been extracted in the monopoly market alone without the need for tying to increase the total product price. Given the consumer perception of a single end product and price, once the monopolist is optimising the price of the principal product in this way he is limited from

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[15] Thus Bork argues that vertical integration is merely the choice by a firm "that administrative action rather than market transaction organizes the cooperation of two or more persons engaged in a productive or distributive activity"; R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 227.

[16] The following analysis of tie-ins is drawn principally from: R. Posner, *Antitrust Law*, *op. cit.*, pp. 197-297; R. Posner, "The Chicago School of Antitrust Analysis", *loc. cit.* *See also* R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, pp. 365-381.

[17] Often the tied product will be a complementary good in relation to the principal good (*i.e.* used in combination to satisfy a particular demand); however, there is no requirement that this be the case since once the purchase of one is linked to the use of the other then no matter how artificial the combination, the purchase of both will be required to satisfy the demand for the principal, as Posner points out: "Had I.B.M. refused to sell computers unless the customers agreed to buy cake mix from it, this would not have enabled I.B.M. to achieve greater profits. The price of the cake mix, minus whatever value the cake mix had, would have been perceived by customers as an addition to the price of the computer"; R. Posner, *Antitrust Law*, *op. cit.*, p. 199.

increasing the price of the complementary product further because he cannot exceed the total end monopoly price regardless of which component market he attempts to do this in without exceeding the point of profit maximisation. Where tying does occur, therefore, it is more likely that it is a form of vertical integration resulting in a degree of efficiency gain.

Likewise, in the case of resale price maintenance (R.P.M.), it will be irrational for a firm to engage in this activity where its only purpose is to assist in the maintenance of a monopoly rent for downstream firms when this can already be extracted at the monopoly sector's level.[18] Consequently, R.P.M. can only be explained by Chicagoans as a means for increasing the value added to the product in the down-stream industry (through for example, store facilities, sales advice and after-sales service) which would actually be indicative of competition in the allegedly monopolised market.

The futile dimension of attempting to leverage a monopolistic position held in one market to create a monopoly in another is illustrated in the case of conglomerate behaviour, whereby a monopoly in one sector attempts to enter an unrelated market (*i.e.* one that is neither upstream, downstream or complementary to that of a monopolist).[19] The Chicago view is hostile to such conglomerate mergers being considered to have harmful efficiency effects. Any advantage which the conglomerate may have over the market incumbents, whether in the form of greater efficiencies of cost or innovation, are unobjectionable since they will result in an overall efficiency gain. Similarly, any 'deep pocket' advantage of the conglomerate overlooks the general freedom of access of all firms to the capital markets. Where the conglomerate merger results in it gaining a monopolistic position in the newly entered market, nothing will have been done to change the structure of the market itself for two reasons. First, any attempt by the new monopolist to extract a monopoly profit which

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[18] This analysis of R.P.M. is based on that in: R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit*, pp. 280-298; R. Bork, "Resale Price Maintenance and Consumer Welfare", (1968) 77 *Yale L. J.* 950; R. Posner, *Antitrust Law*, *op. cit.*, 172-176.

[19] This analysis of conglomerate effects draws from that in: R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, pp. 245-262. Posner does not discuss this issue on the grounds that it is obviously "no longer an object of antitrust concern"; R. Posner, *Antitrust Law*, *op. cit.*, p. 131, fn. 30.

previously was not exploited in the market will ultimately result in the erosion of the conglomerate's revenues as new or potential rivals begin production, with the pre-conglomerate merger, non-monopolistic price tending to indicate the existence of potential competition and low barriers to entry. Secondly, if the conglomerate acquires what already was a harmful monopoly, then at least the consumer would be no worse off than before. The only obvious rational incentive to engage in such mergers would appear to be an ability by the conglomerate to carry out its operations in the new market more efficiently than was previously the case.

One does not have to look very hard to see the difference between the Chicago propositions and the positions adopted in the decisions of the Community courts. Barriers to entry are readily inferred by the courts during their examination of the monopoly power of an undertaking as part of an Article 82 analysis, with economies of scale,[20] access to capital requirements,[21] product differentiation[22] and superior efficiency of itself,[23] all being considered to

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[20] Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207; [1978] 1 C.M.L.R. 429, para. 122: "The particular barriers to competitors entering the market are the exceptionally large capital investments required for the creation and running of banana plantations, the need to increase sources of supply in order to avoid the effects of fruit diseases and bad weather (hurricanes, floods), the introduction of an essential system of logistics which the distribution of a very perishable product makes necessary, economic of scale from which newcomers to the market cannot derive any immediate benefit and the actual cost of entry made up *inter alia* of all the general expenses incurred in penetrating the market such as the setting of an adequate commercial network, the mounting of very-large advertizing campaigns, all those financial risk, the costs of which are irrecoverable if the attempt fails."

[21] Case 85/76, *Hoffmann-La Roche & Co. A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211, para. 48: "[B]ecause of the amount of capital investment required the capacity of the factories is determined according to the anticipated growth over a long period so that access to the market by new producers is not easy...."

[22] Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207; [1978] 1 C.M.L.R. 429, paras. 91, 92-94: "U.B.C. made this product [bananas] by large-scale repeated advertizing and promotion campaigns which have induced the consumer to show a preference for it in spite of the difference between the price of labelled and unlabelled bananas ... and also of *Chiquita* bananas and those which have been labelled with another brand name.... It has thus attained a privileged position by making Chiquita the premier banana brand name on the relevant market.... At the selling stage this distinguishing factor – justified by the

identify not just the existence of a single firm in an industry, but also the ability to impose a monopoly maximising price immune from the pressures of potential competition. Perceived attempts to leverage a monopolistic position in the form of refusals to supply,[24] tying,[25] R.P.M.[26] and conglomerate merger[27] have also

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unchanging quality of the banana bearing this label – ensures that it has regular customers and consolidates its economic strength."

[23] Case 322/81, *Nederlandsche Banden-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, paras. 55-56: "Amongst those advantages [indicating dominance], the lead which the Michelin group has over its competitors in the matters of investment and research and the special extent of its range of products ... have not been denied. ...That situation ensures that on the Netherlands market a large number of users of heavy-vehicle tyres have a strong preference for Michelin tyres."

[24] Cases 6, 7/73, *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corp. v. Commission* [1974] E.C.R. 223, [1974] 1 C.M.L.R. 309, para. 25: "[A]n undertaking which has a dominant position in the market in raw materials and which, with the object of reserving such raw materials for manufacturing of its own derivatives, refuses to supply a customer, which is itself a manufacturer of these derivatives, and therefore risks eliminating all competition on the part of this customer, is abusing its dominant position within the meaning of Article [82]."

[25] Article 82(1)(d) makes express reference to non-complementary tying, prohibiting "the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts". This has been expanded in a number of judgments on the basis of the non-exhaustive nature of the specified prohibitions in the Treaty, thus tying arrangements arising otherwise than through formal contracts or involving complementary or vertically related products have been deemed to be an abuse of dominance: Case T-30/89, *Hilti v. Commission* [1991] E.C.R. II-1439, [1992] 4 C.M.L.R. 16, paras. 115-119; Case C-333/94P, *Tetra Pak International S.A. v. Commission* [1996] E.C.R. I-5951, [1997] 4 C.M.L.R. 662, paras. 34-37.

[26] The provision prohibiting price fixing in Article 81(1)(a) has been interpreted as including resale price maintenance in a number of cases: Case 161/84, *Pronuptia de Paris G.m.b.H. v. Pronuptia de Paris Irmgard Schillgallis* [1986] E.C.R. 353, [1986] 1 C.M.L.R. 414, paras. 22 and 25: "Far from being necessary for the protection of the know-how provided or for the preservation of the identity and reputation of the network, certain clauses do restrict competition between its members. ...Clauses which restrict the franchisee's ability to fix his own prices in complete freedom are restrictive of competition". *See also* Case 243/83, *S.A. Binon & Cie. v. S.A. Agence et Messageries de la Presse* [1985] E.C.R. 2015, [1985] C.M.L.R. 800, paras. 44-45.

[27] Case T-5/02, *Tetra Laval B.V. v. Commission* [2002] 5 C.M.L.R. 28, paras. 142, 196: "It is common ground between the parties that the modified merger is conglomerate in type, that is, a merger of undertakings which, essentially, do not have a pre-existing competitive relationship,

been considered to give rise to anti-competitive effects notwithstanding the Chicago position that the rational producer would seldom opt for such action unless there was some net efficiency gain.

This deviation between the approach of the Community courts and Chicago economics is not an indication of the legal rejection of economics, rather it stems from the differing value judgements made by each within the operation of the economic methodology.

The incongruous perceptions of school and court regarding the nature of barriers to entry reflects the differing temporal value judgements as to the relevant period for studying efficiency effects. The law's stance places a premium on short-term gains in efficiency by identifying monopolistic positions as arising in industries where the current structure is likely to continue for a significant period of time despite being prone in the longer run to new firms entering and competing on viable terms. Thus lengthy lead-in times for capital acquisition, product differentiation, innovation or for the organisation of factors of production may, regardless of being inevitable events within the conception of competition as process, be held to result in too great a deadweight loss for present day society. One symptom of this short-term focus is that the court's examination of the state of competition on a particular market tends to be dominated by an analysis of undertakings already present on the market; and where potential competition is examined the focus shifts no further than the capacity of other existing firms which although not actively involved in the relevant market occupy the same, or a similar, industry.[28] Another indication of the Community legal system's evaluation of relevant time horizons is evident in the Commission's inverted logic regarding efficiency gains by one firm leading

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either as direct competitors or as suppliers and customers. ...The Court finds unconvincing the applicant's argument that no leveraging from one market into another is possible when, as in the present case, a product in one market and a product in another market are merely technical substitutes."

[28] *See* for example the analysis of potential competition by the C.F.I. in *European Night Services* where only the prospective competition from the parties involved in the joint venture under review (being a number of rail companies) or other existing major transport companies was considered: Cases T-374-375, 384 and 388/94, *European Night Services and others v. Commission* [1998] E.C.R. II-3141, [1998] 5 C.M.L.R. 718, para. 137 *et seq.*

to the elimination of less efficient market players. In its Article 81 Guidelines it promotes the view that such gains promote efficiency in the "short-term" (by which the Commission appears to mean the period when less efficient rivals still survive in the market) but may damage it in the "long-term" (which appears to be a reference to the time commencing from when the less efficient rivals are forced out of the market).[29] Such a conclusion is only sustainable if all potential entry during the period after the less efficient rivals are driven from the market is discounted; which is precisely what a temporal value decision in favour of the maintenance of efficiency in the near or relatively near term would achieve.

In contrast, the Chicago School tends to view the period during which efficiency effects are to be measured as being much lengthier, thereby making a temporal value judgement weighted towards creating greater incentives for the improvement of efficiency regardless of time scale, rather than for immediate but perhaps less significant gains. Even then, the position of most mainstream Chicagoans is that at some point the time lag for new entry in the absence of barriers to entry may be so great as to justify the intervention of antitrust policy, as Bork acknowledges:

> If entry were instantaneous, market forces would break up cartels before a typist at the Antitrust Division could rap out a form of complaint. Antitrust is valuable because in some cases it can achieve results more rapidly than can market forces. We need not suffer losses while waiting for the market to erode cartels and monopolistic mergers.[30]

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[29] Commission Notice 2004/C 101/08, Guidelines on the Application of Article 81(3) of the Treaty [2004] O.J. C101/97, para. 105: "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."

[30] *See* R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. 311. A similar point is conceded by Posner: R. Posner, *Antitrust Law*, *op. cit.*, p. 227: "Delaying new entry will have little effect if, as assumed, the industry is competitive; price will be at the competitive level regardless of the condition of entry. I say little rather than no effect because delaying entry may increase the gains from forming a cartel."

Different value judgements are also apparent in the European and Chicago approaches to rational behaviour. For the Chicagoans profit maximising rationality is taken as an opening assumption – thus their rejection of the leveraging theory of monopolistic behaviour is founded not on the basis that leveraging may raise price, but rather that if the monopolist is behaving rationally it is unlikely to raise price any further. Likewise, the existence of high capital requirements or lengthy periods for product differentiation as a conditions for market entry are deemed not to be barriers on the assumption that the potential entrants are rational and not dissuaded by psychologically perceived rather than economically present obstacles. The Community courts, on the other hand, make no such presumption of objective profit maximising rationality on the part of the monopolist.[31] Firms which behave irrationally in order to grab a monopolistic position in order to obtain short-term gains (and thereby generate deadweight losses) ignoring the longer run losses, the expansion of an upstream monopolist into the downstream where for whatever reasons of imperfection in the upstream market (whether personal to the monopolist or not) the full monopoly rent may not there be extractable, or the failure of potential competitors to recognise a good entry opportunity, are all deemed capable of incurring efficiency damaging effects. The judicial analysis still fits within the economic methodology of the assumption of rationality since the outcome of all the market events after the initial irrationality is calculated in the basis of logical reactions by all other actors to the opening events. What differs is that the courts select what they deem to be real life behaviour as the phenomena for study (be it in the form of irrationality on the part of the monopolist or its potential competitors), while the Chicago School selects the existence of the option for the behaviour as the opening event, with the decision of the firm as to whether to execute this option being part of the machinations of the rationality calculus.

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[31] A similar point is made by Nicolaides, when he observes that the distinction between law and economics is a methodological one founded on differences as to the existence of a presumption of rational behaviour, although unlike the present analysis, he does not situate this difference as occurring within the economic paradigm: P. Nicolaides, "Essay on the Economics and Competition Law of the European Community", (2000-2001) 27 *Legal Issues of Economic Integration* 7.

Another way of interpreting the conflicting approaches to rationality is to view the courts' treatment as less presumptive as to what constitutes rational behaviour in particular circumstances. The Chicago School's straightforward reliance on price theory provides neat categorisations of what is or is not rational behaviour, reducing the rationality consideration to a set of binary descriptions – rational or not rational – which hold true throughout a class of described events. The approach of the court is far less restrictive in its categorisation of rational behaviour, and the tendency is to interpret what is reasonable in the light of the complexities of the 'real life' facts presented in a given dispute. For the court, leveraging behaviour may be rational because of the possibilities of strategic considerations (*e.g.* will the leveraging of downstream monopoly secure the position of the upstream one?) and uncertainties as to actions and reactions of other market actors (*e.g.* has the monopoly price for the whole industry been correctly identified and will the leveraging improve information as to the optimisation of monopoly profits?). Likewise, barriers to entry that are dismissed by the Chicago analysis are more readily accepted by judicial reasoning predisposed to consider the possibility that strategic actions or reactions by an incumbent may be an effective entry deterrence when the existence of uncertainties are taken into account (*e.g.* given information imperfections, can irrational barriers be perceived as rational ones?). None of this to say that the courts' value selections in relation to the rationality criterion are more realistic or advanced than those of the Chicago School. No court can ever truly access compelling evidence as to what is uncertain or what is strategic, any more than the Chicago approach can conclusively assert that such considerations are largely irrelevant; both types of reasoning are based on conclusions about the unknowable. What is rational is therefore a subjective variable depending on a predisposition that is ultimately objectively improvable.

This latter element of the Chicago-Community values divide can also be seen as a manifestation of division within the *ceteris paribus* paradigm. If the economic reasoning of the courts or the Chicago School can be described as an abstracted economic model, and the actual behaviour of a firm is said to be the empirical testing of those models, then there is considerable 'wriggle-room' within which this actual behaviour can be described as the outcome of either model distorted only by the general economic friction resulting from the

contiguous nature of real world economic events. This allows each side of the argument to accuse the other of employing immunising stratagems. Thus, from the Chicago perspective, the Community courts' analysis of refusals to supply, tying, R.P.M. and conglomerate merger are all tempered by the elemental view that once taken in isolation the described behaviours are fundamentally anti-competitive; to paraphrase Coase, if the court finds a business practice of one sort or another that it does not understand, it tends to look for a monopoly explanation.[32] From the other side of the fence, the Chicago style of reasoning shows a similar tendency to interpret empirical results as the verification of the school's core findings that rational behaviour ensures efficient outcomes. Fox has parodied this approach in the following terms:

> It is useful to consult Chicago's Lexicon. In the version I find on my bookshelf, it reads as follows: Good (economic): Also called 'efficiency,' 'economic welfare', or 'social welfare'. Economic good is defined in terms of the aggregate wealth of society, because the bigger the pie the better off everyone is. In antitrust, good is defined in the negative. The only way in which firms can behave or perform in a way that will derogate from the good is to restrict output in the whole market – for only in this way will too few resources flow into the restricted market, misallocating resources and shrinking the size of the pie. (Of course [the Lexicon continues] firms cannot do this, because the free market is robust and if a firm tried to restrict output a new entrant or fringe expander would make more goods and spoil the game. Therefore it is fair to say that what is is good.)[33]

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[32] R. Coase, "Industrial Organization: A Proposal for Research", in V. Fuchs (ed.), *Economic Research: Retrospective and Prospect: Policy Issues and Research Opportunities in Industrial Organization* (New York: National Bureau of Economic Research, 1972), p. 59, p. 67, quoted in M. Jacobs, *loc. cit.*, fn. 37.

[33] E. Fox, "Consumer Beware Chicago", (1986) 84 *Mich. L. Rev.* 1714, 1719. Square brackets original. *See also* as an example of this type of critique the discussion of Leff and Stigler and Becker *supra* p. 107.

For both judiciary and Chicagoans alike the determinations that lead to their ultimately distinguishable positions are the moral decisions permitted, indeed required, within the economic paradigm. The extent to which the Chicago School has succeeded in portraying its critique as an economic criticism of an uneconomic legal position, rather than as one of several different economic approaches, bares testament to the power of value-denial within the economic methodology. To a significant degree this perception has been self-propagated by some of the leading Chicagoans. Bork has described as one of the hallmarks of the School the application of "economic analysis more rigorously than was common at the time to test the propositions of the law and to understand the impact of business behaviour on consumer welfare".[34] Similarly, Posner, perhaps the most prolific of the Chicago School's lawyers, has consistently in his writings referred to Chicago doctrine as "the economic approach" to antitrust.[35]

The blame for this misconception of what constitutes economic thought, however, does not rest solely with the Chicagoans. Some of the School's critics have also played their part by characterising the Chicago analysis as thinking "that because antitrust is about markets, as is microeconomics, antitrust should *be* economics",[36] thereby implying that a legal approach to competition which rejects the Chicago propositions has nothing to do with economics at all. There is a tendency on the part of the post-Chicagoans – amongst whom one would include Fox and Hovenkamp – to present a conception of competition law based on non-economic objectives (such as market plurality or the other non-economic socio-political objectives discussed in chapter one) as the alternative to the Chicago approach.[37] This unnecessarily cedes the economic debate to the

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[34] R. Bork, *The Antitrust Paradox: A Policy at War with Itself*, *op. cit.*, p. xi.

[35] R. Posner, *Antitrust Law*, *op. cit.*; R. Posner, *Antitrust Law*, *op. cit.*, pp. 9-32; R. Posner, "The Chicago School of Antitrust Analysis", *loc. cit.*, 925-928.

[36] E. Fox and L. Sullivan, "Antitrust: Retrospective and Prospective: Where Are We Coming From? Where Are We Going?", (1987) 62 *New York Univ. L. Rev.* 936, at 956. Emphasis original.

[37] *See* E. Fox, "The Battle for the Soul of Antirust", (1987) 75 *Cal. L. Rev.* 917; E. Fox, "Consumer Beware Chicago", *loc. cit.*; E. Fox, "The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window", (1986) 61 *N.Y.U. L. Rev.* 554; H. Hovenkamp, "Distributive Justice and the Antitrust Laws", (1982) 51 *Geo. Wash. L. Rev.* 1.

Chicago School by representing the Chicagoans as the proponent of *the* economic value selection, thereby ignoring that they constitute just one value selection *within* the methodology of economics. Consequently, the Chicago rebuttal is made too easy. Relishing their rivals' portrayal of their position as the economic approach, the Chicagoans gloss over the very valid post-Chicago commentary on the Chicago value judgments, and focus instead on their arguments in favour of non-economic objectives. In this vein Posner together with some more impartial observers, such as Jacobs, have commented (and not without due cause) that there is nothing particularly 'post-' about a 'post-Chicago' critique replete with propositions in favour of non-economic objectives for competition law that have existed in some form since the foundation of antitrust policy.[38]

It is important, having highlighted the distinctions between the Community courts' and Chicago approaches, to emphasise there are also some economic value judgments which are shared by both. That the 'consumer is king' and the point of optimal efficiency is reached when consumer welfare is maximised is a position espoused by both. Allocative efficiency is the *sine qua non* of a positive economic outcome from the Chicago perspective,[39] whilst the same outcome flows from the law's fixation on price analysis and consumer benefit.[40] There is also a common hostility to expansive second-best considerations. The courts tend to focus solely on the market impact within the industries where the scrutinised activity is alleged to have taken place, and even then the examination of industry-impact tends to be further narrowed to a specified geographic area.[41] The Chicago reluctance to acknowledge the

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[38] R. Posner, *Antitrust Law*, *op. cit.*, p. vii; M. Jacobs, *loc. cit.*, 236-240.

[39] *See* T. Calvani, "Consumer Welfare is Prime Objective of Antitrust", (1984) 7 *Legal Times* 14, reprinted in T. Calvani and J. Siegfried (eds.), *Economic Analysis and Antitrust Law*, (New York: Little, Brown & Co., 2nd Edition, 1988); R. Posner, *Antitrust Law*, p. 9 *et seq.*

[40] This is supported by virtually every principle of Community competition law. For a singular example *see* Cases 89, 104, 116-117, 125-129/85, *Re Wood Pulp Cartel: A. Ahlström and others v. Commission* [1993] 4 C.M.L.R. 407.

[41] *See* Commission Notice 2004/C 101/08, Guidelines on the Application of Article 81(3) of the Treaty [2004] O.J. C101/97, para. 43: "Negative effects on consumers in one geographic or product market cannot normally be balanced against and compensated by positive effects for consumers in another unrelated geographic or product market". The general principles relating to

relevance of the second-best has already been examined in chapter three as part of the general economic malaise with the concept.[42] The common concern – expressly stated by the Chicagoans and reasonably imputable to the courts' attitude – is an unwillingness to subject antitrust to propositions demonstrable by almost any empirical argument.[43] The existence of this limited level of value agreement is significant for the concept of rhetorical divergence because it highlights that the role of the economic tenets of the metric of efficiency, the rationality function and *ceteris paribus* as vessels within which an array of value judgments can be taken does not necessarily result in an atomised array of economic arguments, each internally correct but insulated from external criticism. Instead, value judgments occur in broad currents of collectively held views – something one would expect given the possibility of inter-subjective agreement – resulting in both clear alignments of evaluations, and contrariwise, singularly identifiable incidences of rhetorical divergence such as those discussed in this chapter.

Normative Functions I: The Breakable Rules Principle[44]

There is a consistency to the rhetorical divergence between the Chicago and Community positions. Chicago prefers to measure efficiency over longer periods, the courts take a shorter term view; Chicago views profit maximising rationality as readily identifiable and universally inherent, the courts see it as complex and its inherency as variable; Chicago defends its economic models by reference to the reliability of the markets, the Community by reference to a latent desire on the part competitors to attain monopoly positions. These divergences are statements of the legal system's autonomy in deciding what it

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market definition are set out in: Case 27/76, *United Brands Co. and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] C.M.L.R. 429, paras. 12-35; Case 322/81, *Nederlandsche Banden-Industrie Michelin v. Commission* [1983] E.C.R. 3461, [1985] 1 C.M.L.R. 282, paras. 23-28.

[42] *See* p. 102 *supra*.

[43] *See* R. Posner, *Antitrust Law*, *op. cit.*, p. 13, fn. 5; R. Bork, *The Antitrust Paradox*, *op. cit.*, pp. 113-114; F. Easterbrook, "Workable Antitrust Policy", (1986) 84 *Mich. L. Rev.* 1696, 1704.

[44] Normative functions 'II' and 'III' are examined in chapter eight *infra*.

considers to be the correct value judgments in endorsing a particular economic conception of antitrust policy. It is possible to extrapolate from these choices a common strain which is indicative of one of the legal system's normative functions – that is, one of those core elements of the legal system's methodology which dictate how it interacts and accepts the propositions of an external element such as economics.

This normative function is best illustrated by first considering the antagonistic position: the extreme Chicago view. This holds that there is little that an undertaking can do to maintain or create a monopoly position unless such an action will also improve efficiency. Attempts to reduce output and create monopoly profits – whether through the creation of cartels or the leveraging of a monopoly position – will eventually be undone by new market entry; something which is an inevitability in a world with no true barriers to entry save for those created by legislation. Other leveraging actions, such as refusals to supply, engaging in R.P.M. or tie-ins, will not occur unless they serve to improve market efficiency because in a world of rational profit maximisers free from strategic considerations, such irrational actions are unlikely – and even if there are firms fool-hardy enough to attempt them, they will soon be driven out of the market by their more intelligent rivals. In short, competition laws would appear to be largely unnecessary because the efficiency maximisation that they seek to protect is largely self-enforcing.[45] Easterbrook sums up this scepticism of the utility of antitrust rules by describing the Chicago School as favouring "little other than prosecuting plain vanilla cartels and mergers to monopoly".[46] Indeed, why require even this level of enforcement? If the absence of barriers to entry means that the price-fixing, output-reducing actions will be competed away by rational rival responses in the form of new entry, then efficiency optimisation will prevail in these circumstances too. It would appear that even the Chicagoans

[45] Minda characterises the Chicago School as being "anti-antitrust", while Page describes its founding belief as the concern that antitrust law tends to be "overinclusive"; G. Minda, "Antitrust at Century's End", (1995) 48 *S.M.U.L. Rev.* 1749, 1769; W. Page, "The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency", (1989) 75 *Va. L. Rev.* 1221, 1251.

[46] F. Easterbrook, "Workable Antitrust Policy", *loc. cit.*, 1700.

have a long-stop to the period they are willing to wait for the fruits of the monopoly profit incentive.

In comparison, each value selection by the courts would appear to be a step in the opposite direction. The rejection of a longer-term efficiency metric increases the likelihood of a present day behaviour being construed as anti-competitive. Likewise, if rational behaviour is not seen as automatic, or not seen as automatically leading to the optimisation of efficiency, the category of actions which could harm efficiency would appear to be somewhat more densely populated than under the Chicago view. Each of the Community courts value selections within the economic paradigm is a move away from the possibility of the self-enforcement of competition policy. The normative function that is revealed by this process is that the legal system will tend not to promote rules that are unlikely or impossible to breach. This is a normative function which is quite elemental to the legal system. If for a particular issue compliance is automatic, if there is no possibility of breach, then there is no requirement for regulation. Laws that cannot be broken require no exercise of the judicial function beyond an initial declaration of their narrow applicability. The legal system has as much interest in interpreting the Community antitrust provisions in line with the Chicago School's teachings as in enforcing a speed limit on the moon or a bathing prohibition in Antarctica.[47] To accept this proposition all that is necessary is for even the smallest modicum of self-promotion to be acknowledged as inherent to the legal system; something which the continued and expanding constructs of the Community legal system alone bear testament to.

The economic approach evident in the decisions of the Community courts thus arise, on one hand, as an assertion of the autonomy the system to select which value criteria it considers important in its rule-making function, and on the other, the ability of the economic system to accommodate within the limits of its methodology the making of value decisions which result in an array of economic conclusions. Informing the courts' choice is one of the irreductibles of the legal systems' methodology indicative of its normative closure, namely, that legal thinking will only reluctantly reason itself out of existence. If there is

[47] Leaving aside, of course, the jurisdictional problems that would arise.

to be a measure of the significance of normative functions, then this must surely be one of the most fundamental of all.

PART III

METHODOLOGICAL REJECTION

CHAPTER FIVE

IDENTIFYING METHODOLOGICAL REJECTION

Methodological rejection is the apex of divergence between the legal and economic systems. Rhetorical divergence, as has been argued, can be explained as the outcome of different value judgments being made within the paradigm of economic reasoning; different determinations based on what is harmful to efficiency and of what constitutes rationality – both being judgments made within the bounds of economic reasoning – may result in disagreements as to whether given types of market conduct are labelled as pro- or anti-competitive. The schism that occurs in methodological rejection is of a different order. These divergences cannot be explained away as differences in value-judgments, because legal and economic positions would remain irreconcilable even if the initial 'economic' value judgments were recalibrated into alignment. Methodological rejection is the manifestation of the legal system's incapacity to process certain economic conceptual structures. The failure to transplant these concepts from an economic to a legal form is not the result of the individual perniciousness or whim of particular courts in particular cases – after all, as has been set out in chapter one, there is little stock in the argument that the courts have attempted to implement anything other than an economic approach when implementing the Community antitrust provisions. Rather, what blocks the acceptance of economic concepts are the immovable normative elements of the legal system which dictate the extent to which legal reasoning is open to accepting external arguments and, consequently, which serve as tangible examples of the law's autonomy.

Providing an abstract description of methodological rejection is the easy bit. The task of this short chapter is to set out how the actual occurrence of this phenomenon may be demonstrated. Rhetorical divergence, as discussed in part

II, would appear to be a widespread occurrence, and provides the category into which much of what is described as the divergence between economic criticism and legal rules can be placed. The key for identifying methodological rejection is to isolate an issue where differences between the legal and economic positions remain even when value judgments are taken out of the equation – that is, a legal argument which cannot be explained by reference to any single economic model. This process requires finding legal conclusions that introduce definitional distinctions of little importance to the economic sphere regardless of the values applied within the economic analysis. Such a test for methodological rejection rests on the existence of certain accepted economic facts[1] which, whether described in terms of being efficiency-improving or -damaging, rational or irrational, constitute part of a common class of factual phenomenon that is left intact when applying the value judgments required by economic methodology. The implication of the legal system treating different elements of such a single class of behaviour in a segregated manner implies that there is something inherent in the normative architecture of the legal system preventing a unified treatment, irrespective of what that unified treatment may be.

The operation of this method for identifying methodological rejection can be illustrated by taking a hypothetical case where the law prohibits a manufacturer of photocopiers from tying his sales with contracts for the supply of blue paper, while permitting similar agreements in the case of red paper. If from the economic perspective there are no substantive factual differences between the markets for red and blue paper, then there will be a divergence between the law and economics regardless of how one characterises the effects of tying paper and photocopiers sales, since every economic outcome will demand the blue-red equivalence with which the law has not complied. Thus the legal position will conflict with a Chicago type value selection because the blue paper tie-in prohibition could be seen as unnecessary on the grounds that eventual market entry and the irrationality of efficiency-reducing monopoly leveraging would ensure that the tie-in would have no harmful effects.

[1] As has been noted in chapter three, there is no absolute distinction between economic facts and economic values. What is meant by economic facts are statements closer to the factual end of the spectrum – *i.e.* where there is a very high level of inter-subjective agreement as to the validity of a particular proposition.

Contrariwise, a member of the Harvard or post-Chicago schools might view the failure to prohibit the red paper tie-in as unduly permissive of behaviour that is calculated to create a monopoly outcome in the market for red paper. In these circumstances divergence will not be avoided by superficially linking the legal distinction made with some other unrelated economic statement – for example, by the court noting that tying red paper was not harmful because red laces could be tied to the sale of shoes without negative efficiency effects.

With this test for methodological rejection in mind, tacit collusion presents itself as a suitable subject for study since *prima facie* it poses the problem of an economic equivalence (*i.e.* between tacit and express collusion) existing in the face of a legal distinction (*i.e.* tacit collusion as generally permitted, and express collusion as rigidly prohibited). The remaining chapters of this part examine the case for methodological rejection in tacit collusion; chapter six examines the issue of equivalence in the economic treatment of tacit and express collusion; chapter seven turns to examining the legal analysis of this type of behaviour and comparing it to the economic treatment; and chapter eight discusses the normative functions which, it is submitted, drive the observed methodological rejection by the law of the concept of tacit collusion.

CHAPTER SIX

THE EQUIVALENCE OF TACIT AND EXPRESS COLLUSION IN ECONOMIC THEORY

Proving the Planes of Equivalence

The first step to establishing the occurrence of methodological divergence is the description of the range of behaviours which are treated by economic reasoning as being sufficiently similar such that they can factually be described as forming part of a single category of event. It is submitted that the phenomena of tacit and express collusion form such a category on the basis that there is no significant microeconomic case for treating them as segregated types of market behaviour. Three grounds supporting this conclusion are discussed in this chapter. First, the efficiency effects of tacit collusion are equivalent to those for explicit collusion both in the short and the long run temporal periods. Secondly, tacit collusion is distinguishable from non-collusive behaviour in a concentrated oligopoly, and consequently tacit collusion cannot be separated from express collusion on the grounds that it is an unavoidable outcome without the discernible choice inherent in express collusion. Thirdly, the election to tacitly collude may be a realistic and rational outcome in the same manner as a decision to expressly collude. Taken together, the occurrence of equivalence on these planes of examination indicate that tacit and express collusion are equivalent in three material respects: they are capable of being rational market outcomes; they do not automatically arise from a given market structure; and they have efficiency effects of an identical nature. Crucially, each of these statements remains true regardless of the value criteria employed in determining the desirability or otherwise in prohibiting collusive behaviour. What they point to instead is a factual grouping within the economic methodology which holds its form regardless of considerations of what in any given real-world scenario is deemed

to be efficiency enhancing or rational. The implication for the study of divergence is that a legal treatment that distinguishes between tacit and express collusion relies on a distinction which, regardless of one's valuation of the harm or otherwise of collusion, has no basis in econmics, and therefore represents an instance of methodological rejection.

Equivalence I: Efficiency Effects

Collusion is the umbrella term to describe those actions undertaken by two or more independent firms which aim to adjust the price-output equilibrium in a given product market towards that existing under monopoly. The rational monopolist will maximise its profits by producing at the scale of output where further output would no longer add to marginal revenue – *i.e.* at the point where marginal cost equals marginal revenue. Since the monopolist is the only firm in the industry it can produce at this level notwithstanding the fact that total revenue exceeds total cost (including normal profits)[1] secure in the knowledge that no other competitors will sell at a lower price. In an industry with many firms, the aggregate super-normal profit for the industry will tend to be lower than that under monopoly, since actual or potential competition from rivals will ensure that price per unit adjusts towards the average cost per unit of production. The competing firm is still producing at a level which maximises its profits, but this is now calculated taking into account the presence of other competitors. Diagrammatically speaking, the individual firm is faced with an individual demand curve which is closer to the horizontal plane than that for the industry as a whole because any attempt to increase unit price will result in consumer defection to rivals' cheaper products resulting in a revenue loss greater than the revenue increase brought about by the price hike. If the competitors could organise their production in such a way that their collective output was the same as that of a profit maximising monopolist, then there would be a corresponding monopoly profit, greater than the aggregate competitive industry profit, to be

[1] Normal profits being that level of return required by the entrepreneur to maintain their presence in the market.

divided amongst the participating firms.[2] It is this prospect of a share of monopoly profits which provides firms with the incentive to collude.

The efficiency effects of successful collusion are the same as those of a profit maximising monopoly. As has been examined in chapter one, the reduced output will result in a deadweight loss for society with a segment of consumers willing to purchase the product at the pre-collusion price now being priced out of the market. So long as the method used is successful, the efficiency impact of collusion will be the same regardless of the collusive action's manifestation.

Express collusion is usually taken to mean that some element of overt contact between the colluding parties has occurred.[3] The most obvious form of express collusion is the formal price-fixing or market-sharing agreement that is put into writing, but more subtle forms of communication also come within the definition, such as the oral understanding or the exchanging of internal policy memoranda detailing price or production information. Tacit collusion,[4] on the other hand, entails the execution by separate undertakings of market policies designed to result in a collusive price or output, without detectable communication occurring between the parties. The lack of communication belies the very real mutual understanding that exists between the conspirators. Posner describes tacit collusion as containing all the elements of a contractual meeting of minds: "one seller communicates his 'offer' by restricting output, and the offer is 'accepted' by the actions of his rivals in restricting their outputs as well."[5] Slade and Jacquemin make a similar observation that even tacit collusion at its core involves an "agreement" between rivals as to the outcome to be

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[2] For a formal economic treatment of the economic concepts of monopoly and collusion examined here *see* H. Varian, *Intermediate Microeconomics: A Modern Approach*, (New York and London: W.W. Norton & Co., 2nd Edition, 1990), pp. 396-424, 454-458.

[3] *See for example* W. Kovacic, "The Identification and Proof of Horizontal Agreements under the Antitrust Laws", (1993) 38 *Antitrust Bulletin* 5, 19

[4] Tacit collusion is sometimes referred to as 'conscious parallelism' or 'oligopolistic interdependence' in legal and economic literature, however, these terms are frequently indiscriminately also used to describe the attainment of the oligopoly reversion price, and for the purposes clarity will not be used in this thesis. On the phraseology of oligopolistic behaviour in the context of European competition policy *see* R. Whish, *Competition Law*, (London: Butterworths, 4th Edition, 2001), pp. 460-462.

[5] R. Posner, *Antritrust Law*, (Chicago: University of Chicago Press, 2nd Edition, 2001), p. 94.

reached.[6] This may not be an agreement within the meaning of anglophonic contract law, but a commonly understood objective and an accorded plan of behaviour is present all the same. Tacit collusion thereby differentiates itself from the express variety not by the absence of communication but by the form that such communication takes. Tacit and express collusion can be seen as two points along a continuum of collusive signalling options between market participants. On one end of the scale are the precisely prescribed obligations and permitted actions of each colluding party as indicated and agreed through direct forms of communication. At the other, are the internal decisions to alter the market policies of the individual firm intended as an invitation to rivals to follow suit – industrial strategy's version of the nod and wink. Somewhere in the middle of the continuum are those colluding tactics which are difficult to label as solely tacit or express. The public announcement of future prices is one action falling into this grey area. Such statements may lack the element of direct contact but if they are published in a trade publication and are rapidly responded to by similar announcements then it becomes difficult to distinguish qualitatively between these acts of megaphone signalling and direct communication.

Various labels have been used to describe the tacit-express distinction – Bishop and Walker, for example, describe the distinction as between "formal" and informal communications,[7] while Kloosterhuis sees the individuality of the decision as the determinant[8] – but these are either synonyms for the direct contact criterion, or built on a similar conceptual foundation. "Formal" communication appears to be identical in nature to direct communication, while the individuality of a decision is merely a function of the degree inter-rival communication during its formation. As such, although there is little difficulty in

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[6] M. Slade and A. Jacquemin, "Strategic Behaviour and Collusion", in G. Norman and M. La Manna, *The New Industrial Economics: Recent Developments in Industrial Organization, Oligopoly and Game Theory*, (Aldershot: Edward Elgar, 1992), p. 48.

[7] S. Bishop and M. Walker, *Economics of E.C. Competition Law: Concepts, Applications and Measurements*, (London: Sweet & Maxwell, 1999), para. 4.08.

[8] E. Kloosterhuis, "Joint Dominance and the Interaction Between Firms", (2001) 22 *E.C.L.R.* 79, 81.

categorising many actions as either tacit or express, the exact position of the dividing line between the two concepts is inescapably imprecise.

What this serves to illustrate is that the concepts of tacit and express collusion are descriptive labels indicating different ways in which a collusive outcome arises, rather than being of themselves descriptions of different collusive outcomes. If a number of rivals are able to co-ordinate their actions in such a manner that the market price approaches the monopoly level, then the harm to consumer welfare is the same whether the parties communicated by binding written agreement or through silent action and response. It is for this reason that economics tends to treat the precise dividing line between tacit and express activity as unimportant. What matters is the impact on efficiency. Consequently, where the quantum of deadweight loss is the same for any one of a range of functionally identical actions then there is no need from an economic perspective to enter into an enquiry as to the number of sub-categories of this action. Since deadweight loss is identical for both tacit and collusive outcomes, then a single umbrella term of collusion will for this purpose suffice. As Slade and Jacquemin put it:

> [I]t is impossible to distinguish pure tacit collusion from illegal price-fixing or other explicit cartel agreements. What matters for the empirical estimates is the outcome and not the cause of the noncompetitive pricing.[9]

One should be careful, however, not to dismiss altogether the usefulness of the concept of tacit collusion within the study of economics. As an account of the circumstances where collusion may occur it remains valuable. In this sense tacit collusion is used as a function of uncertainty as to rivals' actions when modelling rational firm responses with the quality of the informing communications being taken as an indication of certainty as to rivals' reactions. Here again the 'tacitness' of the modelled behaviour is a label assigned to the

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[9] M. Slade and A. Jacquemin, "Cartels, Collusion, and Horizontal Merger", in R. Schmalensee and R. Willig (eds.), *Handbook of Industrial Organisation*, (Amsterdam: Elsevier Science Publishers, 1991), vol. i, pp. 451-452.

abstracted firm's decision given the range of opening assumptions as to the level of knowledge to be attributed to the market actors. Regardless of the tacitness imputed into the model, however, as the amount of information available to the firm increases or decreases, the choice of actions remain the same – to collude or to take any one of a number of non-collusive actions. All that changes as the information deemed available to the firm increases or decreases is the probability of which choice will be taken – with the efficiency effects of each option remaining constant throughout.

It must be conceded that the concordance of the efficiency effects of tacit and express collusion is dependent on a static frame of reference. All collusion, even that anchored by the clearest of agreements, involves some element of uncertainty as to whether the colluding counterparties will behave in line with the required action. If we are dealing with a single period of time the efficiency outcome of tacit and express collusion will be the same so long as the level of certainty is sufficient to reach the threshold that permits the rivals to make the decision to collude, since any additional certainty of the parties as to the likelihood of its rivals' co-operation will not yield a super-collusive (*i.e.* super-monopoly) price level because the point of monopolistic profit maximisation will already have been reached. This efficiency perspective changes when temporal factors are taken into account. Over a prolonged period of time rival firms will have to make decisions to renew, review or commence collusive activities. Each time a decision comes to be made, the industrial climate will be different and consequently so will the levels of market visibility and an individual firm's degree of certainty as to rivals' potential reactions. As a result it may be rational to collude during one period but not in the next. For example, if the cost structure of an industry changes from being relatively stable to being characterised by rapid fluctuations in economic conditions, then the level of certainty as to whether rivals are still conducive to collusion may subside sufficiently to render the collusion no longer rational. Consequently, since all methods of collusion inherently involve some level of uncertainty as to the behaviour of rivals, for some periods the rivals will not collude and the monopoly price will not be attained. When price is averaged over all the time periods the collusive outcome will tend to yield a price lower than that under a monopoly, but higher than that where no collusion at all had occurred. This

result is borne out in several theoretical studies,[10] such as Green and Porter's model of firm behaviour where demand shocks are indistinguishable from rival defection,[11] Haltiwanger and Harrington's model of reactions to random variables,[12] and Rotemberg and Saloner's examination of the observability of price at various points of an economy's business cycle,[13] as well as in a number of empirical studies.[14] If it is considered that to the extent a tacit-express collusion division exists it is a description of the degree of uncertainty that the collusive signal leaves regarding rivals' actions, then it might be concluded that in the long run the more tacit the collusion, the more likely that price will be closer to the non-collusive level with correspondingly lower deadweight losses. Thus while in those periods where both tacit and express collusion satisfy the requisite certainty requirement the efficiency effects will be the same, a probability that tacit collusion is likely to satisfy this level for any given period would appear to suggest that over time tacit collusion has a less damaging aggregate efficiency effect than express collusion.

There are two reservations which must be added to this observation which, it is submitted, mean that tacit and express collusion should still be considered as equivalent in terms of their economic effects. First, the conclusion that tacit collusion results in a lower price depends on viewing the tacitness of the collusion as a proxy for greater relative uncertainty, something which may not necessarily prove to be the case. It is possible to envisage circumstances where observing rivals' pricing behaviour may be a more reliable indicator of

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[10] *See generally*, M. Slade and A. Jacquemin, "Strategic Behaviour and Collusion", *loc. cit.*, pp. 56-58.

[11] E. Green and R. Porter, "Noncooperative Collusion under Imperfect Price Information", (1984) 52 *Econometrica* 87.

[12] J. Haltiwanger and J. Harrington, "The Impact of Cyclical Demand Movements on Collusive Behaviour", (1991) 22 *Rand Journal of Economics* 89.

[13] J. Rotemberg and G. Saloner, "A Supergame-Theoretic Model of Business Cycles and Price Wars During Booms", (1986) 76 *American Economic Review* 390.

[14] *See* R. Porter, "A Study of Cartel Stability: The Joint Executive Committee, 1880-1886", (1983) 14 *Bell Journal of Economics* 301; M. Slade, "Interfirm Rivalry in a Repeated Game: An Empirical Test of Tacit Collusion", (1987) 35 *Journal of Industrial Economics* 499; M. Slade, "Vancouver's Gasoline-Price Wars: An Empirical Exercise in Uncovering Supergame Strategies", (1991) *Review of Economic Studies* 215.

their collusive compliance than the terms of an express price-fixing agreement. The directness of contact may only, therefore, be an imperfect approximation of certainty as to rivals' behaviour. If collusion of any description is observed, all that can be said with absolute certainty is that there is a greater deadweight loss than would otherwise be the case in the absence of collusion. The question of whether the collusion might be more durable under other circumstances is a matter for empirical analysis on an individual case basis. Secondly, even if the equation of tacitness with uncertainty is accepted, because contact between rivals occurs along a continuum of varying directness of communication different long term efficiency effects are as likely to arise between two methods nominally described as express collusion as between one described as tacit and another as express. There is no uniformity of certainty characteristics between any two constituents of either of the linguistic groupings of tacit or express collusion and as such, an economic division between tacit and express, wherever this is placed, is only as valid as any other threshold of directness of contact that could be placed anywhere along the communication spectrum. Thus even if it can be said that in the long term collusion yields different efficiency outcomes depending on whether the action is more or less tacit, this proposition will hold true at every point along the continuum and not just at the point of express-tacit division. Rejecting the equivalence of efficiency effects of tacit and express collusion is therefore only valid if the separate efficiency effects of every form of collusive communication existing under the descriptive tents of the phrases 'tacit' and 'express' are also acknowledged.

In summary, an economic treatment suggests that the short term efficiency effects of tacit and express collusion are identical, while the long term effects are also equivalent in so far as they result in a deadweight loss of some description, with the quantum of such effects potentially varying between tacit and express collusion, but in a manner dependent on the individual circumstances of each case and without any general implication that the tacit deadweight losses will be the lesser. Perhaps the point is best illustrated by

reference to the facts of an actual case, the *La Crespelle*[15] Article 234 reference decision. Here consumers of bovine insemination services were confronted with a uniform pricing structure at almost every articificial insemination centre in France, which, it was alleged, resulted in exboritant fees being charged. What is significant is that in cases such as this the manner in which the collusive price is arrived at is irrelevant from the point of consumer welfare. Regardless of whether athe artificial insemination centres determined their prices between themselves using binding written contracts, informal trade association rules, casual conversations or uncommunicated 'common sense', the efficiency harming effect for the consumer remained the same.[16]

Equivalence II: The Distinction from Oligopoply Reversion

Separate from the examination of efficiency impact is the issue of whether tacit collusion and express collusion are distinguishable from a non-collusive outcome in the same way. The relevance here for the study of methodological rejection is that equivalence between tacit and express collusion in this regard would show that a legal treatment distinguishing between the two types of collusion on the grounds that tacit collusion is better categorised together with some other type of non-collusive oligopolistic behaviour would be without economic justification. Expressed in economic terms the question is whether for both express and tacit collusion there is an identifiable factual paradigm wherein a market is susceptible to collusion (*i.e.* an oligopoly where the firms are collectively capable of exercising market power)[17] but where there exists a

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[15] Case C-323/93, *Société Civile Agricole du Centre d'Insémination de la Crespelle v. Coopération d'Elevage et d'Insémination Artificielle du Départment de la Mayenne* [1994] E.C.R. I-5077

[16] An example in the Irish context is the decision in *A. & N. Pharmacy Ltd. v. United Drug Wholesaler Ltd.* [1996] 2 I.L.R.M. 2, where the basis on which the decision by a group of wholesale pharamacies to refuse to supply a new entrant at the retail level, whether agreed by tacit or express means, had no baring on the degree of harm to consumer welfare.

[17] Usually oligopoly consists of a small number of firms but this will not necessarily be the case. Carlton and Perloff formally identify an oligopoly market as one where goods are homogenous, consumers are price takers, there is no entry into the industry over time, firms have collective

rational course of action yielding something other than the collusive outcome. Put simply, given rational behaviour and the prospect of monopoly profits, is a collusive outcome unavoidable? For the present purposes let us leave aside the problem of the spectral nature of express and tacit collusion and assign these terms respectively to each end of the communication continuum.[18] Taking express collusion first, the factual distinction between collusive and non-collusive behaviour is obvious: the rational collusive outcome is that which results when the identifiable communication occurs, while the rational non-collusive behaviour is that which exists when this communication does not occur (assuming, of course, that there is no contemporaneous tacit collusion). Collusion is thus economically distinguishable from non-collusion and avoidable in so far as the communication can be identified and, in theory at least, prevented. For tacit collusion this distinction is less obvious because a firm's decision whether to collude is based on an independent assessment of the market and not on any external removable communications. The temptation is to conclude that since the decision to tacitly collude is internalised, where collusion is possible it will be the rational (and hence unavoidable) outcome. Such a conclusion would, however, be incorrect, as ever since Cournot's ground-breaking 1838 paper the inevitably of collusion where oligopolists are behaving rationally has been compellingly disproved.[19]

Cournot's model assumes a duopoly with no entry, product and cost homogenity, downward sloping demand curve and fixed levels of output which cannot be adjusted during the relevant period of competition. Each firm calculates what it believes will be the residual demand for every given level of supply provided by the rival. From this the firm will calculate a response

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market power, and each firm sets only its price or output; D. Carlton and J. Perloff, *Modern Industrial Organization*, (Reading (Ma.): Addison-Wesley, 3rd Edition, 2000), p. 154.

[18] Taking into account the communication continuum means immediately discounting the distinction between tacit and express as meaningless, and allows one to skip to the conclusion later in this chapter that the processes of determining the rationality or otherwise of a collusive action is identical for both tacit and express collusion.

[19] A. Cournot, *Research Into the Mathematical Principles of the Theory of Wealth* [*Researches sur les principles mathematiques de la theorie des richesses*], N. Bacon (trans.), (Homewood (Il.), Richard. D. Irwin, 1963 [1838]).

schedule consisting of the profit maximising level of production given the residual demand at each potential level of production by the rival. Essentially the response schedule is the calculation of the monopoly profit that the firm can derive from the market remaining after the rival has supplied its products. If each firm assumes that the other is also behaving rationally, then each will be aware that the other will rely on a response schedule, leading to an eventual decision to produce at an output level which maximises profit taking into account the fact that a similar calculation will be used by its rational rival. The process is best illustrated using the example provided by Kreps, used here with some simplifications.[20] Given Cournot's assumptions and a linear downward sloping demand curve, a total demand of 1000 units of the output when price is at average cost (with no fixed costs), and linear marginal cost and marginal revenue curves such that for any given segment of the demand curve, the profit maximising output will be half that of the total demand for that segment if priced at average cost, then the following outcome will result. Firm 1 will calculate that the maximum output of Firm 2 will be 500 units, since regardless of the level of output of Firm 1, Firm 2 could not maximise profits any further by increasing output further since 500 is the monopoly level of output and also the combined output level of the two firms should they perfectly collude. Having made this calculation Firm 1 will calculate the profit maximising level of output should Firm 2 produce its rational maximum – in other words Firm 1 will have a monopoly over that section of the market prepared to purchase at a price above average cost, but below the market price if market output is confined to 500 units. Given the profit maximising equation, Firm 1 will consider it rational to produce 250 units (500/2) in the worst case scenario (for Firm 1) of Firm 2 producing the monopoly output. Firm 2, as a rational rational actor will be similarly aware of Firm 1's reaction should Firm 2 produce at the monopoly level, thus it revises its reaction to Firm 1's maximum output of 250, and calculates its new maximum output as the monopoly profit to be derived from the market after Firm 1's supply, specifically 375 units ((1000-250)/2). Firm 1 will likewise be aware that Firm 2 will have made this calculation and will in

[20] D. Kreps, *A Course in Microeconomic Theory* (New York: Princeton University Press, 1990), p. 411 *et seq. See also*, E. Kloosterhuis, *loc. cit.*, 90-92.

turn reassess its output given Firm 2's output of 375, which will be half of the remaining market after Firm 2's supply: 312.5 units. This calculation continues until an equilibrium is reached when each firm calculates that the other's recalculations of reaction will only cease when they reach the figure of 333 units of output each ((1000-333/2)= 333). At this level neither firm has any incentive to revise up or down its maximum output since it is aware that this is the price at which the other party will reach the same conclusion.[21] The total industry output (666) will be greater than that under perfect collusion (500), but lower than that under perfect competition (1000). The Cournot equilibrium thus has a smaller negative efficiency effect than arises under collusion, but is less efficient than the perfectly competitive outcome.

As a rational non-collusive outcome in certain oligopolistic market conditions, the Cournot equilibrium can be described as an 'oligopoly reversion' so as to distinguish it from the monopoly and perfect competition equilibria. Nor is it the only oligopoly reversion. Bertrand's study indicates an alternative non-collusive rational outcome where oligopolists are price-setters with flexibility as to output during the competitive period.[22] In these circumstances, if the firms are equally efficient each will have an incentive to reduce price and capture the entire market demand at the lower level. Similarly no firm will be better off by increasing its price because the flexible output of the now lower priced rivals would expand to satisfy all market demand at the lower price. Assuming rationality, each firm will be acutely aware that its rivals know these facts. Consequently, through a process similar to the internal bidding of the Cournot model described by Kreps, market participants will prior to making their pricing decision for the competitive period run through a sequence of undercutting calculations, starting with the assumption that it can capture the entire market and near-monopoly profits by just undercutting the rivals' monopoly price level, followed by a series of downward adjustments contemplating the rivals'

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[21] Consequently it is a Nash equilibrium given the opening assumptions. For a game theoretic analysis of Cournot's model *see* D. Carlton and J. Perloff, *op. cit.*, pp. 157-166; C. Shapiro, "Theories of Oligopoly Behaviour", in R. Schmalensee and R. Willig (eds.), *op. cit.*, vol. i, pp. 333-343.

[22] J. Bertrand, "Book Review of *Researches sur les principles mathematiques de la theorie des richesses*", (1883) 67 *Journal des Savants* 499.

anticipation of the calculating firms' undercutting incentive. This undercutting spiral ends when the incentive to capture further sales no longer exists – *i.e.* when price is at marginal cost. The rational decision for each firm in these circumstances will be to price at the same level as under perfect competition. Even if rivals have different costs, the Bertrand model indicates a market price lower than the Cournot outcome, with the more efficient firm setting price at a level just below its less efficient rival's marginal cost, but above its own marginal cost. Cutting price towards marginal cost remains a rational strategy notwithstanding the fact that both firms would be better off if they colluded and priced at the monopoly level, since each is better off reducing price regardless of the rival's collusive decision: if the rival prices at the monopoly level then undercutting this price results in the firm gaining the entire market, which is a preferable outcome than co-colluding with the rival in those circumstances; conversely, if the rival prices at marginal cost, then the calculating firm stands to make substantial losses unless it adopts a similar price.[23]

The existence of oligopoly reversions implies that the recognition by oligopolists of both their interdependence and the possibility of monopoly profits is not of itself sufficient to conclude that in these circumstances collusion is always the rational outcome.[24] This is a conclusion which is, of course, as relevant to express collusion as tacit collusion. Assuming that the form of

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[23] Again, the Bertrand outcome is a Nash equilibrium. For a game theoretic analysis of Bertrand's model *see* D. Carlton and J. Perloff, *op. cit.*, pp. 167-172; C. Shapiro, "Theories of Oligopoly Behaviour", in R. Schmalensee and R. Willig (eds.), *op. cit.*, vol. i, pp. 343-348.

[24] Similar conclusions are reached by Niels and Posner: *see* G. Niels, "Collective Dominance: More than Just Oligopolistic Interdependence", (2001) 22 *E.C.L.R.* 168, 172: "[T]he mere existence of oligopolistic interdependence (and a certain extent of output restriction) is not sufficient for a collusive outcome to obtain. Oligopolistic interdependence exists in any market with few firms, and output is often lower than it would be in perfect competition (*e.g.* in the Cournot model). However, this does not always mean that firms are maximising joint profits through tacit collusion."; R. Posner, *op. cit.*, pp. 68-69: "[I]nterdependence theorists tend to leap from the sound proposition that concentration is a necessary condition of tacit collusion to the unsound proposition that it is a sufficient condition. There is no sound basis in economic theory for thinking that if there are just a few major sellers in a market, competition will disappear *automatically*. Each seller must still decide whether to limit output, and this implies at least tacit negotiation with his major competitors."

express collusion is not legally binding, the fact that the communication between the rivals deducing the potential to collude is carried out expressly will not affect the Cournot or Bertrand outcomes where these are indicative of rational behaviour, any more than an implicit understanding of the mutual benefits of shared collusion would. Any justification that tacit collusion should be meted out a different legal treatment to express collusion on the grounds that it is best considered as part of the same phenomenon as oligopoly reversion, therefore, would have no basis in economic theory and would indicate the occurrence of methodological rejection.

Equivalence III: The Existence of Rational Decisions to Tacitly Collude

Demonstrating that tacit collusion is not the automatic outcome of oligopolistic interdependence raises the corollary question of whether collusion is in fact *ever* a rational outcome for the oligopolist. The Cournot and Bertrand models suggest that under their respective assumptions it is not, although as both are single period examinations of behaviour they fail to take into account the rational strategic considerations which firms would have where they were expected to compete over several such periods.[25] The seminal study of collusion as a matter for dynamic strategic consideration is Stigler's charcterisation of the decision to collude as a circumstantially dependent determination of the costs as against the benefits of collusion.[26]

Two types of collusion costs are identified. First, is the cost of agreeing the common practice that will result in the collusive price. This will to a significant degree depend on the number of colluders necessary to achieve the desired outcome which will usually be the number of undertakings that collectively control substantially all of the industry output capacity. The smaller

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[25] The failure of both Cournot and Bertrand outcomes to be reflected empirically is usually attributed to this failure to take into account the strategic considerations of several periods of competition; *see* D. Carlton and J. Perloff, *op. cit.*, pp. 157-154; C. Shapiro, *loc. cit.*, pp. 333-348; T. Bresnahan, "Empirical Studies of Industries with Market Power", in R. Schmalensee and R. Willig (eds.), *op. cit.*, vol. ii, p. 1011 *et seq.*

[26] G. Stigler, "A Theory of Oligopoly", in G. Stigler, *The Organisation of Industry*, (New York: Irwin, 1968), p. 39 *et seq.*

the number, the lower the communication and transaction costs and, if collusion is illegal, the lower the risks of detection.[27] While collusive-price formation may be more difficult in the absence of direct communication, this does not mean that the formation costs of tacit collusion will necessarily be prohibitive. One way in which tacit collusion formation may arise is through price leadership where one firm, usually the most efficient in the industry,[28] 'communicates' the collusive course of action by unilaterally adopting that position.[29] Another method is focal point pricing, or 'folk theory'.[30] The observation that even in the absence of direct communication, common cultural points of reference will enable simultaneous actions of co-ordinated behaviour to arise was initially made in Schelling's study of 36 New York residents who were each told that they had to meet another person on a given day but were not told at what place or at what time.[31] The majority selected the information booth at Grand Central Station, while nearly all selected a meeting time of twelve noon. In the economic context, Scherer describes such focal points as being provided by round numbers, odd numbers arising from pricing convention (such as 1.99 or 1.95) and accepted rules such as 'split-the-difference'.[32] The existence of commonly known focal points is a tacit communication of the collusive price in much the

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[27] *See* D. Carlton and J. Perloff, *op. cit.*, pp. 132-136; R. Posner, *op. cit.*, pp. 60-69. This conclusion is borne out in a number of empirical studies of the low average number of firms in cartels; *see* A. Fraas and D. Greer, "Market Structure and Price Collusion: An Empirical Analysis", 23 (1977) *Journal of Economic Theory* 160; G. Hay and D. Kelley, "An Empirical Survey of Price-Fixing Conspiracies", 17 (1974) *Journal of Law and Economics* 13.

[28] M. Donsimoni, "Stable Heterogenous Cartels", (1985) 3 *International Journal of Industrial Organization* 451.

[29] *See generally* S. Martin, *Industrial Economics: Economic Analysis and Public Policy*, (New Jersey: Prentice Hall, 2nd Edition, 1993), p. 156 *et seq.*

[30] *See generally* J. Friedman, "A Guided Tour of Folk Theory", in G. Norman and J. Thisse (eds.), *Market Structure and Competition Policy: Game Theoretic Approaches*, (Cambridge: Cambridge University Press, 2000), p. 51 *et seq.*

[31] T. Schelling, *The Strategy of Conflict*, (Cambridge (Ma.): Harvard University Press, 1960).

[32] F. Scherer, "Focal Point Pricing and Conscious Parallelism", (1967) 12 *Antitrust Bulletin* 495, 496-497: "The focal points chosen may owe their prominence to analogy, symmetry, precedent, aesthetic considerations, or even accident of arrangement, but they must in any case have the property of uniqueness. In economic problems, round numbers tend to be focal points, as do simple rules such as 'split the difference'."

same way as the actions of a price leader, except that the prior communication arises through social precedent without the need for any firm to take on the role of first-mover. As Scherer puts it, each focal point is a rhetorical question to the decision-maker implying the danger of undercutting: "If not here, where?".[33] This point can be generalised to all collusive decisions, highlighting again the status of communication as a continuum. Every act of overt communication or indicative action of a price-leader poses the Schererian question, all that changes is the method of asking. In other words, the process of evaluating the costs of collusion whether by tacit or express means is identical.

The second cost is that of maintaining the collusion price, which can in turn be divided into two components. First, is the likelihood that new entrants or fringe firms which are not party to the colluding understanding will expand their output and thus undermine the colluders' efforts to boost price. Low barriers to entry, high elasticity of demand or a relatively small market share on the part of the potential colluding parties will all reduce the potential gains of collusion, or at least shorten the time during which these gains will be attainable. Second, is the cost of ensuring that the colluding parties themselves abide by the collusion strategy. In large part this is determined by the expectation of the parties regarding the probability and severity of being punished should it 'cheat' by just undercutting the collusion price.[34] Detection of cheating will be facilitated where there are few market participants (since an incident of cheating by just one will be readily observable through the significant changes in demand faced by the others), where market actions are rapidly visible, and also where the different firms' products are relatively homogenous with a correspondingly narrow range of prices identifiable as collusion compliant.[35] A probability of detection alone is

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[33] *Ibid.*, 497-498: "By setting its product at such a focal point, a firm tacitly encourages its rivals to follow suit without undercutting. Conversely, if one firm announces a price that has no such compulsion, a rival is tempted to set its own price just a cent or two below. This leads to a further small retaliatory cut, precipitating a downward spiral which, in the absence of focal points, has no clear-cut stopping point. In setting one's price at a focal point, one in effect asks rhetorically, 'If not here, where?' implicitly warning rivals of the danger of downward spiralling."

[34] D. Carlton and J. Perloff, *op. cit.*, p. 132.

[35] M. Slade and A. Jacquemin, "Strategic Behaviour and Collusion", *loc. cit.*, p. 51; R. Posner, *op. cit.*, pp. 60-69.

insufficient to reduce collusion costs. Once detected, punishment of cheating must be seen as both probable and financially damaging to the extent that this risk outweighs the cheating bonus. The greater the capacity of rivals to expand production to the competitive level within a short period of time, the more credible their threat of retaliation will be, and consequently, the lower the costs of collusion that will arise. This phenomenon has been referred to by Shapiro as the "topsy-turvy" principle: "anything ... that makes competitive behaviour more feasible or credible actually promotes collusion".[36] Once again, there is no discernible difference between the calculation employed to determine the costs of collusion, whether it is collusion instigated by tacit or express means; indeed, even more so than in the case of calculating the costs of establishing the collusion price – the costs of maintaining that price will entail not just the same processes, but also the same form of action since under either express or tacit collusion the operations of enforcement will ultimately rely on market observation alone.

The endurance of the Cournot and Bertrand models owes much to the way in which they mathematically plot the behaviour of rational parties in a manner that takes into account the responses of other rational actors. Stigler's analysis represents a necessary step forward from these classical models by generalising the decision making process beyond the context of Bertrand and Cournot's assumptions. Within Stigler's paradigm, the Bertrand and Cournot outcomes can be seen as the results of the rational enquiry into the costs of collusion – in both cases the answer being that the costs exceed the benefits – but more importantly his method of analysis opens up a vista of the rational firm taking into account dynamic considerations of any and every environmental factor to be processed through the calculus of cost versus benefit. What Stigler leaves unanswered, however, is whether there actually exist factual circumstances where the firm will decide that collusion is the rational option.

It is only with the development of game theory that an analytical tool has been developed which enables this question to be answered. The matrices of game theory follow in the tradition of Bertrand and Cournot by setting out the rational outcome for any given set of assumptions taking into account the

[36] C. Shapiro, *loc. cit.*, p. 357. Original emphasis removed.

awareness that there is more than one agent making choices.[37] In the single period game, the outcome will always be the oligopoly reversion instead of collusion since, as we have seen in our examination of Cournot and Bertrand, each actor is better off cheating regardless of what his rivals decide to do.[38] In a two period game, each party has the added consideration of the impact on future profits of their decision in the first period.[39] However, because in the second period the possibility of future profits no longer exists, the outcome in this period will be the same as the single-period game – *i.e.* each firm will price at the oligopoly reversion. This holds true even if the oligopoly reversion is above the competitive price, as in the Cournot model, since the incentive to punish a rival by pricing below the oligopoly reversion price level in the second period will only be rational if the enforcer's losses can be recouped by collusive compliance on the part of the cheater in future rounds. The implications of this for the first period of the two period game is that there is no longer a credible threat to potential future profits should it fail to collude, since no matter what decision it reaches in the first period the oligopoly reversion will always occur in the second. So long as the participants are aware that the game consists of a finite number of rounds the outcome will be the same regardless of how many rounds are played. In each case the guarantee of an oligopoly reversion in the last round will remove the credible threat for not colluding in the second-last round, leading to a guarantee of an oligopoly reversion there that will in turn deprive the third-last round of a credible threat, with the effect repeating backwards to the first round.

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[37] This is similar to Sonnenschein's basic definition: "Game theory tries to explain how individuals behave in situations with elements of both cooperation and conflict. It explains how they *might* behave and also suggests how they *should* behave. It suggests what the outcome of cooperation and conflict will be. ...With many agents, what each individual should do depends on what he believes others will do." Quoted in an interview with Parkin; M. Parkin, *Economics*, (Reading (Ma.): Addison-Wesley, 1990), p. 276.

[38] M. Slade and A. Jacquemin, "Strategic Behaviour and Collusion", *loc. cit.*, pp. 52-54.

[39] This finite multi-period analysis draws on those used in: J. Friedman, "A Non-Cooperative Equilibrium for Supergames", (1971) 38 *Review of Economic Studies* 1; M. Slade and A. Jacquemin, "Strategic Behaviour and Collusion", *loc. cit.*, pp. 54-55; C. Shapiro, *loc. cit.*, pp. 356-361.

Collusion does arise as a rational outcome if the multi-period game is tweaked in one of two ways. First, if the firms are uncertain as to whether the other party will behave rationally, it may be rational to 'test the water' by opting for the collusive price in the first round, only switching to the oligopoly reversion in subsequent rounds in the event that the rival selects the rational oligopoly reversion in the first.[40] Secondly, if the game consists of infinitely repeating rounds, or at least if the rivals are uncertain as to how many rounds the game consists, then there will be no final round in which firms are aware of the absence of an incentive to collude.[41] In these circumstances, provided that the firms place a broadly similar value on each future euro of profit as each current euro of profit, the gains from cheating in the current period plus the oligopoly reversion profits from each subsequent period will be less than the forgone collusion profit in all the remaining periods. The threat of oligopoly reversion is now credible in each period since it will be the response of rivals in subsequent periods where it has been indicated to them that the cheater is no longer playing along with the collusion and, moreover, because it is an outcome which is dependant on the firm's decision made for the current period. Viewed within Stigler's paradigm of costs, collusion becomes a rational decision provided that the parties perceive the costs of identifying the collusion price as not being excessive (*i.e.* the collusion price is identifiable by market participants such that they can detect deviations from this as cheating and hence increase the credibility of oligopoly reversion) and the cost of maintaining that price is acceptable (*i.e.* deviations are sufficiently detectable and response times for punishing cheating relatively short).

Thus, game theory indicates that tacit collusion may arise as the possible decision of a rational undertaking in certain circumstances, but equally it shows that the collusive outcome is not necessarily the automatic one for rational actors in an oligopoly. Even more importantly, this conclusion demonstrates that the same processes in determining rationality apply regardless of the form of

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[40] R. Rosenthal, "Games of Imperfect Information Predatory Pricing and the Chain-Store Paradox", (1981) 25 *Journal of Economic Theory* 92; E. Green and R. Porter, "Noncooperative Collusion under Imperfect Price Information", (1984) 52 *Econometrica* 87, 88 *et seq.*

[41] This infinite multi-period analysis draws on those used in: D. Carlton and M. Perloff, *op. cit.*, pp. 178-183; C. Shapiro, *loc. cit.*, pp. 361-365.

communication establishing the collusion – be it tacit or express. In the case of express collusion, this provides a theoretical basis for explaining the occurrence of collusion somewhat more robust than the tautologous conclusion that because collusive communication is observed to occur, the collusive action must be rational. For tacit collusion this finding is even more important since in the absence of a readily identifiable act of collusive communication there exists an independent theoretical basis for explaining the possibility of collusion independent of the form of communication entailed. This serves to demonstrate that there are no differences between the two varieties of collusion based on an economic understanding of rational behaviour, and that any such legal distinction would, once again, tend to indicate a divergence between the legal and economic approaches to the issue of tacit collusion.

The Implications of Equivalence for Methodological Rejection

The economic analysis of tacit collusion can be summarised in three statements. First, the efficiency effects of tacit collusion are of the same order as those of express collusion. Both lead to a monopolistic outcome in the short run, while in the long run each is capable of resulting in a market price above the competitive level – the precise extent of this super-competitive price depending on factors that cannot be correlated directly to the description of the collusion as tacit or express. Secondly, both express collusion and tacit collusion are conceptually discernible from the non-collusive oligopoly market outcome; in fact, it is the same process of rational calculation which determines whether collusion in each case will occur. Third, and as a corollary to the second point, the two divisions of collusion rely on the same cost-versus-benefit analysis to determine whether the decision to collude will be rational in the circumstances. Fundamentally, whether the metric of efficiency or the rationality function are taken as the issues for comparison, each type of collusion forms part of a single class of behaviour, with their different labels being mere descriptions of the point where collusion occurs along the spectrum of communication. In the absence of legally enforceable contracts to collude, there is no more economic validity to treating tacit and express collusion as separate events than there is to conclude that the

price-fixing deal cut in the fabled smoke-filled room is materially different from collusion achieved by more complex forms of competitor interchange.

That tacit and express collusion form a single factual phenomenon within the economic paradigm is demonstrated by the resilience of this conceptual unity regardless of the economic value decisions selected.

If the metric of efficiency is considered to be that of allocative efficiency, then the efficiency implications of successful tacit collusion are the same as successful express collusion – both being described as resulting in similarly negative outcomes. Taking the utility maximisation of an alternative group as the concern of a model – say, the interests of a particular group of consumers in a second market where costs and subsequently price would fall with the decreasing output of the colluding market, or of the colluders themselves – means that the efficiency outcome of the collusion would be seen as a positive occurrence regardless of the type of behaviour triggering the collusion. Nor will different determinations of the appropriate temporal period for the determination of efficiency divide the two concepts, both have the same short term and similar long-term efficiency effects. Whatever the metric of efficiency chosen, the upshot is one of two conclusions: both tacit and express collusion should be deemed to be efficiency damaging; or both should be deemed to be efficiency enhancing. There is no middle ground allowing for a segregated treatment because however their efficiency effects are valued, they remain equivalent.

In addition, different evaluations as to the rationality function employed will not dislodge this equivalence of economic treatment. Whether it is rational to collude in any given circumstance will depend on an evaluation of all the costs of collusion involved, the beliefs of competitors as to their rivals' reactions and the extent to which uncertainties are brought into play. No matter how these variable facts are introduced and weighed, and whether collusion in the circumstances is considered to be rational or irrational, the process of calculation remains the same whether one is dealing with tacit or express collusion: *i.e.* something which is considered to reduce the cost of engaging in express collusion will necessarily also be construed as reducing the costs of the tacit variety. Similarly, while the decision to include the subject-actor in the rationality calculus may well impact on the economic model's predictions as to

the probability of collusion, what is being rendered more or less likely by this type of determination is the occurrence of collusion *simpliciter*, and not of any one of its component forms in isolation from the general class.

The singularity of tacit and express collusion is, therefore, not prone to challenge through the selection of different value judgments within the major tenets of the economic methodology. The equivalence of the two concepts can be said to be rhetorical divergence-proof: no matter what answer is given to the five value questions of economics – *i.e.* the five paths to rhetorical divergence discussed in chapter three – the division of collusion into 'harmful' and 'not harmful' varieties cannot be done while remaining internally coherent within at least one range of value selections. The conclusion of economic theory is simply and immovably that tacit and express collusion require an equivalence of treatment, irrespective of what that treatment is. To the extent that the law rejects this equivalence, a true divergence – that is to say a methodological rejection – between law and economics can be said to occur.

CHAPTER SEVEN

OBSERVING METHODOLOGICAL REJECTION: THE EQUIVALENCE AND NON-EQUIVALENCE OF EXPRESS AND TACIT COLLUSION IN COMMUNITY COMPETITION LAW

The Legal System's Turn

The empirical test for methodological rejection, it will be recalled, relies on the existence of a division of concepts in one system, which goes unrecognised in another and which cannot be attributed merely to a different selection of value criteria permitted by the first system. In the last chapter the first stage of this analysis concluded that microeconomics handled the concepts of express and tacit collusion as equivalent – in terms of their efficiency effects, their use of the rationality process and their separation from the concept of oligopolistic reversion – with the implication that evidence of the non-equivalent treatment in the legal sphere would be an indication of the segregation of an economic concept on grounds other than a difference of economic value judgment selection, and hence suggestive of the occurrence of methodological rejection. In this chapter the focus turns to the treatment of tacit and express collusion in the Community case-law as the second step in the process of the empirical testing of the posited concept of divergence.

The issue of tacit collusion and the thresholds of contact necessary for the Community law concept of an anti-competitive concerted practice to be deemed to apply are subjects which have been broached by the E.C.J. on a number of occasions. That these concepts have presented the court with considerable difficulties is evident from the regularity with which successive judicial 'clarifications' have themselves required further explanations shortly

thereafter. Tacit collusion, it might be said, has been something of a boomerang for the Community legal system. It is not surprising, therefore, that the case-law provides no singularly tidy proof as to the existence of equivalence or non-equivalence – or at least not one that can escape being glib. Nevertheless, it is submitted that a number of strands of legal principle can be concisely identified, and that while each provides a different answer to the question of equivalence, individually they stand as a consistent body of decisions as to the treatment of tacit collusion. Broadly these can be broken into four areas of principle.

First, the core doctrine Article 81 of concerted practices demonstrates a rigid and self-acknowledged uneconomic segregation of express and tacit collusion which has been implemented, on the one hand, by rejecting that the prohibition on express collusion should be extended to the tacit variety despite frank judicial recognition that their efficiency effects and rational basis are the same, while on the other, condemning the use of market behaviour as evidence of a concerted practice precisely on the grounds of their economic equivalence – *i.e.* that it would make telling tacit and express collusion apart impossible.

Secondly, there have been particular niche circumstances where the Community courts and the Commission have either made statements of law or applied existing principles in such a manner that, while not calling into question the general legality of tacit collusion, would appear to envisage circumstances where it may be addressed under Article 81. Four of these special cases are discussed: tacit collusion arising from vertical arrangements, tacit collusion occurring in the wake of express collusion (the 'hangover principle'), tacit collusion by fringe players in a market where express collusion is occurring, and express actions which facilitate tacit collusion.

Thirdly, the concept of joint dominance under Article 82 has been sufficiently widely interpreted to allow for tacitly colluding firms to be considered as collectively holding a dominant position, although the difficulty in adducing evidence of an abuse of this position by pricing actions alone greatly reduces its scope as a tool for regulating tacit behaviour.

Fourthly, the application of the merger regulations to prospective tacit collusion is examined and it is argued that this is the only legal doctrine which unambiguously regulates tacit and express collusion on the same basis, and consequently presents itself in alignment with the approach of microeconomics.

The chapter concludes by arguing that the non-alignment of the legal and economic positions indicated by their differing stances on the equivalence of tacit and express collusion amounts to an instance of methodological rejection, and as such, true systemic divergence.

Tacit Collusion Under Article 81: The Birth of Doctrine and the *Dyestuffs* Decision

The principle legal restriction on collusion in the European context is contained in Article 81(1) of the Treaty of Rome:

> The following shall be prohibited as incompatible with the common market; all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply....

Of the three prohibitions contained in this clause, it is the one addressing "concerted practices" that suggests itself most obviously as a vehicle for addressing tacit collusion, lacking as it does the requirement of legal formality or communication inherent to the concepts of an agreement or a decision by an association of undertakings.

The first detailed consideration by the European Court of Justice (E.C.J.) of the types of behaviour governed by the concerted practices prohibition occurred in *Dyestuffs*,[1] a case concerning cartel between the major European producers of aniline dyes. Mayras A.G. laid the foundation of a doctrinal acceptance of the legality of tacit collusion, stating in his opinion that the parallel or concordant common conduct of several undertakings would not

[1] Cases 48-57/69, *I.C.I. and others v. Commission* [1972] E.C.R. 619, [1972] C.M.L.R. 557.

constitute a breach of Article 81(1) if such behaviour was the consequence of the "structure and the economic conditions of the market".[2] Foremost in the advocate general's reasoning was the acceptance that the interdependence of firms in an oligopoly necessarily implied that parallel behaviour was unavoidable.[3] What is notable about this position is that it did not countenance a separate legal treatment of tacit collusion and oligopoly reversion. Mayras A.G. referred to a single inevitable outcome of "conscious parallelism" as arising in oligopoly markets, a term usually taken to mean tacit collusion in the economic literature.[4] Similarly when giving a specific account of the workings of this outcome the advocate general set out a rudimentary description of price leadership – a process again indicative of collusion.[5] Thus the separate and more damaging efficiency effects of tacit collusion (taking a consumer welfare perspective) compared to mere oligopoly reversion were left unrecognised.

Something that is not entirely clear from the advisory opinion is why all oligopolistic behaviour in general should be considered to be *per se* legal. It is possible, however, to identify three considerations which may have informed this view. First, given the advocate general's failure to distinguish between the oligopoly outcomes, the negative efficiency outcome may have been seen as either inevitable or improbable – outcomes that would mean little could be achieved in terms of competition policy by prohibiting the relevant conduct.

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[2] [1972] C.M.L.R. 557, 571-572, 574, *per* Mayras A.G.: "[T]he simple finding of a common conduct, parallel or concordant, of undertakings on the market clearly cannot suffice to establish a concerted practice within the meaning of Article[81](1). It is still necessary for that conduct not to be the consequence, or at least *the main consequence*, of the structure and the economic conditions of the market. ...[I]t must be shown, on the one hand, that the conscious parallel conduct is not exclusively or even mainly due to the economic conditions or to the structure of the market, and on the other, where there is no express meeting of minds, sufficiently precise and concordant presumptions lead to the conviction that the parallel conduct was the result of a concertation, of a co-ordinated policy." Emphasis original.

[3] *Ibid.*, 579, *per* Mayras A.G.: "Oligopolies, the functioning of which most economists accept implies a conscious parallelism, are those in which producers are rigorously interdependent of each other, in such a way that none of them can take a decision on the competitive level, and particularly regarding prices, without the others being immediately affected, conscious of being so and forced to react."

[4] *Ibid.*, 579.

[5] *Ibid.*

Secondly, it is evident that all oligopolistic outcomes are considered in the opinion to be the result of firms behaving rationally. Thus, price-leadership is characterised as "reasonable" behaviour,[6] while all the actions and responses of firms within an oligopolistic market are described as being "forced" upon the participants, presumably being so compelled by their unswerving dedication to profit maximisation.[7] Thirdly, oligopoly is considered to arise only in very specific circumstances, namely, when there is homogenity of products, transparency prices.[8] Similarly, and more perplexingly, the oligopoly outcome (be it of the oligopoly reversion or the tacit collusive variety) is deemed to occur only through price leadership by the most powerful market player exercised in a *downward* direction.[9] Consequently, it may have been the advocate general's conclusion that the occurrence of either or both of tacit collusion or oligopoly reversion was sufficiently uncommon to justify their legality.

From an economic perspective, the criticisms of advocate general's opinion are manifold. The confusion between oligopoly reversion and tacit collusion completely discounts the fact that very different efficiency effects may result from, on one hand Cournot or Bertrand outcomes in an oligopoly and, on the other, the monopolistic outcome of collusion. Likewise, the equation of rationality with acceptability overlooks the fact that even the most overtly communicated of price-fixing agreements could be similarly classified. As Stigler's analysis demonstrates, the occurrence of collusion is dependent on it being a rational decision based on an evaluation of relative costs and benefits.[10]

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[6] *Ibid.*, 579: "In such a situation [oligopoly], the "price leader" will decide upon an increase only in so far as it has the reasonable conviction that its competitors will be forced to align themselves on that increase."

[7] *See* text quoted *supra* fn. 3, 6.

[8] [1972] C.M.L.R. 557, 579, *per* Mayras A.G.: "[I]nterdependence is to be found, if we look in economic theory, only in markets where, apart from the usual criteria of oligopolies, two determining factors exist: homogeneity of products and transparency of the market as regards prices."

[9] *Ibid.*, 579-580: "The thesis whereby a change in price by all participants can be explained by the constraint exercised on an oligopolistic market might seem convincing where it is a change downward."

[10] G. Stigler, "A Theory of Oligopoly", in G. Stigler, *The Organisation of Industry*, (New York: Irwin, 1968).

The role of rationality in assessing economic harm is confined to determining whether a particular course of action is likely to be taken. Assessing the effects of such an action should it transpire is the preserve of efficiency calculations made independently of considerations of the reasonableness or otherwise of the conduct in question. Finally, the definition of the circumstances in which oligopolistic behaviour may arise is unduly restrictive. Following Stigler's analysis again, product homogenity and price transparency are certainly factors which would increase the costs of enforcing collusive arrangements, but while this means that collusion may be more difficult, it does not rule it out as impossible. The description of oligopolistic behaviour as leading to downward only movements seems at odds not only with fundamental economic common sense, but also with Mayras A.G.'s own prior illustration of "forced" price increases through price leadership. This may be an intended reference to the alternative of a Bertrand outcome as the only outcome where actors behave simultaneously rather than through price leadership, although this interpretation sits uneasily with the characterisation of oligopolistic behaviour as necessarily collusive earlier in the opinion. In either event, the possibility of tacit collusion arising through simultaneous focal point pricing, or through price leadership by a party other than the biggest or most efficient in an industry, dictates that this may be a rational course of action where the benefits of collusion are perceived as outweighing the costs.

In defence of the advocate general, it must be pointed out that his conclusions were reached at a time when focal point pricing and Stiglerian analysis were relatively recent theoretical innovations, and he states clearly in his opinion that he has relied upon the evidence given by economic experts.[11] One can find in economic works of the time conclusions not dissimilar from those of the advocate general. In Turner, for example, not only is the likelihood of simultaneous tacit collusion actually occurring questioned (although it is conceded as a possibility),[12] but it is also suggested that since both oligopoly

[11] [1972] C.M.L.R. 557, 580, *per* Mayras A.G.

[12] D. Turner, "The Definition of an Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal", (1962) 75 *Harv. L. Rev.* 655, 660-662.

reversion and tacit collusion are the result of individual and rational choices they are consistent with a competitive norm of profit maximisation.[13]

It is one of the ironies of Mayras A.G.'s opinion that the extremely narrow conception of the circumstances in which tacit collusion might arise which underlies his permissive stance in relation to this type of conduct, is the very thing that opened a 'back-door' to tacit collusion being addressed under Article 81. Having found that the concept of a concerted practice did not cover oligopolistic outcomes, the advocate general was faced with the challenge of identifying exactly what conduct was prohibited under this heading which was not already covered under the ban on anti-competitive agreements. His conclusion was that the concerted practice clause served to prevent a loop-hole from arising in those cases where, although an express policy of action existed as between the parties, "no trace" of a written document fitting the description of an agreement could be found.[14] Consequently, where the conduct of the

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[13] *Ibid.*, 665-667. To this argument Turner examines the rebuttal that antitrust policy treats different situations in different ways, and thus profit maximisation while tolerable at the competitive level should not be considered in monopolistic situations – and replies by arguing monopoly policy is based on the containment of monopolies from spreading to other markets, and the logical extension of this argument to oligopoly would involve finding all monopolies *per se* illegal. It is submitted that from an economic perspective Turner's argument is incorrect. Rational behaviour should not be equated with the "competitive norm", as Turner puts it, since the sole interest in rationality is to further consumer welfare benefits. Where profit maximisation results in optimal consumer welfare, as is the case in perfect competition, then there is no need to interfere with antitrust policy. Where they are not so aligned interference is entirely merited from the efficiency perspective. This does not necessarily lead to the conclusion that all monopolies are *per se* illegal – the single firm industry may be operating at the lowest price, perhaps not in terms of price being at marginal cost, but in the case of an industry with a minimum efficient scale of a single firm (*i.e.* a natural monopoly) at a price which would be lower than that if there were several competing firms in the industry. The reason that tacit collusion is considered obnoxious from an efficiency viewpoint is that the existence of more than one firm suggests a minimum efficient scale greater than one and hence a lower attainable price in those market conditions.

[14] [1972] C.M.L.R. 557, 571, *per* Mayras A.G.: "To give to the latter concept [concerted practice] so limited and so narrow a meaning that it would be reduced to a particular application of the concept of agreement would, certainly, be contrary to a general principle of interpretation which you have often adopted and under which each of the provisions of the Treaty is to receive its full effect, to be given its full scope. Even if it be accepted that a concerted practice involves

undertakings, including their internal communications, actions on the market, relations with customers and rivals, and most significantly, the correlation of their decisions with those of rivals, tended to indicate a co-ordinated express policy, then this could be inferred.[15] Since the likelihood of tacit collusion in general was considered to be slim, and simultaneous focal point pricing collusion non-existent, there was now the potential for tacit behaviour to be caught by Article 81 on the premise that the observation of its occurrence could not be explained other than by the existence of some unseen direct contact between competitors. Indeed, on a superficial level this appears to be exactly the scenario played out in the following passage of the advisory opinion analysing the behaviour of several of the undertakings taking part in price-leadership with an alternating leader – an occurrence which could not be explained within the advocate general's economic conception of oligopolistic behaviour:

> Without it being necessary to seek how to classify that operation [the alternating leadership] under the law of contract, since we are not concerned with an 'agreement', I think that it does in fact imply a meeting of several wills: that of the price-leader, which is not a purely unilateral manifestation of will since the implementation of its decision is subject to its acceptance by the other producers; then that of each of the latter, *which adhere at least tacitly, to the initial decision of the price-leader* or else oppose it and prevent its carrying out or at least limit its scope.

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an agreement in fact, at the same time as it reveals it by the manifestation of certain co-ordinated conduct, it is my opinion without doubt that in making it a separate 'category', the authors of the Treaty have intended to avoid the possibility of the prohibitions of Article 85 concerning anti-competitive acts being evaded by undertakings which, while following a common policy, act in such a way as to leave no trace of any written document which could be described as an agreement."

[15] *Ibid.*, 571: "As opposed to the case of agreements, this common will may, according to the circumstances, be deduced from all the informational data gathered on the conduct of the undertakings; for example, instructions given to the representatives, relations with purchasers, alterations of the conditions of sale, greater or lesser coincidence of the decisions taken, contacts between directors."

> These facts appear sufficient to establish the element of concertation required by Article 85(1). To require a more evident, more explicit manifestation of the wills would lead to us not taking into account the distinction made by that provision of the Treaty between agreement and concerted practice. That would consequently amount to not giving to the notion of concertation the realistic meaning which, in my opinion, it should be given. Concertation is not an agreement; it is not set out in a document which has the purpose of determining the respective obligations of the parties. Nor is it necessarily a 'conspiracy' methodically organised in meetings at which differences of opinion may be expressed or interests confronted. It may consist, and in the present case did consist, in a common but co-ordinated behaviour, based on decisions which appear unilateral but the implementation of which is subject to the participation of the participants.[16]

Read in isolation, this extract would seem to imply a *ratio* at odds with the exclusion of tacit collusion from Article 81 contained in the rest of the opinion. Even when read in context it demonstrates that construing the circumstances in which tacit collusion may arise too narrowly, can lead to conclusions that the evidence of parallel behaviour is only explainable as the occurrence of explicit collusion, when in fact this has not been the case. It should be added, however, that based on its facts *Dyestuffs* does not appear to have been such an instance, since in addition to the almost exact coincidence of the internal communication

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[16] *Ibid.*, 581. Emphasis added. A similar conclusion has also be reached in the Commission decision: "the concerted character of the increase is confirmed by the closeness – simultaneity even – of the dates of their application by the producers in the different Common Market countries affected by the increases. It is not conceivable that without detailed prior agreement the principle producers supplying the Common Market should several times increase by identical percentages the prices of the same major series of products, practically at the same time, and should have done so in various countries in which the market conditions in dyestuff differ"; Commission Decision 69/243/E.E.C., *Re Cartel in Aniline Dyes* [1969] O.J. L195/11, [1969] C.M.L.R. D23, para. 7.

of price rises to subsidiaries by each undertaking (to within the quarter hour in most cases), there was evidence that meetings were held between the parties.[17]

The reasoning of the E.C.J. largely mirrored that of the advisory opinion. No distinction was made between oligopoly reversion and tacit collusion, with both being deemed lawful based on the principle that undertakings should have the freedom to respond to the present and foreseeable actions of its competitors.[18] The role of parallel behaviour as evidence of express collusion was also accepted in so far as it constituted a "strong indication" that behaviour was occurring which did not correspond with the "normal conditions of the market". In this regard, the E.C.J. went even further than the advocate general towards creating a back-door for tacit collusion. Not only were oligopoly and tacit collusion dismissed as a likelihood in all but the narrowest of circumstances,[19] but all behaviour allowing parties to seek price equilibrium higher than that arising under competition or crystallising the current market condition was to be considered as relevant parallel behaviour inferring express collusion.[20] Assuming that the "competition" in question was a reference to the most competitive price equilibrium given the relevant market structure, *i.e.* the oligopoly reversion level in an oligopoly, then nominally the Article 81 prohibition is extended to all activities resulting or likely to lead to the collusive

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[17] Commission Decision 69/243/E.E.C., *Re Cartel in Aniline Dyes* [1969] O.J. L195/11, [1969] C.M.L.R. D23, paras. 7-9.

[18] [1972] E.C.R. 619, [1972] C.M.L.R. 557, para. 118: "While it is permissable for each manufacturer to change his prices freely to take into account for this purpose behaviour, present and forseeable, of his competitors, it is, on the other hand, contrary to the competition rules of the Treaty for a manufacturer to co-operate with his competitors, in whatever manner, to determine a co-ordianted cause of action relating to an increase in prices...."

[19] *Ibid.*, para. 105: "The number of manufacturers involved makes it impossible to consider the European dye-stuffs market as an oligopoly in the strict sense, in which price competition could no longer play a substantial role."; *Ibid.*, para. 109: "[W]hile a parallelism of behaviour on the subject of prices could constitute, for the undertaking concerned, an effective and risk-free objective, the spontaneous attainment of such parallelism as regards the moment, the national markets and the assortment of products concerned, is difficult to conceive."

[20] *Ibid.*, para. 67: "Such is the case especially where parallel behaviour is such as to permit the parties to seek price equilibrium at a different level from that which would have resulted from competition, and to crystalise the status quo to the detriment of effective freedom of the product in the Common Market and free choice of consumers and their suppliers."

price level. These findings of the E.C.J. were all derived from its core definition of a concerted practice which emphasised not any requirement of contact, but rather those actions which reduced or eliminated the "risks of competition", that is to say, the uncertainty as to the future behaviour of rivals.[21]

Dyestuffs can be called without exaggeration the bedrock of the law's treatment of tacit collusion under Article 81. Specifically, two principles can be derived from the case which have permeated subsequent judicial development: first, that tacit collusion was not to be distinguished from oligopoly reversion; and second, that parallel behaviour could infer express collusion in the absence of another compelling explanation. With the exception of a number of special cases, it is submitted that every substantial subsequent development in the Article 81 concerted practices case-law has been based on either the elucidation of the exact triggering factual circumstances or underlying rationale of the former principle or a growing sophistication as to the economic considerations employed in applying the latter which has ultimately closed the back-door to tacit collusion. From the perspective of the study of divergence the significance of *Dyestuffs* is that it marked out the course for the segregated legal analysis of tacit and express collusion in Community competition law which was irreconcilable with any economic approach to the issue.

Development of Doctrine I: The Contact Requirement under Article 81

The uniform treatment of tacit collusion and oligopoly reversions in *Dyestuffs* indicated an underlying judicial method of analysis focused on the form of collusion rather than efficiency effects. It is no great surprise, therefore, that much of the development of this principle has focussed on defining and refining

[21] *Ibid.*, para. 64: "If Article [81] distinguishes the concept of a "concerted practice" from that of an "agreement between enterprises" or "decisions of associations of enterprises", this is done with the object of bringing under the prohibitions of this Article a form of co-ordination between undertakings which, without having reached the stage where and agreement properly so called has been concluded, knowingly substitutes practical co-operation between them for the risks of competition"; *ibid.*, para. 101: "By these prior announcements, the various undertakings eliminated between themselves all uncertainty as to their future behaviour, and hence a large part of the normal risk inherent in any autonomous change in behaviour on one or more markets."

the factual element which separates a concerted practice from 'mere' oligopolistic outcomes. In essence the first principle of *Dyestuffs* has evolved into a requirement of contact between competitors, with considerable precision having been developed as to which actions can be so considered.

In *Sugar*[22] the E.C.J. took the first step towards naming direct contact as the legal touchstone for identifying collusion. Having recited and approved the various statements of law relating to concerted practices in *Dyestuffs*, the court came to the following conclusion in its application of these principles to the Dutch sugar market:

> [E]ach economic operator must determine independently the policy which he intends to adopt on the Common Market, including the choice of the persons and undertakings to which he makes offers or sells.
>
> Although it is correct to say that this requirement of independence does not deprive economic operators the right to adopt themselves intelligently to the existing and anticipated conduct of their competitors, it does however strictly preclude any direct or indirect contact between such operators, the object or effect whereof is either to influence the conduct on the market of an actual or potential competitor or to disclose to such a competitor the course of conduct which they themselves have decided to adopt or contemplate adopting on the market.[23]

This extract, which is perhaps the most often repeated test of a concerted practice in European competition law, invites two observations. First, its reiteration of the collective treatment of all actions, both collusive and non-collusive, taken in market conditions of oligopolistic interdependence is reasoned on the basis that they are "intelligent" (*i.e.* rational) actions. Later in the judgment, during the consideration of the West German sugar market, this subordination of efficiency to rationality is evident when the court states that the

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[22] Cases 40-48, 50, 54-56, 111, 113-114/73, *Suiker Unie and others v. Commission* [1975] E.C.R. 1663, [1976] 1 C.M.L.R. 295.

[23] *Ibid.*, paras. 173-174.

"fact that a vendor aligns his price on the highest price charged by a competitor is not necessarily evidence of a concerted practice but may be explained by an attempt to obtain maximum profit".[24] Second, the reference to "indirect" contact is somewhat quixotic given the apparent efforts to which the court has gone in the same paragraph to exclude tacit conduct from the reach of Article 81. Conceivably this could have been an indication that the signalling nature of price-leadership would be considered to be contact. It is submitted, however, that given the very considerable emphasis placed on the legality of interdependent behaviour and the strong endorsement of *Dyestuffs* contained in the judgment, that the type of contact being referred to was express oral or written communication transmitted wither "directly" between undertakings or "indirectly" through intermediaries. The application of the law to the facts in *Sugar* is not entirely informative in this regard. Evidence of oral and written communication between competitors existed for every market examined except one, the raw sugar market in the western part of West Germany, where the court found that there had been no breach.[25] This last conclusion was based not on the absence of contact, but on the existence of a reasonable alternative explanation for the producers' activities. While it might be tentatively suggested that it was only the lack of evidence of direct communication which left the way clear for arguments based on alternative justifications, nowhere does the E.C.J. specifically identify the absence of communication as the determining factor. Consequently, the consensus view after *Sugar* was that the reference to indirect contact left the law with an unfortunate ambiguity, as Neven put it:

> It is not clear from this formulation whether some forms of market interaction between firms (which may be aimed at establishing a focal

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[24] *Ibid.*, para. 285. *See also* the comments of Slynn A.G. in *Züchner* endorsing this conclusion: Case 172/80, *Gerhard Züchner v. Bayerische Vereinsbank* [1981] E.C.R. 2021, [1982] 1 C.M.L.R. 313.

[25] *Ibid.*, 301-304.

> point for co-ordination or simply at the initiation of a punishment phase) can be seen as a form of indirect contact between firms.[26]

If there was some uncertainty as to the nature of the contact requirement in the wake of the *Sugar* judgment, it can only have been added to by the Commission's growing tendency to interpret parallel behaviour as the result of contact, even in the absence of evidence of actual contact (which is examined in the next section), and by its loose statements in relation to the position of the law in cases such as *Hasselblad*.[27] Here the Commission baldly stated that:

> [f]or a concerted practice to exist it is sufficient for an undertaking knowingly and of its own accord to adjust its behaviour in line with the actions of another undertaking. The motive or the knowledge that the act is unlawful is irrelevant.[28]

On a first reading this appears to be a direct contradiction of the E.C.J.'s acceptance of oligopolistic reactions and the exculpatory value of independent rational behaviour. Such a literal interpretation is undermined to some degree when it is considered that there was ample evidence of direct contact between the undertakings in question (in the form of a direction from Hasselblad to cease parallel imports).[29] In addition, one of the respondent distributors had pleaded coercion as a defence and in this context the Commission's arguments can be seen as more of a rejection of the existence of a principle of economic duress than of the requirement of contact.[30]

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[26] D. Neven, "Legal Standards and Economic Analysis of Collusion in E.C. Competition Policy", in G. Norman and J. Thisse (eds.), *Market Structure and Competition Policy: Game Theoretic Approaches*, (Cambridge: Cambridge University Press, 2000), pp. 35-36.

[27] Commission Decision 82/367/E.E.C., *Camera Care Ltd./Victor Hasselblad A.B. and Hasselblad (G.B.) Ltd.* [1982] O.J. L161/18, [1982] 2 C.M.L.R. 233.

[28] *Ibid.*, para. 47.

[29] *Ibid.*, paras. 43-44.

[30] *Ibid.*, para. 47.

A more definitive statement of the contact requirement was put forward by Darmon A.G. in *Wood Pulp II*.[31] For the advocate general the concept of a concerted practice hinged on the existence of reciprocal communications between the parties aimed at giving rivals assurances as to their conduct on the market.[32] This element of reciprocity was seen as arising only by actual communication between the parties, and not "simply from observing the market".[33] Market outcomes resulting from the monitoring of rivals actions were expressly stated to be *per se* legal regardless of their efficiency effects. The measure of legality was thus dependant on the "certain ways" by which an outcome was achieved, rather than the nature of the outcome itself.[34] It is notable that the advocate general was aware of the distinction between tacit collusion and oligopoly reversion, with each acknowledged as a separate phenomena of legitimate independent oligopolistic behaviour[35] and

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[31] Cases 89, 104, 116-117, 125-129/85, *Re Wood Pulp Cartel: A. Ahlström and others v. Commission* [1993] 4 C.M.L.R. 407.

[32] *Ibid.*, paras. 170-174, *per* Darmon A.G.: "The *form* of the contacts between undertakings matters little. On the other hand, it is clear to me that *by definition* concertation requires *reciprocation* of communications between competitors. Article [81](1) cannot apply to unilateral action by undertakings. But that is what would happen if the requirement of reciprocal communications, by whatever means, was not laid down. In its aforesaid case law [*Dyestuffs* and *Sugar*] the Court does not seem to me to have laid sufficient emphasis on that requirement. ...[T]he concept of concerted practices refers to reciprocal communications between competitors with the aim of giving each other assurances as to their conduct on the market." Emphasis original.

[33] *Ibid.*, paras. 175-176: "It is further necessary that the competitors' knowledge of each other's conduct stem from communications between them, and not simply from monitoring the market. [The decision then quoted from *Dyestuffs* and *Sugar*] The Court ... therefore recognises that each undertaking is entitled to align itself independently on the conduct of its competitors, if knowledge of such conduct is obtained solely by monitoring the market."

[34] *Ibid.*, para. 187, quoting Wathelet: "Article [81] does not rule out uniformity of conduct but only *certain ways* by which it is achieved." Emphasis original.

[35] *Ibid.*, para. 177: "That [the communication requirement] is a vital factor having regard to the principles of economic theory. Parallel conduct is not necessarily the result of prior concertation. It can be explained, or even dictated, by the very structure of certain markets. As a summary outline, let me refer to the two examples most frequently mentioned in this regard. The first situation involves a concentrated oligopoly, in which undertakings are interdependent: each undertaking must take account in its decisions of the conduct of its rivals. Alignment on each

consequently, the common treatment of the two outcomes could not be described as the result of an incomplete understanding of the relevant economic theory, as had arguably been the case in *Dyestuffs*. Instead, the characterisation of both as instances of rational behaviour was portrayed as the root of their legitimacy. In the advocate general's view, where "rational decisions" were taken, legality must surely follow.[36] The significance of this reasoning is that the legal union of oligopoly reversion and tacit collusion became intractable, or at least intractable in the face of economic arguments. From the point of view of the study of divergence it is difficult to underestimate the significance of this reaoning: judicial opinion had now expressly acknowledged both the separate economic identity of the two concepts and unequivocally rejected any consideration that the legality of these outcomes could in some way be dependent on their efficiency effects. Consequently, after *Wood Pulp II* there were no economic arguments in favour of the similar treatment of tacit and express collusion remaining which had not been understood, recognised and rejected by competition law. A divergence from microeconomics had now occurred which could not be dismissed as the result of judicial ignorance of the relevant economic theories nor as the implementation of some non-economic competition law objective.

The E.C.J. in *Wood Pulp II* remained largely silent on the requirement of contact, being principally concerned with the circumstances in which concerted practices could be inferred rather than the question of what they consisted of in the first place. But the court's conclusion that evidence of tacit collusion or oligopoly reversion alone could not infer a breach of Article 81 effectively amounted to an endorsement of the advocate general's analysis.

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other's conduct constitutes a rational response, independently of any concertation. 'Price leadership' constitutes the second situation: undertakings align themselves on a 'price leader' on account of the latter's power on the market. Mention may also be made of spontaneous alignment on a price leader which acts as a barometer, with its decisions reflecting changes in market conditions for reasons linked, for instance, to its previous knowledge of that market."

[36] *Ibid.*, para. 177, quoted *supra* fn. 35; *ibid.*, para. 191: "From parallel conduct it is possible to deduce evidence of a concertation where it cannot have arisen as a result of individual and rational decisions taken by the undertakings concerted having regard to the characteristics of the market in question."

To some extent the *Wood Pulp II* decision had been foreshadowed by the findings of the Court of First Instance (C.F.I.) in *Italian Flat Glass*.[37] Without making any statements as to the exact principle of law being applied, the court had concluded that internal communications within (but not between) each of the three major Italian glass producers under investigation were insufficient evidence of a concerted practice, despite the fact that the firms had engaged in 17 closely timed price increase announcements, albeit setting out prices that only rarely precisely coincided.[38] The implication is that, despite considerable evidence of each party's intention to raise price to the collusive level (the internal documents were replete with references to "truces" and "cartels"), in the absence of these aims being proven to have been actually communicated to rival firms the successful implementation of the collusive policy through tacit means could not be considered to be a concerted practice. Another pre-*Wood Pulp II* C.F.I. judgment, *Rhône-Poulenc*,[39] alluded to the contact requirement in a similar manner, setting the test of a concerted practice as whether a disclosure as to future conduct had been made by one party to its competitors – which would seem to carry with it the connotation that the intentions as to planned conduct observable without express enunciation were beyond the scope of Article 81.[40] These cases tend to endorse the interpretation given to *Sugar*'s "direct or indirect" contact test above, and support the proposition that *Wood Pulp II* was fundamentally a tidying statement of the existing legal position rather than the rejection of some nascent legal treatment of tacit collusion contained in *Sugar*.

Since *Wood Pulp II* an approach consistent with that of Darmon A.G. of acknowledging both an express contact requirement while accepting the potentially identical efficiency effects of tacit and express collusion has been

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[37] Cases T-68, 77-78/89, *Re Italian Flat Glass: Societá Italiano Vetro S.p.A. v. Commission*, [1992] E.C.R. II-1403, [1992] 5 C.M.L.R. 302.

[38] *Ibid.*, paras. 176-192, 223, 228.

[39] Case T-1/89, *Rhône-Poulenc S.A. v. Commission* [1991] E.C.R. II-869.

[40] *Ibid.*, paras. 121: "Although this policy requirement of independence does not deprive economic operators of the right to adapt themselves intelligently to the existing and anticipated conduct of their competitors, it does, however, strictly preclude any direct or indirect contact between such operators the object or effect whereof is either to influence the conduct on the market of an actual or potential competitor or to disclose to such a competitor the course of cinduct which they themselves have decided to adopt or contemplate adopting on the market."

evident in a number of decisions.[41] In *Anic* Cosmas A.G. stated that not all conduct by an undertaking which had an effect similar to express collusion could be regarded as an infringement of the law.[42] A similar conclusion can be drawn from *P.V.C. II*.[43] Here the C.F.I. held that internal I.C.I. documents setting out the collusive levels of output for each producer within the alleged cartel could not of itself amount to evidence of a concerted practice without further evidence that the document had been communicated to rivals.[44] The court found that standing alone this evidence was merely an internal statement of opinion by I.C.I. regardless of whether it amounted to a tacit strategy for collusion.[45] Perhaps the clearest statement of principle to date has been that of Tesauro A.G. in *Kali and Salz* where he acknowledged both that tacit collusion was possible and capable of producing "harmful effects very similar to those generally attributed to a monopoly" and, citing *Wood Pulp II*, beyond the reach of Article 81.[46] In each of these cases, as with every E.C.J. and C.F.I.

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[41] *See generally* A. Jones, "*Wood Pulp*: Concerted Practice and/or Conscious Parallelism" [1993] *E.C.L.R.* 273, 276: "Actual communication between the parties appears therefore, to be a requirement. Something more than simply monitoring the a market since every producer is free to alter his course of action"; A. Jones and B. Sufrin, *E.C. Competition Law: Text, Cases, and Materials*, (Oxford: Oxford University Press, 2001), p. 668: "It is clear that purely parallel oligopolistic behaviour is not prohibited *per se* by Article 81(1). Parallel behaviour will, however, furnish proof of an agreement or concerted practice *only* if it is not the kind of behaviour which would be anticipated on the market involved (whether the parallel conduct alleged by the Commission cannot, taking into account the nature of the products, the size and number of the undertakings, and the volume of the market in question, be explained otherwise than by concertation) and if there is no other plausible explanation for this conduct."

[42] Case C-49/92P, *Commission v. Anic Partecipazioni S.p.A.* [2001] 4 C.M.L.R. 602, para. 18, *per* Cosmas A.G.; "[I]t should be noted that not all conduct by an undertaking which has a similar kind of effect on the market constitutes an infringement of Article [81]".

[43] Cases T-305-307, 313-316, 318, 325, 328-329, 335/94, *Re the P.V.C. Cartel II: Limburgse Vinyl Maatschappij NV and others v. Commission* [1999] 5 C.M.L.R. 303.

[44] *Ibid.*, paras. 584-586, 670.

[45] Although it did go on to conclude that when accompanied by the abundance of evidence of actual contact and meetings between the competitors in this case it could be regarded as evidence of express collusion. *Ibid.*, paras. 674-678.

[46] Cases C-68/94, 30/95, *France v. Commission (Germany intervening), Société Commerciale des Potasses et de l'Azote and Enterprises Minière et Chemique (Kali und Salz Beteiligungs A.G. intervening)* [1998] 4 C.M.L.R. 829, para. 98, *per* Tesauro A.G.: "It is hardly necessary to

examination of collusion since *Dyestuffs*, is the underlying premise, repeated with a Gregorian regularity, that the intelligent independent action of firms should never be prohibited regardless market and efficiency effects. Put simply, the development of the contact requirement under Article 81 represents an unequivocal rejection of the equivalence of tacit and express collusion, and consequently, a divergence from economic theory. What makes this all the more remarkable is the deliberate and reasoned manner in which it is carried out. The suggestions of equivalence of efficiency effects offered by economic thinking are considered, understood and even accepted on their own merits; none of which, ultimately, is sufficient to dislodge the legal system's alternative trumping concerns.

Development of Doctrine II: Inferring Concerted Practices and the Closing of the 'Back-Door'

The types of evidence set out by Mayras A.G.'s in *Dyestuffs* as capable of inferring collusion may broadly be divided into two categories.[47] The first category consists of the traces of the mechanics of an active cartel: the records of meetings, telephone calls, conversations with rivals or intermediary third parties, all alluding to or directly indicating the existence of actual communication between the cartel members. There is nothing particularly economic about this

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point out that an oligopoly, that is to say, a market supplied by only a handful of undertakings, can produce harmful effects very similar to those generally attributed to a monopoly. Added to that is the undeniable fact that, on the one hand there is a certain correlation between concentration and market power, understood specifically as the power to raise prices by reducing production and increasing profit margins, and, on the other, that concentrations can foster collusion between competitors and the adoption of parallel, even if not concerted, conduct. The Commission has pointed out that the problem could not be resolved by relying on Articles [81] and [82] of the Treaty either, since those provisions do not always or in all circumstances allow effective action to be taken against oligopolies. Indeed, at times an oligopoly cannot be contained by recourse to the prohibition on agreements, decisions and concerted practices since, as the Court made clear in its judgment in [*Wood Pulp II*], parallel conduct which sums up the very idea of an oligopoly, 'cannot be regarded as furnishing proof of concertation unless concertation constitutes the only plausible explanation for such conduct'."

[47] [1972] C.M.L.R. 557, 571, quoted *supra* fn. 15.

evidence, the market actions of the investigated undertakings are only relevant in so far as they follow communication between the parties and hence reveal something of their content. The use of this evidence has been described by Posner as the "cops and robbers" approach to collusion, with the detection of legality dependent on the identification of conspiracy regardless of economic effect.[48]

The treatment of this first type of evidence has always been relatively uncontroversial. The classic test for the probative value of such evidence was set out in *Rolled Zinc*,[49] where the E.C.J. stated that a defendant firm could defeat a charge of involvement in a concerted practice by providing any reasonable alternative explanation of the facts presented by the accusing party.[50] Here the Commission had presented evidence that two zinc producers, Royale Asturienne and Rheinzink had ceased supply to a distributor, Schlitz, which had commenced the parallel importing of shipments intended for Egypt into Rheinzink's home market.[51] The zinc producers successfully argued that although the cessation of supply by Royale Asturienne occurred on the same day that Rheinzink complained to Schlitz about the parallel imports, this could be explained by the fact that this was the designated date for completion of Royale Asturienne's current delivery contract and a new contract had not been forthcoming because of the outstanding payments due from Schiltz.[52] The alternative explanation of the conduct still has to meet some minimum threshold of credibility. Thus in *Pioneer* evidence of a refusal to supply following the failure of a distributor to implement a parallel import ban was not dislodged by the defendant's completely unsubstantiated claims of stock shortages and tax

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[48] R. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 2nd Edition, 2001), pp. 53-55.

[49] Cases 29-30/83, *Compagnie Royale Asturnienne des Mines S.A. and Rheinzink G.m.b.H.. v. Commission* [1985] 1 C.M.L.R. 688.

[50] *Ibid.*, para. 16: "The Commission's reasoning is based on the supposition that the facts established cannot be explained other than by concerted action by the two undertakings. Faced with such an argument, it is sufficient for the applicants to prove circumstances which cast the facts presented by the Commission in a different light and which thus allow another explanation of the facts to be substituted for the one adopted by the contested decision."

[51] *Ibid.*, para. 15.

[52] *Ibid.*, para. 17.

calculation errors.[53] The later decision of the C.F.I. in *Sotralenz*[54] illustrates that even *prima facie* reasonable alternative explanations can be rebutted by the Commission. In this case the exchange between two producers of information relating to the volume of imports into the German market was claimed to be justified under the notification and payment terms of a patent licensing agreement between the parties. Having stated that the "court must verify whether matters raised by the Commission can be accounted for by anything other than the existence of a quota arrangement", the C.F.I. nevertheless rejected the producers' account, relying instead upon the Commission's evidence that the information exchange had continued after the expiration of the patent, and that information regarding global output levels transmitted during the agreement's currency was irrelevant to the obligations arising under its terms.[55] The 'no other reasonable explanation' standard of proof remains undeniably high, requiring as it does that the Commission have an irrefutable reply for every credible explanation from the accused undertakings, but in this context it is not an impossible one.

The second category of evidence inferring concerted practice is that which indicates the implementation of an agreement or concerted practice based on an undertaking's price and output decisions alone without any documentary evidence of express communication between rivals. This is the type of evidence which may create a back-door to the prohibition of tacit collusion because, as we have seen in Mayras A.G.'s opinion in *Dyestuffs*, a presumption that tacit collusion is possible in fewer circumstances than is actually the case may result in tacit outcomes being misidentified as the result of actual contact between parties (for clarity this will be termed the 'Mayras inference'). The shortcomings of the Mayras inference were first revealed in the divergence of conclusions between the advisory opinion and the E.C.J. judgment in *Sugar*. The facts uncovered during the Commission investigation into the West German raw sugar marked had revealed that the leading French producer, Raffinerie Tirlemontoise had regularly sold raw sugar to the German firm, Pfeifer &

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[53] Case 100-103/80, *Musique Diffusion Française and others v. Commission* [1983] 3 C.M.L.R. 221, paras. 51-60.

[54] Case T-149/89, *Sotralenz SA v. Commission* [1995] E.C.R. II-1127.

[55] *Ibid.*, para. 69.

Langen, which was then refined and sold by the German producer on its home market. Despite the absence of any documentary evidence indicating actual contact between the two firms, Mayras A.G. concluded that the practice demonstrated the "certain knowledge" that existed between the competitors that neither would interfere with the other's home market since there was no other reason why Raffinerie Tirlemontoise should supply a competitor or fail to refine and supply into the competitor's market itself.[56] The E.C.J., on the other hand, rejected this conclusion, noting that both Raffinerie Tirlemontoise supplied and Pfeifer & Langen purchased raw sugar to and from other producers and consequently the transaction might be explained other than by the existence of a concerted practice.[57] What precisely these alternative explanations were was left unsaid; however, it is reasonable to assume that the E.C.J. had accepted the two firms' arguments that the transfers reflected only their respective limited and excess refining capacities and, in addition, that the court relied on its earlier observation of the absence of any documented quota setting contacts between the firms.[58] Apart from being an illustration of an early form of the 'no other reasonable explanation' test used in *Rolled Zinc*, the E.C.J.'s findings indicate a distinct reluctance to jump to the conclusion that quantity-controlling outcomes must necessarily be the result of actual contact. Although the E.C.J.'s approach to evidence of parallel conduct was markedly different that of the advocate general, it still did not resemble anything approximating a lucid statement of the legal principle on the matter.

The first attempt to provide some guiding principles as to the types of market behaviour (if any) which could infer concerted practice occurred in *Züchner*.[59] This was a reference from a German court querying whether a service charge of 0.15% used by nearly all banks in the common market for inter-bank consumer transfers could of itself constitute evidence of a concerted practice. The answer given by the E.C.J. was that the uniform pricing could be an Article 81 breach if it was "established by the national court that such parallel

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[56] [1976] 1 C.M.L.R. 295, 369-372.

[57] *Ibid.*, paras. 302-304.

[58] *Ibid.*, para. 301.

[59] Case 172/80, *Gerhard Züchner v. Bayerische Vereinsbank* [1981] E.C.R. 2021, [[1982] 1 C.M.L.R. 313.

conduct exhibits the features of co-ordination and co-operation characteristic" of a concerted practice.[60] Although this response was not particularly enlightening as to the manner in which the dispute in question might be resolved – the E.C.J. had effectively answered the question of whether the common pricing policy was evidence of co-operation between competitors by referring the same question back to the national court – the judgment is more revealing as a broader statement of legal policy. In this regard, it provides not only that parallel evidence alone may infer contact between parties, but that this conclusion may be reached where the outcome was one merely characteristic of express collusion, and not exclusively identifiable with it. This marked a departure from the restrictive 'no other explanation' style findings in *Sugar*, and laid the way for all observed collusion, whether tacit or express, being attributable to express contact. While the reasoning employed differs from that used by the advocate general in *Dyestuffs* – the *Züchner* court did not insist that collusive outcomes were only explainable by express collusion – the result of both is the same, namely that observations of collusion regardless of cause could be deemed concerted practices.

Following *Züchner* the development of collusion policy can be seen as occuring in two acts. First, is the line of Commission decisions[61] readily inferring concerted practices from parallel behaviour with relatively little regard to alternative explanations. Second is the éclaircissement by the E.C.J. in *Wood Pulp II*, a decision reigning in the excesses of the Commission and marking out a retreat from the broad interpretation of the statement of principle in *Züchner*.

In *Wood Pulp I*[62] the near identical advance price announcements of fifty pulp producers over a six year period had led the Commission to conclude that the behaviour could not be explained other than by the existence of a concerted practice. Four characteristics of the undertakings' behaviour in particular were relied upon by the Commission. First, it was held that the large number of

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[60] *Ibid.*, para. 22.

[61] In addition to the decisions examined in this section, those in *B.P. Kemi*, *Soda Ash* discussed in the context of the special case of the hangover principle *infra* and *S.S.I.* also examined *infra*, which is identified as an instance of the fringe player princple.

[62] Commission Decision 85/202/E.E.C., *Re Woodpulp* [1985] O.J. L85/1, [1985] 3 C.M.L.R. 474.

competitors should have rendered a policy of identical pricing impossible without some level of communication.[63] Secondly, the step-by-step rises in price followed by prolonged periods of stable prices could not be explained as an oligopoly reversion[64] because there was none of the individual 'testing' of the market by individual undertakings which should have occurred in a competitive market.[65] Third, the behaviour could not have been the result of price leadership since no one firm was powerful enough to fulfil the role of leader and all the price rises had been nearly simultaneous.[66] Fourth, each of the producers had very different transport costs, general cost structures and efficiencies of scale, and yet none of this was reflected in the common pricing.[67] Each of these conclusions overlooks in some way the possibility of focal point pricing being the cause of the collusive behaviour or assumes that the costs of collusion would have been prohibitive in the absence of direct communication which may not necessarily have been the case. Indeed, as Darmon A.G. was to point out in his review of the decision,[68] the exact form of the direct communication of collusive intention is never explained: were the public price announcements themselves the extent of the concerted practice, or were these merely the implementing methods of a deal cut in the proverbial smoke-filled room? The length of the Commission's analysis of the absence of non express-collusive explanations for the behaviour tends to indicate that it did not consider the existence of the price announcements alone to be sufficient, otherwise it could merely have cited these as the concerted practice *ipso facto* followed perhaps by a brief analysis dismissing any legitimate alternative uses. As such, *Wood Pulp I* reflects more closely the approach of Mayras A.G. in *Dyestuffs* than that of the E.C.J. in *Züchner*, with express collusion being inferred on the basis of a limited interpretation of the circumstances in which tacit collusion was possible.

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[63] *Ibid.*, para. 83.

[64] Referred to by the Commission as an "equilibrium price".

[65] [1985] O.J. L85/1, [1985] 3 C.M.L.R. 474, para. 87.

[66] *Ibid.*, paras. 88-89.

[67] *Ibid.*, paras. 99-101.

[68] [1993] 4 C.M.L.R. 407, paras. 242-243, *per* Darmon A.G.

A very similar analysis was applied by the Commission in *Italian Flat Glass*.[69] Here the glass producers' assertion that the evidence of meetings and actual agreements had been unsubstantiated was dismissed by the Commission on the grounds that even if the undertakings were correct in regard to the specific evidence produced the fact remained that:

> the publication of identical price lists over a long period, the existence of the same discount scales and the application of uniform terms of sale to the same customers could only be the result of concerted practices either directly between the three producers or through the intermediary of the spokesman for the wholesalers.[70]

Italian Flat Glass and *Wood Pulp I* marked the high water level of the Commission's approach to parallel behaviour. Prior to these cases, the Commission had been far more sensitive to the risk of capturing instances of oligopoly reversion. In *Zinc Producers*,[71] for example, factual circumstances almost directly analogous with those in *Wood Pulp I* were treated as beyond the scope of Article 81. Here each member of the Zinc Producer Group had published in advance its price in a trade newspaper, with prices gradually increasing with simultaneous announcements over an 18 month period. Nevertheless the Commission decided that in the absence of evidence of actual contacts or exchanges of information between the undertakings no breach could be inferred.[72]

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[69] Commission Decision 89/93/E.E.C., *Re Italian Flat Glass: Industria Vetraria Alfonso Cobelli v. Società Italiana Vetro-Siv S.p.A. and others* [1989] O.J. L33/44, [1990] 4 C.M.L.R. 535.

[70] *Ibid.*, para. 63.

[71] Commission Decision 84/405/E.E.C., *Re the Zinc Producer Group: The Community v. Rio Tinto Zinc Corp. Plc. and others* [1984] O.J. L220/27, [1985] 2 C.M.L.R. 108.

[72] *Ibid.*, paras. 75-76: "The situation prevailing in this case seems to have been more characteristic of that which could give rise to what is known in economic theory as 'barmoetric price leadership'. This does not remove from undertakings the ability to 'determine independently the policy which [they intend] to adopt on the common market'. Under such circumstances, parallel pricing behaviour in an oligopoly producing homogenous goods will not be in itself sufficient evidence of a concerted practice. However, sufficient evidence may result from parallel pricing in combination with other indications, such as contacts between

It was against this backdrop of a Commission readily inferring concerted practices based on evidence capable of indicating tacit collusion alone that the E.C.J. set out its resolute defence of tacit behaviour in *Wood Pulp II*. Both Darmon A.G. and the court implicitly rejected the flimsy burden of proof set out in *Züchner*, citing Mayras A.G.'s approach in *Dyestuffs* as authority for the propostion that parallel conduct could only infer proof of actual conduct between the parties where it constituted the only plausible explanation.[73] This was no wholesale endorsement of the Mayras *ratio*, however. Whereas the advocate general in *Dyestuffs* had rendered the burden of proof a mere formality by discounting the possibility of tacit collusion and oligopoly reversion as alternative explanations for parallel behaviour in all but the most specific of circumstances, *Wood Pulp II* made plain that this *de facto* presumption of improbability no longer applied – henceforth "plausible explanations"[74] would have to be provided as to why uncommunicated policies could not have been the causes of the particular circumstances under investigation. In this particular instance, this was a test which the Commission had failed to satisfy. The similarity and simultaneity of price announcements could be explained by the high levels of transparency and, despite the relatively large number of producers, the essentially oligopolistic market structure.[75] Relying on a simplified but

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undertakings on desirable price changes prior to price changes, or the exchange of information which reinforces contacts of this kind." Insertions original.

[73] [1993] 4 C.M.L.R. 407, para. 171: "In determining the probative value of those different factors, it must be noted that parallel conduct cannot be regarded as furnishing proof of concertation unless concertation constitutes the only plausible explanation for such conduct." *Ibid.*, para. 196, *per* Darmon A.G.: "[I]t is necessary to establish a degree of certainty that goes beyond reasonable doubt. In accordance with the principles governing the burden of proof, it is for the Commission to demonstrate that: the burden of proof cannot be shifted simply by a finding of parallel conduct. Unless the court can be satisfied by a set of presumptions having a solid basis, concertation is not established. In any event, if there is a plausible explanation for the conduct found to exist which is consistent with an independent choice by the undertakings concerned, concertation remains unproven."

[74] *Ibid.*, para. 196, *per* Darmon A.G.

[75] *Ibid.*, paras. 88-89.

recognisable form of Stigler's cost of collusion analysis, the E.C.J. concluded that, all things considered, tacit behaviour was a potentially rational outcome.[76]

In so doing the court sounded the death knell not only for a treatment of tacit collusion within the core doctrine of Article 81, whether by the back-door or otherwise, but also for the use of economic market data as evidence for even express collusion. With the market effects of tacit and express collusion economically identical in every instance, proving beyond doubt that the market outcome was the result of contact without some evidence of the mechanics of this communication became, to say the very least, a very unattractive prosecution strategy and, at worst, theoretically impossible. Even more significantly, the court's simultaneous acceptance of the economic equivalence of the rationality processes and market effects underlying both express and tacit collusion, on one hand, and reiteration of the legality of the latter, on the other, demonstrated yet again, not merely the legal non-equivalence of the two concepts, but that this non-equivalence was knowingly effected. On the basis of this resounding divergence from economic principle, the foundation of every Article 81 case was thus destined to be the existence of conspiracy rather than the loss of efficiency. As a rejection of the equivalence of tacit and express collusive behaviour under the primary doctrine of Article 81, therefore, *Wood Pulp II* is as close to being absolute as to make no difference.

This is not to say that the Commission gave up on the concept of illegal tacit collusion or that there are no cases addressing the regulation of tacit collusion in limited circumstances. In a series of what might be termed 'special cases', principles applicable to niche factual events have been established which envisage certain types of tacit behaviour being considered as concerted practices. Moreover, the Commission has cast it sights beyond Article 81 in the search for a suitable vehicle for regulating oligopolistic outcomes, with both the concept of joint dominance under Article 82 and the mergers regulations

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[76] *Ibid.*, para. 103: "The producers know that, if they were to increase their prices, their competitors would no doubt refrain from following suit and thus lure their customers away. Similarly, they would be reluctant to reduce their prices in the knowledge that, if they did so, the other producers would follow suit, assuming that they had spare production capacity. Such a fall in prices would be all the less desirable in that it would be detrimental to the sector as a whole: since overall demand for pulp is inelastic..." *See* also *ibid.*, paras. 126-127.

providing two further back-doors to the prohibition of tacit collusion. The need to examine these issue acknowledges the autopoietic nature of the interaction of the legal and economic systems. The fact that Community law does not accept the unified treatment of tacit and express collusion under its principle rule for addressing anti-competitive behaviour between rivals does not prevent it from being addressed in some other way by drawing from different elements of its *acquis* – in other words, solving economic problems on the law's own terms.

Special Cases I: Implying Tacit Collusion from Evidence of Many Similar Vertical Agreements under Article 81

The orthodox interpretation of Article 81 is that the anti-competitive agreements and concerted practices referred to are those arrangements made between competing undertakings or their intermediaries. There is nothing, however, within the literal meaning of this provision which confines the prohibition to horizontal interactions, and this has been the applied interpretation in a number of E.C.J. decisions which, although limited in number, offer a deliberately reasoned and uncontradicted line of authority. These cases provide that where the market is characterised by a large number of similar vertical agreements, the combined anti-competitive effect can be considered in determining the validity of any one of the agreements in isolation. The ramifications of this principle for the legal treatment of tacit collusion are considerable. If the communication requirement espoused in *Sugar*, *Wood Pulp II* et al, is met by means of an undertaking's contractual relations with its customers alone, then the way is open for the implementing market behaviour of a firm pursuing a strategy of tacit collusion to be considered illegal regardless of the existence of any evidence of actual contacts between the firm and its rivals.

The seminal case in this regard is *Brasserie de Haecht*.[77] In issue here was an agreement between a Belgian brewer and a small café, whereby the brewer advanced a number of loans on favourable terms in return for the café agreeing to exclusively stock the brewer's products. Evidence was given that

[77] Case 23/67, *Brasserie de Haecht v. Wilkin and another* [1967] E.C.R. 525, [1968] C.M.L.R. 26.

this type of arrangement was very common in the relevant market, with over 300 similar distribution agreements existing at any one time, although there was no suggestion that this was the result of express contacts between the various brewers. The question referred to the E.C.J. by a Belgian court was whether in these circumstances the large number of analogous contracts could be taken into consideration for the purposes of making a determination under Article 81. Darmon A.G.'s analysis of the issue centred the meaning of the E.C.J.'s assertion in *Technique Minière* that an agreement's "position in a series of agreements" was a relevant consideration in determining its legality.[78] Two possible interpretations were considered by the advocate general; first, that the phrase was a reference to the number of simultaneous agreements operated by a single supplier and as such a proxy for market power; and secondly, that it referred to the existence of many similar agreements operated by other suppliers "in parallel" with those of the individual supplier but without any links existing between them.[79] The advocate general opted for the second explanation, reasoning that to hold otherwise would permit a "dangerous gap" to appear in European competition law in cases where "several undertakings severally adopt analogous practices".[80] When expressed in these terms, the potential lacuna to which the advocate general alludes appears to be a direct reference to tacit collusion. Even if this is not the case, Darmon A.G.'s *ratio* is undoubtedly an extension to vertical agreements of the rule of reason style of analysis applied for non-hard core[81] horizontal actions in *Technique Minière*.[82] Taking such an

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[78] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm* [1966] E.C.R. 235, [1966] C.M.L.R. 357, 375.

[79] [1968] C.M.L.R. 26, 34: "[O]ne cannot see as clearly as could be desired what is the meaning of the expression 'the position of the agreement in a series of agreements': does it refer solely to the *independent* systems established by a supplier, or a large number of agreements existing *in parallel* without showing links of interdependence?" Emphasis original.

[80] *Ibid.*, 35.

[81] That is, without the stated intent of fixing price or output as between competitors.

[82] It was in the context of a list of considerations for determining the anticompetitive effect or otherwise of such non-hard core agreements that the "the position of the agreement in a series of agreements" was referred to in *Technique Minière*; [1966] C.M.L.R. 357, 375: "Therefore, in order to decide whether an agreement containing a clause 'granting an exclusive right of sale is to be considered as prohibited by the reason of its object or effect, it is appropriate to take into

effects based approach, tacit collusion comes within the reach of Article 81 where it manifests itself through vertical agreements which are shown to have a collectively adverse effect on competition. In coming to the same conclusion as the advocate general, the E.C.J. placed a similar emphasis on the overall effects of parallel agreements on the market, stating that an individual contract could not be isolated from the broader market context, which included taking into account the cumulative market effects of its competitors' similar agreements.[83]

In another Article 234 reference, *Delimitis*,[84] the E.C.J. again considered the criteria for determining the validity of a "tied-house" agreement between a brewer and a public house set against the backdrop of a market characterised by many such parallel agreements. The court endorsed its decision in *Brasserie de Haecht* and reiterated the relevance of the effects of independent parallel agreements in determining the impact on competition of any one in isolation.[85]

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account the nature and quantity, limited or otherwise, of the products covered by the agreement, the position and importance of the grantor and the concessionaire on the market for the products concerned, the isolated nature of the disputed agreement, or, alternatively, its position in a series of agreements, the severity of the clauses intended to protect the exclusive dealership or, alternatively, the opportunities allowed for other commercial competitors in the same products by way of parallel re-exportation and importation."

[83] [1968] C.M.L.R. 26, para. 4: "[I]n affecting the agreements, decision or practices on grounds not only of their objects but also of their effects on competition, Article [81](1) implies that it is necessary to observe those effects in the context in which they occur, *i.e.*, in the economics and legal context in which such agreements, decisions or practices are to be founds or where they might to gather with others amount to a cumulative effect on competition. It would be futile to consider an agreement, a decision or a practice as regards its effects if the latter could be separated from the market in which they appear and could only be examined detached from the bundle of effects, convergent or not, in the midst of which they are produced. To judge whether it is hit by Article [81](1), a contract can thus not be isolated from that context, *i.e.*, from the factual or legal circumstances resulting in it giving the effect of preventing, restricting or distorting competition. With regard to that objective, the existence of similar contracts can be taken into account in so far as all the contracts of that type as a whole are such as to restrict the freedom of trade."

[84] Case C-234/89, *Delimitis v. Henninger Bräu A.G.* [1991] E.C.R. I-935, [1992] 5 C.M.L.R. 210.

[85] *Ibid.*, para. 14: "In Case 23/67, *Brasserie ed Haecht v. Wilkin* the Court held that the effects of such an agreement had to be assessed on the context on which they occur and where they might also combine with others to have a cumulative effect on competition. It also follows from that

However, the judgment went on to add a significant rider to the principle espoused in its earlier decision, namely, that the cumulative effects consideration would only be applied where the individual agreement being examined made an "appreciable contribution" to the overall anti-competitive effect.[86] If the individual contribution was insignificant, then notwithstanding the aggregate market impact of many such small agreements, there would be no Article 81 violation. During the course of his advisory opinion, Van Gerven A.G. had expressed similar sentiments, stating that "given the same proportion of tied outlets on the relevant market, the agreements of a smaller brewery are less likely to be caught by Article [81](1) than those of a larger brewery".[87] The function of this rider would appear to be to confine the application of *Brasserie de Haecht* to oligopolistic markets by introducing a minimum requirement of quasi-market power for the individual market participants – a restriction which is consistent with reading these cases as implementing a rule against tacit collusion focussed on the implementing measures of the colluding policy.

It should be pointed out that the most visible concern informing both of these judgments related to the restrictive effect of the parallel agreements on new entry into the brewing market rather than a direct attempt at collusion. Thus, in *Brasserie de Haecht* the E.C.J. refers to the relevant cumulative effect of the analogous contracts as one on "freedom of trade",[88] while in *Delimitis* it is their "sealing-off effect"[89] and impact on "opportunities for access"[90] which are

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judgment that the cumulative effect of several similar agreements constitutes one factor amongst others in ascertaining whether, by way of a possible alteration of competition, trade between members-States is capable of being affected."

[86] *Ibid.*, para. 24: "[R]esponsibility for such an effect of closing off the market must be attributed to the breweries which make an appreciable contribution thereto. Beer supply agreements entered into by breweries whose contribution to the cumulative effect is insignificant do not therefore fall under the prohibition under Article [81](1)."

[87] *Ibid.*, para. 22, *per* Van Gerven A.G.

[88] [1968] C.M.L.R. 26, para. 4, quoted *supra* fn. 83.

[89] [1991] E.C.R. I-935, para. 20: "The existence of a bundle of similar contracts, even if it has a considerable effect on the opportunities for gaining access to the market, is not, however, sufficient in itself to support a finding that the relevant market is inaccessible, in as much as it is only one factor, amongst others, pertaining to the economic and legal context in which the

seen as the measure of agreements' anti-competitive effect. The proposition that these cases are authority for the prohibition of certain acts of tacit collusion within Article 81 thus relies on the extrapolation of a general concept of "anticompetitive effects" broader than the specific effects considered by the E.C.J. Such a generalisation would not be unreasonable – after all the result of restrictions to market entry are ultimately detrimental to efficiency and consumer welfare in the same way as collusion is – but it nevertheless retains the appearance of an extension of principle beyond that actually espoused by the E.C.J. in these cases.

One thing that is certain is that *Brasserie de Haecht* and *Delimitis* cannot be dismissed as pre-*Wood Pulp II* anomalies. In the 1995 case of *Almelo*[91] the E.C.J. repeated its support for the consideration of the cumulative anti-competitive effects of unconnected agreements set out in these cases. Moreover, *Almelo* gives a strong indication that anti-competitive effects beyond the question of market access may be considered within this paradigm. In issue here was a clause in an energy distribution agreement between the regional supplier and the local municipal distributor that prohibited the latter from sourcing its supply from any other regional or local distributor, and which appeared in equivalent contracts throughout the Dutch market as one of the standard terms of the contract approved by the national energy undertakings association.[92] Without having any regard to the issue of actual contacts or arrangements between the regional distributors, the court concluded that the clause was a breach of Article 81. This finding appears to have been based on a conception of anti-competitive effects broader than the consideration of upstream market access, entry to which in any event was heavily regulated. Instead, the mischief of the clause was its allotment of exclusive territories as between the regional distributors, with each

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agreement must be appraised. The other factors to be taken into account are, in the first instance, those also relating to opportunities for access." Citations omitted.

[90] *Ibid.*, para. 27: "[T]he agreement in question must make a significant contribution to the sealing-off effect brought about by the totality of those agreements in their economic and legal context."

[91] Case C-393/92, *Municipality of Almelo and others v. Energiebedrijf Ijsselmij N.V.* [1994] E.C.R. I-1477.

[92] *Ibid.*, paras. 34-39.

effectively guaranteeing not to compete with the others on price outside of their own area. If anything, *Almelo* is actually an instance of express collusion, with the concrete agreement of the regional distributors visible in the form of the approved general terms of contract of their trade association. But the reasoning of the court disregards completely any considerations of actual contact between the parties or any other implication that they were operating as a cartel. Instead, by using the *Brasserie de Haecht* and *Delimitis* analysis of market effects in the context of collusion and by ignoring the issue of contact between parties altogether, it applied a form of reasoning applicable equally to both tacit and express arrangements which stands in marked contrast to the conspiracy focus of Article 81's core doctrine.

Special Cases II: Tacit Collusion Arising After Express Collusion under Article 81 and the Development of the 'Hangover Principle'

The second special case for examination concerns the situation where a number of competitors who have previously been engaged in express collusion continue to abide by the terms or spirit of this arrangement even after the formal period of expiry of the agreement or all regular contacts between the parties have ceased. The scenario is a realistic one because a previous history of cartel arrangements will reduce the costs of tacit collusion since focal point prices can be more readily established and the reactions of competitors to collusive initiatives will be better known. In addition to reducing collusion costs, as Bishop and Walker[93] and Posner[94] have pointed out, a previous cartel history will indicate generally a market structure conducive for collusion of every variety. Post-cartel tacit

[93] S. Bishop and M. Walker, *Economics of E.C. Competition Law: Concepts, Applications and Measurements*, (London: Sweet & Maxwell, 1999), para. 4.08: "The factors which imply that tacit collusion is more likely are similar to those which make sustainable cartel behaviour more likely. For this reason industries in which firms have formed, or attempted to form, cartels are more often viewed as being prone to tacit collusion."

[94] R. Posner, *op. cit.*, 79: "In a market in which collusion is attractive we can expect a history of attempts at express collusion, some of which may have been detected by antitrust enforcers. A "record" of price fixing or related antitrust violations is some evidence, therefore, that the structure of the market is favorable to collusion."

collusion has been examined in a number of court and Commission decisions from which have emerged a set of principles reflecting a judicial reluctance to permit such behaviour to escape the reach of competition law.

The first of these cases was *E.M.I.* where the E.C.J. stated categorically that the application of Article 81 was not dependent upon there being an agreement formally in force, as it would continue to apply to all post-termination actions leading to results envisaged under the agreement.[95] The only restriction placed on this principle, which might be the termed the 'hangover principle', was that this subsequent behaviour be recognisable as the implementation of a course of action distinctly attributable to the defunct agreement.[96] Warner A.G.'s advisory opinion contains an almost identical statement of principle, save that it additionally makes reference to the consequences of retired concerted practices in addition to expired formal agreements as coming within the scope of the concept of continued anti-competitive effects.[97] In *E.M.I.* the court was concerned with the effects of an agreement to assign exclusive intellectual property rights to a competitor within that competitor's designated home

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[95] Cases 51, 86, 96/75, *E.M.I. Records v. C.B.S.* [1976] E.C.R. 811, 871, 913, [1975] 2 C.M.L.R. 235, para. 30: "For Article [81] to apply to a case, such as the present one, of agreements which are no longer in force it is sufficient that such agreements continue to produce their effects after they have formally ceased to be in force."

[96] *Ibid.*, para. 31: "An agreement is only regarded as continuing to produce its effects if from the behaviour of the persons concerned there may be inferred the existence of elements of concerted practice and coordination peculiar to the agreements and producing the same results as that envisaged by the agreement."

[97] *Ibid.*, 261-262, *per* Warner A.G.: "It would, I think, be going too far to say that Article [81] can apply only in a situation where there is a subsisting agreement or there are subsisting concerted practices. Suppose that, after the entry into force of the Treaty, two undertakings (whether established within or outside the Community) entered into an agreement which unquestionably had the effect of restricting competition within the Common Market and unquestionably was susceptible of affecting trade between member-States, and suppose that one of the means chosen by those undertakings to give effect to that agreement was an assignment of trade marks. It could not in my opinion be held that, after the agreement has been terminated, perhaps as a result of action taken by the Commission under Regulation 17, each undertaking remained free to exercise the trade mark rights it had thus acquired even though such exercise of them itself had the effect of restricting competition in the Common Market and was susceptible of affecting trade between member-States."

markets apparently as a means of enforcing collusion through the segmentation of exclusive market areas. The agreement was formally terminated prior to the accession of the United Kingdom to the E.E.C., but the actual assignment of rights which had been required under this master agreement continued in force after this date. Based on these facts there was still an express agreement in existence at the time of the breach (albeit in the form of the rights assignments rather than the master agreement), nevertheless the principle set out by the E.C.J. was potentially broad enough to cover post-cartel tacit collusion if the continued actions of the relevant undertakings could be construed as the continued performance of their obligations under a retired agreement.

The E.C.J. revisited its *E.M.I.* judgment in *Binon*[98] when considering an agreement between several Belgian music publishers and the distributor A.M.P. This agreement replaced an earlier one which required unanimity of consent from all the publishers before A.M.P. would distribute to a new outlet, providing instead that each music publisher could issue its approval independently with the caveat that if it failed to do so within eight days the recommendation of A.M.P. as to the proposed new distribution would be effected. The E.C.J. found that the uniformity of decisions achieved under the new "independent choice" system reflected the continued obedience of the publishers to the previous unanimity requirement. Repeating the hangover principle of *E.M.I.* the court concluded that this behaviour was a breach of Article 81 notwithstanding the termination of the original agreement which had required this conduct.[99]

Binon was more than a simple endorsement of *E.M.I*, it also represented a development in terms of both the formulation and application of principle. Prior to *Binon* the factual circumstances of *E.M.I.* meant that the hangover principle could be seen as creating a rule merely for governing agreements that had a lasting binding effect even after their termination, in that instance through the creation of more durable secondary formal agreements, the assignments, which continued after the master agreement. The hangover principle was thus susceptible to being regarded only as an evidential tool for construing several

[98] Case 243/83, *SA Binon et Cie. v. S.A. Agence et Messageries de la Presse* [1985] E.C.R. 2015, [1985] C.M L.R. 800.

[99] *Ibid.*, para. 16.

distinct agreements as forming part of a single whole. In this sense, the 'agreement' in question in *E.M.I.* could be considered as consisting of the master and assignment agreements combined, with this single contractual entity deemed to have continued in formal effect so long as this was the case for its implementing component (the assignments) regardless of the demise of its introductory enabling element (the master agreement).

In contrast, in *Binon* the independent choice arrangement could not be construed as the planned implementing element of the previous agreement because there was no legal compulsion forcing the publishers to exercise their new rights in a manner consistent with their old practices. The hangover principle as applied in *Binon* thus emerges not merely as a tool for delineating the bounds of an agreement, but as a powerful implement for capturing all behaviour made in reliance upon the new landscape of collusion costs resulting in the market after a period of express collusion, taking into account changes such as greater specificity of focal point prices and increased knowledge as to the methodologies of collusion enforcement and competitors' likely reactions. This emphasis in *Binon* is not reflected in any adjustment to the original principle since, as we have seen, that expressed in *E.M.I.* was already wide enough to lead to this application; rather, it is vocalised when the E.C.J. refers to the application of Article 81 being determined by the "economic effects" of an agreement.[100] This phraseology, when compared to the more generic "effects" of the *E.M.I.* formulation, encapsulates more clearly a concept of post-cartel impact analysis beyond a narrow consideration of whether several formal agreements can be integrated into a greater single prohibited 'agreement'.

Two other aspects of the *Binon* decision are indicative of this approach. First, the requirement set out in *E.M.I.* that the lasting effects of an agreement be directly attributable to the terms of the agreement in order for the hangover principle to apply is neglected in the *Binon* judgment. Although ostensibly this caveat in *E.M.I.* did not undermine a complete post-cartel effects analysis being employed in the application of the hangover principle, it did leave some scope for interpreting the principle as applicable only to the secondary arrangements

[100] *Ibid.*, para. 17: "E.E.C. Treaty is concerned with economic effects of agreements or of any comparable form of concerted practice or co-ordination rather than with their legal form".

explicitly referred to in the terminated contract and for this reason its omission in *Binon* is notable. Secondly, the E.C.J. stated that the lasting effects of formally concluded concerted practices, as well as agreements, could be considered. This is significant because a concerted practice is unlikely to have continued effects in the form of secondary formal agreement (given that no such agreement existed during the express collusion phase); consequently, the scope of the hangover principle is widened beyond the context of formally required effects.

All of this is not to say that *Binon* was a clear-cut case of tacit collusion – on the contrary, there appears to have been some evidence of actual contact between the publishers.[101] What it does illustrate is that the legality of the continuing effects of post-cartel behaviour will be considered without the burden of demonstrating the existence of subsequent contacts between rivals or the continuance of a binding arrangement linked to the original agreement.

Judge Vesterdorf's advisory opinion in *Polpropylene* is an example of the wider application of the hangover principle. Here, the acting advocate general noted that the while the continued effects in the present case manifested themselves in the patterns of behaviour of the competitors rather than in any formal agreements of the type examined in *E.M.I.* and *Binon*, the same rule nevertheless applied.[102] As such, the cartel arrangement between the

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[101] *Ibid.*, para. 14. The E.C.J. without referring to any specific evidence alludes to the fact that A.M.P. acted essentially as a framework for the communication of collusive decisions and intentions.

[102] Combined Opinion for Case T-1/89, *Rhône-Poulenc S.A. v. Commission*; Case T-2/89, *Petrofina S.A. v. Commission*; Case T-3/89, *Atochem S.A. v. Commission*; Case T-4/89, *B.A.S.F. S.A. v. Commission*; Case T-6/89, *Enichem Anic S.p.A. v. Commission*; Case T-7/89, *Hercules Chemicals N.V. v. Commission*; Case T-8/89, *D.S.M. N.V. v. Commission*; Case T-9/89, *Hüls A.G. v. Commission*; Case T-10/89, *Hoechst A.G. v. Commission*; Case T-11/89, *Shell International Chemical Company Ltd. v. Commission*; Case T-12/89, *Solvay & Cie. S.A. v. Commission*; Case T-13/89, *Imperial Chemical Industries Plc. v. Commission*; Case T-14/89, *Montedipe S.A. v. Commission*; Case T-15/89, *Chemie Linz A.G. v. Commission* [1991] E.C.R. II-869, 981, *per* Judge Vesterdorf: "The situation in the two cases cited [*Binon* and *E.M.I*] was somewhat different from that in the present cases. They concerned proper agreements which were formally terminated and not arrangements made within the framework of a cartel in which the agreements, by their the very nature, are characterized by the fact that the parties to the agreement knew perfectly well that their purpose was unlawful. The same principle must,

polypropylene producers was not deemed to have ended until the implementation of the collusive pricing policy desisted, which only occurred some months after the rivals' last interaction.[103] That the hangover principle covers all actions within the post-cartel market which are causally connected to the re-aligned structure of collusive costs is evident earlier in the opinion of Judge Vesterdorf, where he states that in order for an undertaking to demonstrate that its actions were not informed by its prior involvement in express collusion, compelling evidence that it had "closed its mind" to the information obtained during this period was required, such as the existence of new management.[104] This exacting standard demonstrates that post-cartel conduct consistent with that which occurred during the formal cartel stage may be deemed to be a breach of Article 81 without more, and in particular without further evidence of contact. It also shows that the possibly irrevocable effect of a cartel on the collusion cost structure of the industry can be considered to be the lasting secondary effects of the hangover principle, in this case in the form of the greater certainty of focal prices and of competitor reactions.

Separate from the hangover principle cases, there are a number of decisions which draw on the pre-*Wood Pulp II* concept of inferring express collusion in the absence of evidence of actual contact by relying on evidence of previous formal cartels to infer subsequent express collusion where the observed behaviour resembles that occurring under the earlier arrangement. In the wake of

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however, apply. If, therefore, it can be established that a similar pattern was followed in the period after the meetings ceased to take place, the obvious assumption is that the agreements or concertation previously entered into were being put into effect in the period after the Commission's investigation."

[103] *Ibid.*

[104] *Ibid.*, 943: "[T]he view contended for here means that it remains at least theoretically possible to prove that the practice being pursued is not concerted in the sense that in some circumstances a party will be able to show that it has cast off the ties or bonds ensuing from the concertation and closed its mind to the knowledge gained from it. This might be conceivable where, for example, an undertaking is taken over and the new management seeks to clean up the business or is simply unaware of the collusion which had taken place. In a continuous process such as existed in the formation of the alleged polypropylene cartel, it is, of course, clear that in practice it may be difficult to argue plausibly that after collusion occurred the previous course of action was changed before the knowledge obtained from the meetings was put to use."

Wood Pulp II the authority of these cases may be questioned, but to the extent that they still form part of the Article 81 *acquis* they bear examination.

One such decision is the Commission's consideration of the post-cartel behaviour in the ethanol sector in *B.P. Kemi*.[105] In this case a number of ethanol producers had concluded a formal price setting and information sharing agreement for the year 1974. Following the expiration of this agreement the signatory firms continued to abide by both the information sharing requirement and the fixed prices specified in the agreement until the Commission commenced an investigation into the producers' practices at the end of 1976. The decision found the post-agreement practices to be a breach of Article 81 in the absence of any evidence of actual contact between the parties during this latter period on the basis that the resulting co-ordination could not have occurred without the existence of express contact subsequent to the agreement's expiry. This finding was based on two observations. First, was the Mayras inference that tacit collusion was an improbability in all but a few narrowly defined market structures.[106] Second, the Commission drew on the previous express agreement as evidence that actual contacts were required in this particular industry in order for a collusive outcome to result, as otherwise there would have been no need to enter into the initial agreement.[107]

The C.F.I. utilised an identical method of analysis in *Soda Ash*,[108] during which it examined the behaviour of Solvay and I.C.I. following the formal

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[105] Commission Decision 79/934/E.E.C., *A.T.K.A. A.S. v. B.P. Kemi A.S. and A.S. De Danske Spritfabrikker* [1979] 3 C.M.L.R. 684.

[106] *Ibid.*, para. 54: It does not seem possible that the parties could have continued the application of the same prices to individual customers without co-ordination. An application of identical price may not by itself prove a concerted practice, but it may amount to strong evidence of such a practice when it is likely to occur in the normal conditions of the market...."

[107] *Ibid.*: "such evidence is further reinforced when the companies concerned were previously bound by an express price stipulation and when they regularly exchange detailed information concerning quantities sold to individual consumers. Similarly, it does not seem possible that the exchange of sensitive information of the said kind could take place without co-ordination of the behaviour of the parties, in particular when such behaviour was previously laid down in an express stipulation."

[108] Commission Decision 91/297/E.E.C., *Re Soda Ash: The Community v. Solvay et Cie. S.A. and Imperial Chemical Industries plc.* [1991] O.J. L152/1, [1994] 4 C.M.L.R. 454.

termination of their cartel agreement upon the United Kingdom's accession to the E.E.C. The two producers contended that their post-1972 behaviour was the result of independent policies, albeit with oligopolistic outcomes resulting.[109] The court dismissed this argument not by citing the evidence of actual contact between the parties (of which there appeared to be an abundance)[110] but instead by concluding that the existence of the original cartel agreement was conclusive evidence that the resulting behaviour could only have come about through the existence of a contemporaneous equivalent.[111]

Given the conclusions of Bishop and Walker and Posner, the inferring of actual agreements in *B.P. Kemi* and *Soda Ash* lacks a firm economic foundation. While it is at least arguable that tacit collusion may be less likely given the potentially higher collusion costs compared to those for express collusion, the fact that express collusion has been preferred does not necessarily mean that tacit collusion is impossible – all that the selection reveals is the relative collusion costs of various means of collusion. If anything is to be surmised from the previous cartel, it is only that collusion of all varieties is more likely and that the collusive price and level of output are more likely to be ascertainable by market participants and regulatory authorities alike. As with Mayras A.G.'s approach in *Dyestuffs*, this denial of the possibility of tacit collusion leaves the way open for evidence indicative only of tacit collusion being used to ground a

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[109] *Ibid.*, paras. 40-44. It is unclear from the report whether their defence was based on the existence of tacit collusion or oligopoly reversion.

[110] *Ibid.*, para. 27. The undertakings attended meetings together and exchanged sales and sales policy information.

[111] *Ibid.*: para. 46: "The argument that their policy of mutual abstention in the market is the result of 'individual business judgment' might be more persuasive had there never been any agreement between them. This is not a case where two large competitors had fought each other to a standstill and had entirely without any contact without any contact decided that intensive rivalry brought no benefit to either one. It has never been satisfactorily explained why, if the division of markets is entirely the result of natural competitive and geographic conditions, the two producers should ever have thought it necessary to conclude agreements such as the 'Alkali Cartel' and 'Page 1000' [the pre-1972 agreements]."

breach of Article 81 – giving rise to a second unintended hangover principle arrived via a very different path of reasoning.[112]

Special Cases III: The Treatment of 'Fringe Players' under Article 81

With some trepidation, a third special case might be identified as arising in the following scenario. A particular market consists of several large undertakings, together capable of exercising market power, and one or more smaller[113] firms, the 'fringe players', whose output, either actual or potential, is relatively insignificant compared to that of the bigger firms and is incapable of affecting significantly the market price within the given period of analysis. If the larger firms take the decision to expressly collude, it is possible that they will not seek to involve fringe players in their arrangements. This may be the case if the larger firms consider that the extra collusion costs accruing from the involvement of additional firms (such as increased transaction costs of price agreement, enforcement costs and greater risks of detection) outweigh the negative impact that the fringe firms producing at the oligopoly reversion level would have on collusion profits.[114] The larger the number and the smaller the market power of the fringe firms in the relevant market, the less likely it is that they will be included in the formal cartel arrangements of the major undertakings. Where an express collusive arrangement comes into being, the uninvolved fringe player is presented with the option of whether to follow a policy that aligns its price with

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[112] *E.M.I.* was not discussed or cited in the course of *Soda Ash*, which also pre-dated both *Binon* and *Polypropylene*.

[113] The diminutive is used in this section in the sense of a relative lack of market power, by which is meant in the present context a general inability to adjust output such as to affect significantly overall market price. Thus a firm may be large in terms of world-wide turnover, and yet still be a fringe-player in a particular product or geographical market. Likewise, an undertaking with a very low current output may nevertheless *not* be a fringe player if it has considerable potential capacity capable of being brought online within a time period which would undermine attempted collusion without its involvement.

[114] *See* R. Posner, *op. cit.*, p. 71: "[I]t may be unnecessary to obtain the agreement of the little firms in order to collude effectively – they may not be able to expand their output rapidly enough to offset the output restriction of the colluding sellers in the short term and may in any event have higher costs than the colluders...".

that of the cartel, or one that results in a price closer to the oligopoly reversion. Given that such a firm's exclusion from the express arrangement may have been due in large part to its capacity constraints, and thus its inability to capture a large part of the market by undercutting the cartel, it is not difficult to envisage circumstances where a fringe player will rationally elect to follow the lead of the collusive firms rather than maintain the pre-cartel price. In these circumstances, whether its information relating to the collusive agreement comes by way of market observation or industrial intelligence other than reciprocal communication with its competitors or intermediaries, then the reaction of a fringe firm to adopt the collusive price can be seen as an instance of tacit collusion existing side-by-side but independent of an express arrangement.

There is some support within a number of Commission and C.F.I. decisions for the assertion that the tacit collusion of the fringe player in these circumstances may be a breach of Article 81. It should be stressed, however, that such a principle is only visible as a distillate from the factual findings in these cases and at no point have the courts or the Commission come close to declaring the illegality of such behaviour as a general principle. Consequently, and by way of further caveat, the findings of fact in these cases are subject to alternative explanations and, moreover, even to the extent that such a principle once existed, in the wake of *Wood Pulp II* it may now be considered to be *per incuriam*.

The issue of the fringe player first arose during the Commission's examination in its *Dyestuffs* decision of the Italian market-leader's, Azienda Colori Nazionali Affini (A.C.N.A.), involvement in the three price increases expressly agreed by the aniline dyes producers' cartel.[115] In the run up to the third increase, that of 1967, it was accepted by the Commission that A.C.N.A. was the only defendant that had not been present at any of the price discussion meetings,[116] and that while all the other producers implemented this increase within two days of each other, A.C.N.A. did not follow suit until two weeks after the last of its rivals on some markets, and even then did not implement the

[115] Commission Decision 69/243/E.E.C., *Re Cartel in Aniline Dyes* [1969] O.J. L195/11, [1969] C.M.L.R. D23.

[116] *Ibid.*, para. 9. *See also* [1972] E.C.R. 619, [1972] C.M.L.R. 557, 584 *per* Mayras A.G.

change on its home market.[117] Moreover, for some markets A.C.N.A. was shown to have implemented a price increase in advance of the common increases by the other producers.[118] The decision is less specific with regard to A.C.N.A.'s actions during the previous cartel increases of 1964 and 1965, although it was stated that A.C.N.A. had not implemented the 1965 increase on its home market and that in 1964 it had only implemented an increase on this market after other producers had done so.[119] While the description of A.C.N.A.'s behaviour in the decision (as in the later advisory opinion and E.C.J. judgment) is neither particularly detailed nor illuminating, in relation to the 1967 increase at least there appears to have been no formal contacts by the Italian producer with the other defendants and its unsynchronised pricing decision vis-à-vis the highly co-ordinated actions of its rivals (most of whom issued their price increase orders within the same fifteen minute period) lends credence to the argument that they were involved in tacit collusion. Nevertheless, the Commission concluded that A.C.N.A. was "responsible" for all three price increases, reducing its fine by 20% compared to that imposed on the other producers only because of its more restrained actions on its home market.[120] The implication of this finding is that the Commission had inferred a breach from evidence only sufficient to support a charge of fringe tacit collusion.

The E.C.J., in contrast, came to a different conclusion regarding A.C.N.A.'s behaviour in 1965 and 1967, finding that had their actions in these years been "considered alone" then the Commission decision would not have been justified, and consequently reduced its fine to a level 40% below its colluding rivals' penalties.[121] The phrasing of the E.C.J. does not rule out entirely the possibility that evidence of tacit fringe behaviour could incur liability. The fine, notably, was not reduced to one third (which would have reflected its temporal proportion of proven active involvement compared to that of the other undertakings) and the phraseology of the court's comments

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[117] *Ibid.*, para. 7. *See also* [1972] E.C.R. 619, [1972] C.M.L.R. 557, 582 *per* Mayras A.G.

[118] *Ibid.*

[119] *Ibid.*, paras. 25-26.

[120] *Ibid.*

[121] Case 57/69, *Azienda Colori Nazionali Affini v. Commission* [1972] E.C.R. 619, [1972] C.M.L.R. 557, paras. 40-41, 98.

regarding the 1965 and 1967 evidence is equivocal since it may be read either as a general dismissal of the illegality of fringe tacit collusion, or of such evidence being inadmissible only when uncorroborated by some evidence of express collusion. If such corroboration can be provided in the form of evidence of the simultaneous existence of an express agreement between other competitors then fringe tacit behaviour could be caught under Article 81. Alternatively, if the prior participation of the fringe player in an express agreement is capable of being supporting evidence, then this would appear to be another instance of the hangover principle examined in the previous section.

Another instance of the adoption of this fringe player principle by the Commission arose in *S.S.I.*[122] Here the Commission had investigated the Dutch cigarette producers association, S.S.I., which comprised of six members collectively controlling 96% of the market. They had been found to have entered into several formal producer-margin setting agreements going beyond the retailer and wholesaler margin setting agreements permitted under national regulations. In addition to the S.S.I. producers, three smaller manufacturers – Tabaksfabriek Gruno, Imperial Tobacco Holland and Reemstsma – who had not been party to either the illegal or permitted S.S.I. agreements had consistently throughout the period of examination maintained the same producer-margins as those followed by the S.S.I. members.[123] The Commission held these three fringe players to have been involved in a concerted practice notwithstanding the fact that nowhere in the decision was any evidence of communication between these parties and S.S.I. or its constituent firms averred to. Again, however, caution must be taken in viewing this case as a statement of a fringe player principle. The Commission's finding against the three smaller firms was based on the conclusion it was "inconceivable that the practice [of adopting margins identical to those in the S.S.I. agreements] was simply the product of the market

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[122] Commission Decision 82/506/E.E.C., *Re Stichting Sigarettenindustrie Agreements* [1982] O.J. L232/1, [1982] 3 C.M.L.R. 702.

[123] *Ibid.*, para. 123: "That these undertakings consistently applied the same margins and always maintained a common front when new arrangements were made is clearly evidenced by the documents of the case." No indication is given that the documents referred to here contained any evidence of direct contact, only that they implemented a pricing system identical to the S.S.I. producer-margin.

situation without contact between the participants".[124] This style of reasoning bears a close resemblance to that used in other pre-*Wood Pulp II* decisions, and it may be that the conclusion of the Commission in this case was based more on an application of the Mayras inference or the *Züchner* approach to inferring express contact from tacit behaviour than to a discrete principle of fringe behaviour.

In *Rhône-Poulenc*,[125] one of the polypropylene cartel cases, the C.F.I. examined the involvement of one of the many smaller producers in a market dominated by a "big four".[126] Rhône-Poulenc was accused of having followed the price increases of the larger players, in particular that of Montedipe, with the announcement of its own inflated price in a trade paper, *European Chemical News* (E.C.N.). The Commission's case rested on two points.[127] First, the presence of a number of Rhône-Poulenc executives at a Paris convention of customers and producers where some of the firms had stated publicly their intention to raise prices. Second, was the allegation that E.C.N. was merely an implement of communication for the cartel. Accepting both of these arguments, the C.F.I. concluded that the announcements were sufficient to satisfy the contact requirement and, consequently, Rhône-Poulenc was in breach of Article 81.[128] Although in this case the evidence of actual contact is more substantial than for either A.C.N.A. in *Dyestuffs* or the minor producers in *S.S.I.*, it would still seem to be lacking in the element of reciprocity typically associated with express collusion. Indicative of this is the Commission's argument that the Paris announcement and the E.C.N. publications could not be believed as having occurred without prior contact,[129] illustrating that in the Commission's view these actions were the results of prior contact rather than the contact itself. If this

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[124] *Ibid.*

[125] Case T-1/89, *Rhône-Poulenc S.A. v. Commission* [1991] E.C.R. II-869.

[126] *Ibid.*, paras. 37-38. The big four consisted of Montedipe, Hoechst, I.C.I. and Shell.

[127] *Ibid.*, paras. 39-42.

[128] *Ibid.*, paras. 43-44: "It follows from the foregoing that the Commission has proved to the requisite legal standard that the applicant, in the presence of its competitors, expressed general support for the policy of increasing prices initiated by Monte ... and that the applicant gave them a precise indication as to theconduct it had decided to adopt on the market."

[129] *Ibid.*, para. 39.

is the case, then *Rhône-Poulenc* can be seen again as authority for the proposition of a fringe behaviour rule or else another instance of the pre-*Wood Pulp II* willingness to infer express collusion in circumstances where economic reasoning would not treat this as an irrefutable implication. Either way, the subtle distinction evident in the Commission's argument is not present in the C.F.I.'s conclusion where the Paris and E.C.N. announcements seem to be treated as the instances rather than the results of communication. Judge Vesterdorf (acting as advocate general) makes a similar finding in his opinion, acknowledging first that a fringe player's knowledge of an express agreement reached by the big four could be no more unlawful than price leadership (an effective assertion of the legality of fringe player tacit collusion), followed by the assertion that in the present case communication through public channels could be interpreted as evidence of direct contact between competitors.[130]

Even on this basis, *Rhône-Poulenc* does provide a principle applicable to fringe behaviour, namely that a low contact threshold will apply where a small market participant is present during the major players' price or output announcements such that no actual assent or intention to comply with a policy of

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[130] [1991] E.C.R. II-869, 967-968: "I do not believe that it is inconceivable or improbable that in a situation like that prevailing at that time quick decisions were taken to follow the leading producer, all the more so since on 22 November the undertakings had their own forum available to announce their intentions. As I have mentioned, we know that some undertakings had had discussions with the Big Four [Montedipe, Hoechst, I.C.I. and Shell], but we do not know which, and identification would be necessary in order to establish that particular undertakings were actually involved. It is clear that there might well have been discussions going on in the corridors in connection with the meeting in Paris and that decisions might have been taken after telephone conversations, but we just do not have any evidence at our disposal. It must therefore, I think, be assumed that the other undertakings, that is to say Rhône-Poulenc, Chemie Linz, Hercules and Solvay, took the decision each for themselves to follow Monte. The same is true, in my view, even if it must be assumed that the said undertakings were aware of the Big Four's (unlawful) agreement, which Hercules must be considered to have been. For an undertaking to align itself to a price level in the fixing of which it was not involved cannot, in my opinion, be unlawful per se, any more than it can be unlawful to follow a 'price-leader' and indeed what is involved here is a form of 'price- leadership' put into effect by the Big Four acting together. If the position were otherwise, it would mean that there would be a prohibition against undertakings' reacting intelligently to the existing market, which cannot be the intention of the competition rules". The same advisory opinion applied to all the polypropylene cases.

collusion is required in order for participation in the concerted practice to be inferred. There is no shortage of direct authority for this proposition. In two of the other C.F.I. polypropylene cases, *Atochem*[131] and *Solvay*,[132] the pleas of two new market entrants that the reason for their attendance at price meetings was to inform their aggressive undercutting strategies were dismissed on the basis that they had failed to meet the additional requirement of making its co-attendees aware of their unstated underlying pro-competitive aims.[133] A similar view was formed by the E.C.J. in *Anic*, where it was held that:

> Once an undertaking's participation in meetings has been proved, it may be concluded that it participated in the anti-competitive scheme. It is then incumbent on any undertaking which claims that to have dissociated itself from decisions reached on agreed action to provide express proof thereof.[134]

An even more rigid principle was applied against another aggressive new entrant, Société Artésienne de Vinyle, in *P.V.C. II*,[135] where presence at the relevant meetings automatically inferred involvement in the concerted practice regardless of the issue of the other parties' awareness of their true intentions. This stricter approach has been reiterated more recently by the C.F.I. in *Tate & Lyle*,[136] where it was held that independently of reasons given for a firm's

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[131] Case T-3/89, *Atochem v. Commission* [1991] E.C.R. II-1177.

[132] Case T-12/89, *Solvay et Cie. S.A. v. Commission* [1992] E.C.R. II-907.

[133] [1991] E.C.R. II-1177, paras. 52-53: "[I]t should be observed that since it has been established that the applicant took part in those meetings and that their purpose was *inter alia* to fix price and sales volume targets the applicant at least gave its competitors the impression that it was participating in the meeting in the same spirit. In those circumstances it is for the applicant to adduce evidence to show that its participation in the meetings was without anti-competitive intention by showing that its competitors knew that it was participating in the meetings in a spirit which was different from theirs."; [1992] E.C.R. II-907, paras. 85-88.

[134] Case C-49/92P, *Commission v. Anic Partecipazioni S.p.A.* [2001] 4 C.M.L.R. 602, para. 95.

[135] Cases T-305-307, 313-316, 318, 325, 328-329, 335/94, *Re the P.V.C. Cartel II: Limburgse Vinyl Maatschappij N.V. and others v. Commission* [1999] 5 C.M.L.R. 303, paras. 885-891.

[136] Cases T-202, 204/98, *Tate & Lyle plc. and others v. Commission* [2001] All ER (EC) 839, [2001] 5 C.M.L.R. 22.

presence when rivals' strategies were discussed, it would always be inferred that the core intention was to collect information reducing uncertainty as to its competitors' future actions in a manner satisfying the contact requirement under Article 81.[137] All these decisions, and in particular these latter two, phrase the principle of participation in general terms not confined to fringe players, but since in the main it is only these smaller firms that can raise arguments of non-collusive presence with any degree of credibility, it is *de facto* a rule addressed to this narrow constituency.

Just as it has been noted that the directness of communication in *Rhône-Poulenc* was greater relative to that in *S.S.I.* and *Dyestuffs*, the decisions addressing the issue of meeting participation are situated further along again the express contact end of the communication continuum. As such these cases do not of themselves amount to a strong proposition of a principle of fringe tacit collusion illegality. What they do illustrate however, is the existence of an awkward grey area between express and tacit collusion which arises in the case of fringe players, and in response to which a cornerstone of the courts concept of contact, the existence of direct reciprocity, has been flexibly interpreted, although not discarded.

Special Cases IV: Information Exchange and Acts Facilitating Tacit Collusion under Article 81

There has been one other instance where the courts have appeared to address the issue of tacit collusion within the context of Article 81, namely in relation to the exchange of information between competitors as to price, output and territorial confinement, although it is submitted that the issue is better seen as a demonstration of what factually can be construed as express contact rather than

[137] *Ibid.*, para. 67: "By participating at one of those meetings, each participant knew that during the following meetings its most important competitor, the leader in the industry concerned, would reveal its future price intentions. Independently of any other reason for participating in those meetings, there was always one, at least, which was to eliminate in advance uncertainty concerning the future conduct of competitors. Moreover, by merely participating in the meetings, each participant could not fail to take account, directly or indirectly, of the information obtained during those meetings in order to determine the market policy which it intended to pursue."

the foundation of a broader legal rule prohibiting tacit collusion. In *John Deere*[138] the C.F.I. examined the information exchange system maintained by tractor dealers whereby the details of a customer's postcode in every sale made by a participating dealer would be transmitted to its rivals through a formal notification network. Consequently, every dealer was presented with an exact picture of the output and geographical area of operation of its rivals. The court found the information exchange system to be an illegal concerted practice not on the grounds that it in itself constituted the express price-fixing arrangement, but that it indicated such an agreement existed in either express or tacit form:

> [T]he court considers that the provision of information collected upon registration of every vehicle presupposes an agreement, or at any rate a tacit agreement, between the traders concerned to define the boundaries of the dealer sales territories by reference to the United Kingdom postcode system, as well as an institutional framework enabling information to be exchanged between traders through the trade association to which they belong. If such an agreement did not exist, the information disseminated could not be exploited in the same way by the addressees.[139]

The C.F.I.'s decision is capable of being construed as a general principle against actions increasing the level of market transparency where this may result in *inter alia* tacit collusion. Such a putative rule must immediately be qualified, however, by the fact that the transparency increasing act in *John Deere* involved the type of direct communications between rivals which would satisfy the contact requirement of the post-*Wood Pulp II* interpretation of Article 81. It might therefore be more accurate to construe the information exchange in this case as the expressly communicated indication of a reciprocal intention to collude, notwithstanding the fact that the content of this contact was not absolutely specific as to the terms of understanding. In this light, the division of the anti-competitive conduct in *John Deere* into two separate actions of, on one

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[138] Case T-35/92, *John Deere Ltd. v. Commission* [1994] E.C.R. II-957.

[139] *Ibid.*, para. 66; *see also* para. 52.

hand, express facilitation, and on the other, tacit understanding, appears more as an exercise in semantics than a broadening of principle. The principle that emerges from this case is better seen as authority for the proposition that express communication need not spell out the precise functioning of the scheme of collusion in order for it to be considered a concerted practice, and as such it fits into the general canon of Article 81 that the careful avoidance of the technical terms of collusion in the phrasing of cartel communications will not be grounds for evading liability.[140]

Putting the Special Cases in Context

Taking all four categories of special cases together, it is strongly arguable that they establish a principled basis for stating that in certain factual scenarios tacit collusion does come under the Article 81 prohibition. In this regard they can each be said to form important exceptions to the core Article 81 doctrine because they indicate a level of equivalence between the legal treatment of express and tacit collusion, and hence an alignment with the economic methodology.

There remains, however, a certain nagging doubt regarding their cohesiveness as a body of principle-establishing cases. In part this is because none of them unambiguously dispense with the contact requirement of the core doctrine and neither the term tacit collusion, nor any of its pseudonyms, are mentioned in detail, if at all, in the texts of the decisions. Even more significantly, except for the special case of many similar vertical agreements, all of the special cases examined address factual situations surrounding or otherwise connected to the investigation of known express agreements. On this basis it is tempting to conclude that the special cases are an attempt to ease the evidential burden of proving instances of express collusion. It is perhaps more than coincidental that there have been relatively few special cases over the last decade, a period which has seen considerable expansion in the efficacy of the

[140] *See* for example, *Polypropylene* [1991] E.C.R. II-869, 962, full citation *supra* fn. 102, *per* Judge Vesterdorf: "Things can always be called by a name different from what they are normally called and the joint "indication" of prices is at any rate normally an expression for the co-ordination of the undertakings' pricing policies."

Commission's evidence gathering processes with the development of greater whistle-blower incentives, leniency programmes, powers of search and enhanced co-operation between enforcement agencies.[141] Of course, the fact remains that regardless of the intention behind the special cases, in so far as they establish principles reducing the burden of showing actual contact and that the alternative of market-behaviour evidence is identical for both tacit and express collusion, it automatically follows that they remove the only barrier to allowing evidence of tacit evidence to be adduced as proof of a concerted practice. In this sense they marked out important potential points of equivalence between the economic and legal treatments of tacit collusion, once gain demonstaring that the legal system was capable of adapting to economic questions on its own terms outside of the confines o fthe core Article 81 doctrine.

Joint Dominance under Article 82 as a Vehicle for Prohibiting Tacit Collusion

The prohibition contained in Article 82 provides that an abuse of dominance may be committed by "one or more undertakings" thus lending itself to a potentially broad interpretation whereby several oligopolists together having a degree of market power could be considered to be jointly dominant.[142] This raises the question of whether a number of firms could be deemed to be jointly dominant and abusing this position by virtue of their tacit collusive conduct alone, and as such, whether Article 82 presents an alternative legal avenue for examining tacit collusion by drawing on a different part of the corpus of competition law rea

As a preliminary step to examining the relevant case law it is useful to identify the different tests that can be used to determine the presence of joint dominance. It is submitted that there are four alternative approaches.[143] First, at

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[141] *See Thirty-Third Report on Competition Policy, 2003*, (Luxembourg: Office of Official Publications of the European Communities, 2004), para. 724.

[142] Joint dominance is also referred to as collective dominance.

[143] The first categorisation of the types of joint dominance was carried by Whish, who identifies two interpretations, the "narrow view", described in this thesis as the single economic entity approach, and the "wide view" which is used as a generic description of the other three

its narrowest joint dominance can be seen as an alternative description for the single economic unit doctrine, arising only where there is an element of common ownership, control, management or other institutional structure which allows the undertakings to be regarded as different limbs of the same beast.[144] Secondly, and more broadly, structurally independent firms may be deemed to be jointly dominant where there are express arrangements between them to act in a common manner in a given range of situations. To borrow a phrase used by Soames, this might be termed joint dominance arising from "consensual links".[145] The archetype of this conception of joint dominance is the joint venture between competitors. If this type of relationship has an anti-competitive effect then it will almost certainly be considered to be express collusion prohibited under Article 81. Thirdly, joint dominance might be inferred from the collusive conduct of a number of undertakings as evidenced through price and output decisions on the market. A test for this form of joint dominance, which can be termed the 'market behaviour test', would rely on the observation of parallel collusive behaviour between competitors on the market and would thus encapsulate both 'tacitly collusive' joint dominance and that arising from consensual links. Since express collusion will usually come under the consensual conduct interpretation of joint dominance, the key aspect of the market behaviour test is that it expands the concept of joint dominance to include tacitly colluding undertakings. Fourthly, firms could be categorised as jointly dominant by virtue alone of their mutual presence in an oligopolistic

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approaches here described; R. Whish, *Competition Law* (London: Butterworths, 4th Edition, 2001), 473-477. *See also* R. Whish, "Collective Dominance", in D. O'Keefe and M. Adenas (eds.), *Liber Amicorum for Lord Slynn*, (London: Kluwer, 2000).

[144] On the single economic unit doctrine in general *see* Case C-73/95P, *Viho Europe B.V. v. Commission* [1996] E.C.R. I-5457, [1997] 4 C.M.L.R. 419, paras. 13-18; Case 17/74, *Centrafarm B.V. and Adnaan De Peijper v. Sterling Drug Inc.* [1974] E.C.R. 1183, [1974] 2 C.M.L.R. 480, para. 41; W. Wils, "The Undertaking as Subject of E.C. Competition Law and the Imputation of Infringements to Natural or Legal Persons", (2000) 23 *E.L. Rev.* 99; A. Jones and B. Sufrin, *E.C. Competition Law: Text, Cases, and Materials*, (Oxford: Oxford University Press, 2001), p. 103.

[145] T. Soames, "An Analysis of the Principles of Concerted Practice and Collective Dominance: A Distinction Without a Difference", (1996) 17 *E.C.L.R.* 24.

market – in other words, oligopoly reversion would be sufficient to trigger a finding of dominance. This will be referred to as the 'market structure' test.

The first indirect reference to the concept of joint dominance was made by Darmon A.G. in *Brasserie de Haecht*, where he adverted to the fact that Article 82 was "solely aimed at the abuse by undertakings of their dominant position in the market, *i.e.* those cases more or less where there is oligopoly".[146] Although only an aside, the comment was made as part of a more general argument in favour of avoiding an intellectual gap between the two principal competition provisions in the Treaty through which certain actions with anti-competitive effects might slip. As a guiding principle, however, it suggests little more than the test for joint dominance is wider than the single economic entity doctrine.

In *Sugar* the E.C.J. utilised the concept of joint dominance in the course of its examination of the Belgian market, finding that two of the smaller producers, Moerbeke-Waas and Oreye, could be regarded as a composite part of the dominant position held by Raffinerie Tirlemontoise, since this latter company had a 50% shareholding in the smaller firms as well as several common managers who appeared to have implemented the same sales policy in each undertaking.[147] On the facts of the case these firms seem to satisfy the single economic entity criterion, although in the absence of any statement of the court's underlying reasoning, the E.C.J.'s conclusion could not be regarded as definitively ruling out the other joint dominance tests. In the course of its *Sugar* decision, the Commission also examined the issue of joint dominance, this time in the context of the Dutch market. The Commission found that Suiker Unie and Centrale Suiker were jointly dominant by virtue of their combined market share of 85% and their control over all Dutch production and importation.[148] While

[146] [1967] E.C.R. 525, [1969] C.M.L.R. 26, 35.

[147] [1976] 1 C.M.L.R. 295, para. 378.

[148] [1973] O.J. L140/17, [1973] C.M.L.R. 295, para. 172: "The dominant position of these two producers is due to the fact that they produced all Dutch sugar and their sales represent more than 85 per cent of the Dutch market, and that they are able to behave independently which permits them to act without taking any particular account of their competitors. This dominant position is strengthened further by the fact that they control by various direct or indirect means almost all the sugar imported into the Netherlands."

this would suggest a market structure test, the Commission only came to this conclusion after detailing the firms' joint purchase of raw materials and use of intermediary products and their close collaboration in research and development, advertising, sales promotions and in establishing sale terms and prices[149] – in short, the type of behaviour indicative of a joint venture with strong consensual links. Consequently, the E.C.J. and Commission decisions in *Sugar* contain statements in support for nearly all of the alternative constructions of joint dominance.

The reaction to the mélange of principle in *Sugar* is evident in the narrow conceptions of joint dominance set out in the two subsequent judgments of *Hoffmann-La Roche*[150] and *Züchner*. In *Hoffmann-La Roche* the E.C.J. held that:

> A dominant position must also be distinguished from parallel courses of conduct which are peculiar to oligopolies in that in an oligopoly the courses of conduct interact, while in the case of an undertaking occupying a dominant position the conduct of the undertaking which derives profit from that position is to a great extent determined unilaterally.[151]

The ruling out of oligopolistic behaviour and the reference to unilateral behaviour amount to a rejection of the market structure and market behaviour tests for joint dominance. Whether consensual links between independent undertakings are sufficiently unilateral in character is less apparent, with the result that at its most restrictive *Hoffmann-La Roche* implies the equation of

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[149] *Ibid.*, para. 171: "The two Dutch sugar-producers, S.U. and C.S.M. have a dominant position on the Dutch market which constitutes a substantial part of the Common Market. These two producers co-operate closely in almost all their activities, that is to say the joint purchase of raw materials, rationing of production, collaboration in the use of intermediate products, pooling of research, co-operation on market research, advertising and sales promotions and the harmonization of ex-factory prices and conditions of sale. Towards other undertakings and particularly towards the three dealers mentioned above, these two producers have acted in a uniform manner and always appear as a single entity."

[150] Case 85/76, *Hoffmann-La Roche A.G. v. Commission* [1979] E.C.R. 461, [1979] 3 C.M.L.R. 211.

[151] *Ibid.*, para. 39.

joint dominance with the existence of single economic entity.[152] In *Züchner* Slynn A.G. again emphasised the "unilateral nature" of Article 82 without elaborating as to whether more than one independent undertakings could be found to be acting in such a manner.[153] The view that these two cases establish a general principle of joint dominance must be tempered by the fact that the point being addressed in both instances was whether the facts indicating a concerted practice under Article 81 could be recycled for the purposes of Article 82. In this context, the unilateral nature criterion rings truest as a procedural mechanism for determining the relevant Treaty provision to be applied. This is most apparent in the E.C.J.'s judgment in *Züchner* where the mutual exclusivity of Articles 81 and 82 is addressed directly without any discussion of unilateral characteristics.[154] What this serves to illustrate is that the joint dominance concept in these cases is fixated on avoiding the potential overlap between the two Treaty provisions and, as such, assumes the two are contiguous in their ability to capture all anticompetitive activities regardless of the level of concentration of the market in which they occur. Tacit collusion is simply not considered.

Following these decisions joint dominance remained a dead-letter within European jurisprudence until a deliberate effort was undertaken by Commission towards the end of the 1980s to revive the doctrine. In its *Sixteenth Report on Competition Policy*[155] the Commission described what it deemed to be the two features of joint dominance: first, the existence of a small number of undertakings accounting for most of an industry's turnover without any single

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[152] McGregor, for one, endorses such a single economic entity reading of *Hoffmann-La Roche*; L. McGregor, "The Future for the Control of Oligopolies Following *Compagnie Maritime Belge*", (2001) 22 *E.C.L.R.* 434, 435.

[153] [1982] 1 C.M.L.R. 313, [1981] E.C.R. 2021, 2029, *per* Slynn A.G..

[154] *Ibid.*, para. 10: "In view of the fact that the order submitting the reference considers only the existence of a concerted practice as a possible infringement of Community rules on competition and having regard to the fact that Article [82] deals with abuse of a dominant position and does not cover the existence of concerted practices, to which solely the provisions of Article [81] apply, examination of the question which has been referred to the Court must be restricted to the latter Article."

[155] *Sixteenth Report on Competition Policy, 1986*, (Brussels and Luxembourg: Office for the Official Publications of the European Communities, 1987).

firm enjoying a dominant position in its own right, and secondly, a high degree of interdependence between these undertakings.[156] In so doing it launched its campaign to have the market structure test become the determinant of joint dominance. More recently, the Commission has reiterated this stance in its *Notice on Access Agreements in the Telecommunications Sector*:

> In addition, for two or more companies to be jointly dominant it is necessary, though not sufficient, for there to be no effective competition between the two companies on the relevant market. This lack of competition may in practice be due to the fact that the companies have links to such agreements for cooperation, or interconnection agreements. The Commission does not, however, consider that either economic theory or Community law implies that such links are legally necessary for a joint dominant position to exist. It is a sufficient economic link if there is the kind of interdependence which often comes about in oligopolistic situations. There does not seem to be any reason in law or in economic theory to require any other economic link between the jointly dominant companies.[157]

The revival of a broader notion of joint dominance by the courts is first evident in the E.C.J.'s Article 234 reference decision in *Ahmed Saeed*[158] where the court allowed for the possibility that the same behaviour could be considered under both Articles 81 and 82 simultaneously,[159] and further, that the actions of two economically independent undertakings could constitute a breach of Article

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[156] *Ibid.*, para. 331.

[157] Commission Notice 98/C 265/2, Notice on Access Agreements in the Telecommunications Sector: Framework. Relevant Markets and Principles [1998] O.J. C265/2, para. 79. *See* R. Whish, *op. cit.*, 476-477.

[158] Case 66/86, *Ahmed Saeed Flugreisen and Silver Line Reisebüro G.m.b.H.. v. Zentrale zur Bekämpfung unlaurteren Wettbewerbs E.V.* [1989] E.C.R. 803.

[159] *Ibid.*, para. 37: "Those considerations do not exclude the case where an agreement between two or more undertakings which simply constitutes the formal measure setting the seal on an economic reality characterized by the fact that an undertaking in a dominant position has succeeded in having the tariffs in question applied by other undertakings. In such a case, the possibility that Articles [81] and [82] may both be applicable cannot be ruled out."

82 subject to the ambiguous requirement that "the conditions laid down in that article are satisfied".[160] *Ahmed Saeed* thus struck a blow at the twin pillars of mutual exclusivity of Treaty provisions and single economic entity reasoning underlying the analysis of joint dominance in *Hoffman-La Roche* and *Züchner*. This result may be explained by the court's awareness in *Ahmed Saeed* that a dividing line based on unilateral conduct could leave a legal lacuna for certain anti-competitive acts, such as in this case where a tariff agreement potentially[161] binding the two major market players (two carriers on particular international routes) into a relationship of joint dominance was exempted from Article 81 under a block exemption.

The death-blow for the single economic entity test for collective dominance was delivered by the C.F.I. in *Italian Flat Glass*.[162] Here the court made clear that two independent undertakings could hold a position of joint dominance if there existed sufficient "economic links" between them.[163] What exactly such links might be was illustrated by way of an example of a common technological lead exclusively enjoyed by two firms vis-à-vis the rest of the market and governed by agreements or licensing arrangements between them.[164] By coming to this conclusion, the C.F.I. not only disregarded the narrow rule in *Hoffman-La Roche* and *Züchner*, but also the broader interpretation adopted by the Commission in the present case. The Commission had argued that joint

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[160] *Ibid.*, para. 38.

[161] The factual determination of whether joint dominance existed in this case was left to the referring German court to decide.

[162] Cases T-68, 77-78/89, *Re Italian Flat Glass: Società Italiano Vetro S.p.A. v. Commission* [1992] E.C.R. II-1403, [1992] 5 C.M.L.R. 302.

[163] *Ibid.*, para. 358: "The Court considers that there is no legal or economic reason to suppose that the term 'undertaking' in Article [82] has a different meaning from the one given to it in the context of Article [81]. There is nothing, in principle, to prevent two or more independent economic entities from being, on a specified market, united by such economic links that, by virtue of that fact, together they hold a dominant position *vis-à-vis* the other operators on the same market."

[164] *Ibid.*: "This could be the case, for example, where two or more independent undertakings jointly have, through agreements or licences, a technological lead affording them the power to behave to an appreciable extent independently of their competitors, their customers and ultimately of their consumers."

dominance arose by virtue of the 80% combined market share of the three Italian automotive glass producers under investigation and the fact that they "presented themselves on the market as a single entity and not as individuals", a position which the Commission contended could be adopted without the existence of any express contact between the undertakings.[165] This argument employs a narrower concept of joint dominance than that contained in the *Sixteenth Report on Competition Policy* since an oligopolistic structure alone is conceded as being insufficient for a finding of dominance. Nevertheless, the fact that only a low level of interaction between the producers is required in order for their actions to be presented as that of a single entity suggests that the Commission here relies on a market behaviour test of joint dominance, since this is only conception of tacit collusion remaining between that of the consensual links and market structure tests.

Taking the C.F.I.'s statement of principle, example of application and rejection of the Commission's viewpoint, *Italian Flat Glass* is best interpreted as an endorsement of a consensual links test of joint dominance.[166] This observation is, of course, dependent on the C.F.I.'s example being exhaustive if not *in specie* at least *in genus*. On its own the 'economics links' formulation is nebulous and potentially encapsulates both the market behaviour and market structure definitions of joint dominance. In addition, as Soames has stated, the C.F.I.'s comments were made by way of general *obiter dicta*, with the Commission's argument having already been rejected on the grounds that it had failed in the preliminary step of proving the dominance of even a single undertaking occupying the same market position as that of the three glass producers combined.[167] The only certainty arising from *Italian Flat Glass* was the rejection of the single economic entity test as the sole measure of joint dominance, with the subsequent judicial considerations of the matter locating (with varying degrees of lucidity) the requisite economics links somewhere between the consensual links and market structure concepts.

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[165] *Ibid.*, para. 350.

[166] A similar conclusion is reached by McGregor who regards it as authority for the propostion that there is a requirement for "the existence of some form of legal relationship between the undertakings"; L. McGregor, *loc. cit.*, 436.

[167] T. Soames, *loc. cit.*, 32.

In *Almelo* the E.C.J. examined the market position of a number of regional electricity distributors, each holding a non-exclusive concession for a particular part of the national territory. The court held that the undertakings could be considered to be jointly dominant if they were connected in such a way that they would "adopt the same conduct on the market".[168] Although the phrasing of principle is similar to that used by the Commission in *Italian Flat Glass* it is unclear whether this demonstrates an intention to state a market behaviour or market structure test. Indeed, it is also conceivable that the court is alluding to a consensual links test similar to that of the C.F.I. in *Italian Flat Glass*, given that one of the connecting bonds between the regional electricity producers was the common form of contract used by all in accordance with the trade association standard form. The interpretation of this case is not helped by the E.C.J.'s reluctance to provide any firm guidance as to the finding of fact which the referring national court might reach. Nor is an examination of the *Bodson*[169] decision, the sole authority cited by the E.C.J. in support of its statement of principle, particularly enlightening. As has been hinted at by Fennelly A.G. in his advisory opinion in *Compagnie Maritime Belge*,[170] it is difficult to read *Bodson* as anything other than a straightforward application of the single economic entity rule in the context of Article 81 with little relevance to the issue of joint dominance under Article 82.[171] Overall, the only contribution made by *Almelo* to the principle of joint dominance has been to provide a hook upon which each of the competing versions of the doctrine can be hung.

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[168] [1994] E.C.R. I-1477, para. 41.

[169] Case 30/87, *Corrine Bodson v. Pompes Funèbres des Régions Libérées S.A.* [1988] E.C.R. 2479, [1989] 4 C.M.L.R. 984.

[170] Case C-395-396/96, *Compagnie Maritime Belge Transports S.A. and others v. Commission* [2000] 4 C.M.L.R. 1076, para. 24, *per* Fennelly A.G.: "*Bodson* has been cited by the Court as an authority on collective dominance, although the expression does not appear anywhere in the judgement."

[171] In *Bodson* the E.C.J. examined the role of P.F.R.L., a parent company operating a number of subsidiaries holding exclusive concessions in various towns to provide funeral services; [1988] E.C.R. 2479, [1989] 4 C.M.L.R. 984, paras. 19-26.

More revealing is the brief treatment given to joint dominance by Lenz A.G. in a *Bosman*[172] where the issue of whether the clubs in a professional football league could be considered to occupy a position of joint dominance was examined. Referring to the economics links test of *Italian Flat Glass*, the advocate general found that while joint dominance could be found to exist in the context of the clubs collectively negotiating television rights the same could not be said in their dealings with competitors.[173] Lenz A.G. did not elaborate on this point, but it might be suggested that his reluctance to equate the two circumstances stems from a consensual links analysis. During the course of television negotiations the clubs would appear as a joint venture collectively bargaining as a single body as far as the broadcasters are concerned, while retaining their economic independence, as may be demonstrated in the existence of a prior round of 'share-of-the-cake' negotiations between the clubs. In contrast, the clubs do not present themselves as a joint venture when competing for suppliers (*i.e.* players), with any connecting links (in the absence of proven collusion) occurring on a market structure level, which in the very specialised case of professional sports league industries would entail structural links based on the formal market rules of engagement.

In *D.I.P.*[174] there was some diversity in the approaches taken by Fennelly A.G. and the E.C.J., with the advocate general repeating the economic links test

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[172] Case C-415/93, *Union Royale Belge des Societes de Football Association v. Bosman* [1996] 1 C.M.L.R. 645.

[173] *Ibid.*, paras. 285-286, *per* Lenz A.G.: "In my opinion it could very well be assumed that the clubs in a professional league are "united by such common links" that together they are to be regarded as having a dominant position. One could cite in particular here the fact, referred to several time above, that those clubs are dependent on each other if they wish to be successful. ... The question need not be gone into in more depth here, however: the present case does not concern the power on the market which he clubs taken together have against competitors, customers or consumers. The *players* do not, in my opinion, belong to any of those categories. There would be such a question, by contrast, if – to take an example already mentioned – the clubs themselves acted as a group to market the television rights for their matches." Citations omitted.

[174] Cases C-140-142/94, *D.I.P. S.p.A., Lidl Italia S.r.l. and Lingral S.r.l. v. Comune di Bassano del Grappa, Comune di Chioggia* [1996] 4 C.M.L.R. 157.

of *Italian Flat Glass*[175] while the court, citing *Hoffmann-La Roche* as supporting authority, phrased the issue as an examination of whether the undertakings had adopted the same conduct on the market.[176] But the neither advisory opinion nor the judgment gave any detailed consideration to the matter, and the finding in both – that a very disparate committee made up of small traders from many different disciplines did not hold a position of joint dominance – would have been made under even the very broadest of market structure tests. *Irish Sugar*[177] is a similarly clear-cut case, although in this instance being an obvious circumstance of joint dominance. Here the C.F.I. considered that the control exercise by Irish Sugar over its partly owned subsidiary, Sugar Distributors, through the appointment of directors, exclusive purchasing arrangements and the funding of promotions and rebates, indicated a position of joint dominance without entering into any detailed discussion as to the applicable legal principles other than the statement that the legal independence of the firm (which of itself, based on the facts in *Irish Sugar* seems a dubious assertion) would not inhibit such a finding.[178]

It was not until the E.C.J.'s decision in *Compagnie Maritime Belge* that the issue of whether consensual links were a required element of the economic links test was directly considered. In issue here was an agreement establishing a shipping conference between a number of undertakings which operated an exclusive concession over several freight routes between Zaire and various northern European ports. The agreement was covered by block exemption for the purposes of Article 81, but various practices operated under the institutional structures of the conference had been found by the Commission to be breaches of Article 82, in particular the use of "fighting ships" by the conference as a rudimentary form of predatory pricing. Although the links between the firms which supported the court's ultimate finding of joint dominance were demonstrably consensual in nature (in the form of the conference agreement and the participation of the firms in the various committees created in accordance

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[175] *Ibid.*, para. 65, *per* Fennelly A.G.

[176] *Ibid.*, para. 26.

[177] Case T-228/97, *Irish Sugar plc. v. Commission* [1999] 5 C.M.L.R. 1300.

[178] *Ibid.*, paras. 46-54.

with its terms),[179] the E.C.J. set out a very broad test enabling joint dominance to be established apparently independently of any evidence of formal links:

> The existence of a collective dominant position may therefore flow from the nature and terms of an agreement, from the way in which it is implemented and, consequently, from the links or factors which give rise to a connection between undertakings which result from it. Nevertheless, the existence of an agreement or of other links in law is not indispensable to a finding of a collective dominant position; such a finding may be based on other connecting factors and would depend on an economic assessment and, in particular, on an assessment of the structure of the market in question.[180]

This decision marked the first clear advancement in principle since *Italian Flat Glass*, and appeared to indicate a movement beyond a test based on consensual links alone. What it did not spell out, however, was whether a market structure test alone is sufficient to infer dominance or if some evidence of monopolistic behaviour by the firms must also be demonstrated, which in the absence of any evidence of formal contacts would indicate a market behaviour test for joint dominance capable of covering acts of tacit collusion. To the extent that Fennelly A.G.'s advisory opinion is read as underlying the reasoning of the court – something which is not beyond doubt given that the advocate general did not pronounce anything approaching a principle as broad as that of the E.C.J. and cites only instances of consensual joint dominance in his list of examples – his identification of the "absence of the competition" between a number undertakings as an indicator of joint dominance would seem to suggest that some element of market behaviour beyond oligopoly reversion may be required.[181]

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[179] [2000] 4 C.M.L.R. 1076, para. 54.

[180] *Ibid.*, para. 45.

[181] *Ibiid.*, para. 34, *per* Fennelly A.G.: "In any event it emerges clearly from the case law ... that the absence of competition between a number of putatively collective dominant undertakings is a salient feature of collective dominance, it would not suffice, in my view, for such undertakings, in answer to a charge from the Commission that they had adopted a single market strategy in

For the purposes of the present examination, the precise categorisation of the test used in *Compangnie Maritime Belge* is unimportant, as it is sufficient to note that regardless of whether a market behaviour or a pure market structure concept is used there is the potential for tacit collusion to undergo legal scrutiny under Article 82. At this stage it is important to bear in mind that not only must there be a finding of joint dominance but also an abuse of dominance in order for a breach of Article 82 to occur. Thus in order for the distinction between dominance and an abuse of dominance to be maintained it must be possible to describe some other outcome in the given market structure which does not constitute an abuse. Immediately this rules out the possibility of mere oligopoly reversion constituting an abuse because oligopoly reversion is, by its nature, the most efficient equilibrium possible in the given market structure.

In the case of tacit collusive behaviour there would also appear to be very considerable, perhaps insurmountable, difficulties in concluding that an abuse has occurred, even following the identification of joint dominance. While in *Ahmed Saeed* Lenz A.G. appeared to suggest that the mere fact that collective dominance had been established would indicate a fettering of competition and *ipso facto* an abuse,[182] more recently the E.C.J. in *Compagnie Maritime Belge* placed a greater emphasis on the requirement to demonstrate abuse as a distinct element in joint dominance cases.[183] The problem here is that the head of abuse under which tacit collusion most naturally falls, that of excessive or unfair

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respect of price competition, to contend that the presence of other forms of competition between them, such as competition regarding the quality of service provided, should negate a finding of collective dominance based on links established in respect of their mutual pricing strategy...."

[182] [1989] E.C.R. 803, para. 35, *per* Lenz A.G.: "Since through their tariff agreements the participating airlines substantially eliminate not only competition in the field of prices but also, in view of the restricted access to the individual routes, any other possible competition, to the disadvantage of the consumers – apart perhaps from a measure of competition as regards the services provided – that in itself can be regarded as constituting an abuse of a dominant situation. Support for this view is forthcoming from the case-law, since in its judgment of [Case 6/72, *Europemballage Corp. and Continental Can Co. Inc. v. Commission* [1973] E.C.R. 215, [1973] C.M.L.R. 199 where] the Court held that the mere fact that competition was substantially fettered on the relevant market by a dominant undertaking or dominant undertakings acting together constituted an abuse, regardless of the means and procedure by which it was achieved."

[183] [2000] 4 C.M.L.R. 1076, para. 40.

pricing, is one of the areas of Article 82 jurisprudence most notable for its paucity of successful prosecutions. The main reason for this is the exacting standard of proof required for such a finding. In *United Brands*[184] the E.C.J. held that in order for excessive pricing to be established evidence as to the cost structure of the undertaking under examination and the cost of production of the product in question would have to be ascertained – in and of itself a significant logistical challenge – following which it would then have to be demonstrated that the resulting profit margin led to a sale price which bore "no reasonable relation to the economic value of the product". Jones and Sufrin argue that this last evidential requirement effectively casts the judicial arbitrator as price regulator[185] – a role which, according to the Commission, competition policy has little desire to fill, as is evident from the following observation in its *Twenty-Fourth Report on Competition Policy*:

> The existence of a dominant position is not itself against the rule of competition. Consumers can suffer from a dominant company exploiting this position, the most likely way being through prices higher than would be found if the market were subject to effective competition. However, the Commission in its decision-making practice does not normally control or condemn the high level of prices as such. Rather it examines the behaviour of the dominant company designed to preserve its dominance, usually directed against competitors or new entrants who would normally bring about effective competition and the price level associated with it.[186]

Whether this reluctance to rely upon the excessive pricing head of Article 82 extends to undertakings in a position of joint dominance remains to be seen; however it is submitted that the evidential test is likely to be the same for both individual and joint dominance, and further, that the task of gathering the

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[184] Case 27/76, *United Brands Co, and United Brands Continental B.V. v. Commission* [1978] E.C.R. 207, [1978] 1 C.M.L.R. 429.

[185] A. Jones and B. Sufrin, *op. cit.*, p. 328.

[186] *Twenty-Fourth Report on Competition Policy, 1994*, (Brussels and Luxembourg: Office for the Official Publications of the European Communities, 1995), para. 207.

required economic evidence in the case of several firms is, if anything, likely to present an ever greater challenge than in the case of a single firm. As will be examined more fully in chapter eight, it is this logistical and econometric difficulty which presents the greatest barrier to a legal concept of tacit collusion. As such, the doctrine of joint dominance is the damp squib of an equivalence analysis; it raises the possibility of tacit collusion being found to constitute a dominant position, but holds out little scope for dominance so identified to be deemed abusive. In this sense, joint dominance holds out the prospect of a *de jure* equivalence between the treatment of tacit and express collusion without leading to any tangible impact on the principled segregation of the core Article 81 doctrine. It is difficult to see, therefore, how it presents a usable general rule capable of prohibiting tacit collusion, and thereby closing the divergence of approach on this matter between law and economic theory.

Tacit Collusion and the Considerations of Joint Dominance under the Merger Regulations

It is apparent from the above analysis of tacit collusion under European law that the illegality of this type of conduct is either ruled out in principle or obliquely regulated through the potential capturing of such behaviour as part of more general evidential rules for identifying collusion or other anti-competitive behaviour. There is still one area of the law where considerations of tacit collusion have been indisputably accepted as the basis for prohibiting certain activities, namely in the sphere of merger approval. Based initially on a somewhat tenuous interpretation of the first merger regulation,[187] the Commission and the courts have developed a doctrine whereby the effect of a concentration on *inter alia* the likelihood of tacit collusion in the post-merger market will be grounds for refusing merger consent even in the absence of any one of the post-merger market participants holding a dominant position in its

[187] Council Regulation 4064/89/E.E.C., on the control of concentrations between undertakings, [1990] O.J. L257/14, as amended by Council Regulation 1310/97/E.C., [1997] O.J. L180/1.

own right. More recently, the second merger regulation[188] has given the imprimatur of legislative approval to this principle.

The first merger regulation referred only to the blocking of those concentrations which "create or strengthen a dominant position as a result of which effective competition would be significantly impeded",[189] with no mention of joint dominance (a concept already established in the Article 82 *acquis* at the time of the adoption of this regulation) or even to the "one or more undertakings" in a position of dominance formulation contained in the Treaty text. This absence of an obvious concept of joint dominance in the language of the regulation was highlighted by the differences of opinion within the Advisory Committee on Concentrations' report prepared as part of the Commission's consideration of the legal issues arising from the planned take-over of the mineral drinks producer Perrier by the Nestlé food conglomerate.[190] Three alternative interpretations of the merger were taken by the Committee. One minority group rejected that considerations of joint dominance, however the concept was construed, could be taken into account during the application of the regulation.[191] Another minority endorsed the existence of a power to control the creation or furthering of positions of joint dominance provided that this dominance involved the "economics links" required by the C.F.I. in *Italian Flat Glass*.[192] The majority favoured a simple statement acknowledging the pertinence of joint dominance without any reference to the C.F.I.'s test.[193] The distinction between the second minority view and that of the majority is unclear. It may be that the division was based on the endorsement by one group of a market structure test (*i.e.* that joint dominance means *per se* an oligopolistic market) and by the other of a concept based on the propensity for a collusive

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[188] Council Regulation 139/2004, on the control of concentrations between undertakings, [2004] O.J. L42/1.

[189] [1990] O.J. L257/14, arts. 2-3.

[190] Opinion of the Advisory Committee on Concentrations given at the 11th and 12th meetings on 3 and 14 July, 1992 concerning a preliminary Draft Decision Relating to Case IV/M.190 – *Nestlé/Perrier*, [1992] O.J. C319/3.

[191] *Ibid.*, para. 3.

[192] *Ibid.*

[193] *Ibid.*

outcome, whether tacit or express (*i.e.* joint dominance as understood by the market behaviour test).[194] Given, however, that *Italian Flat Glass* is not a particularly clear authority itself on this issue of this distinction (as has been discussed above), it is difficult to see how its invocation delineates which view was held by each group.

The final Commission decision reached in *Nestlé/Perrier*[195] is more informative. Nestlé and Perrier were two of the three major players in the French market for spring water, with the third being B.S.N. After the proposed merger Nestlé-Perrier and B.S.N. would together have controlled between 75% and 82% of the relevant market, depending on the calculation used.[196] The Commission rejected the merger as proposed[197] on the grounds that the pre-existing, highly developed systems of monitoring rivals' brand prices and performance, the inelastic demand, the absence of potential new entrants and the equivalence of production capacity and costs structures of B.S.N. and the merged entity were likely to result in a market where:

> any competitive action by one would have a direct and significant impact on the activity of the other supplier and most certainly provoke strong reactions with the result that such action could considerably harm both suppliers in their profitability without improving their sales volume. This reciprocal dependency thus creates a strong common interest and

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[194] The same four possible interpretations of the principle of joint dominance discussed in the context of Article 82 are applicable here, save that the "tacitly collusive" test can probably be seen as a general "collusive test" given the prospective nature of the examination and the lack of certainty as to what form likely collusion might take. This would appear to subsume the consensual links test, although it might be seen as forming in the mergers context another different interpretation of joint dominance, *i.e.* the existence of current consensual links, as opposed to a likelihood of future ones which would be covered under the collusive test.

[195] Commission Decision 92/553/E.E.C., *Re the Concentration between Nestlé S.A. and Source Perrier S.A.* [1993] 4 C.M.L.R. M17.

[196] *Ibid.*, paras. 118-119.

[197] It was subsequently permitted subject to the Nestlé and Perrier undertaking certain commitments.

incentive to maximise profits by engaging in anti-competitive parallel behaviour.[198]

Expressed in these terms, the Commission's reasoning reveals a policy aimed at preventing collusive outcomes rather than oligopolistic behaviour *per se*. Reference is made to the existence of a market equilibrium where there is an incentive to "cheat" by increasing production, a corresponding ability to retaliate and production occurring at a profit maximising level the maintenance of which is dependant upon the self-enforced restraints of the various rivals – none of which are factors that are symptomatic of oligopoly reversion. Moreover, the market circumstances described as likely in this case to result in anti-competitive behaviour is effectively a list of factors that reduce collusion costs. Specifically, the monitoring systems, the absence of potential competition and the similarity of cost structures all increase the chances of cheating being correctly identified and attributed. Although the Commission did not directly allude to the risk of tacit collusion, by basing its decision solely on a prospective analysis of collusion costs in the mineral water sector it relied on a simple rule of collusion probability, ignoring the economically unimportant question of whether the portended outcome would arise from contact.

A direct reference to joint dominance arising through tacit collusion was made by the Commission in the subsequent case of *Gencor/Lonhro*,[199] where having set out the equivalent harmful effects of oligopoly and monopoly, it was held that "active collusion would not therefore be required" to establish a joint dominant position since "mere adaptation" by the undertakings to the market conditions could be sufficient.[200] The Commission also relied upon a costs of

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[198] *Ibid.*, para. 121.

[199] Commission Decision 97/26E.C., *Re the Concentration between Gencor Ltd. and Lonrho Plc.* [1997] O.J. L11/30, [1999] 4 C.M.L.R. 1076.

[200] *Ibid.*, para. 140: "Similar negative effects which arise from a dominant position held by one firm arise from a dominant position held by an oligopoly. Such a situation can occur where a mere adaptation by members of the oligopoly to market conditions causes anti-competitive parallel behaviour whereby the oliopoly becomes dominant. Active collusion would therefore not be required for the members of the oligopoly to behave to an appreciable extent independently of their remaining competitors, their customers and, ultimately, the consumers."

collusion analysis of the platinum market similar to that employed in *Nestlé/Perrier*, emphasising the transparency of the market and the absence of potential competition capable of eroding a collusive price,[201] in addition to documentary evidence of internal company reports indicating the existence of detailed policies of retaliation in the event of price reductions and the involvement of several of the oligopolists in cartel activities in related precious metal markets.[202]

The Commission's approach to joint dominance in *Nestlé/Perrier* was criticised in Tesauro A.G.'s *Kali and Salz*[203] advisory opinion concerning the take-over of Kali und Salz by the rival potash fertiliser producer, Mitteldeutsche and the resulting threatened duopoly with the French producer, S.C.P.A. The advocate general acknowledged that the economic harm arising from collusion between several undertakings could be just as damaging as that under a monopoly even where such collusion was tacit in nature[204] but went on to state that this fact did not permit the language of the first merger regulation to be contorted into accommodating considerations of joint dominance.[205] In contrast, the E.C.J. held that the regulation allowed for the examination of both the dominant position of the merged entity on its own and the joint dominant position of that entity and third parties combined.[206] The textual argument relied

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[201] *Ibid.*, paras. 143-154.

[202] *Ibid.*, paras. 155-158.

[203] Cases C-68/94, 30/95, *France v. Commission (Germany intervening), Société Commerciale des Potasses et de l'Azote and Enterprises Minière et Chemique (Kali und Salz Beteiligungs A.G. intervening)* [1998] 4 C.M.L.R. 829.

[204] [1998] 4 C.M.L.R 829, para. 95, *per* Tesauro A.G.: "It is hardly necessary to point out that an oligopoly, that is to say, a market supplied by only a handful of undertakings, can produce harmful effects very similar to those generally attributed to a monopoly. Added to that is the undeniable fact that, on the one hand, there is a certain correlation between concentration and market power, understood specifically as the power to raise prices by reducing production and increasing profit margins, and, on the other, that concentrations can foster collusion between competitors and the adoption of parallel, even if not concerted, conduct." Citations ommitted.

[205] *Ibid.*, para. 98: "In the final analysis, I consider that the Regulation is not applicable to oligopolistic dominant positions and that this interpretation of the relevant provisions is the most consistent, not only with their wording, but also with the rationale on which they are based and, more generally, with the overall scheme of the system."

[206] *Ibid.*, para. 178.

upon by the court in this regard was somewhat tenuous, with the wording of the regulation being deemed to permit considerations of joint dominance by virtue of the absence of an express exclusion of this possibility.[207] A more substantive justification adopted by the court was the teleological argument which had been rejected by the advocate general – *i.e.* that joint dominance was potentially harmful and consequently "incompatible with the system of undistorted competition which the Treaty seeks to secure".[208] The court was less clear as to exactly what type of connection between the relevant undertakings was required before they could be described as occupying a position of joint dominance. On the facts of the case the E.C.J. held that the established lines of communication between Mitteldeutche and S.C.P.A. through their involvement in a legal export cartel were insufficient to indicate that they were likely to withdraw from further competition given that the existence of the cartel had not to date had this effect. This finding suggests an approach based on market analysis rather than on the existence of formal pre-merger connections, although whether the test used is indicative of a market structure test or a prospective collusive approach (whether tacit or express) is uncertain.[209] A similar implication may be drawn from the

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[207] *Ibid.*, para. 166: "[I]t cannot be deduced from the wording of Article 2 of the Regulation that only concentrations which create or strengthen an individual dominant position, that is, a dominant position held by the parties to the concentration, come within the scope of the Regulation. Article 2, in referring to "a concentration which creates or strengthens a dominant position", does not in itself exclude the possibility of applying the Regulation to cases where concentrations lead to the creation or strengthening of a collective dominant position, that is, a dominant position held by the parties to the concentration together with an entity not a party thereto."

[208] *Ibid.*, para. 171: "A concentration which creates or strengthens a dominant position on the part of the parties concerned with an entity not involved in the concentration is liable to prove incompatible with the system of undistorted competition which the Treaty seeks to secure. Consequently, if it were accepted that only concentrations creating or strengthening a dominant position on the part of the parties to the concentration were covered by the Regulation, its purpose as indicated in particular with the abovementioned recitals would be partially frustrated. The Regulation would thus be deprived of a not insignificant aspect of its effectiveness, without that being necessary from the perspective of the general structure of the Community system of control of concentrations."

[209] An alternative interpretation is suggested by Ysewyn and Caffarra and Motta, who argue that *Kali and Salz* sets out a requirement for formal links at the time of the merger given the facts of

court's formulation of principle in this regard which, utilising phraseology reminiscent of that in *Almelo*, alluded to a market effects analysis without stating further what such a test would entail:

> In the case of an alleged collective dominant position, the Commission is therefore obliged to assess, using a prospective analysis of the reference market, whether the concentration which has been referred to it leads to a situation in which effective competition in the relevant market is significantly impeded by the undertakings involved in the concertation and one or more other undertakings which together, in particular because of correlative factors which exist between them, are able to adopt a common policy on the market and to act to a considerable extent independently of their competitors, their customers, and also of consumers.[210]

Almost a year to the day later, the C.F.I. in *Gencor*[211] returned to consider the issue the links indicating joint dominance. Upholding the Commission's decision, the court tidied up the uncertainties remaining after *Kali and Salz* with a wholesale endorsement of the principles used in *Nestlé/Perrier* and *Gencor/Lonhro*. First, it made clear that a position of joint dominance arose where firms were able to anticipate each other's behaviour, observe rivals' prices and align their prices so as to "maximise their joint profits". Given this description of its characteristics, joint dominance was contemplated by the court

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the case; J. Ysewyn and C. Caffarra, "Two's Company, Three's a Crowd: The Future of Collective Dominance After the *Kali & Salz* Judgment", (1998) 19 *E.C.L.R.* 470; M. Motta, "E.C. Merger Policy and the *Airtours Case*", (2000) 21 *E.C.L.R.* 199, 204. This view, however, ignores the fact that while there were formal links between Mitteldeutche and Kali und Salz were considered, it was in the context of testing their market-effects rather than their formal nature, and it is further apparent from the judgment that formal links alone may be insufficient to satisfy the requirement of market-effects.

[210] *Ibid.*, para. 221.

[211] Case T-102/96, *Gencor Ltd. v. Commission (Germany intervening)* [1994] 4 C.M.L.R. 971. *See generally* V. Korah, "*Gencor v. Commission*: Collective Dominance", [1999] 20 *E.C.L.R.* 337; P. Christensen and O. Owen, "Comment on Judgment of the C.F.I. of 25 March 1999 in Merger Case IV/M619: *Gencor/Lonhro*", [1999] 2 *Competition Policy Newsletter* 19.

as that circumstance giving rise to collusion rather than oligopoly reversion.[212] It then went on to state that this test included the consideration of collusion arising when "undertakings become aware of common interests and ... cause prices to increase without having to enter into an agreement or resort to a concerted practice".[213] Thus it was in these terms that the C.F.I. approved a unified costs of collusion principle and in so doing delivered the first judgment to pronounce specifically and deliberately upon the grounds for regulating tacit collusion in European law.[214]

The commitment of the C.F.I. to a costs of collusion analysis was illustrated most recently in its *Airtours*[215] decision, where the court reiterated the test applied in *Gencor*. In particular, the analysis of the court focussed on the distinction between oligopoly reversion and tacit collusion, emphasising that it was only the latter concept which could be considered within the framework of joint dominance. The relevant market in this case was the package holiday industry in Ireland and the United Kingdom, which comprised of four major players (Airtours, First Choice, Thomson and Thomas Cook) each with vertically integrated airline and travel agency operations. Within each holiday season the firms were subject to a capacity constraint based on its hotel accommodation purchasing decisions taken prior to the commencement of that season. There was no general capacity constraint, however, as the firms were

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[212] *Ibid.*, para. 276: "Furthermore, there is no reason in legal or economic terms to exclude from the notion of eocnomic links the relationship of interdependence existing between the parties to a tight oligopoly within which, in a market with the appropriate characteristics, in particular in terms of market concentration transparency and product homogenity, those parties are in a position to anticipate one another's behaviour and are therefore strongly encouraged to align their conduct in the market, in particular in such as way as to maximise their joint profits by restricting production with a view to increasing prices."

[213] *Ibid.*, para. 277: "That conclusion is all the more pertinent with regard to the control of concentrations, whose objective is to prevent anti-competitive market structures from arising or being strengthened. Those structures may result from the existence of economic links in the strict sense argues by the applicant or from market structures of an oligopolistic kind where each undertaking may become aware of common interests and, in particular, cause prices to increase without having to enter into an agreement or resort to a concerted practice."

[214] Christensen and Owen express the post-*Gencor* test for joint dominance as an examination of "the likelihood of tacit co-ordination in the market"; P. Christensen and P. Owen, *loc. cit.*, 23

[215] Case T-342/99, *Airtours v. Commission* [2002] 5 C.M.L.R. 317.

free during its purchasing planning stage to increase its supply of hotel rooms. Thus competition took place in three stages: first, capacity was determined in the absence of information as to market demand; secondly, market demand was revealed; and thirdly, the firms selected their market prices based on the demand and the capacity constraints of their previous choice. As Staiger and Wolak demonstrate in their game theory study of three-stage competition, collusion can occur in such industries even if it will not be rational to collude in the third stage because of the finite duration of that period.[216] Instead, collusion may occur during the selection of capacity constraints phase, with each firm selecting the parameters of its subsequent ability to compete and in so doing having the option of punishing those who cheated during the previous season's purchasing period, such a threat being credible because each firm is uncertain as to the number of future seasons. The Commission, opted for a somewhat simpler analysis in its decision to reject the merger between Airtours and First Choice, stating that proof of the existence of a mechanism for retaliation was unnecessary for a finding of joint dominance once there was some scope for the post-merger industry players to behave in a parallel anti-competitive way.[217] By indicating that the most fundamental evidence of a likelihood of a collusion – the existence of a system of credible threats – was superfluous for a finding of joint dominance, the Commission appeared to suggest that the prospect of oligopoly reversion on its own could be grounds for declining to approve a concentration. The C.F.I. on the other hand, gave short shrift to the Commission's reasoning, concluding that while joint dominance was conceivable in an industry with a three-stage competitive structure, this would only be the case where there existed a credible threat of retaliation for cheating

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[216] R. Staiger and F. Wolak, "Collusive Pricing with Capacity Constraints in the Presence of Demand Uncertainty", (1992) 23 *Rand Journal of Economics*, 203.

[217] Commission Decision 2000/276/E.C., *Re the Concentration between Airtours and First Choice* [2000] O.J. L93/1, [2000] 5 C.M.L.R. 494: "Airtours considers that...it would be impossible for the major suppliers to retaliate in the event that one of them tried to win market share from the others by increasing capacity and offering lower prices. However the Commission did not suggest, nor does it consider that all the features have to be present and/or aggravated by the merger in order for collective dominance to arise in a given case. Nor does it regard a strict retaliation mechanism...as a necessary condition for collective dominance in this case."

in the following season's planning phase,[218] something which in this instance the Commission had failed to prove.[219] In terms of general principle the court made clear that a substantiated risk of collusion – and not mere oligopoly reversion – was the prerequisite for a finding of joint dominance, by setting out three criteria which would have to be satisfied in order for a merger to be rejected as anti-competitive: first, a high degree of market transparency sufficient to allow the detection of cheating; secondly, a credible retaliation mechanism; and thirdly, the anticipated reaction of current and potential competitors would not undermine the collusion, which – in so far as the other two criteria already covered the incentives for current firms – implied the existence of barriers to entry and price inelasticity removing the threat to the sustainability of the collusive price level from new entrants.[220]

The second merger regulation rephrases its core prohibition to capture those concentrations which "significantly impede effective competition", with the "creation or strengthening of a dominant position" being described as such an incidence but not necessarily the only one.[221] It is not clear whether the "dominant position" referred to in this provision means single firm dominance, and the other acts capable of significantly impeding effective competition is a reference to the creation of joint dominance as articulated by the C.F.I. in *Gencor* and *Airtours* (*i.e.* covering the risk of collusion but not oligopoly reversion), or alternatively encapsulates within its terms both the concept of single and joint dominance, with oligopoly reversion outcomes capable of being considered as part of the general class of impeding acts. The former interpretation, which will can termed the 'narrow reading', suggests a straightforward application of the C.F.I.'s existing principles. On the other hand,

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[218] [2002] 5 C.M.L.R. 317, paras. 193, 195.

[219] The C.F.I. held that the two-season planning time lag (*i.e.* the first period of planning occurred before the third periods of the previous two seasons had occurred) meant that the undertakings lacked a sufficiently severe method of punishment to countermand the incentive to cheat; *ibid.*, paras. 198-210.

[220] *Ibid.*, para. 62.

[221] [2004] O.J. L42/1, art. 2(3): "A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market."

the latter construction, the 'broad reading', implies an expansion of the current principle in line with that attempted by the Commission in *Airtours*. Central to resolving which is the correct interpretation of the prohibition is Recital 25 of the regulation:

> Many oligopolistic markets exhibit a healthy degree of competition. However, under certain circumstances, concentrations involving the elimination of important competitive constraints that the merging parties had exerted on each other, as well as a reduction of competitive pressure on the remaining competitors, may, even in the absence of a likelihood of coordination between the members of the oligopoly, result in a significant impediment to effective competition. The Community courts have, however, not to date expressly interpreted [the first merger regulation] as requiring concentrations giving rise to *such non-coordinated effects* to be declared incompatible with the common market. Therefore, in the interests of legal certainty, it should be made clear that this Regulation permits effective control of all such concentrations by providing that any concentration which would significantly impede effective competition, in the common market or in a substantial part of it, should be declared incompatible with the common market. The notion of "significant impediment to effective competition" in Article 2(2) and (3) should be interpreted as extending beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.[222]

The most important phrase in this recital is "non-coordinated behaviour", and it is submitted that it should be read as a reference to tacit collusion, which carries with it the implications that the merger regulation should be given a narrow reading. There are two arguments which support this view. First, is the fact that prior to the final adoption of the regulation, the Council rejected the

[222] Emphasis added.

Commission's suggestion that the merger prohibition should be phrased so as to cover non-collusive oligopolies,[223] from which it may be concluded that the reference to non-coordinated behaviour should not be used to achieve a manifestly discarded objective. Secondly, there is nothing inherent in the term non-coordinated behaviour which excludes the fact that it may refer to tacit collusion. Within the Article 81 case law the term "coordinated behaviour" is frequently used to describe the outcome of express collusion (*i.e.* agreements and concerted practices).[224] This suggests that the exclusionary application of the term may include all other classes of parallel behaviour, including both tacit collusion and oligopoly reversion.

This last argument also casts some doubt on the validity of the terminology relied upon by the Commission in its endorsement of the broad reading set out in its guidelines on the application of the second merger regulation.[225] The guidelines interpret non-coordinated effects as those giving rise to a "reduction of competitive pressure" by describing the process whereby the equilibrium price level of the oligopoly reversion is raised through the reduction of the number of competitors in line with Cournot's model of oligopoly.[226] The factors set out by the Commission as likely to lead to this outcome – product homogenity,[227] price inelasticity,[228] capacity constraints[229]

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[223] *See* K. Gibbons, "European Merger Control", in *Competition Law for General Practice: Mergers* (Dublin: Law School of the Law Society of Ireland, 2004), p. 7.

[224] *See* for example: *Polypropylene*, full citation *supra* fn. 102, [1992] E.C.R. II-867, 924, 930 *per* Judge Vesterdof; Case T-141/94, *Thyssen Stahk A.G. v. Commission* [1999] 4 C.M.L.R. 810, para. 314.

[225] Commission Notice 2004/C 31/03, Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings [2004] O.J. C31/5.

[226] *Ibid.*, para. 24: "[I]f prior to the merger one of the merging firms had raised its price, it would have lost some sales to the other merging firm. The merger removes this particular constraint. Non-merging firms in the same market can also benefit from the reduction of competitive pressure that results form the reduction of competitive pressure that results from the merger, since the merging firms' price increase may switch some demand to the rival firms, which, in turn, may find it profitable to increase their prices. The reduction in these competitive constraints could lead to significant price increases in the relevant market."

[227] *Ibid.*, para. 28: "The higher the degree of substitutability between the merging firms; products, the more likely it is that the merging firms will raise prices significantly."

and barriers to entry[230] – are effectively a list of the assumptions underlying a Cournot outcome.[231] Co-ordinated effects, in contrast, are described as the results of the creation or strengthening "of a collective dominant position, because it increases the likelihood that the firms are able to co-ordinate their behaviour ... and raise prices, even without entering into an agreement or a concerted practice within the meaning of Article 81...."[232] or in other words, the outcome of tacit or express collusion. The criteria set out in the guidelines for identifying co-ordinated effects read as an elaboration of the costs of collusion analysis used by the C.F.I. in its interpretation of the first merger regulation,[233] with the ability of the undertakings to form a collusive price[234] and maintain it

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[228] *Ibid.*, para. 31: "Customers of the merging parties may have difficulties switching to other suppliers because there are few alternative suppliers or because they face substantial switching costs."

[229] *Ibid.*, paras. 32-35: "When market conditions are such that the competitors of the merging parties are unlikely to increase their supply substantially if prices increase, the merging firms may have an incentive to reduce output below the combined pre-merger levels, thereby raising market prices. ...[O]utput expansion is, in particular, unlikely when competitors face binding capacity constraints and the expansion of capacity is costly or if existing excess capacity is significantly more costly to operate than capacity currently in use."

[230] *Ibid.*, para. 36: "[T]he merged entity may have such a degree of control, or influence over, the supply of inputs or distribution possibilities that expansion or entry by rival firms may be more costly. Similarly, the merged entity's control over patents or other types of intellectual property (e.g. brands) may make expansion or entry by rivals more difficult."

[231] This approach would follow the well established merger control policy in the U.S. which focuses on preventing potential oligopoly reversion outcomes as well as collusive ones; *see* T. Kauper, "Merger Control in the United States and the European Union: Some Observations", (2000) 74 *St. John's L. Rev.* 305, fn. 70; U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines 1992*, paras. 2.1-2.2.

[232] *Ibid.*, para. 39.

[233] *Ibid.*, para. 41, where the Commission repeats the three requirements for a merger to be deemed anticompetitive identified by the C.F.I. in *Airtours*; *see* p. 220 *supra*.

[234] *Ibid.*, paras. 44-48: "Coordinating firms should have similar view regarding which actions would be considered to be in accordance with the aligned behaviour and which actions would not. Generally, the less complex and the more stable the economic environment, the easier it is for the firms to reach a common understanding on the terms of coordination. For instance, it is easier to coordinate among a few players than among many. It is also easier to coordinate on a price for a single, homogenous product, than on the hundreds of prices in a market with many differentiated products. Similarly it is easier to coordinate on a price when demand and supply

through monitoring rivals' actions,[235] the maintenance of a credible deterrent mechanism[236] and the existence of constraints on the expansion of output by existing and potential rivals,[237] all described in some detail as the issues forming the core of any Commission investigation.

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considerations are relatively stable than when they are continuously changing. In this context volatile demand, substantial internal growth by some firms in the market or frequent entry by new firms may indicate that the current situation is not sufficiently stable to make coordination likely. ...Firms may find it easier to reach common understanding on the terms of coordination if they are relatively symmetric, especially in terms of cost structures, market shares, capacity levels and levels of vertical integration." Citations ommitted.

[235] *Ibid.*, paras. 49-51: "Only the credible threat of timely and sufficient retaliation keeps firms from deviating. Markets therefore need to be sufficiently transparent to allow the coordinating firms to monitor to a sufficient degree whether other firms are deviating, and thus know when to retaliate. Transparency in the market is often higher, the lower the number of active participants in the market. ...[T]ransparency is liekly to be high in a market where transactions take place on public exchange or in an open outcry auction. ...Coordinating firms should be able to interpret with some certainty whether unexpected behaviour is the result of deviation from the terms of deviation. For instance, in unstable environments it may be difficult for a firm to know whether its lost sales are due to an overall low level of demand or due to a competitor offering particularly low prices. Similarly, when overall demand or cost conditions fluctuate, it may be difficult to interpret whether a competitor is lowering its price because it expects the coordinated price to fall or because it is deviating." Citations ommitted.

[236] *Ibid.*, paras. 52-55: "Coordination is not sustainable unless the consequences of deviation are sufficiently sever to convince coordinating firms that it is in their best interest to adhere to the terms of coordination. It is thus the threat of future retaliation that keeps the coordination sustainable. However the threat is only credible if, where deviation by one of the firms is detected, there is sufficient certainty that some deterrent mechanism will be activated. ...For example, if a market is characterised by infrequent, large-volume orders, it may be difficult to establish a sufficiently sever deterrent mechanism, since the gain from deviating at the right tome may be large, certain and immediate, whereas the losses from being punished may be small and uncertain and only materialise after some time."

[237] *Ibid.*, paras. 56-57: "For coordination to be successful, the actions of non-coordinating firms and potential competitors, as well as customer, should not be able to jeopardise the outcome expected from coordination. For example, if coordination aims at reducing overall capacity in the market, this will only hurt consumers if non-coordinaating firms are unable or have no incentive to respond to this decrease in capacity, or at least to render the coordinated capacity decrease unprofitable." Citations ommitted.

The Commission's expansive interpretation of its powers under the second merger regulation places it on a collision course with those likely to argue that the new provision contains nothing more than a restatement of the judicial interpretation of the first regulation. Of course, regardless of how the courts resolve this conflict – as inevitably they will be called upon to do – it is indisputable that the new regulation makes clear provision for the consideration of tacit collusion as a ground for prohibiting proposed concentrations. The merger regulations thus stand out as the beacon of an equivalent treatment between tacit and express collusion, albeit one confined to the prospective plane of analysis.

Observing Methodological Rejection

In overview, Community competition law applicable to tacit collusion may be expressed in the form of two general rules. The first principle that emerges is that tacit collusion will not be considered illegal *ex post facto* the collusive act, save in a number of narrowly defined circumstances where there exists a theoretical possibility of liability. This principle can be described as consisting of a general proposition qualified by a number of exceptions. The general element is derived from the core Article 81 doctrine which envisages concerted practices arising only from direct contact between competitors, with allegations of such behaviour founded on the circumstantial evidence of the relevant undertakings' market actions alone being admissible only where it can be demonstrated that the observed conduct cannot be explained as the result of tacit collusion or some other non-consultative form of market behaviour. While the concept of joint dominance under Article 82 does raise the prospect of tacitly colluding rivals being found to be abusing their position through excessive pricing, the ambiguous and burdensome evidential requirements established by the E.C.J. in this regard and the reluctance of the Commission to take on the role of price regulator effectively required by this standard of proof, together with the absence of a successful prosecution of tacit collusion under this head, all point toward the improbability of this Treaty provision dislodging the requirement of express communication as the *sine qua non* of illegality in oligopolistic markets. The exceptions to this principle arise in three scenarios. The first of these is the

principle whereby tacit collusion is evident from the existence of similar standard terms of agreement operated by each of the colluding firms in their vertical dealings with suppliers or customers. Second, is the hangover principle whereby firms which continue to collude using tacit means following the termination of their previous express arrangements. Third, and based on a somewhat speculative interpretation of the authorities rather than on any firm statement, is the possibility that the behaviour of fringe market players who have not been privy to the express collusive arrangements between the larger players in the market, may be found to be in breach of Article 81 where without any contact they ape the policy of the cartel participants. It is reasonable to omit from this list of exceptions the fourth set of special cases examined – actions designed to facilitate tacit collusion – since the relevant decisions are probably better interpreted as a measure of what express acts of communication are sufficiently direct to satisfy the contact threshold.

The second legal principle, in contrast with the first, is prospective in nature and provides that the expectation of an increased likelihood of tacit collusion occurring on a given market following the merger of a number of its participants will be grounds for refusing to authorise that concentration.

Thus, in the main, tacit collusion is served up with a separate legal treatment from that afforded to express collusion when examining events of the past (when tacit collusion is grouped with non-collusive oligopoly reversion), but the two concepts are equated when it comes to evaluating the legality of future actions. The divergence of this position from the micro-economic conclusions on the same subject are immediately apparent. On one hand, tacit collusion and express collusion are deemed equivalent in economics because there is no correlation between the manner in which a firm forms the belief that competitors will reciprocate collusive advances and the ultimate efficiency effects of the reciprocal parallel behaviour when it does occur, and the process of rational decision-making employed by an undertaking in making the decision whether to collude is the same costs of collusion analysis for both tacit and express varieties. On the other, a distinction is made between the efficiency effects of tacit collusion (or collusion in general, given the equivalence of express collusion) and non-collusive oligopoly reversion.

No matter how the economic value judgments are decided, there remains a divergence between the legal system's separate rule for historical tacit collusion and the unified economic concept of collusion. If collusion is deemed harmful (because of its perceived likelihood, *i.e.* rationality, or selection of the physical or temporal group whose efficiency is affected), then there is no reason why both tacit and express collusion should not be equated. Where collusion is not deemed harmful (because a judgment is made as to what feasibly can be maintained as a rational barrier for a damaging period), both should be treated as legal. Either way, from the economic perspective, there is little reason for treating the composite elements of the same phenomenon in arbitrarily different fashions. What we are left with is equivalence in one system matched with non-equivalence in another, without there being resort to characterising the division as a matter of value selection. Instead, what is presented is a real picture of divergence; the case study of tacit and express collusion reveals an instance of methodological rejection as fundamental as that of the hypothetical case of the red and blue paper.

Of course, just as the non-equivalence of tacit and express collusion under the core Article 81 doctrine reveals divergence, the special cases and the prospective rule applied during mergers analysis indicate equivalence. This invites the question, which is the subject of the next chapter, what are the normative legal functions which explain the simultaneous incidence of methodological rejection and alignment with economic concepts.

CHAPTER EIGHT

THE DRIVERS OF METHODOLOGICAL REJECTION

Explaining Divergence and Convergence

Methodological rejection, as examined in chapter two, is the manifestation of both the autonomy of the legal system and its limitations in adapting and applying concepts from other paradigms in its own terms. In chapters five, six and seven the diverging treatment of express and tacit collusion has been presented as a forum within which methodological rejection, as opposed to mere rhetorical divergence, has occurred through the development, on one hand, of unified economics treatment of the two types of collusion, and on the other, a general legal rule which segregates the treatment of historic tacit collusion from express instances. What this study has also revealed is that there are a number of exceptions to this rule covering past occurrences of tacit collusion, and that there is separate rule in the form of merger analysis governing prospective tacit collusion. In these latter cases, there is an alignment with the economic equivalence of tacit and express collusion. These conclusions raise a double-sided question: what are the normative elements of the legal system which both drive its divergence from an economic approach in some instances, and allow its convergence in others?

This chapter examines the two normative functions of the law which, it is submitted, cause the divergence between law and economics on the issue of tacit collusion and simultaneously account for the convergence between the two systems in the special cases and merger analysis. The first of these is the legal system's evidential methodology which dictates that absorption of legal reasoning into the law is confined to a role in rule formation rather than fact deduction. Secondly, one of the normative fundamentals of the law is what can broadly be described as its certainty requirement, something which appears in

the guise of numerous legal principles, all of which rest ultimately on the idea that economic actors should only be penalised for actions which they are internally capable of identifying as unlawful.

Normative Functions II: Evidential Requirements[1]

One of the reasons why the European courts have displayed a reluctance to prohibit tacit collusion has been the evidential difficulty in adducing as a matter of fact behaviour which is indicative of tacit collusion which is not at the same time capable of being construed as evidence of oligopoly reversion, in particular in the guise of the Cournot outcome. This difficulty is clear from the earliest statements of the concerted practices doctrine, in cases such as *Dyestuffs*,[2] where Mayras A.G. failed to discriminate between the two classes of behaviour, alluding instead to a single phenomenon of parallel behaviour arising in oligopoly market conditions, thus describing an attribute common to both tacit collusion and oligopoly reversion.[3] The rejection by the E.C.J. of the possibility that tacit collusion could fall under the Article 81 prohibition in *Wood Pulp II*[4] can also be read as a result of the evidential difficulty in distinguishing between the different types of oligopoly behaviour. Here the similarity and simultaneity of the advance price announcements of the pulp producers in this case was held by the court to have been as likely the result of the natural customer-driven transparency of the market (since pulp was a significant percentage of the customers' final product cost and since there were relatively few customers each dealing with several pulp producers) as the outcome of a conscious effort to put in place the mechanics of a tacit signalling structure.[5] As a further explanation of the parallel pricing behaviour the E.C.J. put forward the supposition that any price reduction by one of the pulp producers would be construed by its rivals as

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[1] Normative Function I is discussed *supra* p. 130 *et seq.* as one of the determinants of the value choices take that leads to rhetorical divergence.

[2] Cases 48-57/69, *I.C.I. and others v. Commission* [1972] E.C.R. 619, [1972] C.M.L.R. 557.

[3] *Ibid.*, 579 (C.M.L.R.), *per* Mayras A.G. *See* quoted text *supra* chap. 2, fn. 3.

[4] Cases 89, 104, 116-117, 125-129/85, *Re Wood Pulp Cartel: A. Ahlström and others v. Commission* [1993] 4 C.M.L.R. 407.

[5] *Ibid.*, paras. 73-88.

an indication of increased capacity on its part and hence was likely to be followed, which given the absence of an examination as to whether such excess capacity was used as soon as it was created, held back in reserve as a threat mechanism or merely imagined on the part of rivals, suggests factual circumstances capable of being construed as either the result of a Cournot or collusive equilibrium.[6] Likewise, in *Italian Flat Glass* the C.F.I. held that the coincidence of the timing and prices in the list announcements of three glass producers could be ascribed to the "normal functioning" of an oligopolistic market which appeared to be a reference to either oligopoly reversion or a collective description of tacit collusion and oligopoly reversion, in any event indicating an inability to discern from market evidence alone whether the behaviour was collusive or otherwise.[7] Each of these cases was an instance where the courts struggled in the absence of evidence of a visible act of conspiracy to distinguish between collusion and non-collusive oligopoly.

Underlying this evidential difficulty is a limitation inherent to the economic methodology – or at least, a limitation when perceived from the legal perspective. When presented, without more, with a given market combination of price and output, micro-economic theory does not present any immediate test for determining if the market outcome is indicative of collusion, competitive pricing or the super-competitive non-collusive oligopoly price of the Cournot equilibrium. Economic models may be constructed based on the study of the industry in question to describe the observed outcome; however, even with the careful selection of opening assumptions, the impossibility in recreating an exact simulation of all factors impacting on the relevant market means that any prediction will be imprecise to some degree, perhaps to the extent that it is of little practical application. This is the great shortcoming of the economics' core tenets of the rationality function and the *ceteris paribus* principle: first there is no guarantee that those presumed to be rational will in the event so react; and second, the complexity of real life means that the predicted outcome will be highly sensitive to small alterations in opening criteria. The point here is not to

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[6] *Ibid.*, paras 89-120, *espec.* para. 103.

[7] Cases T-68, 77-78/89, *Re Italian Flat Glass: Societá Italiano Vetro S.p.A. v. Commission* [1992] E.C.R. II-1403, [1992] 5 C.M.L.R. 302, para. 326.

criticise the intellectual credentials of economics, rather to establish that the usefulness of economics is ordinal rather than cardinal. Economics is not a tool for making static observations as to whether a precise market price-output level will occur; instead it employs a form of relative analysis indicating whether a particular action will lead to an improvement in efficiency (however defined) vis-à-vis the effects of an alternative action or inaction, without precisely defining what this end outcome will be.

The problem with identifying tacit collusion is that there is no visible behaviour from which events can be observed to flow as its consequences. Instead, the only real-world evidence is the market's price-output level which, even if the price can be described as super-competitive, cannot be convincingly differentiated from the non-collusive oligopolistic outcome. Express collusion avoids this difficulty by presenting a manifest and objectively discernible event – the express inter-rival contact – from which the collusive level of price or output is revealed either from the content of the communication directly, or as the market price arising as its intended effect. With the act of collusion definitively proven, express collusion removes the necessity for secondary evidence based on market observations, probability and imperfect assumptions to demonstrate the occurrence of the primary event.

The confinement of the practical applicability of the economic methodology to the realm of relative and ordinal statements is due, in part, to the subjectivity of individual perceptions of utility and, in another part, to the acceptance of competition as a process rather than a particular outcome, which are two of the factors underlying the metric of efficiency.

Turning to the issue of subjectivity first, Coase aptly describes relative analysis as the necessary implication of a concept of consumer utility that is ultimately beyond objective quantification when he notes that while the reason "[w]hy a man will take a risk of being killed in order to obtain a sandwich is hidden from us ... we know that, if the risk is increased sufficiently, he will forgo seeking that pleasure".[8] Thus since the personal valuations of an economic actor are *a priori* unknowable, the role of the machinations of economic

[8] R. Coase, *The Firm, the Market and the Law*, (Chicago and London: University of Chicago Press, 1998), p. 5.

reasoning is confined to indicating that at some similarly unspecifiable point a given type action may result in an alteration of the individual's actions. In the case of collusion, the internal weighting by an undertaking of the costs versus the benefits of collusion will remain unclear so long as the individual firm's valuations of current versus future profits and of monetary gain in general are unknown and, consequently, it may only be stated with certainty that at some unknown point an alteration in the costs or benefits of collusion will cause a firm to adjust its calculations of the prevailing circumstances, with each such alteration incrementally altering the probability of an occurrence of collusion.

Perceiving competition as a process rather than a particular market outcome also compels the adoption of relative analysis. Once it is accepted, as first set out by the dynamic theorists, that greater efficiency gains in the long run are achieved through the restructuring of supply and demand in a given industry arising from shifts in taste, income, innovation and cost, than from the eradication of deadweight losses within the current static market organisation, then it becomes difficult to determine whether a given market price is competitive notwithstanding an ability to determine the relation of that price to marginal cost and the identification of some level of deadweight loss. Thus, even if the mass array of computations of every relevant impacting factor on a market could be taken into account to produce a compelling calculation as to the competitive price for a given market for a particular moment in time, it would remain accurate only for that scintilla when the ever-changing factors of innovation, taste, income and cost – which are the fundamental determinants of supply and demand – are revealed as a snapshot of constant flux. Consequently, as soon as such an improbable calculation had been made its power of identification would rapidly deteriorate with the passage of time. In particular, it would fail to indicate the extent to which a price level above marginal cost operated as an incentive for the innovation that brings forward the dynamic shifts in market structure resulting in greater societal utility. Against this backdrop of continual change, relative analysis presents itself as the prime function of the economic methodology since, as Neumann states, "[e]ven though a welfare maximum cannot be identified in advance, competition can be

understood as a process approaching the maximum".[9] One need not accept the value judgements of the dynamic theorists in relation to the temporal balance of efficiency demands of current society against those of future populations in order to recognise that the practical application of the economic methodology is limited to relative analysis. All that is needed is some acknowledgement that current arrangements of production are not fixed for all time, regardless of the moral perspective of what is an acceptable period to wait for dynamic structural change.

In the absence of any observable evidence as to market behaviour, the only recourse to proving the existence of tacit collusion is deduction based on theoretical conjecture – *i.e.* because collusion in the circumstances is rational, then this must be what is in fact occurring. The difficulty with this type of evidence is immediately obvious: that the model predicts that – other things being equal and assuming the rationality function will operate from the opening assumptions – collusive behaviour will occur in given circumstances, cannot be relied upon as conclusive proof that other things *will* remain equal or that the rationality function will in fact occur.

In this regard, the characterisation of economics as ordinal rather than cardinal informs the extent to which the law is willing to absorb economic concepts. The legal system has little difficulty in relying upon economic theories when engaged in the process of rule formation. The acceptance by the courts of an economic argument that, say, retail price maintenance is more likely than not to be harmful to efficiency, allows the development of a rule on the issue: since it is likely that this type of activity is harmful, then it is permissible for it to be prohibited. The role of economics in rule formation is one that the courts accept, because the law does not require that a given rule be just in every circumstance; as Easterbrook points out, "the difference between 'always' and 'almost always' is unimportant in antitrust whether it cuts against or for a practice. Rules that do well on average are the best courts can produce and apply."[10] The law's comfort with this use of economic relative analysis is evident in the judicial formulation

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[9] M. Neumann, *Competition Policy: History, Theory and Practice*, (Cheltenham and Northampton (Ma.): Edward Elgar, 2001), p. 5.

[10] F. Easterbrook, "Workable Antitrust Policy" (1986) 84 *Mich. L. Rev.* 1696, 1704.

of how the legality or otherwise of a particular event will be determined, as revealed in the seminal statement in this regard in *Technique Minière*.[11] Here both the E.C.J. and Roemer A.G. set out as the basic test for determining the economic effects of allegedly anti-competitive agreements the comparison of the market following the implementation of the agreement against that which would have obtained had the arrangement in question not been entered into.[12] The matter for consideration was thereby characterised not as the location of a particular outcome vis-à-vis marginal cost, but in terms of its relative contribution to, or retardation of, the onward march of the competitive process towards efficiency maximisation.

In contrast, the legal system is unwilling to rely on economic reasoning for adducing whether a particular event has in fact occurred. This evidential operation of the court is fundamentally different to its rule-making function: what is being determined is whether the behaviour has occurred at all, and not how its competitive effects should be characterised. Behind the reluctance to use economic models in this regard is the legal system's normative requirement that evidence be produced to a standard beyond the mere probabilities offered by statements founded on assumptions of rationality and isolation from other phenomena. Herzberger has argued that the legal system's evidential requirements display an acute concern for correct factual conclusions in the individual cases which is unmatched by the generalised models of the social sciences:

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[11] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.m.b.H.*. [1966] E.C.R. 235, [1966] C.M.L.R. 357. *See generally* on the test for anti-competitive effects under Article 81(1), A. Jones and B. Sufrin, *E.C. Competition Law: Text, Cases, and Materials*, (Oxford: Oxford university Press, 2001), pp. 149, 162-172.

[12] *Ibid.*, 375-376: "The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute."; 368-369, *per* Roemer A.G.: "In such a case, a comparison with the situation which would obtain on the market without the exclusive concession may lead to a finding that it is precisely the absence of an agreement which leads to a reduction in competition, because it goes together with a reduction in what is offered." This test has been repeated in a number of subsequent cases, *see* Case T-34/92, *Fiatagri U.K. Ltd. and New Holland Ford Ltd. v. Commission* [1994] E.C.R. II-905, para. 49.

> This distinction between predicting in the aggregate versus predicting consequences to individuals is important for understanding when social science research can best serve the law. Social science research is appropriately applied to predict characteristic behavior within certain groups of people; it is hazardous and perhaps unethical for social scientists to apply such research to predict or render judgments about individual behaviour. ...The situation is different, however, in the legal system. The continuation of a viable legal system is based upon our perception that individuals are treated fairly. Contributing to the perception of fairness is the individual's belief that her full story was heard and that she was treated as an individual, not as a member of a group. Thus, legal professionals may need to pay more heed to the individual than social scientists believe is warranted.[13]

General predictions, of course, will suffice in the course of the rule formation process because the legal methodology readily accommodates rules protecting against potential, as well as certain, harm.[14] The disinclination of the law to accept economic probabilities as facts does not extend to the situation where the fact for discussion is the existence of probability in and of itself. Ultimately, this means that while the law is willing to accept ordinal assertions during the course of its rule making function, adducing evidence of factual occurrences requires cardinal facts.

The limitations placed on the use of economic reasoning within the legal system is that law has no way in which to evidentially satisfy itself of the occurrence of tacit collusion. Certainly, it can be stated that in a given market structure it will be rational for the undertakings to collude, and it may even be possible to determine that the resulting market price is higher than that which might be described as the competitive one, but, as Ivaldi, Jullien, Rey, Seabright and Tirole's commented in their report to the Commission on tacit collusion, "the fact that firms *could* sustain collusion does not mean that they actually

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[13] S. Herzberger, "Social Science Contributions to the Law: Understanding and Predicting Behavior", (1993) 25 *Connecticut Law Review* 1067, 1078-1079.

[14] Faull and Nikpay reach a similar conclusion; J. Faull and A. Nikpay (eds.), *The E.C. Law of Competition*, (Oxford: Oxford University Press, 1999), paras. 1.01-1.04.

succeed in doing it ... [and it] is thus impossible to rely on a theoretical analysis alone to determine whether collusion is *actually* taking place."[15]

Given that the legal system is unwilling to accept evidence based on theoretical prediction or which could equally be ascribed to a form of legal behaviour, tacit collusion is an economic concept with which the law cannot cope on its own terms. This has not prevented attempts being made to concoct evidential tests capable of indicating tacit collusion, the most notable being Posner's.[16] Inevitably, given the described impossibility of identifying the occurrence of tacit collusion in isolation, as a means for identifying tacit collusion to the exclusion of oligopoly reversion it has a number of shortcomings – most of which, it must be said, are acknowledged by Posner to some degree.[17] Posner's approach can be broken into three component tests.

First, is the test of whether a market is conducive to collusion, which involves a systematic examination of those factors increasing the likelihood of anti-competitive behaviour based on the Stiglerian cost of collusion analysis. A high concentration ratio, inelastic demand at the competitive price, product homogeneity, symmetrical costs, together with a raft of other indicators demonstrating that a collusive price would be both highly profitable and relatively easy to attain, are all taken to be indications of collusion. As a stand alone test for tacit collusion it is unsatisfactory since no indication is given of the set of circumstances which will tip the cost-benefit calculation in favour of a rational decision to collude. Even if one could define a given market as one where a rational firm will collude, there is no guarantee that the firms in the industry in question are in fact acting rationally (however this is defined) and, hence, that the resulting efficiency effects (again, no matter how defined) are occurring.

The second potential indication of tacit collusion is evidence demonstrating the operation of a super-competitive price in the market.

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[15] M. Ivaldi, B. Jullien, P. Rey, P. Seabright and J. Tirole, *The Economics of Tacit Collusion: Final Report for D.G. Comp.*, (Toulouse: I.D.E.I., 2003), p. 63.

[16] R. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 2nd Edition, 2001), p. 52 *et seq.*

[17] *See also* First's critique of Posner's tacit collusion analysis: H. First, "Book Review of R. Posner, *Antitrust Law: An Economic Perspective*", (1977) 52 *N.Y.U. L. Rev.* 947.

Although not stated in so many words, Posner's understanding of a competitive price is a dynamic one characterised not by the coincidence of price with marginal cost, but as the level at which if the market had no barriers to entry (based on the Chicago view) competitors will not be induced to enter the market and compete on the same or a lower price. Elasticity of demand at market price, declining market share on the part of the leading or longer established firms and the falling of market price with each new entrant are all therefore taken as indications of the existence of collusive pricing arrangements. The problem of such an approach is that it does not identify which of the market participants are engaged in the practice – a pertinent issue since several of the indicators of super-competitive pricing are dependent on the occurrence of new entry without accession to the terms of collusion (tacit or express). An even greater problem is the fact that super-competitive pricing is not an exclusive attribute of collusion since it will be equally indicative of a Cournot oligopoly reversion, as Posner concedes:

> If a monopolist responds to a new entrant by curtailing its output, and the entrant responds to that response by limiting its own output (as in the Cournot oligopoly model...) the entrant might be held liable, along with the monopolist, for having tacitly colluded to limit the market's output.[18]

Third is the occurrence of actions tending to increase market transparency, such as exchanges of price information or industry wide retail price maintenance. It is important to note that each of these instances may be explained as the results of non-collusive behaviour designed to improve the efficiency of the service or product in question. In effect this was the conclusion of the E.C.J. in *Wood Pulp II* as to the prior price announcements of the various producers. It might also be questioned, as in the discussion of the *John Deere*[19] decision in chapter four,[20] whether information exchange might in and of itself be better descried as an instance of express collusion.

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[18] R. Posner, *op. cit.*, p. 98.

[19] Case T-35/92, *John Deere Ltd. v. Commission* [1994] E.C.R. II-957.

[20] *See* p.211 *et seq. supra.*

The absence of a clear evidential test for both identifying tacit collusion and distinguishing it from the occurrence of oligopoly reversion explains in large part the exclusion of this type of behaviour from the general prohibition in Article 81. Conversely, it is the capacity of certain instances of tacit collusion to be isolated and identified by the legal evidential methodology which explains the occurrence of the special cases exemptions to the general principle and the acceptance of considerations of prospective tacit collusion during merger analyses. In the case of both the hangover principle and the tacitly colluding fringe player, there is little difficulty in determining whether the behaviour of the undertakings under scrutiny is collusive since a frame of reference is provided by the existence of a known collusive price in the form of the price resulting from known express collusion. Thus in the case of the hangover principle the price resulting from the previous express arrangements becomes the benchmark against which the collusive nature of future market outcomes will be revealed. If market conduct continues to reflect that which occurred under the formal agreement and there have been no significant changes in the economic environment, then the identification problem associated with tacit collusion is, if not completely solved, at least minimised to a very significant degree. Likewise, in the case of a fringe player operating on a market where the major undertakings are involved in express collusion, the collusive price/output combination is readily and objectively identifiable using the expressly agreed price as the frame of reference. In these cases the inability to describe the resulting market outcome as collusive, which usually arises in the case of tacit collusion, disappears since although still instances of tacit collusion, they are causally connected to the occurrence of express collusion and hence the same *a priori* identification of the collusion price.

The acceptability of considerations of tacit collusion during a merger analysis arises for the different reason that a relative or ordinal analysis is perfectly suited to the prospective nature of the assessment involved. The matter for consideration during the review of a merger decision is whether there exists an increased probability of collusion arising in the relevant market and consequently, the fact that firms are more likely than not to behave in a rational manner and the fact that those environmental economic occurrences with the strongest possibility of impacting on the expected outcome may be taken into

account, are sufficient tools to permit a relative analysis of the proposed merger against the maintenance of the *status quo*.

Where the law's evidential normative function fails to provide an explanation, however, is in the special case of anti-competitive effects being inferred from many similar but independent vertical arrangements in so far as this principle may be used as a measure against tacit collusion. Unlike the hangover principle and the case of the fringe player, there is no externally verifiable statement of the collusive position. In addition, as a determination of historical occurrences rather than prospective probabilities, it is not a use of economic relative analysis that is permitted by the legal methodology. The only concession to the identification of a monopolistic outcome evident in these cases is the requirement that the undertakings imposing the restrictive agreements exercise some degree of quasi-market power which, even if this is a test for determining the existence of an oligopoly in the relevant market, fails ultimately to demonstrate whether the practices in question are demonstrative of oligopoly reversion (whether Bertrand or Cournot) or collusion. It should be observed, however, that the application of the case law in relation to a multiplicity of vertical agreements in the context of tacit collusion has yet to be expressly considered by the courts, and it is not unreasonable to speculate that should this be attempted the result will be either a restatement of principle excluding considerations of tacit collusion or else the setting out of a standard of proof which is difficult to satisfy in the extreme. A parallel may be drawn here with the evolution of the concept of joint dominance, which although capable in theory of capturing acts of tacit collusion, imposes a standard of proof as to the existence of an 'excessive' price so logistically and conceptually fraught with difficulties as to render the principle practically ineffective as an instrument of tacit collusion control. Ultimately, the implications of the legal evidentiary methodology are inescapable whether stated as a rule of law or a standard of poof because the existence of historical events cannot be demonstrated to the degree required by the law's methodology based on the suggestions of a model of rational behaviour alone.

Normative Functions III: The Requirement of Certainty

When the Community courts speak of the requirement of certainty they usually mean one of three things:[21] the principle against retrospective application of Community acts (*sécurité juridique*); the principle of *protection de la confiance légitime*, which approximately accords with the common law notion of legitimate expectations; or the requirement of clarity in the application of the law, effectively a civil equivalent of the criminal law maxim, *nullum crimen sine lege*, which was expressed by the E.C.J. in *Kloppenburg* as the requirement that "Community legislation be unequivocal and its application must be predictable for those who are subject to it".[22] It is this last conception of the certainty criterion which merits the greatest attention for present purposes, specifically in the context of the ease with which the decision-makers within a firm can identify the legality of the various courses of action available to them.

In the case of a prohibition on express collusion, the exercise of identifying the scope of the illegal act is relatively straight forward since the action requires a definite externally recognisable action of contacting the firm's rivals with a view to establishing a mutually beneficial restriction on output, increase in price or delimitation of geographical area. Certainly there will be some courses of action which will be borderline legal or illegal where the firm may be uncertain as to the legal characterisation of its actions, such as in the case of information exchange or meetings with rivals to discuss joint actions which may not be necessarily collusive. The nature of the express contact requirement is such, however, that even in these hard cases the firm is presented with a clear choice whether to engage or refrain from the questionable activity. In other words, the action of express collusion involves the taking of a conscious and externally verifiable step which is capable of being avoided by an economic actor that is continuing to perform its core functions in a rational manner.

The situation for a rule prohibiting tacit collusion while permitting all other behaviour resulting in oligopoly reversion, including the Cournot outcome, is more complex. Assuming the internal decision-maker is capable of discerning

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[21] *See generally* T. Hartley, *The Foundations of European Community Law*, (Oxford: Oxford University Press, 4th Edition, 1998), pp. 142-147; T. Tridimas, *The General Principles of E.C. Law*, (Oxford: Oxford University Press, 1999), p. 163 *et seq.*

[22] Case 70/83, *Gerda Kloppenburg v. Finanzamt Leer* [1985] 2 C.M.LR. 205, para. 11.

two clear strategies – on the one hand, pricing at the collusive level with the expectation that rivals will follow suit, with a second option of pricing at the oligopoly reversion (*i.e.* either the super-competitive Cournot level if capacities are fixed for the relevant period of competition, or else the Bertrand competitive level if capacities are variable) – then the adoption of either strategy involves the same internal process of calculating how to maximise profit. The fact that determining which of these choices is taken is impossible to externally verify will, of course, be relevant for the ease of enforcement and the practicality of adducing evidence of infractions, adding to the difficulties in satisfying the evidential requirements discussed in the previous section. From the point of view of the certainty criterion the issue is whether the decision to tacitly collude is internally verifiable – *i.e.* that it is a conscious decision. Posner suggests that it is, describing the process of the deliberate election to tacitly collude by way of the following examples:

> If a firm's sales manager recommends that the firm offer a wider variety of products in order to exploit consumer demand more effectively, and the financial vice president recommends against that course on the ground that it will make it more difficult for the industry to maintain 'healthy' prices, the president of the firm can be in no doubt of the significance of his actions if he adopts the financial vice president's recommendation. Or if a salesman has correctly calculated that a proposed sale would yield a handsome profit, and his boss turns it down on the ground that it might provoke a competitor to retaliate because the sale price would be considered price cutting, again there would be no ambiguity that the firm's action was designed to preserve a collusive arrangement. Or take the common case in which each seller in a market has "sleepers", that is, customers who do not shop around for the best deal but are content with their current supplier. If each seller declines to try to wake the other seller's sleepers, on the ground that of he does so the others will try to wake his sleepers and everyone will be worse off,

the seller will know that he is acting to preserve a collusive arrangement.[23]

It has to be conceded that each of these cases would appear to present an instance of an internally verifiable decision to tacitly collude; although, it should be noted that each of Posner's examples involves an election not to deviate from the currently prevailing market policy. Since the decision to collude results in no visible deviation in market behaviour, the chances of an external verification of the conduct in question recede, with the phenomena of tacit collusion through inertia of pricing or output becoming indistinguishable from the non-collusive failure in an industry to develop more efficient methods of operation.

In contrast, when the internal decision is to adjust market policy from a non-collusive stance to a collusive one, it is the problem of internal verification that comes to the fore. Within the laboratory of perfect knowledge an economic actor determines the difference between a collusive course of action and the adoption of the relevant oligopoly reversion by the virtue of fact that the adoption of the former carries with it the risk of significant losses if its rivals fail to follow suit, while the former option will result in no such losses regardless of competitors' reactions. This is in essence the premise of the basic single period two player game. If the condition of perfect knowledge is removed and it is assumed instead that there is some level of uncertainty as to a rival's capacity and/or marginal costs, then the distinguishing characteristic of the presence of a risk of undercutting which existed between the tacit collusion and oligopoly reversion options disappears. In the case of the oligopoly reversion being the Bertrand outcome this is because the decision of the firm to enter or continue to compete in the market may result in substantial losses if its rival is more efficient and capable of pricing below the firm's marginal cost. In the case of Cournot, if the firm underestimates its rival's profit maximising level of output, it may result in substantial losses being suffered by both firms due to the firm's subsequent over-production. Where a firm has a range of estimates as to the possible costs and capacities of its rivals, then the decision to collude becomes just one of a myriad of options dependent on a prediction of a rival's potential

[23] R. Posner, *op. cit.*, p. 97.

actions, each involving an incremental change in risk and benefit. Evaluating any one of these options entails the same process of computation as to competitor reaction regardless of whether it is a strategy of collusion or oligopoly reversion. It is not unreasonable to hypothesise that the subtleties of formal economic classification for each of a potentially infinite range of upside-downside options may be lost in the mists of industrial reality, and that ultimately in these circumstances a rule against tacit collusion is uncompliable without imputing a level of market visibility unlikely to be found outside the artificial strictures of a board-game.

A prohibition on tacit collusion is thus left in an impossible legal bind. On one hand decisions to achieve collusion through inertia are externally invisible, even before the evidential difficulties examined in the previous section are considered. On the other hand, the election to adjust market policy towards a collusive position may be beyond internal recognition. Either way, whether from the perspective of the judge or the economic actor, the requisite level of certainty for identifying breaches of the rule against tacit collusion would appear to be lacking. This has been acknowledged by the courts in their collective characterisation of all non-expressly collusive oligopoly conduct under the heading of permitted independent behaviour. Thus in *Dyestuffs* the E.C.J. stated that "it is permissible for each manufacturer to change his prices freely to take into account for this purpose behaviour, present and foreseeable, of his competitors",[24] while the court in *Sugar* reasserted independence as the litmus test of legality:

> Each economic operator must determine the policy which he intends to adopt on the Common Market... it is correct to say that this requirement of independence does not deprive economic operators the right to adopt themselves intelligently to the existing and anticipated conduct of their competitors....[25]

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[24] [1972] C.M.L.R. 557, para. 118.

[25] Cases 40-48, 50, 54-56, 111, 113-114/73, *Suiker Unie and others v. Commission* [1975] E.C.R. 1663, [1976] C.M.L.R. 295, para. 173.

Underlying both of these statements is the understanding that decisions to tacitly collude may not be internally or externally verifiable, falling within a more general and readily identifiable class of rational independent actions. As such, in the hierarchy of judicial concerns, legal certainty is elevated above fidelity to mirco-economic theory.[26] This priority of objectives is evident in Tesauro A.G.'s examination of the remit of the first merger regulation[27] in *Kali and Salz*[28] where he declared that notwithstanding the existence of a "justification in economic terms" a particular conclusion could not be allowed to stand where it would "ultimately foster uncertainty" and ignore the requirement that the law "be predictable for those who are subject to it".[29]

Where tacit collusion is made the subject of legal restrictions in European law it is almost invariably because the certainty requirement has been satisfied. This is most obvious in the case of the mergers regulation since the event which is the subject of judicial determination has yet to occur and the economic actors are provided with binding guidance as to the legality of their planned course of action safe in the knowledge that there will be no subsequent retrospective reclassification of its legality. For the fringe player operating in compliance with the express collusion occurring between other market participants or an undertaking continuing to act in compliance with a defunct formal agreement as in the case of the hangover principle, the internal verification that their current market activity is an act of collusion becomes possible by reference to the similarity of their current market policy with either their own historical actions or the contemporaneous behaviour of rivals which are known to have been the result of inter-rival communication.

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[26] This has been stated as a general proposition by a number of commentators, *see* A. Neale and D. Goyder, *The Antitrust Laws of the United States of America: A Study of Competition Enforced by Law*, (Cambridge: Cambridge University Press, 3rd Edition, 1980), pp. 489-460; A. Jones, "*Wood Pulp*: Concerted Practices and/or Conscious Parallelism?", [1993] 14 *E.C.L.R.* 273, 276; V. Korah, "*Gencor v. Commission*: Collective Dominance", (1999) 20 *E.C.L.R.*. 337, 339.

[27] Council Regulation 4064/89/E.E.C., on the control of concentrations between undertakings, [1990] O.J. L257/14, as amended by Council Regulation 1310/97/E.C., [1997] O.J. L180/1.

[28] Cases C-68/94, 30/95, *France v. Commission (Germany intervening), Société Commerciale des Potasses et de l'Azote and Enterprises Minière et Chemique (Kali und Salz Beteiligungs A.G. intervening)* [1998] 4 C.M.L.R. 829.

[29] *Ibid.*, para. 98, *per* Tesauro A.G.

Once again, however, the exception from the legality of tacit collusion in the case of many vertical arrangements is difficult to reconcile with a normative function of the legal system, since there is no clear current or historical indicator of illegality nor method of prospective verification to which a firm determining the scope of its vertical arrangements can refer. In one of these cases, *Brasserie de Haecht*,[30] Darmon A.G. directly alluded to the potential uncertainty associated with this principle in the following terms:

> [The appellants contend that] if under Article [81](1) account must be taken of the brewery contacts concluded by all the breweries established in a member-State, that involves an intolerable legal insecurity, since the parties to each of those contracts have no possibility of knowing the number and content of all the other agreements (some of which may have been concluded abroad) and thus knowing the legal consequences of their obligations. ...In truth, it cannot be denied that certain difficulties arise in this connection. But their importance must not be overestimated.[31]

The advocate general went on to justify the trumping of the uncertainty concerns on two grounds.[32] First, some uncertainty as to the precise legal implications for an action was an unavoidable trait of economic law, with the requirement of certainty as an element of the rule of law being satisfied so long as the undertaking in question was able to make an objective determination of the potential liability arising from a given situation. There is no doubt that this proposition is an accurate description of the certainty criteria, after all, as Darmon A.G. pointed out, this is the premise which makes the abuse of dominance prohibition under Article 82 enforceable. What it does not address, however, is the specific problem of distinguishing acts of tacit collusion from oligopoly reversion since, as we have seen, an objective characterisation of the dividing line where an action crosses over from being one to being the other

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[30] Case 23/67, *Brasserie de Haecht v. Wilkin and another* [1967] E.C.R. 525, [1968] C.M.L.R. 26.

[31] *Ibid.*, 36-37, *per* Darmon A.G.

[32] *Ibid.*

may be impossible. The advocate general's second argument was that Article 81(3) provided market participants with a prospective method for determining the illegality of an intended action. Where the action to be considered comprises of the adoption of a standard set of terms which will be used by the economic operator as the basis for a substantial number of transactions, this pre-approval mechanism may be a means for satisfying the certainty requirement. However, where the action concerned arises during the minutiae of day-to-day decision making, involving its own unique set of considerations of little importance relative to the overall activities of the economic actor – such as the decision to compete for a particular customer's business – then as a matter of practicality the utility of Article 81(3) as a safeguard of certainty is greatly diminished, even before one begins to consider the anachronistic element of the advocate general's arguments in the current era of a directly applicable Article 81(3). It may therefore be concluded that to the extent that the principle of tacit collusion through multiple vertical agreements is an element of the Article 81 prohibition, the problem of certainty remains. Perhaps a final analysis of this can only be made if and when there is a definitive statement by the courts as to whether vertical agreements may be used as a back-door to prohibiting tacit collusion, for it will only be then that the position of this principle in relation to the normative function of legal certainty will be ascertainable.

Regardless of the outcome of this latter issue, it is clear that the stance of the court in relation to independent economic actions privileges a form of economic behaviour the prohibition of which, notwithstanding the similarity of its efficiency effects to those of express collusion so assiduously pursued by the judicial principle, is simply beyond the countenance of the law's methodological requirement for certainty.

Methodological Rejection beyond Tacit Collusion

The two normative functions described as driving methodological rejection in this chapter represent inherent elements of the legal system controlling the terms on which external arguments are considered, admitted, and – as in the case of the non-equivalence of historic tacit and express collusion – excluded from the bounds of legal reasoning. The occurrence of tacit collusion is an event which

the legal system is incapable of isolating and addressing in its own terms because it is a concept that cannot be accommodated within the inherent systemic requirements of evidence and certainty. Since the normative functions are inherent to the legal system as a whole, it would seem to follow that they operate across the entire system and not just in the particular case of tacit collusion, and it may be that in other instances too they are the drivers of methodological rejection. Two such possibilities immediately suggest themselves for further study.

First, is the failure of the courts to develop any significant case law on the issue of monopolistic pricing as an abuse of dominance under Article 82. This would appear to be an instance of a non-equivalence within the law's selection of economic values indicative of divergence beyond mere rhetorical divergence. On one hand, price-fixing agreements deemed harmful under Article 81 are deemed harmful to efficiency, while the potentially identical effects of an integrated monopoly are left *de facto* unregulated. The explanations that seem to present themselves for this *prima facie* case of divergence would appear to be, once again, the normative functions of the evidential burden (how do we know that the alleged monopolistic price is in fact so without any external reference event such as collusive agreement?) and the requirement for individual certainty (how would a monopolist be expected to know when his every-day profit maximisation motive moves beyond the bounds of legality?).

A second area for further study may be the non-equivalence of the Community courts' market-power requirements under Article 81 compared to those under Article 82. One potential answer is that the need for an elaborate market dominance definition procedure is obviated when addressing behaviour under Article 81 because the very occurrence of the behaviour would tend to indicate that it is capable of having a malign efficiency effect, whereas there can be no such automatic inference under Article 82.

It might also be hoped that the concept of methodological rejection and the autopoiesis understanding of the interaction of systems upon which it is based raised the possibility of normative functions driving divergence in addition to the two discussed in this chapter.

CHAPTER NINE

A BRIEF WORD ON BROAD EFFICIENCY AND FORMALISM

The two normative functions examined in chapter eight reflect the kernel of the legal methodology as a system for imposing the rule of law: on one hand, a legal rule must be knowable for compliance to be attempted, and on the other, breaches must be detectable if the regulation in question is to be enforced. If at times these concerns trump a strict fidelity to micro-economic theory, then it must be seen as a necessary compromise for the policy suggestions of economic study to be translated into force of law. As Llewllyn points out, this is not to say that knowledge means obedience, but that without knowledge obedience is impossible and conformity an accident.[1] This loss of fidelity is thus a transaction cost unavoidable in attempting to implement efficiency maximising solutions. Relying on Coase's theorem of transactions costs, the methods by which these costs are minimised – as in the adoption of simple rule of contact-based collusion prohibition – are themselves indicative of an economic outcome, that is, the resulting legal rule is the most efficient method of enforcement given an overall aim of efficiency maximisation.[2] In this sense one can legitimately ask whether the observation of the divergence of law and economics set out in this thesis relies on an unduly narrow conception of what can be understood as being consistent with economics: are the legal rules applicable to tacit collusion actually in line with a 'truer' conception of an economic approach which takes

[1] K. Llewllyn, "The Effect of Legal Institutions upon Economics", (1925) 15 *Am. Ec. Rev.* 665, 669-670; *see also* T. Tridimas, *The General Principles of E.C. Law*, (Oxford: Oxford University Press, 1999), p. 163: "Economic and commercial life is based on advance planning so that clear and precise legal provisions reduce transaction costs and promote efficient business. Legal certainty may thus be seen as contributing to the production of economically consistent results."

[2] R. Coase, *The Firm, the Market and the Law*, (Chicago and London: University of Chicago Press, 1998), pp. 10-15.

into account the need for efficiency of enforcement? This effectively subjects the description of methodological rejection to the same criticism levelled in chapters three and four at rhetorical divergence and the claimed observations of the uneconomic nature of the law – namely, that the identification of the divergence in question is the result of an unduly narrow definition of what constitutes economics. In essence this is the charge of formalism raised by Freeman[3] in relation to using autopoietic constructs of thought: every normative element of the legal system is capable of being construed as a cognitive element and *vice versa*, and thus an autopoietic framework of divergence rests ultimately on descriptions of form which are uncorroborated, and perhaps even incapable of objective corroboration. In the current context, the categorisation of the normative functions of evidence and certainty as the normative elements of legal methodology which block the cognitive absorption of the economic concept of tacit collusion are susceptible to reclassification as economic phenomena (*i.e.* the minimisation of transaction costs) which are cognitively absorbed into the legal system, and consequently the observation of divergence set out in this thesis becomes vulnerable.

The response to this charge is to point out that constructing a conception of economics so broad that it describes the rejection of micro-economic implications in the judicial application of competition law as a result of the adoption by the legal system of a greater economic efficiency concern effectively reduces the study of economics to an infinite set of descriptions capable of explaining every worldly phenomenon as an economic one. Of course, this assertion is itself a value judgment as to the bounds of micro-economics not altogether dissimilar from those characteristic of the occurrence of rhetorical divergence. The charge of formalism is thus irrefutable, but only in the sense that all nihilistic perspectives are. As an article of faith, this thesis has taken as its starting point the existence of objectively discernible literatures of law and economics which are representative of the respective methodologies of each system. From these an empirical study has been carried out, from which in turn a commentary as to the contents of each element of the literature has been

[3] M. Freeman, *Lloyd's Introduction to Jurisprudence*, (London: Sweet & Maxwell, 7th Edition, 2001), p. 702, *see generally* on the charge of formalism in autopoiesis *supra* p. 75 *et seq*.

set out and an observation as to the differences between the two made. The selection of the literature for study – *i.e.* the selection choice of micro-economics as the economic element and Community case law as the legal one – no doubt involves some element of formal division from which has flowed both the submission of a new analysis of divergence and a critique of the several prevailing explanations of this concept. However, if, as is hoped, the opening literatures have been correctly selected (in the sense that these are the ones considered with some level of consensus by the judges, lawyers and economists operating in the field of competition policy to be the relevant ones from which they postulate their arguments and form their positions), the formalism involved dissipates into the background of a general inter-subjective agreement as to the nature of study. Consequently, to the extent that there is a formalism in this study it is a collective one determined by many individual actors, and by virtue of this fact enjoys some claim to objectivity. Ultimately the charge of formalism is defeated by the falsifiable empirical nature of this study, either through the demonstration that the selection of opening literature is incorrect on the inter-subjective level or that the commentary based on this literature is in some way wanting.

CONCLUSION

The aim of this work has been to provide an account of the divergences between Community competition law and micro-economic theory and the reasons why they occur. More specifically, the question attempted to be addressed from the outset is how these disparities can arise given that economic thinking plays such a central part in the judiciary's rule-making and fact-finding in competition cases.

The thesis proposed is that the argument that divergence is the result of judicially endorsed non-economic competition law objectives is unsubstantiated; that much of what is described as divergence misidentifies the clash between a given legal decision and one of possibly many economic arguments, as divergence from economics as a whole; and that while there is a more authentic form of divergence, it is the result of the impossibility of adapting certain abstract economic theories into a form that can be utilised by a legal system operating under practical constraints (in particular, the need for evidence based on proven facts rather than assumptions, and the requirement for some basic level of certainty as to the legality of a given action), rather than the outcome of any deliberate relegation by the courts of economic policy concerns. In short, Community competition law only departs from its objective of protecting 'competition' in the economic sense where it lacks the conceptual tools to accept a particular economic idea into the legal sphere.

Central to the suggested concept of divergence is the idea of the law as an autonomous social structure capable of accepting external arguments, but doing so on the basis of its own selection as to which non-legal elements will be absorbed, and subject always to the ultimate restriction that the legal system can only accept that which its own methodology is capable of adapting.

Divergence can therefore be understood as two phenomena. On one hand, the Community courts have accepted economic reasoning, and in particular efficiency maximisation, as *the* determinant of what constitutes anti-

competitive behaviour; however, the independence of the legal system together with the possibility afforded by micro-economic theory that there may be more than one 'correct' economic conclusion to most real-world problems, means that the courts are able to select from between several equally economic conclusion, more than one of which may be mutually exclusive to some of the others. Where the supporters of one of the rejected economic arguments point to their theory as obviously economic, it is a small leap for them to conclude that the model selected by the courts must therefore be 'uneconomic'. This is rhetorical divergence; in essence it is the mistaken belief that since the law's position on a particular issue is irreconcilable with a particular line of economic thinking, it must therefore be divergent from economics in general. In the Community context the occurrence of rhetorical divergence shows a tendency by the courts to favour both economic models valuing short term increases in competition over the longer term promotion of the competitive process, and ones that are less likely to treat rational behaviour as a readily identifiable certainty. This in turn suggests the legal system's preference for rules that are more likely to require positive acts of compliance by forbidding events with a realistic probability of occurring – in other words, rules that are capable of being broken. This revealed trend is one of the underlying 'normative functions' of the legal system, that is to say a tangible element of the legal system's methodology which both characterises and maintains it as an independent social system.

On the other hand, there is the more authentic concept of divergence. Again this is not the result of the law prioritising some non-economic objective of competition law. Instead, because law is an autonomous social system, and therefore necessarily subject to its own boundaries, there are some economic concepts which are incapable of being absorbed into the law's system of meanings. This form of divergence is not the result of any deliberate decision to reject an economic approach or favour an alternative non-economic interpretation of competition law; rather it is the manifestation of the fact that some aspects of economic thinking cannot be effected in the form of workable legal rules. To repeat the linguistic analogy used in the introduction to this work, it is not that the law does not understand or positively rejects the language of economics, it is that no translation of the economic concept is possible. As such, this type of divergence has been termed as 'methodological rejection' since it is

caused by a wholesale incompatibility between the legal and economic systems that goes to the core of their respective ways of thinking – something which cannot be dismissed as the merely rhetorical divergence between the acceptance by the legal system of one legal model at the expense of another. More concretely, methodological rejection can be seen as being caused by two further normative functions; first, while the law is willing to rely on economic models to decide whether a particular act in specified circumstances is anti-competitive, the legal system's own evidential methodology prohibits the use of predictions generated by the economic presumption of rationality alone from being construed as proof that the act in question has in fact occurred; secondly, the requirement for a minimum standard of legal certainty means that individuals may only be found in breach of legal rules where they have taken conscious decisions to carry out the prohibited act, and these decisions can be externally verified as such.

In putting forward this thesis, this work was divided into three parts. The objective of part I (chapters one and two) was to set out the shortcomings of some of the prevailing explanations of divergence which focus on the supposed predominance of non-economic policy concerns in judicial decisions, and to set out the theoretical basis for an analysis of divergence which addressed this criticism; part II (chapters three and four) was intended to examine the occurrence and causes of rhetorical divergence; while part III (chapters five to nine) aimed to do the same in respect of methodological rejection.

The first step of this analysis was to challenge some of the orthodoxies as to the causes of divergence. In chapter one it was argued that an economic analysis (of some description) of the impact on efficiency of an impugned action has been pivotal to the courts' determination of that action's legality under Article 81 and 82. This is evident from the manner in which the basic test for deciding whether an undertaking's conduct has anticompetitive effect – that is, the simple question first formulated in *Technique Minière*[1] as to the market effect of the action under scrutiny – has been continually developed into a series of ever more finely tuned econo-legal principles for examining market structures

[1] Case 56/65, *Société La Technique Minière v. Maschinenbau Ulm G.M.B.H.* [1966] E.C.R. 235, [1966] C.M.L.R. 357.

and market power. Thus, economic arguments regarding monopoly power, potential competition, barriers to entry and elasticities of demand and supply have not only entered the legal vernacular, but become the 'points of law' to be debated and adjudicated on in antitrust cases. This is borne out both by taking a holistic view of the Articles 81 and 82 jurisprudence, and by examining some of the more recent express policy statements issued by the Commission in this regard – the statement in its recent guidelines on vertical restraints that "the protection of competition is the primary objective of E.C. competition policy" being typical in this regard.[2]

There is, of course, a considerable chorus of opinion that holds that this centrality of economics holds true only up to a certain stage, beyond which other judicial concerns emerge to trump the efficiency objective of competition law. These arguments form the back-bone of the conventional explanations of divergence, *i.e.* that competition law differs from competition economics because on occasion the legal definition of the term 'competition' draws on meanings and policy concerns unconnected to the microeconomic concept of the same name. Chapter one took issue with this contention by challenging its supposed foundations in the case-law. The formalistic-prohibitory interpretation of antitrust – that is, the view that the legality of an action is determined by its formal appearance rather than its effect on competition – has failed to take root in Community law. Thus the better interpretation of the doctrine of anticompetitive objects under Article 81 is that only the need for empirical market evidence of efficiency harm is obviated, and there remains a requirement to consider in principle the efficiency effects of the action in question. Likewise, there is little support in the decisions of the Community courts for the argument that alternative non-economic competition objectives are the drivers of divergence. There is a lack of evidence in the *acquis* for the contention that concerns for the maintenance of the protection of market plurality or the maximisation of employment are capable of trumping economic arguments to the contrary. Too often the proponents of these analyses of non-economic divergence overlook the courts' express espousal of efficiency arguments,

[2] Commission Notice 2000/C 291/01, Guidelines on Vertical Restraints [2000] O.J. C291/1, para. 2(7).

preferring instead to take an unduly narrow view of what the 'correct' economic decision in the circumstances would have been, before concluding that, since the court failed to follow this economic view, the 'real' reason for the decision must have been some non-economic policy concern which – as it is nowhere stated in the case-law in as many words – must be implied into the courts' reasoning as the obvious underlying judicial policy objective. Nowhere is this flawed approach more clearly evident than in the most celebrated of the non-economic explanations of divergence: the market integration imperative. Each of the major cases held out as an example of the rejection by the courts of efficiency-promoting rules in favour of principles protecting cross-border trade are more easily reconciled as instances of the protection of intra-brand competition – a valid efficiency goal, albeit one that prioritises short-term efficiency gains over perhaps greater improvements in the long run. Even the judgment most often claimed as the centre-piece of the market integration approach, *Maize Seeds*[3] (a case whose alleged internal inconsistency in efficiency terms is usually alluded to as the result of the triumph of the market integration reasoning) fails to support the conclusion attributed to it for it raises an even wider point – is it theoretically possible for a market integration objective to be in conflict with an efficiency maximisation goal, for surely if a restriction is a necessary incentive for market entry in the first place (thereby improving efficiency), and that market entry occurs across a Community border, then it must automatically follow that the restriction is a prerequisite also for the cross-border trade to occur.

What chapter one served to demonstrate was that a convincing account of divergence cannot be found in the old reliable explanations of prohibitory-formalism, market plurality and the market integration imperative, or by pointing to some stereotyped portrayal of the legal thought process as so wedded to reasoning by analogy as to be incapable of properly understanding straightforward economic concepts. The challenge for understanding divergence thus becomes a question of reconciling the non-alignment of legal and economic principle with the pivotal role of economic objectives within competition law.

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[3] Case 258/78, *Nungesser K.G. and Kurt Eisele v. Commission* [1982] E.C.R. 2015, [1983] 1 C.M.L.R. 278.

Chapter two set out to address this issue by recasting the issue of divergence as a question of autonomy: how can the ready acceptance by the legal system of much of the theory and mode of thinking of the economic system be reconciled with the self-determined conceptual control to reject external suggestions which divergence presupposes? The answer (or at least a useful framework for considering the issue) is found in Luhmann's theory of autopoiesis, which accounts for the independence-interaction dichotomy by proposing social systems with their own closed but evolving methodologies which respond to external elements by drawing on the aspects of their pre-existing internal structures best-suited to reacting to the external events. The autopoietic selection and internalisation of external elements suggests that the occurrence of divergence can be understood as the result of one of two processes. First is rhetorical divergence, which in autopoietic terms can be described as the selection of one of several externally suggested options based on the legal system's inherent modes of reasoning, which in the case of competition law have resulted in an efficiency-orientated approach that is constantly being refined by further selections of as between economic arguments, each such selection being informed by the legal system's inherited body of reasoning. Second is methodological rejection, which arises from the legal system's inability to adapt any aspect of its existing methodology to cope with the particular economic issue in question – that is to say that there is no conceivable legal rule adequately capable of addressing the problem identified by the economic system. The contrast between this autopoietic approach to divergence and those criticised in chapter one is immediately apparent. Rhetorical divergence is the result of differences between alternative economic suggestions as to how the legal rule should be formulated and, as such, there is no need to resort to inferred evidence of non-economic policy objectives in order to explain the divergence in question. The idea of methodological rejection also fits in comfortably with an economic competition law; the rejection of the economic system's way of thinking is not the result of a deliberately-reasoned furtherance of some non-economic policy objective, it merely reflects a paucity of legal reactions to the economic issues envisaged.

Taking this outline of the nature divergence as its theoretical point of reference, parts II and III turned to examining the operation of each of the

proposed types of divergence in more detail. In chapter three the prerequisite for the occurrence of rhetorical divergence was examined, namely, that there be more than one correct economic outcome for the same given factual situation, one of which is taken and promoted by the legal system, and at least one alternative that is held out by some part of the critical literature as the model which the court should have followed in the circumstances. Initially it may appear somewhat unscientific to surmise that economics allows for several correct outcomes for any given question, but this is the conclusion that inevitably follows from the acceptance that value judgments rest at the heart of every economic inquiry. These irrefutable judgments fall into two categories: first, a decision must be made as to what types of empirical evidence will be deemed to be capable of refuting the economic model being proposed (because in theory almost any contradictory evidence can be explained away as the result of some other interfering factor); and second, there will be a choice as to the boundaries of inquiry beyond which further questions will not be asked (for otherwise every inquiry would have to look both for the ultimate cause of the studied phenomenon and at every possible environmental event that might have a baring on the predicted outcome). The value judgements that must be taken within the major methodological tenets of microeconomics – the metric of efficiency, the rationality function and the *ceteris paribus* presumption – can be identified with some degree of precision with some degree of precision. Specifically, every economic inquiry must commence with the determination of five value questions, for which no answer can ever be described as incorrect:

(vi) What is the grouping with whose utility we are centrally concerned?

(vii) Over what time period is efficiency to be measured?

(viii) What will not be considered as rational behaviour?

(ix) Are the subject-economic actors assumed to behave rationally?

(x) To what extent can empirical observations deviating from the theory be reasonably explained away?

Thus, for example, the answer to the second question will require a weighting of the interests of current consumers against those of the future. If the

period is too short, actions pushing price towards marginal cost will reduce the incentive of producers to innovate towards the next dynamic shift in the mode of production, given the knowledge by the would-be innovators that once the shift occurs their super-normal profits are likely to be reduced more rapidly towards cost than would otherwise be the case. Of course, if the cut-off point is too distant, the utility of current society will be permanently subjugated to future gains. Determining what is the right balance is a question for which there may be more than one correct answer.

Rhetorical divergence can be seen in the Community context as the result of differing answers being given to these value questions. In chapter four the distinctions between the principles advocated by the by the Chicago School of antitrust criticism and those adopted by the Community courts were presented as an instance of rhetorical divergence in action. The two core disagreements between these approaches to competition law are their treatment of barriers to entry (the Chicago School takes a long-term view that ultimately all inefficient monopolies will be eroded in the absence of government protection, while the Community courts tend to take the possibility of immediate entry as their main consideration) and in their assessment of the ability of an undertaking to leverage its monopoly position to create a second monopoly in another market (the Chicagoans, based on their opening presumptions of rationality, view such leveraging as unlikely, or at least unlikely to be efficiency-harming, while Community law tends to treat such leveraging as a commercial reality). These divisions of doctrine are the result of different value judgments as to what is the relevant temporal period for measuring efficiency; as to the extent to which the undertakings under investigation (and possibly also their rivals) are presumed to be behaving rationally; and as to the facts that may be taken into consideration to determine what is rational in the circumstances. Ultimately, neither approach is any more economic than the other, for both rely on value judgments taken within the methodology of economics. To the extent that Community law is seen to diverge from the economic criticism of the Chicago School, what is being observed is an instance of rhetorical divergence. Looking at the issue from as an autopoietic operation, the Community legal system draws on its own traditions to determine which types of economic value judgments prevail in its examination of the issues brought before it. It is not surprising, therefore, that

there is a definite trend in the courts' decisions: economic models are preferred which lead to legal rules the breach of which is more than a theoretical possibility. This unwillingness of the law to reason itself out of a role, therefore, presents itself as the normative function that is the root causes of divergence, at least in its rhetorical guise.

Chapter five opened the detailed examination of methodological rejection by suggesting a test for this form of divergence based on the isolation of divergences that cannot be explained as the result of an economic value judgment. The test suggested was the identification of a single economic phenomenon which in some situations is treated by the law as being anticompetitive, but which in others is deemed to be legally permissible. The implication of such a differentiated legal treatment is that, regardless of the value judgments used to characterise the acceptability or otherwise of the behaviour in question, the very fact of segregation would mean that the legal treatment of the phenomenon would be irreconcilable with every economic approach, since whatever the economic model the demand for a unified treatment of the behaviour would remain, irrespective of what that unified treatment might be. Such an outcome is indicative of something in the methodological structure of the legal system which serves to prevent the full integration of certain economic concepts.

The treatment of tacit collusion in economic theory and Community law, it was submitted, presents a case that satisfies this test for methodological rejection. Chapter six, examined how in economic terms tacit collusion and express collusion are equivalent phenomena, with the labels of 'tacit' and 'express' being largely irrelevant for the purposes of economic theory. Thus, the efficiency effects of each variety of collusion are essentially identical; neither is the automatic outcome in an oligopolistic market and can be differentiated from the non-collusive output in such markets in the same way; and the rational thought calculations for determining whether it is worthwhile to collude involves the same mental processes, whether or not actual communication occurs. The conclusion to be drawn from this analysis is that in all material respects tacit and express collusion form part of the same economic phenomenon. In contrast, the legal treatment of collusion, the subject of chapter seven, demonstrates a clear division between the tacit and express varieties. The

main Article 81 doctrine has over a number of cases – starting with the *Dyestuffs*[4] decision and culminating with the definitive statements in *Wood Pulp II*[5] – developed a carefully reasoned principle that actual evidence of contact between the rival undertakings under investigation is needed before a finding of a concerted practice can be made. As one would expect from the autopoietic interaction of the legal and economic systems, the fact that the Community courts have declined to introduce the concept of tacit collusion into the mainstream concerted practices analysis does not mean that it cannot drawn upon some other elements of its doctrinal armoury to address the issue; after all, the law adapts to economics on its own terms. On this basis a number of instances can cited as being alternative legal avenues to addressing the issue of tacit collusion. First, are the 'special cases' of Article 81: that is, those cases from which can be distilled principles addressing tacit collusion where: it can be implied from the existence of many similar vertical agreements; tacit collusion remains as a hangover from a period of express collusion; tacit collusion by fringe players in a market where other undertakings are expressly colluding; and where the actions in question are designed to aid tacit collusion, albeit not amounting to acts of tacit collusion in their own right. Second, is the use of the concept of joint dominance under Article 82 as a mechanism for controlling tacit collusion between two or more independent firms which, together, are held to be abusing their combined market power notwithstanding the absence of any direct communication between them. Joint dominance, however, is not without its limitations as a tool for imposing a prohibition on tacit collusion akin to that placed on express collusion under Article 81, since although the tacitly colluding firms may be found to hold a position of joint dominance, it is doubtful whether setting prices at the monopoly level can ever be held to be an abuse of that position. Thirdly, the expectation of an increased likelihood of tacit collusion occurring on a given market following the merger of a number of its participants

[4] Cases 48-57/69, *I.C.I. and others v. Commission* [1972] E.C.R. 619, [1972] C.M.L.R. 557.

[5] Cases 89, 104, 116-117, 125-129/85, *Re Wood Pulp Cartel: A. Ahlström and others v. Commission* [1993] 4 C.M.L.R. 407.

will be grounds for refusing to authorise that concentration under the merger regulation.[6]

From this analysis it can be seen that, save for the limited exceptions offered by the special cases, Community law has failed to implement an equivalent rule for tacit collusion as that which it applies for express collusion in its *ex post facto* review of the legality of conduct, although this differentiation of treatment is not maintained during the courts' prospective analysis of collusion under the merger regulation. In chapter eight it was suggested that this mix of equivalent and non-equivalent treatment by the Community courts of the single economic phenomenon of collusion indicated a legal system operating at its conceptual limits. Clearly there is a willingness on the part of the courts to address the perceived harm resulting from tacit collusion, as otherwise it is different to understand the lengths to which the courts have gone in developing the concept of joint dominance and the permissibility of considerations of tacit collusion under the merger regulations. Behind this apparent willingness, however, are two very real methodological restraints preventing the implantation of a clear rule against tacit collusion beyond the special cases of Article 81 and the prospective form of regulation used in the merger clearance context. First, the legal system's use of economic presumptions as to the behaviour of economic entities is confined to formulating principles as to what types of action which should or should not be considered as efficiency harming, with the law's entrenched evidential methodology unable to countenance the use of such presumptions to infer whether or not the act in question has in fact occurred. Thus, where tacit collusion is prohibited by the courts in the special cases of the hangover principle and the actions of fringe players, there exists a clear factual reference to the existence of actual collusion in the form of the known express collusion which has occurred simultaneously (in the case of the fringe players) or nearly simultaneously (in the case of the hangover principle) on the same market; therefore, there is no need to resort to presumptions as to behaviour to infer tacit collusion. Likewise, the problem of inferring tacit collusion does not arise in merger cases, because the 'fact' to be established is not the actual

[6] Council Regulation 139/2004, on the control of concentrations between undertakings, [2004] O.J. L42/1.

occurrence of collusion, but its mere possibility – which is something that a presumption is capable of definitively demonstrating. Second, is the legal system's emphasis on the issue of certainty. For an action to be prohibited by law it must involve the taking of a conscious and externally verifiable step which is capable of being avoided by an economic actor that is continuing to perform its core functions in a rational manner. This is a test that express collusion readily satisfies: the managers of a firm can make a decision not to contact their rivals to discuss price-fixing or output-restricting measures. Similarly, in the case of the special cases of fringe players and the hangover principle a tacit course of action can be deduced as being manifestly anti-competitive by virtue of the direct link between the tacit behaviour and other conduct known to be illegal. The concern for certainty is also alleviated when considering tacit collusion under the merger regulation where there is no historic conduct which can be subjected to a retrospective legal treatment. These two normative functions at the heart of methodological rejection, together with the self-promotion of the legal system's own role which informs its selections between competing economic concepts during rhetorical divergence, can be said to be the three fundamental causes of the divergence between law and economics in Community competition policy.

In the introduction to this work the study of divergence was described as touching on those issues at the heart of competition law jurisprudence – the series of 'big' questions of antitrust fundamental its understanding. Is competition law primarily driven by economic reasoning? How does the law select between competing economic theories? Is there a limit to the role of economic argument? Are there restrictions on the legal system's own ability to adopt the methodology of economics? Having examined the nature of divergence in Community law, and its manifestation as rhetorical divergence and methodological rejection, it is worth revisiting these questions to place the conclusions of this study within the broader jurisprudential context. In reply to the first question, it is submitted that microeconomic theory is the primary intellectual tool used by the Community courts in deciding whether conduct is anticompetitive under Articles 81 and 82. This is not to say that economic efficiency is the sole political or historical goal of competition policy, but in adjudicating competition law disputes the economic understanding of what is

meant by 'competition' reigns supreme; in so far as other non-economic objectives are visible in this operational sense, it is only because they are aligned with the economic conclusions on the matter in question. Turning to the second question, the law selects between competing economic arguments based on the resonance of the value judgments underlying the various theories with those promoted by the legal order. Thus the law decides on relevant economic rules based on its determination, *inter alia*, of the acceptable periods for measuring efficiency effects, the groups of society whose utility maximisation is to be advanced, and the selection of rationality presumptions heavily influenced by what it sees as real-life strategic influences and uncertainties. Above all else, the courts prefer those economic models where anticompetitive outcomes are seen as rational possibilities requiring the intervention of the law. In relation to the third and fourth questions, the instance of methodological rejection in tacit collusion suggests that there is a limit to the ability of the legal system to integrate some aspects of the economic theory. The use of the economic rationality presumptions are confined to the law's rule-formation processes, with the law's entrenched evidential tradition refusing to countenance their use in making factual findings. In addition, the importance of certainty of prohibited actions as one of the defining characteristics of the legal system means that those economic events capable of being described in the abstract but which are not always discernible from desirable permitted actions in real life, cannot be used as the basis of legal rule. Of course, as was discussed in chapter nine, it is always possible to take a broad definition of what is meant by economics and an economic approach to the law, whereby even the two normative functions underlying methodological rejection can be described as reflecting optimal enforcement efficiencies by the legal system. The weakness of this reference to broad efficiency is that it moves the term 'economic' so far beyond its accepted usage in the antitrust literature that it takes on the appearance of the dogmatic statement that the law necessarily always reflects the optimal economic outcome.

Ultimately, this thesis is as a call to re-assess the role of economics in competition law. The significance of value judgments underlying different economic models submitted for judicial attention should be more clearly articulated and acknowledged in the course of debate. Thus while the occurrence

of rhetorical divergence will always remain – for it is unavoidable that economic argument will be framed by reference to a set of opening value judgments – it would be far more desirable for the differing underlying values to be examined and argued in the open, rather than ignored amid the mutual branding of rival theories as 'uneconomic'. It is also important to acknowledge the law's limitations in adapting certain aspects of economic policy, or to put it another way, the economic system's occasional inability to present concepts capable of practical implementation. Observing methodological rejection is not an exercise in attributing blame to one system of thought or the other; instead, it is intended to highlight where the difficulties in transition between law and economics exist, so that solutions to new economic challenges confronted by competition policy might be implemented with greater precision. In the wake of the rise of the Chicago School and its widespread acceptance in the U.S., Community competition policy has struggled somewhat to articulate its fundamental purpose. On one hand, it has rejected many of the tenets of the Chicago mode of analysis, but at the same time it has continued to use economic theory as the foundation for all its major principles of law. In these circumstances the excuse that Community follows a different path to the 'economic approach' will clearly no longer suffice. There is a need instead for a truly post-Chicago perspective which accepts both that Community competition law is grounded on economic foundations, and that these foundations are just as entitled to the badge of being economic as those of the Chicago critique. Viewing competition policy as a forum within which the role of economic values and systemic limitations may be argued releases the antitrust debate from the intellectual blind alley of doggedly holding to one particular economic conception as the exclusively logical legal policy to be followed. It should therefore be possible to have both post-Chicago Chicagoans – that is to say, those holding forth the traditional Chicago School views on antitrust while simultaneously acknowledging the value judgments on which they are based and the limitations of the legal system – as well as economic post-Chicagoans capable of contradicting Chicago arguments without resorting to non-economic justifications for competition law. In the final analysis there can be no one economic theory that holds all the answers for antitrust; indeed, even for a system of laws that locates economic reasoning at its core, there will be problems for which the entire corpus of economic thinking

will fail to present even a single legally intelligible solution. Perhaps, ultimately, the reason for this conclusion can be expressed in terms no more complicated than this: competition law is, and will always be, a system apart from competition economics.

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