CLEARY GOTTLIEB

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I. Vertical Restraints

I.1 Advocate General Opinion

Case C-551/03 General Motors and Opel Nederland.
On October 25, Advocate General Tizzano advised the Court of Justice to reject the appeal filed by General Motors against the Court of First Instance's judgment, which confirmed the Commission's finding that Open Nederland had violated Article 81 by adopting a general strategy of restricting exports from the Netherlands, and by granting bonuses to Dutch dealers only for domestic sales, but not for exports.

The Advocate General confirmed the Court's settled case law that Article 81 applies to an agreement that has an anticompetitive purpose even though it might also pursue other legitimate objectives. The Advocate General added that Article 81 applies not only to agreements that totally prohibit or obstruct a distributor from carrying out export sales, or that make them entirely unprofitable, but also to agreements that are obviously capable of inducing traders to give priority to the national market over exports, for example by influencing the economic and financial conditions of making export sales.

The Advocate General concluded that the Court of First Instance had been correct to compare the bonus for domestic sales and for exports, adding that, if export sales had not been excluded from bonus payments, Dutch dealers could have offered potential buyers outside the Netherlands better conditions than were possible without the bonus. They could also have left the conditions unchanged, thereby increasing their profit margins.

Case C-74/04 Volkswagen.
On November 17, Advocate General Tizzano advised the Court of Justice to reject the Commission's appeal against the Court of First Instance's judgment, which annulled the Commission's decision that Volkswagen's dealers had to be presumed to have agreed to Volkswagen's unilateral unlawful variations of their lawful distribution contracts on the grounds that Volkswagen had acted in the context of continuous commercial relations governed by a pre-existing contract, and that admission of a dealer to a selective distribution network implies acquiescence with the supplier's distribution policy.

The Advocate General reasoned that a dealer can be presumed to have agreed to the supplier's unlawful measures only if the dealer signs an agreement that contains them or that allows for or contemplates their adoption. The Commission must otherwise adduce evidence of the dealer's express or tacit acquiescence in such measures, as shown, for example, by the dealers' conduct following the adoption of the measure. Interestingly, the Advocate General doubted that acquiescence could

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be inferred merely from the dealers' lack of opposition to the measure.

2. Abuse of Market Power

Commission Discussion Paper on Article 82.

On December 19, the Commission published a discussion paper on the review of Article 82.[1]

In essence, the Discussion Paper proposes a greater emphasis on economic analysis in Article 82 cases, stresses the need for evidence of actual or likely exclusionary effects to prove an abuse, and signals potentially important shifts in enforcement policy on vertical restraints, such as exclusive dealing by dominant firms, loyalty rebates, and price bundling practices.

The Discussion Paper deals only with exclusionary abuses. The Commission has indicated that it intends to produce similar documents on exploitative abuses (such as excessive pricing) and discrimination in due course, although no indication on timing has yet been provided.

Concerning dominance, certain past decisions under Article 82 have been criticized for over-reliance on market shares in the assessment of dominance, and insufficient analysis of the degree of actual competition on the market, as well as barriers to entry. While repeating statements from the case law that a presumption of dominance arises where market shares exceed 50%, the Discussion Paper also states that "market share is only a proxy for market power" and that it "is therefore necessary to extend the dominance analysis beyond market shares" (¶ 32). The Discussion Paper also notes that market shares are less relevant where products are differentiated (¶ 33). Finally, and most importantly, the Discussion Paper states that the key factor is not market share, but whether that share is sustainable (¶ 34), which calls for a detailed assessment of barriers to entry and expansion.

Concerning collective dominance, the Discussion Paper confirms a recent holding of the Court of First Instance[2] that the conditions for collective dominance under EC merger control rules, as set out in the Court's judgment in *Airtours*, should also be applied under Article 82, namely that each member of the group must be able to know whether the other members are complying with the common policy, that there must be no incentives to depart from it and that retaliation in respect of conduct deviating from it must be possible so as to permit tacit coordination to be sustainable over time on the market, and that the foreseeable reaction of current and future competitors, as well as of consumers, must not jeopardize the results expected from the common policy.[3] It is less clear whether a finding of collective dominance is excluded where the *Airtours* criteria for tacit collusion are not, in particular whether a finding of structural links is relevant only to the extent it has a bearing on the *Airtours* conditions or whether it can independently support a collective dominance finding. In addition, the Discussion Paper does not comment on the standard of proof in applying the *Airtours* criteria under Article 82. Unlike in merger cases, the Commission under Article 82 must in each instance show the prior existence of collective dominance, which suggests that there must be evidence that tacit collusion actually took place.

Concerning the general concept of an abuse, the Discussion Paper recognizes some of the inherent difficulties associated with seeking to identify a comprehensive, all-encompassing test for abusive conduct. Instead, it clarifies certain important points, as explained below.

First, the Discussion Paper confirms that consumer welfare should be the focus of attention in assessing exclusionary conduct (¶ 54). Certain past cases made statements that came close to protecting competitors or the "structure of competition" without explicitly considering that the ultimate goal of EC competition rules is to prevent consumer harm.

Second, the Discussion Paper generally favors the use of an "equally efficient competitor" test for pricing abuses (¶ 63). A *prima facie* abuse would exist if the conduct excludes or forecloses rival firms with at least the same level of cost efficiency as the dominant firm. This test has already been applied in predatory pricing and margin squeeze cases under Article 82. More controversially, the Discussion Paper states that, where insufficient data on the dominant firm's costs are available, the Commission may look at cost data of "apparently efficient" competitors (¶ 67). It is not clear under what circumstances a competitor, potentially the complainant, will be considered "apparently efficient." Equally controversially, the Discussion Paper states that it may sometimes be necessary to protect firms that are less efficient but would become as efficient over time (¶ 67), which may be relevant in industries with network effects or requiring large sunk investments, for instance, in R&D. It is not clear how a dominant firm can be expected to determine a hypothetical benchmark

[1] www.europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf

[2] Case T-193/02 *Laurent Piau v. Commission* judgment of January 26, 2005, not yet published.

[3] Case T-342/99 *Airtours plc v. Commission* [2002] ECR II-2585, para. 62.

and whether it is reasonable to expect a dominant firm to compete less aggressively with less efficient .

Third, the Discussion Paper states that abusive practices require evidence of actual or likely harm to competition (¶ 55). This is an important change, since a number of past decisions and cases did not apply an effects analysis and, worse, ignored evidence tending to suggest a lack of anti-competitive effect (such as declining shares for the dominant firm, or falling prices).[4]

Finally, the Discussion Paper recognizes an efficiency or objective justification defense under Article 82. This test would essentially adopt the same analytical approach to efficiencies as currently applies under Article 81 in respect of restrictive agreements.

Concerning specific practices, the Discussion Paper comments on rebates, exclusive dealing, refusals to deal, tying, and predatory pricing.

Concerning rebates, the Discussion Paper signals a shift from the current approach of prohibiting rebates granted to a customer that do not reflect economies of scale arising from the sale of larger quantities to that customer.[5] Instead, it proposes to focus only on rebates that are conditional upon a customer reaching a target that applies to *total sales*, namely, that "roll back" to the unit sold during the reference period before the sales threshold was achieved. Even then, the Discussion Paper does not advocate a *per se* illegality rule, but proposes an analysis based on how pervasive the rebate is in practice and, most importantly, on whether the dominant firm's prices are below average total cost as a result of the discount. It adds, however, that average total cost should not be calculated over all of the dominant firm's sales, but should be applied to "commercially viable amounts" that rivals could supply to customers. Although attractive in theory, this concept is likely to be difficult to apply in practice.

Concerning exclusive dealing, the Discussion Paper signals a shift from what is currently, in practice a *per se* prohibition against exclusive purchasing agreements.[6] Instead, it proposes an assessment

[4] Case T-219/99 *British Airways v. Commission* [2003] ECR II-5917; Case T-203/01 *Michelin v. Commission* [2003] ECR II-4071.

[5] Case T-219/99 *British Airways v. Commission* [2003] ECR II-5917; Case T-203/01 *Michelin v. Commission* [2003] ECR II-4071.

[6] Case 85/76 *Hoffman-La Roche v. Commission* [1979] ECR 461; Case T-65/89 *BPB and British Gypsum v. Commission* [1993] ECR II-389.

firms and, if so, for how long

of the pervasiveness of the exclusive dealing requirement among customers, the importance of the "tied" customers for new entry or expansion by rivals, evidence of actual or likely foreclosure effects, and analysis of any applicable defenses (such as customer-specific investments).

Concerning refusals to deal, the Discussion Paper distinguishes between first-time refusals to deal and situations where a dominant firm terminates an existing course of dealing. The latter category is subject to a stricter rule, on the grounds that an existing course of dealing shows that the dominant firm at one stage considered dealing with third parties to be efficient (¶ 217). The Discussion Paper also recognizes that first-time refusals to deal are generally lawful, since the right to freely exploit property rights—whether intellectual or physical—is pro-competitive in all but exceptional cases (¶ 213). One shortcoming, however, is that the Discussion Paper does not resolve the ambiguity in recent case law on how the "exceptional circumstances" test for a duty to license intellectual property should be understood. Finally, the Discussion Paper confirms that it may be objectively justified for a dominant firm to refuse to share property rights which reflect high investment and/or innovation efforts, if an obligation to share could reduce future overall innovation in the industry (¶ 235).

Concerning tying and bundling, the Discussion Paper essentially repeats the rule-of-reason assessment relating to contractual and technological tying made in the Commission's 2004 *Microsoft* decision. However, potentially important shifts in policy are envisaged for "mixed bundling"—offering two or more products at a lower package price than the price of the products on a stand-alone basis. Certain past decisions treated mixed bundling as a *per se* offense if the reduction did not reflect cost savings. The Discussion Paper confirms that, in general, a package price that covers the long-run incremental cost of the bundled product should be lawful (¶ 190). Questions remain, however, as to what is included in the calculation of long-run incremental cost, and how this notion is to be applied in practice, especially in innovation industries or industries characterized by network effects.

Concerning predatory pricing, the Discussion Paper envisages only minor modifications to current policy. First, it favors the use of average avoidable cost (AAC)—variable costs plus any fixed costs that are not sunk—instead of the average variable cost (AVC) standard historically applied under Article 82.

The difference between these two standards will typically be small unless there are substantial avoidable fixed costs. Second, the Discussion Paper proposes to apply a standard based on long-run incremental costs—all product-specific variable and fixed costs—in the case of network industries and recently-liberalized markets, although it is not clear why this standard should not also apply in other industries with similar cost structures. Third, it clarifies the circumstances in which pricing above AVC/AAC but below average total costs (ATC) will be considered abusive. In essence, no "meeting competition" defense is available where prices are below AVC/AAC, but a defense may be available where prices are above AVC/AAC, but below ATC, and the dominant firm's response is suitable, indispensable, and proportionate. Fourth, consistent with past case law, it rejects the need to show future recoupment in Article 82 cases. Finally, it clarifies that certain defenses may be available even if the dominant firm is technically pricing below cost. For example, the dominant firm may be minimizing losses in response to an unexpected market downturn or reacting to a situation of excess capacity.

Concerning aftermarkets, the Discussion Paper largely repeats the analysis set out in the Commission's decision in *Pelikan/Kyocera*.[7] Thus, in order to test for aftermarket power, it should be assessed whether customers in the primary market take sufficient account of prices for aftermarket products or services (such as spare parts, maintenance services, or consumables), such that a competitive primary market will preclude dominance in the aftermarket. The Discussion Paper further suggests that, once market dominance has been established using this methodology, the Commission "presumes that it is abusive for the dominant company to reserve the aftermarket for itself by excluding competitors from that market" (¶ 264). It is unclear, however, what this means in practice: if the Discussion Paper intends that no additional exclusionary conduct or effects in the aftermarket need be shown, this would seem to go too far.

In sum, the Discussion Paper clearly signals important and welcome potential shifts in enforcement policy on Article 82, most notably in the area of rebates. Less clear, however, is whether some of the rules set out in the Discussion Paper for exclusionary practices are capable of being applied by firms at the time when they formulate their price or non-price strategies. In particular, it is not clear that a firm would be able to calculate rivals' "commercially viable amounts" in applying a below-cost pricing test for rebates or how the "apparently efficient" competitor test for certain pricing practices would work.

3. Mergers and Acquisitions

3.1 CFI Judgment

Case T-210/01 General Electric v. Commission. On December 14, the Court of First Instance confirmed the Commission' prohibition of General Electric's (GE) acquisition of Honeywell, on the grounds that the prohibition decision could be justified by the creation or strengthening of GE's dominance on a number of markets as a result of overlaps between GE's and Honeywell's activities on these markets (so-called horizontal overlaps).

The Court disagreed with the Commission's two other grounds for its decision, namely, that the operation would have enabled GE to strengthen its dominance on the large commercial jet engine market through vertical foreclosure, and would have created a dominant position in avionics through conglomerate effects. In confirming the Commission's decision, the Court stated that a decision based on several pillars of reasoning must be annulled only if each of those pillars is vitiated by an illegality, which was not the case here. This reasoning led the Court to reject Honeywell's parallel appeal in summary form because Honeywell had not challenged all the pillars of reasoning supporting the decision, implying that the decision could not be annulled even if Honeywell's appeal were successful on the points submitted.[8]

The Court agreed with the Commission on a number of points:

The Court held that a company with a strong dominant position cannot contend that the acquisition of a competitor does not raise concern simply because that rival is already weak or merely exercises an indirect competitive constraint. Rather, in these circumstances, the reduction of any residual competition is particularly harmful. The Court stated this in the context of the horizontal overlaps in the large regional jet engine market, in regard to which the Court confirmed the Commission's finding that GE's dominant position would have been strengthened, even though GE's and Honeywell's engines did not compete directly. Airlines cannot choose the engines for their aircraft because airframe manufacturers certify only one engine for a given airframe, and GE's engines can be used only on a two-engine platform while

[7] Case No. IV/34.330 *Pelikan/Kyocera*, XXVth Competition Policy Report (1995) p.140; Commission Competition Policy Newsletter (1995) Volume 1 No. 6 (Autumn/Winter) p.13.

[8] Case T-209/01 *Honeywell* judgment of December 14, 2005, not yet published.

Honeywell's engines can be used only on a four-engine platform.

The Court nevertheless noted that large regional jet engines compete indirectly through the selection by airlines of complete aircraft equipped with engines. Among other things, the Court pointed to internal GE documents demonstrating that GE granted discounts on its engines in order to boost the sale of aircraft equipped with its engines. Given that the merger would have effectively given GE a monopoly in engines for large regional aircraft, the Court rejected GE's contention that the acquisition of Honeywell would have had only a marginal impact on its position. The Court also found no fault with the Commission's rejection of commitments offered by GE in an effort to address this concern, since there were legitimate doubts as to whether the divestiture of Honeywell's large regional engine business would have created a viable business.

The Court also agreed with the Commission that the merged entity's shares of 50-60% of the installed based of engines for corporate jets, and 80-90% of engines for medium corporate jets, were in themselves sufficient to demonstrate dominance.

Furthermore, the Court held that the Commission did not commit a manifest error in identifying a relevant market limited to marine gas turbines of 0-10 MW for marine applications, and in finding that GE and Honeywell's turbines competed against one another because, out of three responses to information requests, one was consistent with this definition, one advocated a broader definition but confirmed that both parties' turbines competed against one another, and a third response was ambiguous. The Court also rejected GE's complaint that the Commission had failed to obtain information from the only European customers of each of the parties on the grounds that GE had not shown or alleged that this failure affected the Commission's finding. The Court considered it irrelevant that Honeywell's turbine had competed against GE's in a bidding process only once during the previous five years, since bids in this market are rare.

The Court also confirmed that the Commission could rely on GE's market share in the large commercial jet engine market to conclude that GE was dominant, even though this is a bidding market. In bidding markets, where orders are large and infrequent, high market shares may not necessarily indicate dominance, because shares may fluctuate significantly according to recent wins and losses. However, the Court noted that GE had not only succeeded in maintaining its leading position over five years, but had also enjoyed the highest market share growth rate during this period. The Court also observed that "lively competition on a particular market" does not rule out the existence of dominance.

In addition, the Court found that the Commission was correct in allocating the market share of a 50/50 joint venture between GE and Snecma in large commercial jet engines entirely to GE, even though it rejected the Commission's suggestion that the joint venture was a quasi-subsidiary of GE. The Court highlighted the facts that: the joint venture's engines do not compete with GE's engines; GE and the joint venture effectively acted as a single entity *vis-à-vis* competitors and customers; Snecma, unlike GE, did not and could not produce engines independently, meaning that allocating part of the joint venture's sales to Snecma would not have reflected true market reality; and GE's own annual reports attributed the joint venture's market share entirely to GE.

The Court also agreed that the Commission could treat GE's reliance on its leasing subsidiary GECAS as an element that strengthened GE's dominance in the large commercial jet engine market. GECAS buys aircraft from manufacturers and leases them to airlines. The Court found that GECAS had enabled GE to influence large commercial engine selection by airframe manufacturers and airlines, and thus to win contracts that it would not have won through competition on the basis of price and technical quality alone.

The effects of GECAS on engine competition differed depending on which company selected the engine for a given aircraft type. If the airframe manufacturer selected the engine for a given aircraft type, GECAS's role as a large purchaser of aircraft would create a strong incentive for manufacturers to place GE engines on their new airframes, since GECAS had a well-established record of buying only GE-powered aircraft. GECAS accounted for 7-10% of all large commercial aircraft purchases. Aircraft manufacturers would know that if they did not select GE engines, GECAS would not purchase their airplanes and they would thus be cut off from this portion of the market. If the airline selected the engine, GECAS as a leasing company could offer airlines concessions if they took GE's engines. In addition, GECAS could influence the choice of airlines indirectly by "seeding" the market with GE equipped aircrafts. Because it is beneficial for airlines, in terms of lower maintenance costs, to use the same engine type across their entire fleet, GECAS's seeding policy created incentives for airlines to standardize their fleet on GE engines.

The Commission's decision included evidence that GECAS had in fact played an important role in actual large commercial engine selection decisions by airframe manufacturers. The Court also found it irrelevant that the Commission had been unable to provide statistical data showing that GECAS actually had increased GE's overall market share. According to the Court, the individual incidents described by the Commission were sufficient to demonstrate that GE had used GECAS to promote its engines and that this policy had met with success in individual cases. Moreover, GE's

economists had not been able to show convincingly with their own statistical models that the use of GECAS had no impact on the market.

However, the Court disagreed with the Commission's findings that GE's acquisition of Honeywell's significant engine-starter business would strengthen GE's pre-existing dominance in large commercial jet engines because it would allow GE to disrupt supplies of Honeywell engine starters to GE's engine competitors, which needed engine starters to create a full engine package (so-called vertical effects).

The Court also disagreed with the Commission's findings that the combination of GE's dominant position in large commercial jet engines and Honeywell's leading positions in a broad range of avionics and non-avionics systems would create a dominant position in the avionics markets and reinforce GE's pre-existing dominance in large commercial jet engines (so-called conglomerate effects). The Commission argued that a first conglomerate effect would arise from GE's reliance on GECAS as a commercial lever by offering airframe manufacturers and airlines concessions in return for specifying Honeywell avionic products on the aircraft they purchase. According to the Commission, a second conglomerate effect would arise from GE's bundling of its large commercial jet engines with Honeywell's avionics products, in the form of either pure bundling (refusing to make available the engines without the avionics) or mixed bundling (offering a discount if customers take both the engines and the avionics from GE).

Concerning the alleged conglomerate and vertical effects, the Court held that whether such effects create or reinforce a dominant position depends entirely on the merged entity's future behavior. This is in contrast to horizontal effects, which immediately modify the structure of a market as a result of a direct overlap in the merging parties activities on the same market. In light of this difference, the Court held that the Commission must comply with a strict standard of proof to establish that the alleged future behavior is likely to occur. Thus, consistent with the judgment of the Court of Justice in Case C-12/03 P *Commission v. Tetra Laval*,[9] convincing evidence must demonstrate not only that the merging parties are capable of engaging in practices leading to the vertical or conglomerate effects in question, but also that there are concrete economic incentives for them to do so, and that they can therefore be expected to do so, thereby significantly impeding effective competition.

In making its assessment, the Commission may rely either on internal documents or an examination of the parties' commercial interests in the relevant market at issue. However, the fact that one of the merging parties is engaging in similar conduct on a different market will not generally be sufficient to support an adverse finding. Also, the merged entity will likely have fewer incentives the more distant the anticipated impact, since it will likely prefer to maximize short run profits rather than pursue a policy intended to obtain possible, but uncertain, long run gains.

The Commission must also consider the factors liable to reduce such incentives, including the deterrent effect that Article 82 may be expected to have on the merging parties' incentives to engage in such practices. The Court held that the Commission need not, however, establish that the future conduct will actually violate Article 82 or that such an infringement would be detected and punished. The Commission is entitled to limit itself in this regard to a "summary analysis" based on the evidence available to it.

The Court found that the Commission had failed to comply with this strict standard of proof. Concerning the alleged conglomerate effects, it held that the Commission had provided insufficient evidence to demonstrate that GE would have had a concrete incentive to engage in leveraging practices leading to the creation of a dominant position for Honeywell's avionic products. The Court pointed out that GE's reliance on GECAS entailed costs in the form of the concessions that GECAS made to customers. In the case of engines, these costs were off-set by the revenue streams generated from aftersale services. Yet in the case of Honeywell's avionics, the Commission had not examined whether the revenue generated from avionics sales would be capable of compensating the costs of relying on GECAS and therefore whether such reliance would be worthwhile for GE.

The Court also found that the Commission had not proven that GE's reliance on GECAS for the promotion of avionic products would effectively lead to the creation of a dominant position. The Commission had ignored the fact that GECAS was only active in the area of large commercial and large regional aircraft, while Honeywell's avionic products were also sold for other aircraft. In addition, the Commission's analysis had failed to distinguish properly between the different avionics product markets. As a result, the Commission failed to demonstrate the likely impact of the transaction on each relevant market.

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[9] [2005] ECR I-987.

The Court held that the Commission had provided insufficient evidence of GE's incentive to engage in bundling practices. It noted, for example, that (i) engines and avionics for the same aircraft are not always selected by the same operators, (ii) bundling entails costs, since GE would lose customers that preferred a different combination, or would have to grant discounts to overcome such preferences, (iii) the Commission relied on a simplistic and purely theoretical economic model, and (iv) the Commission failed to factor in to its analysis the possible deterrent effect that Article 82 could play towards practices—pure or mixed bundling—that would have infringed Article 82.

Concerning the alleged vertical effects, the Court agreed that GE's engine competitors were dependent on Honeywell engine starters and that GE would have a commercial incentive to delay or disrupt supplies of Honeywell engine starters to its competitors post-merger. This was because engine-starter sales represented only a small fraction (around 0.2%) of the profits that GE could derive from additional engine sales. As a result, it would be to GE's advantage to forego profits from engine-starters in order to win engine market share at the expense of its competitors.

Interestingly, the Court rejected GE's objection that the Commission had not produced an economic study to prove GE's incentives and the likely market development. The Court explained that where it is "obvious" that the merged entity will have the incentives to behave in a certain way, the Commission does not commit a manifest error in holding that it is likely that the merged entity effectively will behave in that way. In such circumstance, the "simple economic and commercial realities" of the case may constitute "convincing evidence" for supporting the Commission's conclusions, thus meeting the standard of proof set by the Court of Justice in *Tetra Laval*. However, the Court held that the Commission's analysis was incomplete because the Commission had failed to take into account the deterrent effect of Article 82. According to the Court, a disruption of engine starter supplies as contemplated by the Commission would "clearly amount to an abuse".

To conclude, this judgment confirms that, while the Commission enjoys a margin of discretion in appraisals of an economic nature, as illustrated by the Court's discussion of GE's dominance, issues of market definition, the competitive interaction between GE and Honeywell, and the assessment of GE's commitments, the Court will review whether the Commission's evidence is factually accurate, reliable, and consistent, whether that evidence contains all the information which must be taken into account in order to assess a complex situation, and whether it is capable of substantiating the conclusions drawn from it.

3.2 Second-Phase Decisions with Undertakings

Johnson&Johnson/Guidant.

On August 25, the Commission cleared Johnson & Johnson's (J&J) acquisition of medical devices company Guidant, subject to conditions.

The Commission focused on surgical devices for coronary and endovascular applications and particularly on the markets for "stents"—expandable wire tubes that can be placed in an occluded artery in order to remove the plaque and support the walls of the artery, thereby ensuring normal blood flow. Few significant players are active in those markets, particularly due to high barriers to entry. Moreover, surgical devices and stents in particular are highly differentiated products.

The Commission decision, which was adopted in close cooperation with the US Federal Trade Commission, illustrates the increased emphasis placed on the consumer welfare effects of mergers rather than on post-merger market shares, and the increased caution with respect to the assessment of conglomerate effects resulting from the restrictions placed by Community Courts on the Commission's past approach.

Combined shares on the above markets exceeded 50%, which led the Commission to analyze in detail the closeness of substitution between J&J's and Guidant's products in order to assess the risk of unilateral price increases arising from the transaction. Relying on various opinions from eminent surgeons across the EU, the Commission concluded that the merger would entail the disappearance of J&J's closest substitute in a broad range of markets and thus remove the most important competitive constraint on J&J. This would allow the merged entity to carry out profitable unilateral price increases, notably of its stents.

Given the post-merger increase in J&J's product portfolio, the Commission also assessed the potential foreclosure effects resulting from bundled sales of complementary cardiology devices following the analytical structure set by the Community Courts: it analyzed the ability of the merged entity to engage in bundling practices, its incentive to do so and whether such strategies could effectively give rise to a foreclosure of competition. The Commission concluded that package sales in the cardiology devices sector are not systematic and, more importantly, that competitors could match a bundled sales strategy and that no foreclosure effects could therefore be expected.

The decision also contains a detailed analysis of the role played by potential competition as a constraint over J&J's position in the coronary stents market, where only J&J and Boston Scientific are currently active while Guidant, Medtronic and Abbott are in the process of developing competing devices.

3.3 First-Phase Decisions with Undertakings

Amer/Salomon.
On October 12, the Commission authorized Amer Group's acquisition of the Salomon business segment of Adidas-Salomon, subject to modifications of the current cooperation agreement between Salomon and Fischer.

The transaction reduced the number of major European suppliers of alpine skis and bindings from five to four, giving Amer high market shares in the "Alpine countries" (Austria, France, Germany, and Italy) and in other Member States, with shares of 50-60% in the Austrian and UK alpine bindings markets. Head, K2, and Rossignol, as well as several smaller players, remain active throughout the EU. Moreover, the parties' products are not considered close substitutes: Amer's Atomic brand has a strong "racing" image while Salomon has a so-called "lifestyle" image. The Commission therefore considered that the transaction would not enable Amer to increase unilaterally the prices of its alpine skis to a supra-competitive level. The Commission also found that the transaction would not create a collective dominant position because alpine skis and bindings are highly differentiated, making market behavior difficult to monitor and the alignment of competitors' pricing behavior unlikely.

The transaction also made Amer the second largest European supplier of cross-country skis, behind Fischer. The combined market share of Amer/Salomon and Fischer was significant in Austria (80-90%), Germany (70-80%), and France (55-65%). Moreover, Salomon and Fischer had entered into an extensive cooperation agreement, which was to be extended to Amer following the transaction.

The Commission first examined the risk of the creation of a collective dominant position in the relevant markets without taking account of the agreement between Salomon and Fischer. The Commission found that competition in the markets for cross-country skis was driven by product differentiation, innovation, and brand positioning, and that these features were not conducive to coordinated behavior. Moreover, Amer/Salomon's and Fischer's market shares were not symmetrical. The likelihood of coordination was further diminished by potential competition from players active in neighboring markets. Finally, the markets for cross-country skis were sufficiently diversified to render monitoring of competitors' actions improbable.

However, the Commission considered that the cooperation agreement increased the risk of coordination between the parties. Amer therefore undertook to eliminate the provisions of the cooperation agreement facilitating exchange of strategic information on production decisions and cost structures. The provisions relating to the OEM sales of skis by Fischer to Salomon, and of bindings by Salomon to Fischer, were maintained. The Commission considered that the termination of these sales would have weakened Fischer by forcing it to reduce its production of skis and switch to another OEM supplier of bindings.

TUI/CP Ships.
On October 12, the Commission cleared TUI's acquisition of CP Ships, creating the world's fourth largest shipping operator, subject to Hapag-Lloyd's (controlled by TUI) withdrawal from two liner shipping conferences.

The Commission examined the transaction's impact on the market for containerized liner shipping, namely, the provision of regular, scheduled services for the carriage of cargo by container. The geographical dimension of the market for liner shipping consists of single trades, defined by the range of ports which are served at both ends of the service (for example, North Europe/North America).

The parties' combined market shares did not exceed 40% in any relevant market. However, when assessing the effects of the transaction, the Commission aggregated market shares of the parties and those of the conferences and consortia in which at least one of the parties was a member. The Commission also adopted this analysis in its decision *Møller-Maersk/Royal P&O Nedlloyd*.[10] Shipping conferences are groups of carriers, which engage in price-fixing and capacity regulation, and shipping consortia consist of cooperation agreements between carriers. Both are currently exempted from Article 81(1) pursuant to a block exemption, the repeal of which the Commission proposed in December 2005.

The Commission considered that the transaction raised competition concerns on the North Europe/North America and the Mediterranean/North America trades by creating links between CP Ships, the Trans-Atlantic Conference Agreement (TACA) and the US South Europe Conference (USSEC). To alleviate these concerns, TUI undertook to withdraw Hapag-Lloyd from TACA and USSEC.

Jefferson Smurfit/Kappa.
On November 10, the Commission cleared the acquisition by Jefferson Smurfit (JSG) of Kappa Holding B.V., subject to conditions.

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[10] Case COMP/M.3829 *Møller-Maersk/Royal P&O Nedlloyd*, Commission decision of July 29, 2005. See too Case COMP/M.3973 *Delmas/CMA CGM*, Commission decision of December 1, 2005 (clearance without commitments of a merger between two French shipping companies).

The Commission examined the transaction's impact on the market for corrugated cases (used for transport packaging) in Denmark and Sweden. In Denmark, the concentration removed JSG as Kappa's closest competitor and created a duopoly between the new entity (40-50%) and SCA (40-50%). In Sweden, the concentration reduced the number of market players from four to three and gave the new entity a market share of 40-50%. The parties therefore undertook to sell five of JSG's plants in Denmark and Sweden, which removed the overlap in Denmark and reduced the parties' Swedish share to 30-40%.

In addition, the Commission considered that the transaction raised competition concerns in the market for solid board cases (used for transporting fresh products). While the Commission found that the relevant market covered a radius of 400-500 km around each plant, it nevertheless examined the transaction's effects at national level and found that the transaction conferred on the new entity a 60-70% share in the Netherlands and France. In order to alleviate this concern, the parties undertook to divest JSG's Dutch solid board cases plant, which removed the overlap in the Netherlands and France.

Furthermore, the transaction removed Kappa's main European competitor for graphic board (processed into applications such as book covers, filing systems, games boards, and jigsaw puzzles). The parties held a combined share of 50-60% in the EEA graphic board market, while the remaining competitors had market shares below 10%. In order to avoid the creation of a dominant position, the parties undertook to sell two Dutch graphic board plants belonging to Kappa, which reduced the parties' combined market share to 20-30%.

Finally, the parties held 80-100% combined shares in the UK and Irish markets for solid board partitions (used to separate and protect products transported in corrugated cases). The parties argued that the market was EEA-wide due to low transport costs, but the Commission rejected this argument without clearly justifying its position. To allay the Commission's concerns, the parties undertook to divest JSG's solid board partitions business in Glasgow, thereby removing the overlap in the UK and Ireland.

3.4 First-Phase Decisions without Undertakings

Verizon/MCI.
On October 7, the Commission unconditionally authorized Verizon's acquisition of MCI. The Commission focused on three distinct sectors: Internet connectivity; Global Telecommunications Services (GTS); and International Voice Telephony Services (IVTS).

As in past cases, the Commission considered that the global Internet connectivity sector consists of two markets: one for "top tier" (or "top level") connectivity, and one for "second tier" connectivity. Providers of top tier connectivity operate long-distance "backbone" transmission networks with a large geographic coverage, while providers of second tier connectivity only operate networks of smaller geographic reach. The Commission rejected the parties' arguments that these markets are no longer distinct due to various technical and market-related developments, including new transmission and storing techniques such as caching or mirroring, and the increased importance of peer-to-peer traffic.

The market for GTS includes advanced communication services and special access services on high-capacity lines, which are purchased mainly by multinational corporations. The Commission was initially concerned that the vertical integration of MCI's GTS with Verizon's control of special access in certain parts of the US would lead to exclusionary effects. Due to the customized nature of GTS, the applicable regulatory framework, and GTS's customers' multi-sourcing strategies, the Commission nonetheless concluded that its concerns were unfounded. Concerning the market for IVTS, the Commission did not identify concerns because there was no overlap in the parties' activities in Europe.

In parallel to this transaction, the merger between SBC and AT&T combined two companies with very similar profiles to those of Verizon and MCI. This gave rise to initial concerns that Verizon/MCI and SBC/AT&T could engage in coordinated anti-competitive behavior on the markets for Internet connectivity and GTS. The Commission rejected such concerns on the grounds that the combined market shares of Verizon/MCI and SBC/AT&T would be insufficient to allow them to "tip" the market for Internet connectivity in their favor, and that the risk of tacit collusion in the GTS market would be low due to the customized nature of the services, low market concentration, and an effective regulatory framework.

4. State Aid

4.1 ECJ Judgment

Case C-276/03 Scott v. Commission.
On October 16, the Court of Justice dismissed Scott Paper's appeal against the Court of First Instance's rejection of Scott's application for partial annulment of the Commission's decision of July 12, 2000. Scott argued that the Commission had violated Article 15 of Regulation 659/1999.[11]

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[11] 1999 OJ L 83/1.

The Commission found that preferential conditions granted in August 1987 by two French cities to Scott for the sale of land and the calculation of a water treatment levy amounted to illegal state aid. Article 15 of Regulation 659/1999 provides that the Commission may recover illegal state aid within 10 years from its grant. Article 15 further provides that this prescription period is interrupted by "any action taken by the Commission or a Member State acting at the request of the Commission". Each interruption restarts the prescription period.

The Commission argued that the prescription period had been interrupted by its letter of January 17, 1997, requesting the French authorities to provide information on Scott's benefits. Scott took the position that only actions which had been notified to the beneficiary of the aid could interrupt the prescription period. The Court accepted that interested parties, such as aid beneficiaries, have a practical interest in being informed of action taken by the Commission that is capable of interrupting the prescription period. However, this does not confer on the beneficiary the status of a party to the procedure, and does not require the notification of actions contemplated by Article 15 of Regulation 659/1999 to the beneficiary of the aid.

Joined Cases C-266/04 to C-270/04, C-276/04 and C-321/04 to C-325/04 Nazairdis and Others v. Commission.

On October 27, the Court of Justice confirmed its settled case law by holding that a tax cannot amount to illegal state aid if it is not "hypothecated" to the aid measures that it finances.[12] A tax is hypothecated to an aid measure if it forms an integral part of the measure, in the sense that the revenue from the tax is necessarily allocated for the financing of the aid. In the event of hypothecation, the revenue from the tax has a direct impact on the amount of the aid.

The French *Taxe d'aide au commerce et á l'artisanat* (TACA) is a progressive tax borne by retailers with a sales area exceeding 400 m^2 and an annual turnover in excess of € 460,000. Initially, tax revenue was earmarked to support traders and craftsmen over 60 years of age who had ceased their activities. Increasing revenue from the TACA had allowed surpluses to be allocated to further projects supporting the craft sectors, such as providing old-age insurance schemes (Organic), supporting the retention of local craft businesses in specific geographical areas (Fisac), and pursuing the reform of fuel distribution networks (CPDC).

The applicants argued that the exemption from the TACA benefiting retailers falling below the thresholds constituted illegal state aid in favor of exempted retailers. The applicants also argued that the above aid measures constituted illegal state aid and that the TACA was thus also illegal state aid because it was hypothecated to the aid measures.

Concerning the exemption, the Court stated that a tax cannot be hypothecated to an exemption from payment of that same tax benefiting a category of businesses. The application of a tax exemption, and the extent of the exemption, do not depend on the tax revenue. Accordingly, even if the tax exemption for certain businesses constitutes an aid measure, the possible illegality of that aid cannot affect the legality of the tax. As a result, businesses liable to pay a tax cannot argue that an exemption enjoyed by other businesses constitutes illegal state aid in order to avoid payment of that tax.[13]

Concerning the argument that the tax amounted to illegal state aid because it was hypothecated to an illegal state aid measure, the Court found that the legislation establishing the TACA does not hypothecate the tax to the financing of the aid measures, noting that the amount of the payments made to recipients under the schemes is determined by Organic, Fisac, and CPDC independently of the TACA legislation. These bodies have discretion to allocate funds based on the personal circumstances of the traders and craftsmen concerned. Such decisions are made irrespective of the funds available. In these circumstances, the Court held that the TACA could not amount to illegal state aid even if the aid measures themselves turned out to be illegal state aid.

4.2 Advocate General Opinion

Case C-368/04 Transalpine Oelleitung in Oesterreich and Others v. Commission.

On November 29, Advocate General Jacobs advised the Court of Justice to apply its settled case law to hold that state aid granted to companies prior to notification of the aid to the Commission remains illegal for the period prior to notification, even if the Commission subsequently confirms the aid to be legal.

In 1996, Austria granted manufacturers a rebate on energy tax if the amount of tax owing exceeded 0.35% of the value of the goods produced. The measure was not notified to the Commission. In 2001, following a preliminary reference from an Austrian Court in a case in which service undertakings had challenged the legality of their exclusion from the rebate, the Court of Justice held that, because the rebate was selective (in that it

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12 Case C-174/02 *Streekgewest* [2005] ECR I-85.

13 Case C-390/98 *Banks* [2001] ECR I-6117.

excluded service providers), it constituted an aid.[14] The aid was then notified to the Commission, which held in 2002 that, for the period 1996-2001, the aid was legal. On the basis of this decision, the Austrian tax authorities denied the rebate to the service undertakings. Those undertakings appealed, giving rise to the present case—a preliminary reference to the Court of Justice from the national court concerning the effect of the Commission's authorization decision for the period prior to notification.

In the meantime, in 2004, the Commission subsequently reconsidered the aid, which had since been extended to include service undertakings. The Commission concluded that the 0.35% threshold, above which undertakings were entitled to the aid, was itself selective as it favored energy-intensive undertakings, and that the aid was not compatible with the common market for 2002 and 2003.

Advocate General Jacobs noted that, prior to the Commission's decision in 2002 authorizing the aid, it had been granted contrary to the duty to notify it to the Commission. Prior to 2002, the aid was therefore unlawful and ought to have been recovered. The fact that the Commission authorized the aid in 2002 could not change that conclusion, as the Commission's decision could not have retroactive effect. To hold otherwise would, in the Advocate General's view, greatly diminish the incentives for Member States to notify aid and the Commission's ability to control the granting of aid.

As regards remedies, Advocate General Jacobs noted that the service undertakings had argued that they should be permitted to claim the benefit of the aid, not only because the non-notified aid should not have been granted for the period 1996-2001, but also because the modified aid was subsequently held by the Commission to be selective (albeit for the period 2002-2003) because of the 0.35% threshold, which also applied during the period 1996-2001.

The Advocate General concluded that while national courts were required to impose remedies that negated the effect of the non-notified aid, such as recovery of the aid or an award of damages to those not granted it, extension of the aid to service undertakings was problematic, as the 0.35% selective threshold would still apply. In such circumstances, the aid would still be selective, even if both manufacturers and service undertakings could benefit.

[14] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365.

More generally, however, the Advocate General also concluded that extending the benefit of the aid would be contrary to the fundamental aim of the state aid scheme, namely, to ensure that aid is not granted until it has been notified and authorized. The Advocate General therefore concluded that national courts should not be permitted to include within the aid scheme undertakings which had originally been excluded.

Case C-88/03 Portuguese Republic v. Commission.

On October 20, Advocate General Geelhoed advised the Court of Justice to dismiss an appeal by Portugal against the Commission's decision declaring a tax scheme for the Azores region incompatible with the common market.

In 2000, Portugal notified to the Commission an adaptation of the national tax system to the specific characteristics of the Azores, which had been proposed by the autonomous local authorities pursuant to a national law granting it the power to create and regulate taxes in force solely in the autonomous region. In 2002, the Commission informed the Portuguese authorities that it did not object with the parts of the scheme concerning the tax base and tax credits. However, the Commission found that the parts of the scheme concerning corporation and income tax constituted state aid within the meaning of Article 87(1). As to whether the scheme benefited from any derogation to the state aid rules, the Commission found that the scheme was compatible insofar as it allowed firms not involved in the financial sector to improve their financial situation and contribute to regional development. However, corporate tax reductions to firms in the financial sector were not justified by their contribution to regional development, and were therefore deemed incompatible with Community law.

The Advocate General noted that this was the first opportunity for the Court to set forth the principles relevant for the assessment of whether variations in national tax rates adopted solely for a designated geographical area of a Member State fall within the scope of Community state aid rules.

The central issue concerned the criteria to be taken into account in determining whether geographically limited national tax rate variations are unlawfully selective because they favor certain undertakings or the production of certain goods. The Advocate General identified three different scenarios: (i) the central government unilaterally decides on a reduction in the national tax rate within a defined geographic area, which was regarded as selective; (ii) the local authority has autonomous power to set the tax rate for its geographic region, which was not regarded as selective, because it would not derogate from a general system; and (iii) a local tax rate that is lower than the national rate, decided on by local authority and applicable only within the

geographic region of that authority, which was regarded as being non-selective only insofar as the local authority is truly autonomous.

Concerning the last point, the Advocate General highlighted three aspects of autonomy—institutional, procedural and economic—and stated that the absence of any one of them would mean that the lower tax rate must be classified as selective for purposes of Article 87(1).

The Advocate General concluded that the system was unlawfully selective in this case because there were doubts as to the local authority's procedural and economic autonomy. In particular, laws contributing to the economic development of the Azores were based on the concept of national solidarity, pursuant to which the state cooperates with regional authorities to promote development and correct inequalities. According to the Advocate General, the principle of national solidarity negates the concept of true procedural and economic autonomy and requires regional authorities and the central government to cooperate to promote the redistribution of wealth across Portugal. The Advocate General found that Portugal had failed to provide sufficient justification for this selective system.

5. Policy and Procedure

5.1 Advocate General Opinion

Joined Cases C-105/04 P and C-113/04 P FEG and Others v. Commission.
On December 6, Advocate General Kokott advised the Court of Justice to set aside the judgment of the Court of First Instance of December 16, 2003 in Joined Cases T-5/00 and T-6/00, and to refer the cases back to the Court of First Instance. The Court of First Instance had dismissed the applications by FEG, a Dutch association of electro-technical equipment wholesalers, and one of its members, Technische Unie, for annulment of a Commission decision of October 26, 1999 imposing fines for collusive conduct on the Dutch wholesale market for electro-technical equipment.

The Advocate General agreed with the Court of First Instance that the preliminary investigation and the period between the adoption of the Statement of Objections and the final decision had been too long. The Advocate General observed that, even though cartel proceedings are not of a criminal law nature and are directed against companies rather than individuals, they are nonetheless subject to the principle of Community law that action must be taken within a reasonable period. The Advocate General agreed with the Court of First Instance that the relevant period for determining whether cartel proceedings are exceptionally long begins with the first investigative measure which substantially affects the companies concerned.

Recalling the settled case law, the Advocate General stated that excessive duration of proceedings will lead to the annulment of a Commission decision only if it adversely affected the rights of defense of the companies concerned. In the Advocate General's view, however, the Court of First Instance erred in law by confining the scope of its examination of this issue to the period after the notification of the Statement of Objections. The Court should have also examined whether the excessive duration of the preliminary investigation prior to notification of the Statement of Objections could have adversely affected the ability of the companies concerned to defend themselves, since an excessive duration of this first stage of the procedure may affect their ability to defend themselves against the Statement of Objections.

5.2 CFI Judgment

Case T-38/02 Danone v. Commission.
On October 25, the Court of First Instance clarified that threats of retaliatory measures directed from one cartel participant to another, in the event the latter refuses to extend the scope of the cartel, could constitute an aggravating circumstance for fining purposes, provided that a causal link between the threat and the extension of the cartel could be established.

The Court found that the Commission had established that Danone had threatened to drive Interbrew out of the French market if it resisted extending its cooperation on the Belgian market, and that the scope of the cartel had subsequently been extended. However, the Court found that the Commission had failed to establish a causal link between these two events, reasoning that the extension of the cartel could be explained by the participants' shared interest in restricting competition, as reflected by the fact that both had taken initiatives to that effect in the past.

The Court also confirmed that the Commission may rely on recidivism as an aggravating circumstance, irrespective of the time that had elapsed since the previous infringements. According to the Court, taking account of infringements dating back 17 years and 27 years in order to establish Danone's recidivism did not violate the principle of legal certainty. The Court explained that the applicable legal rules, including the Commission's fining guidelines, did not impose a limitation period in respect of recidivism.

The Court also rejected Danone's arguments on the principle of double jeopardy (or *non bis in idem*), emphasizing that recidivist behavior was a strong indicator that previous sanctions had not been sufficiently deterring. The Court ruled that taking recidivism into account as an aggravating circumstance serves the purpose of dissuading undertak-

ings from repeatedly engaging in anti-competitive behavior, and therefore does not violate the principle of double jeopardy.

Case T-48/02 Brouwerij Haacht v. Commission.
On December 6, the Court of First Instance rejected Brouwerij Haacht's argument that the Commission should have concluded that Brouwerij Haacht had played merely a passive role in a beer cartel involving Brouwerij Haacht, Interbrew and Alken-Maes, and that this should have been taken into account as a mitigating circumstance when determining the level of fine to be imposed.

Brouwerij Haacht argued that, in imposing fines on other undertakings, the Commission had taken into account the fact that Interbrew and Alken-Maes had taken a particularly active role in the cartel. Brouwerij Haacht also argued that Danone had implied that Brouwerij Haacht's role was passive.

The Court explained, however, that the mere fact that the active role played by others was taken into account as an aggravating circumstance against them did not automatically mean that Brouwerij Haacht should be regarded as having played a passive role, nor did it mean that the company should automatically benefit from this mitigating factor. Rather, any such conclusions as to the conduct of Brouwerij Haacht must be based on evidence relating to its own conduct, and not the conduct of others. The Court noted in this regard that the evidence did not support the applicant's argument that it had played an exclusively passive role.

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