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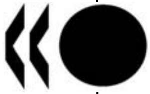

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CRISIS CARTELS

Contribution from Ireland

-- Session III --

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CRISIS CARTELS

-- Ireland --

1. Introduction

1. In January 2011, the Competition Authority (the "Authority") won court proceedings in which it challenged the compatibility with EU and Irish competition law of an agreement between competitors to reduce capacity in the Irish beef processing industry.

2. The Authority initiated the proceedings in 2003 and in July 2006 the Irish High Court decided that the agreement did not have the object of restricting competition and therefore did not infringe Article 101(1) of the Treaty on the Functioning of the European Union ("TFEU") or the equivalent section in the Irish Competition Act, 2002 (the "2002 Act"). In view of that finding, the High Court considered it unnecessary to decide whether the agreement satisfied the conditions for exemption in Article 101(3) and in its Irish equivalent. The Authority appealed this decision to the Irish Supreme Court. In March 2007, the Supreme Court sought a preliminary ruling from the European Court of Justice (the "ECJ") on the question as to whether such an agreement, providing for a restructuring of an entire industry by agreement between the competitors in that industry, has the object of restricting competition. In November 2008, the ECJ held that such an agreement did, indeed, have such an object. Following that preliminary ruling, the Supreme Court referred the case back to the High Court for a decision as to whether the agreement satisfied the conditions of Article 101(3) TFEU. In the end, the High Court did not have to rule on this issue as the parties to the agreement decided not to implement it and withdrew from the proceedings.

3. This submission is primarily focused on the application of competition rules by the different courts involved in the proceedings to the agreement at issue in the Irish case. However, it also addresses some other issues which are relevant in the context of agreements aimed at reducing capacity in specific industries. In particular, it considers the application of competition law to crisis cartels; it deals with recent developments in Ireland regarding situations of reduced consumer demand and overcapacity; and, it suggests a response from an advocacy perspective for times of economic difficulties.

2. Application of competition law to crisis cartels

2.1 Crisis cartel terminology and historical context

4. The term "crisis cartel" has traditionally been used to refer to agreements or other forms of cooperation between competing undertakings aimed at addressing difficulties arising in the context of industries suffering from overcapacity in times of economic recession and/or declining demand.

5. The European Commission's (the "Commission") traditional approach to the application of competition law to crisis-cartels has been to draw a distinction between cyclical over-capacity and structural over-capacity.

6. Cyclical over-capacity is the result of the drop in demand that occurs during a business cycle downturn. In such circumstances, supply and demand can be brought into equilibrium relatively quickly

through the normal play of market forces, with the least efficient players leaving the market either by their own choice or as a result of insolvency.

7. Structural over-capacity is, however, generally recognised as having quite different characteristics. As long ago as 1982, in its annual report on competition policy, the Commission defined structural over-capacity as existing where *"over a prolonged period **all** the undertakings concerned have been experiencing a significant reduction in their rates of capacity utilisation and a drop in output accompanied by substantial operating losses and where the information available does not indicate that any lasting improvement can be expected in this situation in the medium term"* (emphasis added).

8. The issue of how EU competition law should be applied to "crisis cartels" is not new. It has arisen during every economic downturn or recession suffered by the European Union since at least the 1970s. There is, of course, an obvious tension between competition law and the measures that industry (and politicians) often wish to adopt in order to resolve the problems created by serious over-capacity in particular industrial sectors, whether those problems relate to the insolvency of local firms, increased unemployment or the threatened loss of “national champions”. The question as to how competition law should be applied in such circumstances therefore remains a matter of some controversy.

9. In the past, the Commission has reviewed agreements aimed at reducing capacity throughout an entire industry. For example, in *Synthetic Fibres*[1] the Commission dealt with an agreement notified by the main European producers of synthetic fibres to reduce capacity in the synthetic fibres industry. In *Stichting Baksteen*[2] (also known as the *Dutch Bricks* case) the Commission dealt with a restructuring agreement providing for a collective reduction in capacity in the Dutch bricks industry.

10. As indicated above, the European Commission’s consistent approach has been to draw a distinction between cyclical over-capacity and structural over-capacity, emphasising that it is only where an industry is suffering from structural over-capacity that agreements between market participants to reduce capacity in the sector could satisfy the conditions for exemption set out in Article 101(3) TFEU[3]. Whether this is a distinction that should still be considered relevant following the adoption by the European Commission of its Guidelines on the application of Article 101(3)[4] (the “Guidelines”) is discussed at 4.2.2 below.

2.2 Observations of the Competition Authority

11. Competition law as rules of general application to all sectors of the economy with few exceptions are intended to be applied in good and bad economic times. Nevertheless, where an industry or even an entire economy is experiencing difficult times, there is pressure on competition agencies not to apply competition laws or to apply them in an attenuated way. Sometimes, governments are invited to enact laws exempting certain conduct or certain sectors from the application of competition laws on the grounds that the application of competition laws will hinder industry-led efforts to address the crisis in which there may be a persistent low level of demand coupled with chronic excess capacity in the sector. Where the industry is important to the economy including being a major source of employment, governments are called upon to act.

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1 Synthetic Fibres, OJ [1984] L 207/17.

2 Stichting Baksteen, OJ [1994] L 131/15.

3 Being the same conditions as appeared in the corresponding Article of the EC Treaty (numbered Article 81(3) initially and later Article 85(3).

4 OJ C 101, 27.4.2004.

12. From the perspective of competition law, there is no place to apply a different set of analytical principles to examining a 'crisis cartel' that would be different from any form of collaboration among businesses who are competitors of each other. In the Authority's view, it is irrelevant in applying competition laws to crisis cartels to determine whether the crisis is (a) cyclical, being a result of a temporary drop in demand, or (b) chronic, being a product of a low level of demand coupled with a chronic excess productive capacity[5].

13. Thus, a crisis cartel as with all types of competitor collaborations can be examined under the laws prohibiting anti-competitive agreements and the laws prohibiting anti-competitive mergers and acquisitions. For Ireland, the relevant laws are section 4 of the Competition Act 2002 ("2002 Act") and Article 101 TFEU with respect to anti-competitive agreements and Part III of the 2002 Act and EU Merger Regulation with respect to anti-competitive mergers or acquisitions.

14. With respect to section 4 of the 2002 Act or Article 101 TFEU, a critical question in analysing a crisis cartel is whether the collaborative conduct contemplated by the cartel will meet the cumulative requirements of Article 101(3) TFEU (the so-called "efficiency defence") (or section 4(5) of the 2002 Act), assuming the conduct infringes Article 101(1) TFEU (or section 4(1) of the 2002 Act) by object or by effect.

15. In such circumstances, industry-wide agreements to reduce capacity may be justifiable in terms of consumer welfare, for example where the agreements speed up the removal of inefficient plants, allowing the remaining efficient plants to increase production using the same plant, thereby reducing total unit costs. Such an increase in efficiency would not, however, be sufficient to warrant an exemption under Article 101(3) TFEU. The other conditions for exemption would also need to be met.

16. Thus the parties to the agreement would have to show that the agreement and the restrictions it contains are indispensable for the achievement of the claimed efficiencies – that the desired outcome could not be achieved by any less restrictive means or, indeed, through the normal operation of market forces.

17. They would also have to show that the benefit of the claimed efficiencies will be passed on to consumers (in the broadest sense of that term). This requires a rigorous analysis of the nature of the efficiencies which are likely to be achieved and of the likelihood that the benefits will accrue to consumers. Such an agreement will only satisfy this condition if it can be demonstrated that the benefits of the agreement for consumers will at least compensate them for the negative effects of the restrictions of competition resulting from the agreement.

18. Finally, the parties will have to show that the agreement will not result in the elimination of competition. This will depend on the nature and extent of the competitive constraints that will apply in the market after the agreement has been implemented (e.g. in the form of actual and potential competition and buyer power). The market analysis required to demonstrate this is similar to the analysis that needs to be undertaken when reviewing mergers.

19. This approach to the analysis of industry restructuring agreements is consistent with (and, indeed, follows) the approach adopted generally by the Commission in the Guidelines, in which great emphasis is placed on the economic analysis of the likely effects of restrictive agreements.

20. There is, however, very little recent case law of direct relevance to the assessment of "crisis cartels" under Article 101(3) TFEU. The precedent cases most commonly cited when considering the

[5] See further at 4.2.2 below.

application of the competition rules to crisis cartels are *Synthetic Fibres*[6] and *Dutch Bricks*[7], in both of which the Commission granted exemptions under Article 101(3) TFEU [8]. However, both cases were decided long before the adoption of the Guidelines and, in the Authority's view, should no longer be regarded as providing authoritative guidance on the application of EU competition law to "crisis cartels".

21. In the Authority's view, there is also a not insignificant risk inherent in the Commission's traditional distinction between cyclical and structural over-capacity in the context of "crisis cartels". This is that it may encourage an assumption (for example, by national courts) that industry restructuring agreements/crisis cartels are generally acceptable in situations of structural overcapacity and that their assessment under Article 101(3) TFEU in such cases should be a generous and relatively benign one. The approach adopted by the Commission in its Guidelines, which insists on a rigorous economic analysis of the compliance of such an agreement with the conditions in that Article, shows that such an assumption would be quite wrong. Insofar as it remains relevant, the distinction should instead be seen as one which emphasises that industrial restructuring agreements will rarely, if ever, qualify for exemption where the over-capacity is the result of relatively short-term cyclical factors.

3. Recent developments in Ireland

22. Like many other countries, Ireland has experienced a sharp decline in economic activity over the last number of years. One implication of the economic downturn is that a mis-match was created between supply and demand in many sectors. Under normal conditions, markets would be expected to adjust to a new equilibrium. For example, in response to falling demand, with fixed capacity in the short run, prices would be expected to fall. As prices fall, the least efficient operators would fail and capacity would adjust as firms exit. While this story of how markets may move from one equilibrium to another is simplistic, it does illustrate that price and capacity play key roles.

23. Different sectors of the economy have attempted to manage the effects of reduced consumer demand differently, with some sectors focussing on price, and others on capacity. For example, publicans operating in the licensed alcohol trade have attempted to collectively manage the impact of reduced consumer demand by limiting price competition. At the end of 2008, the publican trade associations issued a joint press release, announcing "*a one year price freeze in drinks prices in pubs with immediate effect*"; this encouraged members not to exceed the existing price levels that they applied to drinks products over the following twelve months.

24. The announcement took place at a time when general price deflation was expected throughout the economy. The Authority's view was that a freeze in prices, when prices are expected to fall, is as harmful to consumers as an agreement to raise prices is in a normal inflationary environment. Moreover, the Authority's resolve to take action with respect to the publicans' associations actions was not driven only by concerns arising solely in the drinks industry. If the price freeze policy adopted by the publicans were to be replicated in other sectors of the economy, consumers and businesses alike would suffer.

25. In July 2009, the High Court held that the announcement breached an undertaking which had previously been given to the High Court by the associations concerned in which they had agreed not to recommend prices to its members. It was therefore unnecessary for the Court to rule on whether there had been a breach of the 2002 Act.

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6 Synthetic Fibres, OJ [1984] L 207/17.

7 Stichting Baksteen, OJ [1994] L 131/15.

8 Formerly, Article 81(3), EC Treaty.

26. In other sectors, the level of capacity has been a focus of industry representative groups. For example, in the hospitality sector, the Irish Hotels Federation commissioned a report to analyse options for the industry in light of the economic downturn and the fall in the number of tourists visiting Ireland. A report entitled *Over-Capacity in the Irish Hotel Industry and Required Elements of a Recovery Programme* was published in 2009. The report contains a number of recommendations aimed at reducing capacity in the sector and calls on the government to drive this programme:

> *"It is imperative that a planned programme of closure must first identify the optimal future structure of the hotel sector in terms of location, grade, etc. It is recommended that a group be convened as soon as possible to begin this work including representatives of the hotel industry, tourism development agencies and the financial sector. It is recommended that the aim should be to agree a speedy and orderly decommissioning of supply in a manner that leaves the profile of substantially reduced supply appropriate to the long term demand for Irish tourism.*

27. As far as the Authority is aware, the Irish Government has resisted attempts by the sectoral interests to involve it in a coordinated attempt to reduce capacity in the sector. In addition to competition law implications, the Government's approach is perhaps informed by the view that surplus capacity in the sector will drive prices down and help the Irish hospitality sector recover some of its lost competitiveness internationally.

4. Competition Authority v Beef Industry Development Society

28. The above case involved an agreement[9] between competitors to reduce capacity in the Irish beef processing industry (i.e., the slaughter of cattle and de-boning of meat). The structure of the proposed scheme (which was never implemented) involved the establishment by the principal participants in the sector of a corporate vehicle, the Beef Industry Development Society Limited (BIDS).

29. The Authority took the view that the scheme was incompatible with both section 4(1) of the 2002 Act and Article 101(1) TFEU. The case has been a long-running saga involving one High Court trial, one Supreme Court judgment and a judgment from the European Court of Justice (ECJ). Following a ruling by the ECJ that an agreement of this kind is illegal, the Supreme Court held that the BIDS agreement had infringed Article 101(1). The Supreme Court remitted the case to the High Court to allow BIDS the opportunity to argue that the agreement should be exempt from the prohibition in Article 101(1) on the grounds that it satisfied the conditions for exemption set out in Article 101(3). In January 2011, BIDS decided not to implement the agreement and withdrew its claim for exemption under Article 101(3). This meant that the High Court did not have the opportunity to reach any decision on the application of Article 101(3) to the BIDS agreement.

30. The background to the case is that, in the late 1990s, there was significant over-capacity in the Irish beef-processing industry. Following a market study in 1998, a task force set up by the Minister for Agriculture and Food recommended a reduction in the number of beef processors from 20 to between 4 and 5. In May 2002, the 10 largest processors established BIDS in order to implement a rationalisation plan which provided for a reduction in processing capacity of about 25%. The plan was to be implemented by means of agreements between processors under which some of them agreed to leave the industry (the "goers") in consideration of the payment of compensation by those who stayed (the "stayers"). In return for this compensation, the goers would: (i) decommission their plants and agree to restrictions on the future use of their equipment; (ii) refrain from using their lands for beef processing for five years; and (iii) enter a two year non-compete clause in respect of processing on the island of Ireland.

31. The essential terms of the BIDS arrangements are set out in Annex 1.

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9 A summary of the essential terms of the agreement is provided in the Annex to this submission.

4.1 Application of Section 4(1) and Article 101(1)

4.1.1 High Court trial (1)

32. In 2003, the Authority brought a civil action before the High Court alleging that the BIDS arrangements infringed Irish and EU competition law, in particular, section 4(1) of the 2002 Act and Article 101(1) TFEU.

33. After an 11 day hearing, the Irish High Court issued a judgment in July 2006 in which it dismissed the Authority's application for a ruling that the proposed scheme infringed Irish and EU competition law. The Court held that the Authority had not demonstrated, on the balance of probabilities, that the proposed scheme had the object or effect of restricting competition in the upstream market for the purchase of cattle for slaughter and the de-boning of meat or in the downstream market for the sale of processed beef. (Interestingly, since the defendants had conceded that the scheme was liable to have an appreciable effect on trade between Member States, the High Court also found that the case was "*an Article 101 case and not one requiring independent consideration under section 4 of the 2002 Act*".)

4.1.2 Supreme Court appeal (phase 1)

34. The Authority appealed to the Supreme Court, but the appeal was suspended in March 2007 when the Court decided to refer a question to the European Court of Justice ("ECJ") under the preliminary ruling procedure in Article 267 TFEU[10]. In essence, the Supreme Court asked the ECJ whether agreements with features such as those of the BIDS arrangements were to be regarded, by virtue of their object alone, as being anti-competitive and prohibited by Article 101(1) or whether it was necessary, in order to reach such a conclusion, first to demonstrate that such agreements had anti-competitive effects.

4.1.3 ECJ ruling

35. In its judgment[11], the ECJ pointed out that it was settled case law that there is no need to take account of an agreement's actual effects once it appears that its object is to prevent, restrict or distort competition within the common market. That examination must, however, be made in the light of the agreement's content and economic context.

36. Having reviewed the arguments of the parties, the ECJ said that it was apparent that:

> *"the object of the BIDS arrangements is to change, appreciably, the structure of the market through a mechanism intended to encourage the withdrawal of competitors".*

37. It also said that the arrangements were intended:

> *"to enable several undertakings to implement a common policy which has as its object the encouragement of some of them to withdraw from the market and the reduction, as a consequence, of the overcapacity which affects their profitability…. That type of arrangement conflicts patently with the concept inherent in the [TFEU] provisions relating to competition, according to which each economic operator must determine independently the policy which it intends to adopt on the common market. Article [101(1) TFEU] is intended to prohibit any form*

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10 Formerly Article 234, EC Treaty.

11 Case C-209/07, Competition Authority v. Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd. (November 20, 2008),

of coordination which deliberately substitutes practical cooperation between undertakings for the risks of competition."

38. The Court therefore concluded that an agreement with the features of the BIDS agreement had as its object the prevention, restriction or distortion of competition within the meaning of Article 101(1) TFEU. The precise wording of its conclusion was as follows:

> *"An agreement with features such as those of the standard form of contract concluded between the 10 principal beef and veal processors in Ireland, who are members of the Beef Industry Development Society Ltd, and requiring, among other things, a reduction in the order of 25% in processing capacity has as its object the prevention, restriction or distortion of competition within the meaning of Article [101(1) TFEU]".*

4.1.4 Supreme Court appeal (phase 2)

39. Following this ECJ ruling, the matter returned to the Supreme Court for the application of the ruling to the specific facts of the case. In its judgment of 3 November 2009[12], the Supreme Court noted that, in light of the ECJ's judgment, the parties accepted that the only issue which remained to be determined was whether or not the BIDS arrangements could benefit from an exemption under Article 101(3). It therefore referred the case back to the High Court for determination of this question. In doing so, it emphasized that the High Court would need to consider this issue *de novo*, having regard, in particular, to the terms of the ECJ's judgment in which the very object of the BIDS arrangements was found *"to conflict patently with the concept inherent in the Treaty regarding competition"*[13].

4.1.5 High Court trial (2)

40. As indicated above, the Supreme Court referred the case back to the High Court for determination of the application of the exemption under Article 101(3) TFEU to the BIDS agreement. The onus was on BIDS to proof that all four conditions under Article 101(3) TFEU were satisfied to avail of the exemption under Article 101(3) TFEU.

41. In January 2011, BIDS withdrew its claim before the High Court in respect of the application of Article 101(3) TFEU to the agreement. Consequently, the High Court did not reach any decision on the application of Article 101(3) TFEU to the BIDS agreement.

42. Notwithstanding BIDS' withdrawal of the proceedings, the developments before the High Court in relation to Article 101(3) are set out below.

4.2 Application of Article 101(3)

43. During the High Court proceedings (High Court trial (2)), the parties asked the Court to issue directions (prior to the hearing of the Article 101(3) conditions) in respect of the period in time at which the Article 101(3) assessment must be made. In particular, the High Court was asked to decide whether the four conditions must be satisfied at the time of the proposed implementation of the BIDS arrangements (i.e. 2010) or at the time of the earlier proceedings before the High Court (i.e. 2005/2006).

44. Furthermore, the Commission decided to intervene as Amicus Curiae in this case and submitted written observations to the Court pursuant to Council Regulation (EC) No 1/2003. The primary objective

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12 Competition Authority -v- Beef Industry Developments Society Limited & anor [2009] IESC 72.

13 Competition Authority -v- Beef Industry Developments Society Limited & anor [2009] IESC 72.

of the Commission's intervention in this case was to ensure a coherent application of Article 101(3) in respect of agreements to reduce capacity. The rationale behind the Commission's decision to intervene was, on one hand, the likelihood of agreements to reduce capacity in various industries across Europe in the context of the current economic downturn and, on the other hand, the limited precedents available in respect of the application of Article 101(3) to this type of agreement since the adoption by the Commission of its Guidelines on the application of Article 101(3). This was only the fourth time that the Commission has intervened as *Amicus Curiae* before a national court.

4.2.1 The period in time relevant for the Article 101(3) assessment

45. The Authority is of the view that the four conditions under Article 101(3) must be satisfied at the time of the proposed implementation of the agreement. The evidence and data used to demonstrate that the four conditions are satisfied must be valid in the date of implementation of the agreement and not some earlier date.

46. The Authority's view is supported by paragraph 44 of the Guidelines:

> *"The assessment of restrictive agreements under Article 81(3) is made within the actual context in which they occur and on the basis of the facts existing at any given point in time. The assessment is sensitive to material changes in the facts. The exception rule of Article 81(3) applies as long as the four conditions are fulfilled and* ***ceases to apply when that is no longer the case****. (Paragraph 44) (Emphasis added)*

47. The Guidelines advise further (Paragraph 45) that in the case of an agreement which is irreversible (in other words, where the *ex ante* situation cannot be re-established), the Article 101(3) assessment must be exclusively on the basis of the facts pertaining at the time of the implementation.

48. In light of the above, the Authority considers that, the BIDS arrangements must meet the four conditions of Article 101(3) as of the date of their implementation, that is to say, 2010. It is irrelevant that the BIDS arrangements, had they been implemented at some past date, might have satisfied Article 101(3).

4.2.2 Commission's decisions in Dutch Bricks and Synthetic Fibres

49. In the past, the Commission dealt with agreements concerning the restructuring of the synthetic fibres and Dutch bricks industries in the *Synthetic Fibres*[14] (1984) and *Dutch Bricks*[15] (1994) cases, respectively. However, in the Authority's view, the reasoning in both cases, to the extent that it is apparent from the decisions, is inconsistent with the current approach of the Commission to the application of Article 101(3) as set out in its own Guidelines.

50. In the Authority's view, neither case is indicative or representative of the Commission's current approach to the application of Article 101(3) for the following reasons. First, the Commission decisions contain little analysis under Articles 101(1) and 101(3): the *Synthetic Fibres* decision consists of 55 short paragraphs and the *Dutch Bricks* decision consists of 45 short paragraphs. Second, the economics-based approach adopted in the Guidelines in respect of the application of Article 101(3) is absent in both cases. Third, neither case is cited in the Guidelines. Fourth, both cases contain inaccurate statements of the law on Article 101(3), particularly on the interpretation of the indispensability criterion.

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14 Synthetic Fibres, OJ [1984] L 207/17.

15 Stichting Baksteen, OJ [1994] L 131/15.

51. The Authority considers that the Commission's interpretation of the indispensability criterion (further discussed below) in both *Synthetic Fibres* and *Dutch Bricks* was incorrect. In both cases, the Commission seemed to consider that the third condition is satisfied where the restrictions are indispensable to the objective of capacity reduction and not, as the text of Article 101(3) makes clear ought to be the approach, to the objectives of attaining efficiencies and providing a fair share of them to consumers[16]. As the Guidelines point out at paragraph 74:

> *"[…] The question is not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction."*

4.2.3 First condition: Contributing to the improvement of production or distribution of goods or to promoting technical and economic progress

52. The first condition of Article 101(3) is that the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress.

53. The purpose of the first condition of Article 101(3) is to ascertain the efficiency gains resulting from the agreement. In assessing the efficiency gains that are claimed to flow from the agreement, it is important to remember that they must outweigh its anti-competitive effects. Accordingly, all efficiency claims must be substantiated. This involves verification of the following matters[17].

- First, it must be demonstrated that the claimed efficiencies are of objective value.
- Second, a causal link between the agreement and the claimed efficiencies must be demonstrated. The Authority is of the view that this normally requires that the efficiencies result from the economic activity that forms the object of the agreement. Furthermore, the causal link must be sufficiently close. It follows that in the BIDS case, the Court must be satisfied that the claimed efficiencies result directly from the restructured beef processing industry.
- Third, the likelihood and the magnitude of each claimed efficiency must be demonstrated. The Authority considers that the undertaking seeking the benefit of Article 101(3) must, as accurately as reasonably possible, calculate or estimate the value of the efficiencies and describe in detail how the amount has been computed. It must also describe the method(s) by which the efficiencies have been or will be achieved. The data submitted must be verifiable so that there can be a sufficient degree of certainty that the efficiencies have materialised or are likely to materialise and the undertaking(s) involved must explain how and when each claimed efficiency will be achieved.
- Fourth, the undertaking seeking the benefit of Article 101(3) must substantiate any projections as to the date from which the efficiencies will become operational so as to have a significant positive impact on the market.

54. The Authority is of the view that mere speculation or general statements on cost savings are not sufficient to discharge the onus under the first condition under Article 101(3). Furthermore, in the context of restructuring agreements under which a number of undertakings will leave the industry, the Authority considers that knowing the identity of either the undertakings leaving the industry or the undertakings

[16] Synthetic Fibres, paras. 42 to 47 and Dutch Bricks, paras. 32-37.

[17] Guidelines, paras. 50 and 51.

staying in the industry is essential to estimate the likely efficiency gains (if any) with the degree of accuracy necessary for the purposes of Article 101(3).

55. Any calculation of cost savings requires knowing the output produced by the undertakings leaving the industry and the costs of producing that output. Similarly, one would need to know which of the undertakings staying in the industry (if any) will increase output consequent upon implementation of the agreement, the amount of such increase in output and the cost of producing the additional output. Cost savings are more likely to be achieved if the rationalisation agreement ensures that the least efficient plants exit the industry.

4.2.4 Third condition: Indispensability of the restrictions

56. The third condition under Article 101(3) (which, as in the Guidelines, we discuss before the second condition) is that the agreement does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of the objectives of improving the production or distribution of goods or to promoting technical or economic progress. In other words, the restrictions must be indispensable to achieving the claimed efficiencies.

57. The Authority considers that the third condition under Article 101(3) will be satisfied if the restrictions are shown to be indispensable to achieve the claimed efficiency gains, not the attainment of the goals intended by the parties to the agreement.

58. In this particular case, one of the Supreme Court judges who heard the BIDS appeal, Mr. Justice Fennelly, also seems to understand it in this way, as is clear from his judgment in the instant case, where he says:

> *"Finally, compliance with Article 81(3)(a) requires it to be demonstrated that the restrictions imposed by any arrangements being examined under the provisions be "indispensable to the attainment of these objectives,"* ***i.e., the objectives whose attainment enables them to survive Article 81(1)****." [Emphasis added]*

59. Indeed, the Guidelines also make this point clear at paragraph 73, which says:

> *"According to the third condition of Article 81(3) the restrictive agreement must not impose restrictions which are not indispensable* ***to the attainment of the efficiencies created by the agreement in question****."[Emphasis added]*

60. As the Guidelines explain, the third condition under Article 101(3) implies a twofold test.

- First, it must be shown that the overall arrangement itself is necessary[18]. In order to prove this, it must be shown that the efficiencies are specific to the arrangement and that there are no other economically practical and less restrictive ways of achieving them; and
- Second, it must be shown that each individual restriction flowing from the arrangement is necessary in order to achieve the efficiencies[19]. The restrictions must be clearly explained, because if they are indeterminate, the Court will not be in a position to assess whether they are indispensable[20].

[18] Guidelines, para. 73.

[19] Guidelines, para. 73.

[20] Joined cases T-528/93, T-542/93, T-543/93 and T-546/93, Metropole television SA and Reti Televisive Italiane SpA and Gestevision Telecinco SA and Antena 3 de Television v Commission [2006] ECR II-649.

61. In the case of restructuring agreements, some questions that might be asked concerning alternative ways of achieving efficiencies are whether the claimed efficiencies could be realised through a merger or whether the claimed efficiencies can be achieved by closing less efficient plants.

4.2.5 Second condition: Consumers must receive a fair share of the resulting benefits

62. According to the second condition under Article 101(3), consumers must receive a fair share of the efficiencies generated by the restrictive agreement.

63. The Guidelines explain that the term “consumers” encompasses both direct and indirect users of the products covered by the agreement[21]. The concept of “fair share” implies that the pass-on of benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition found under Article 101(1)[22].

64. The Authority is of the view that, under this second condition, the following test must be satisfied. First, it must be shown that consumers will not be worse off as a result of the agreement, and second, that the efficiencies must be balanced against and compensate for the negative effects of the agreement on consumers. This balancing exercise explained in the Guidelines implies, as has already been indicated in the section dealing with the first condition under Article 101(3), that the efficiency gains must be quantified.

65. Paragraphs 95 to 101 of the Guidelines describe in more detail the analytical framework for assessing consumer pass-on and the balancing of cost efficiencies. This framework is particularly important in cases where it is not immediately obvious that the competitive harms exceed the benefits to consumers or vice-versa.

66. Paragraph 96 notes that cost efficiencies may lead to increased output and lower prices for consumers. In assessing the extent to which cost efficiencies are likely to be passed on to consumers and the outcome of the balancing test contained in Article 101(3), factors such as the characteristics and structure of the market, the nature and magnitude of the efficiency gains, the elasticity of demand and the magnitude of the restriction of competition should be taken into account.

67. According to the Authority, to answer the question of whether consumers will get a fair share of any purported efficiencies, it is crucial to understand the effect of the agreement on marginal costs. It is well understood in economic theory that, once a firm has decided to produce (i.e. has incurred any relevant fixed costs and decided to either enter or remain in a market), marginal costs are the principal supply side determinant of what level of output will be produced and at what price. In essence, a firm will produce where marginal cost equal marginal revenue, or in other words, a firm will produce up to the point where the cost of producing an additional unit of output is not less than the revenue that will be generated from selling that last unit.

68. In this regard, paragraph 98 of the Guidelines states:

> *“According to economic theory undertakings maximise their profits by selling units of output until marginal revenue equals marginal cost. Marginal revenue is the change in total revenue resulting from selling an additional unit of output and marginal cost is the change in total cost resulting from producing that additional unit of output. It follows from this principle that as a general rule output and pricing decisions of a profit maximising undertaking are not determined*

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21 Guidelines. para. 84.

22 Guidelines. para. 85.

by its fixed costs (i.e. costs that do not vary with the rate of production) but by its variable costs (i.e. costs that vary with the rate of production). After fixed costs are incurred and capacity is set, pricing and output decisions are determined by variable cost and demand conditions."

69. In the context of restructuring agreements where the undertakings staying in the industry must pay a levy linked to their output levels, it is important to bear in mind that the effect of this levy on marginal costs could result in reduction in output which could lead to higher prices to consumers.

4.2.6 Fourth condition: Possibility of eliminating competition in a substantial part of the products in question

70. According to the fourth condition of Article 101(3) the agreement must not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products concerned.

71. As the Guidelines explain, notwithstanding the possibility of exemption for agreements that would otherwise offend Article 101, ultimately priority must be given to the protection of rivalry and the competitive process over efficiency gains arising from anti-competitive agreements[23].

72. The Authority considers that, in assessing whether undertakings will be afforded the possibility of eliminating competition, the Court must consider both actual and potential competition, and must examine the state of existing competition. The question that must be decided is whether there is a possibility of elimination of competition in a substantial part of the market. The fact that competition remains in the rest of the market is not relevant to satisfy the requirement.

73. As stated in the Guidelines, the application of the 'no elimination of competition' condition of Article 101(3) requires an assessment of the competitive process and the impact of the agreement:

"a realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered.

74. As the Guidelines highlight, the elimination of competition condition is not fulfilled if competition with respect to an important dimension is eliminated.

75. Restructuring agreements which involve a large number of players accounting for a large market share and which prevent the possibility of expansion or entry of productive capacity are unlikely to satisfy the requirement that there is no elimination of competition.

5. Policy response: Good times bad times

76. Transparent, open and competitive markets deliver benefits to consumers, producers and the wider economy generally. Competition law and policy exists to ensure that these benefits (improved efficiency, innovation and competitiveness) are not undermined by cartelisation, monopolisation and other anticompetitive practices. The realisation of these benefits, however, takes time and, when juxtaposed with the very tangible and instant impacts of recession, can and does result in calls for a relaxation of the implementation of competition policy.

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23 Guidelines, para. 105.

> *"In a recession, the short-run may be prioritised:… the immediate costs of competition to existing business, employees and consumers may be up-front and visible, with the benefits delayed and less visible. Tolerance for this will be lower in a recession."*[24]

77. Frequently this is manifest through the promotion by government of soft competition between competitors and/or the development of national 'frameworks' to achieve wider macroeconomic policies such as the creation of national champions. These policy objectives are then advanced more vigorously than competition policy under the belief that they will lead to economic recovery and growth. On the contrary, history[25] teaches us that the relaxation and/or suspension of competition law leads to cartelisation and other anticompetitive activities that achieve precisely the opposite.

78. Romer's analysis of the impact of the National Industrial Recovery Act ("NIRA") in the US during the 1930s confirms this. The NIRA provided for the establishment of industry wide agreements, as long as certain other policy objectives were achieved, that allowed competitors to come together and agree prices, output levels, investment plans and labour costs. In Romer's view the removal of price competition deprived the economy of the essential mechanism whereby declining prices act as a signal to industry to adjust output accordingly and to dispense with inefficient companies:

> *"it prevented the economy's self-correction mechanism from working. Thus the NIRA can be best thought of as a force holding back recovery… ."*[26]

79. Thus, far from being a contributor to recession, competition policy can be one of the solutions for recovery.

80. It is this message that needs to be clearly advocated by competition agencies amidst the opportunistic calls by vested interests that the current economic situation requires the setting aside of competition rules:

> *"Keeping markets competitive is no less important during times of economic hardship than during normal times."*[27]

81. In this vein there are a number of competition advocacy steps that agencies can and should pursue:

- reinforce the lesson outlined above in discussions with other government departments and agencies;
- encourage pragmatism and flexibility in the implementation of competition rules through quick decision-making, and the development of transparent case selection and prioritisation criteria;
- upskill staff such that they can readily identify and react to the wider economic context; and
- maintain active and informative communication with government, industry and other external stakeholders.

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24 John Fingleton, Competition Policy in Troubled Times, pp 4, OFT paper, January 2009.

25 For example the US financial 'Panic of 1907' and the 'Great Depression' of the 1930s.

26 Christina Romer, "Why Did Prices Rise During the 1930s?" Journal of Economic History, 59(1),167-199.

27 Carl Shapiro. Competition Policy in Distressed Industries, pp1, Remarks prepared for the ABA Antitrust Symposium: Competition as Public Policy, May 2009

ANNEX

1. The essential features of the BIDS arrangements were the following:

   (i) Goers killing and processing 420,000 animals per annum, representing approximately 25% of active capacity would enter into an agreement with Stayers to leave the industry and to abide by the following terms;

   (ii) Goers would sign a two year non-compete clause in relation to the processing of cattle on the entire island of Ireland;

   (iii) The plants of Goers would be decommissioned;

   (iv) Land associated with the decommissioned plants would not be used for the purposes of beef processing for a period of five years;

   (v) Compensation would be paid to Goers in staged payments by means of loans made by the Stayers to the society;

   (vi) A voluntary levy would be paid to the society by all Stayers at the rate of EUR 2 per head of the traditional percentage kill and EUR 11 per head on cattle kill above that figure;

   (vii) The levy would be used to repay the Stayers' loans; levies would cease on repayment of the loans;

   (viii) The equipment of Goers used for primary beef processing would be sold only to Stayers for use as back-up equipment or spare parts or sold outside the island of Ireland; and,

2. The freedom of the Stayers in matters of production, pricing, conditions of sale, imports and exports, increase in capacity and otherwise would not be affected.