

“By Object” Restrictions of Competition Revisited: European Court of Justice Endorses Narrow Interpretation

EU High Court adopts narrow interpretation of “by object” restrictions and boosts effects-based approach with significant implications for cooperation/joint venture agreements.

The European Court of Justice has provided much awaited clarification of the notion of “by object” restrictions of competition under EU competition law in granting an appeal by the Groupement des Cartes Bancaires “CB”. In a landmark and welcome ruling, the Court confirmed that the European Commission (the Commission) needs to abandon its simplistic use of the “by object” restriction notion in cases that are not obviously harmful to competition and focus on the actual effects of the conduct. The Court also emphasized the obligation on the General Court to ensure a full judicial review, including a detailed and thorough analysis of the arguments of the parties and of the evidence on which the decision relies. Latham & Watkins represented the Groupement des Cartes Bancaires “CB”.

On 11 September 2014, the European Court of Justice quashed the judgment of the General Court that had previously upheld the European Commission’s decision finding that certain pricing measures adopted by the Groupement des Cartes Bancaires “CB” (CB Group) were “by object” restrictions of competition.¹ The CB measures in question were aimed at balancing the issuing and acquiring activities within the CB payment system in France. The Court of Justice held that for an agreement to restrict competition by object it must by its very nature be sufficiently harmful to the proper functioning of normal competition. The Court of Justice held that the elements relied on by the General Court did not support that conclusion. The judgment marks a significant turning point in EU competition law. In recent years, the Commission expanded the category of “by object” restrictions to avoid having to show likely adverse effects on competition. There are now clear limits on doing so in cases that do not involve hardcore restrictions. The judgment signals a welcome return to normality where agreements involving integration of economic activity are caught by Article 101(1) TFEU only when they have potential restrictive effects on competition.

Background

CB Group was established by the main French banks to manage a system for bank card payments and withdrawal (the CB system). This system accounted for over 75 percent of card payments in France and enabled the use of bank cards to make payments to all affiliated merchants and withdrawals from ATMs belonging to any of the 148 members of CB Group. The disputed measures consisted mainly of a series of fees paid by CB Group members when issuing cards, and in particular: (i) the so-called MERFA² formula determining the fees payable by card issuers based on a series of parameters. Members that mainly issued cards (compared to acquiring merchants and installing ATMs) paid higher fees; (ii) a three-year membership fee per card issued, and (iii) a so-called “wake-up” fee applied to members that were

inactive or not very active before the date of application of the new pricing measures. According to CB Group those measures were introduced to combat “free-riding” on the investments made by the main member banks and to encourage new competitors to acquire merchants and install ATMs so as to maintain incentives to expand interoperability within the CB system, i.e., the ability for card users to use their cards with all merchants and in all ATMs regardless of the card issuer.

In 2002, CB Group notified the measures to the Commission under Regulation 17/62 and in 2004 the CB Group decided not to implement those measures. However, the Commission adopted an infringement decision in 2007.³ The Commission found that the purpose of the measures was to keep the price of payment cards artificially high to the advantage of major banks and to the detriment of new entrants. The Commission ordered CB to abolish the measures concerned and to refrain from adopting measures with a similar object or effect in the future. CB Group contested the Commission’s decision before the General Court. In 2012, the General Court upheld the Commission’s decision⁴ finding that the Commission was right in concluding that the pricing measures had as their “object” to restrict competition and decided that it was not required to examine the pleas contesting the analysis in the decision of the effects of the measures. According to the General Court, these measures hindered new entry on the market for the issuing of payment cards in France. CB Group appealed to the Court of Justice arguing, *inter alia*, that the General Court had erred in applying the concept of restriction of competition “by object”.

The Court of Justice Judgment

Article 101(1) TFEU prohibits agreements that have as their “object or effect” the restriction of competition. If it is shown that an agreement has an anti-competitive object, anti-competitive effects are presumed and there is no need to show adverse effects on competition before concluding that Article 101(1) TFEU is infringed. The Court of Justice recalled that, according to settled case law, “by object” restrictions of competition are those that are “regarded, by their very nature, as being harmful to the proper functioning of normal competition”. The Court of Justice gave the example of a price fixing cartel. “Experience shows that such behavior leads to falls in production and price increases, resulting in poor allocation of resources to the detriment, in particular, of consumers”. The assessment of the object of an agreement is based *inter alia* on the “content of its provisions, its objectives and the economic and legal context of which it forms part”, as well as the “nature of the goods or services affected”. The parties’ intention may also be taken into account, but is not a “necessary factor in determining whether an agreement [...] is restrictive”.

The Court of Justice found that the General Court had failed to properly apply the core criterion for ascertaining the object of the CB measures, namely whether in themselves they “revealed a sufficient degree of harm to competition”. The Court of Justice rejected the General Court’s view that the concept of “by object restrictions” should not be interpreted restrictively since “otherwise the Commission would be exempted from the obligation to prove the actual effects on the market of agreements which are in no way established to be, by their very nature, harmful to the proper functioning of normal competition”. The Court of Justice held that the General Court erred in law by taking the view that a restrictive object could be inferred from the wording of the measures and the possibility that the measures may restrict competition. Having acknowledged that the measures sought to establish a certain balance between the issuing and acquiring activities of the members of the CB Group, the “General Court was entitled at the most to infer from this that those measures had as their object the imposition of a financial contribution on the members which benefit from the efforts of other members for the purposes of developing the acquisition activities of the system”. The Court of Justice held, however, that this element could not, by its very nature, be considered harmful to the proper functioning of normal competition.

The Court of Justice also noted that by carrying out the market analysis solely on the market for the issuing of payment cards in France, rather than considering also the downstream market for payment systems, the General Court had mixed up the definition of the relevant market and the contextual analysis needed to decide whether an agreement has as its object to restrict competition. Very importantly it clarified that this assessment must take into account all relevant factors irrespective of whether they relate to the relevant market. Finally, as a logical consequence, the Court of Justice held that the balancing between issuing and acquiring activities under Article 101(1) TFEU and ultimately determining whether the measures foreclosed new entrants was to be assessed in the context of examining the effects of those measures on competition.

Analysis and Practical Implications

The Commission's practice in recent years has shown an increasing reliance on "by object" analysis when applying Article 101(1) TFEU, which was often done in a rather simplistic and formalistic way. In the last 10 years the Commission has issued 12 Article 101(1) TFEU (non-cartel) infringement decisions, in 10 of which competition was considered restricted "by object".⁵ This record suggests that the Commission — probably prompted by the desire to achieve procedural economies — opts for the "by object" box whenever possible to avoid the need to perform a full effects analysis before considering efficiency benefits under Article 101(3) TFEU. To avoid such analysis the Commission has sought to create new categories of "by object" infringements that in the past would most likely have been treated as restrictions "by effect" (e.g., integrated airline alliances such as *AA/BA/IB*⁶ and *Continental/United/Lufthansa/Air Canada*).⁷ This has blurred the boundaries between "by object" and "by effect" restrictions.⁸

The Court's judgment is a landmark ruling that has three very important consequences. First, it is now clear that the Commission must show likely effects on competition unless it is clear that the restriction at issue, by its very nature, harms competition. Second, showing that a certain measure is merely "capable" of restricting competition is insufficient to find a "by object" restriction except in the case of clear cut restrictions. Finally, and most importantly, agreements involving complex measures, such as the one at issue in the CB system, are not subject to the "by object" standard because the truncated analysis under the "by object" concept is not suitable for determining if such complex measures are caught by Article 101(1) TFEU. A proper effects-based analysis must be conducted. Many will welcome this new boost to economic analysis, including within the European Commission.

For companies, the characterization of a restriction "by object" in non-cartel situations has serious consequences. It shifts the burden of proof leaving Article 101(3) TFEU as the only avenue to escape prohibition. The efficiency defence of Article 101(3) TFEU is rarely invoked successfully in "by object" cases and as such the pressure to accept conditions on the arrangements in order to reach a "settlement" with the Commission and avoid an infringement decision has grown in recent years. Moreover, as is clear from the recent judgment in *Expedia*,⁹ "by object" restrictions are presumed to appreciably restrict competition and are automatically excluded from the safe harbor of the De Minimis Notice.¹⁰ These consequences show the practical importance of this ruling in confirming that the "by object" concept has a much narrower scope than what the Commission has claimed in applying it to individual cases in recent years.

The Court's more restrictive interpretation of the notion of "by object" restrictions also goes a long way in reestablishing the balance that was intended by the Commission's own Guidelines on the application of Article 101(3) TFEU, which generally equated restrictions by object with hardcore restrictions. The Commission's language in the Guidelines to describe "by object" restrictions resembles that of the Court of Justice: "These are restrictions which in light of the objectives pursued by the [EU] competition rules have such a high potential of negative effects on competition that it is unnecessary for the purposes of

applying Article [101(1) TFEU] to demonstrate any actual effects on the market. This presumption is based on the serious nature of the restriction and on experience showing that restrictions of competition by object are likely to produce negative effects on the market and to jeopardize the objectives pursued by the Community competition rules. Restrictions by object such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources, because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question”.

This type of analysis is obviously not applicable to a complex set of arrangements whereby an association of undertakings, like CB Group, decides that some new pricing measures are needed to rebalance the issuing and acquisition activities of its bank members with the objective of ensuring its continuation as the most reliable and successful payment system in France. Certainly such measures would have forced some banks to change their contribution and/or issuing policies and prices. But that change was precisely what CB Group considered necessary to prevent the risks of implosion to be expected from the continuation of massive free riding by those who, without having invested in the creation and development of the payment system, were happy to be admitted and actively use it. Given the absence of relevant precedents, the General Court and the Commission could not consider such measures as restrictive by object “by its very nature” without properly proving it. In the absence of any proof of a restriction by object, the General Court had to examine its effects on competition before finding them restrictive under Article 101(1) TFEU, even more so since it found that combating free-riding is in itself perfectly legitimate.

Another notable contribution of this ruling is the clarification by the Court of Justice that when examining conduct in two-sided markets (like payment systems) competition rules cannot be applied to one side only (i.e., issuing of credit cards) with total disregard of the other side (i.e., acquisition of merchants). Consideration must be given to the interactions between the issuing and acquisition activities of a payment system and to the fact that those activities produce ‘indirect network effects’ (i.e., the extent of merchants’ acceptance of cards and the number of cards in circulation each affects the other). Such analysis needs to be done when considering whether the conduct at issues has anticompetitive effects. The Court’s apparent rejection of the so-called truncated or abridged contextual analysis for the determination of “by object” restrictions by looking into the effects increases predictability and legal certainty in this very important area. The reduced scope for shifting the burden of proof means that cooperation arrangements like those of CB Group are now less exposed. The challenger must show likely anticompetitive effects before the parties are required to show that efficiencies outweigh the adverse effects on competition. That is the way it should be. The Court of Justice has rightly corrected an anomaly.

It is finally worth noting that this ruling confirms the importance of a full and thorough judicial review. It is remarkable how clearly the Court of Justice has expressed its regret at the “general failure of analysis by the General Court”. It is also noteworthy how the Court of Justice emphasizes the importance of ensuring a full judicial review of Commission competition decisions, i.e, the obligation to do a detailed and thorough analysis of the arguments of the parties and of the evidence on which the decision relies. It is welcome that the Court of Justice highlighted the need for the General Court to carefully examine whether the evidence used by the Commission in the decision enabled it to conclude correctly that the measures at stake, in the light of their wording, objectives and context, displayed a sufficient degree of harm to competition to be regarded as having as their object a restriction of competition within the meaning of Article 101(1) TFEU and, consequently, whether that evidence constituted all the relevant data which had to be taken into consideration for that purpose.

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Endnotes

- ¹ Case C-67/13 P, *Groupement des cartes bancaires (CB) v Commission* [2014], n.y.r
- ² Mécanisme de Régulation de la Fonction Acquéreur.
- ³ Commission Decision COMP/D1/38606 – *Groupement des cartes bancaires “CB”* [2007].
- ⁴ Judgment in *CB v Commission*, T-491/07, EU:T:2012:633.
- ⁵ In the period from 01/01/2004 to 31/06/2014, the Commission found anticompetitive practices to restrict competition “by object” in the following cases: case COMP/39685 – *Fentanyl* [2013]; case COMP/39226 – *Lundbeck* [2013]; case COMP/39839 - *Telefónica and Portugal Telecom* [2013]; case COMP/39510 – *Ordre National des Pharmaciens en France (ONP)* [2010]; case COMP/38606 – *Groupement des cartes bancaires “CB”* [2007]; case COMP/38698 – *CISAC* [2008]; case COMP/38662 - *GDF/ENEL* [2004]; cases COMP/36623, COMP/36820, COMP/37275 – *SEP et autres/Peugeot SA* [2005]; case COMP/38549 - *Barème d'honoraires de l'Ordre des Architectes belges* [2004]; case COMP/37980 - *Souris – Topps* [2004]. The only decision in which the Commission judged the practice anticompetitive by its effects on competition was adopted in case COMP/37860 – *Morgan Stanley/Visa International and Visa Europe* [2007]. In case COMP/34579 – *Mastercard I* [2007], Commission admitted that it cannot reach a 'definite conclusion' as to whether the alleged practice concerns a restriction by object (see recital 407 of the decision).
- ⁶ Commission Decision COMP/39596 – *BA/AA/IB* [2010].
- ⁷ Commission Decision COMP/AT.39595 – *Continental/United/Lufthansa/Air Canada* [2013].
- ⁸ See Opinion of Advocate General Wahl, *Groupement des cartes bancaires (CB) v Commission*, Case C-67/13 P, ECLI:EU:C:2014:1958, paragraphs 47 et seq.; See also speech of Alexander Italianer, in “Competitor Agreements under EU Competition Law”, 40th Annual Conference on international Antitrust Law and Policy at Fordham, New York, 26 September 2013. “[A]part from cases like price-fixing, output limitations and the like, the line between restrictions by object and those by effect is not always bright. Reading its more recent rulings one may wonder whether the Court, whilst finding a restriction by object, may not have gone rather far towards analysing the effects of the agreement when it looked at the market structure, the functioning of the market, the degree of concentration, the market power of the firms involved, etc.”. Available at: http://ec.europa.eu/competition/speeches/text/sp2013_07_en.pdf.
- ⁹ Judgment in *Expedia Inc. v Autorité de la concurrence and Others*, C-226/11, ECLI:EU:C:2012:795.
- ¹⁰ Communication from the Commission - Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union, of 25.6.2014, C(2014) 4136 final, (Point 13).