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## **Chapter 9**

### **Enforcement of Articles 81 and 82 of the EC Treaty:**

#### **Insights from Law and Economics**

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#### **Introduction**

In a significant number of industries, cartels continue to form and succeed in maintaining discipline over a long period of time. A major problem of the cartel prohibition (Article 81 of the EC Treaty) thus seems to be an implementation issue. The purpose of this chapter is to investigate the strengths and weaknesses of the current enforcement regime, contained in Regulation 1/2003. In economic terms, the enforcement of European competition law may be qualified as optimal if welfare reducing anti-competitive practices can be deterred, no enforcement errors are made and enforcement costs are minimised. Full deterrence is achieved when all firms abstain from engaging in welfare reducing anti-competitive practices, since the gains from doing so are lower than the costs of the sanctions that are imposed for violating the competition rules. Error costs may occur when anti-competitive practices that do not harm economic welfare are falsely prohibited (type I errors), or, conversely, harmful practices are allowed (type II errors). Enforcement costs are not minimised when the benefits of the competitive processes that are preserved do not outweigh the administrative costs of detection and sanctioning violations of the competition rules. These administrative costs include both the expenses of the public sector (costs of competition authorities, prosecutors and courts) and the costs borne by the businesses or individuals concerned (costs of lawyers and experts). Full deterrence will not be efficient if the latter costs are higher than the benefits resulting from prohibiting harmful practices.

In designing enforcement mechanisms, policy makers face difficult choices. All decisions made will have an impact on the level of deterrence and on the risks that errors are made or that enforcement costs are not minimised. The relevant policy questions are even more complex since, besides from the deterrence objective, goals of corrective and proportional justice have to be taken into account as well. This chapter highlights the relevant insights on the enforcement of the European competition rules from an economic perspective, without neglecting their relation with the justice goals. In recent years, the analysis of enforcement mechanisms has been focused mainly on Article 81 of the EC Treaty, in particular the hard core cartels (price fixing, market sharing, bid rigging). A large part of this chapter is devoted to this discussion, but also a number of questions concerning the optimal enforcement of the prohibition of vertical restraints and Article 82 of the EC Treaty are dealt with. Since a comparison of European competition law and American antitrust law is useful to illustrate the consequences of the different choices of enforcement mechanisms that can be made, the economic analysis hereafter uses a comparative perspective.

In this chapter four questions are addressed. The structure of the chapter follows Shavell's distinction of the three basic dimensions according to which methods of law enforcement can differ: the form of the sanctions, the role of private parties versus public agents in enforcement, and the timing of the legal intervention.<sup>1</sup> In a federal or quasi-federal context, such as the European Union, a fourth dimension must be added: the division of competences between the central competition authority and decentralised enforcement agencies (competition authorities and judges of the Member States). The "modernisation" debate on the enforcement of European competition law<sup>2</sup> was largely limited to the third and fourth dimension of the choice between different enforcement systems. The discussion was focused on the following two questions: Should there be an *ex ante* control of anti-competitive practices (notification and authorisation regime) or is it sufficient to have an *ex post* control (legal exception regime)? And: should enforcement of the European competition rules be decentralised by giving more powers to national competition authorities and judges, thereby alleviating the burden of a single central enforcement agency (European

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<sup>1</sup> S. Shavell, "The Optimal Structure of Law Enforcement", *Journal of Law and Economics*, 1993, vol. 36, pp. 255 -

<sup>2</sup> This debate started with the publication of the White Paper on Modernisation of the Rules Implementing Articles 81 and 82 (Formerly Articles 85 and 86) of the EC Treaty (O.J. , C 132, 12.5.1999, pp.1-23) and resulted in the enactment of Regulation 1/2003 (O.J., L 1, 4.1.2003, pp. 1-25). This Regulation replaced the old enforcement system contained in Regulation No. 17, which was enacted back in 1962 (Council Regulation No. 17 [1962] O.J. L 13, .....pp. 204- ) Together with Regulation 1/2003 the Commission has published a total of six Notices: two on cooperation (within the Network of Competition Authorities (O.J., C 101, 27.4.2004, pp. 43-53) and between the Commission and the courts of the EU Members States (O.J., C 101, 27.4.2004, pp. 54-64), one on the handling of complaints (O.J., C 101, 27.4.2004, pp. 65-77), one on informal guidance relating to novel questions concerning Articles 81 and 82 (O.J., C 101, 27.4.2004, pp. 78-80) and two Guidelines on the interpretation of concepts of competition law: the effect on trade concept (O.J., C 101, 27.4.2004, pp. 81-96) and the application of Article 81(3) of the Treaty( O.J., C 101, 27.4. 2004, pp. 97-118).

Commission)? Economic analysis can be helpful in answering these two questions and provide criteria to evaluate the enforcement regime that has been chosen. Even though the importance of the modernisation debate should be acknowledged, the first two questions on the type of sanctions and the role of private parties in the enforcement of the competition rules merit equal attention and are gaining importance in the most recent literature. In this chapter, the discussion of these issues precedes the analysis of the modernisation package.

The question addressed in the first section relates to the sanctions. The main choice is between administrative fines and criminal sanctions. In cases of infringement of competition rules, fines can be imposed on companies only. It is, however, also possible to supplement those fines with individual sanctions imposed on the responsible decision-makers within the companies; such sanctions may include fines, imprisonment, or disqualification of directors who committed an antitrust violation. Generally, if sanctions are too low, the expected benefits from violating the competition rules may exceed the expected costs of infringing the law and underdeterrence will result. The first section of this chapter gives an overview of the sanctions as contained in both European and American antitrust law and provides an economic assessment of the divergent regimes from a comparative perspective. It also provides an evaluation of the different sanctions from the viewpoint of corrective and proportional justice.

The second section discusses the question relating to the enforcement agents: not only public agents (antitrust authorities), but also private parties bringing cases before ordinary courts can play an important role in the enforcement of the competition rules. By claiming damages for the harm suffered as a consequence of the violation of the competition rules before the civil courts of the respective Member States, private parties may contribute to the achievement of both deterrence and justice objectives. Again, the European and the American situation differ. Whereas private parties so far have played a rather modest role in enforcing the European competition rules, they have been much more active in the United States, and this has had an impact on both the number and type of cases under antitrust investigation. The second section of this chapter discusses the advantages and disadvantages of private enforcement to find out whether, from an efficiency perspective, private court actions are an alternative for or a desirable supplement to enforcement by administrative agencies. Also the role of private enforcement in reaching corrective justice is assessed.

The question discussed in the third section relates to the timing of the legal intervention. Intervention may take place before an undesirable act is committed or after harm has occurred.

Under a notification regime, firms may be required to inform the competition authorities on practices they are contemplating, so that antitrust authorities may screen agreements before they are put into practice. The alternative regime tries to achieve deterrence by imposing sanctions if competition is harmed and no exception to the prohibition of anti-competitive practices applies. In European competition law, one may observe a shift from an *ex ante* to an *ex post* control. Until May 2004, undertakings could notify their agreements to the European Commission, asking for a formal decision implying that the agreement did not constitute a restriction of competition (negative clearance) or that it did, but could profit from an exemption. The Commission was the only agency empowered to grant individual exemptions. This notification system was abolished and has been replaced by a directly applicable legal exception regime. Under the new enforcement system, the European Commission as well as all competent national competition authorities and judges conduct a full evaluation of the agreements, including the conditions to grant an exemption. It may be assumed that firms react differently to these divergent regimes and that this will have an impact on the type of agreements entered into. If the system change entails the risk that some beneficial agreements are not longer signed or that more harmful agreements are implemented (type I and type II errors), the new regime will be far from optimal. The third section of this chapter gives an overview of the theoretical economic literature, which sheds some light on these questions, and attempts a preliminary economic evaluation of the system change.

Finally, the last section of this chapter discusses the fourth question relating to the choice between a centralised enforcement system by a single antitrust authority and decentralised enforcement by different agencies at lower levels of government. In the policy discussion, a major argument to justify decentralisation is that it may allow a division of labour, which permits the central authority to chase the most serious infringements. The question whether decentralisation is desirable requires a much more refined analysis, however. According to the subsidiarity principle contained in the European Union Treaty, matters that can be “better” taken care of by the Member States should not be entrusted to institutions of the European Union. Decentralisation may allow competition between legal orders, which in turn may achieve important efficiency benefits. Subsidiarity in the area of competition law has two aspects: both the formulation of the substantive rules and their enforcement may take place at the national, rather than at the European, level. There is no (or very little) competition as far as the formulations of the substantive rules are concerned.<sup>3</sup> The picture is different with respect to enforcement of the competition rules. Whereas there has always been some degree of decentralisation (enforcement of Article 81(1) by national courts, co-operation between

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<sup>3</sup> See the discussion in chapter 3 of this book.

the European Commission and judges), the new enforcement regime takes subsidiarity a decisive step further. In interpreting and enforcing the rules, the European Commission now has shared competences with the competition authorities and judges of the Member States. Whether this sort of competition at the enforcement level is benign is the last question to be addressed in this chapter.

## **1. The choice of sanctions**

### 1.1. A brief comparison of European and American sanctions

#### 1.1.1. Differences in type and severity of sanctions

As far as sanctions for infringement of competition rules are concerned, there are remarkable differences between European competition law and American antitrust law.<sup>4</sup> These differences relate to the range of antitrust offenders that can be fined, the type of the sanctions and their magnitude. The first difference is that European competition law is enforced by imposing fines on undertakings, whereas in American antitrust law such penalties are combined with fines on individuals as well as imprisonment. The European Court of Justice has defined undertakings as economic units, even if in law the economic unit may consist of several natural or legal persons.<sup>5</sup> In practice, for reasons of enforceability, the European Commission imposes fines on companies (or other legal persons), to which the violation committed by the undertaking is imputed. The situation in the United States is different, since antitrust law is also enforced by means of criminal liability of individuals, including corporate directors, officers and employees.

A second difference relates to the type of the sanctions. Fines can be either criminal or civil or administrative. Criminal fines carry a stigma effect, showing that society morally disapproves a certain behaviour. Whereas such censure is clearly present in American antitrust law, the fines imposed under European competition law are not of a criminal law nature.<sup>6</sup> It should be added that competition laws of some EC Member States also allow for criminal sanctions, imposed both on companies and individuals (see Box 9.1)

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<sup>4</sup> For an excellent comparison, also from an economic perspective, see W. Wils, "Does the Effective Enforcement of Articles 81 and 82 EC Require Not Only Fines on Undertakings But also Individual Penalties, In Particular Imprisonment?", in C.D. Ehlermann and I. Atanasiu, (eds), *European Competition Law Annual 2001: Effective Private Enforcement of EC Antitrust Law*, Hart, 2002, reprinted in W. Wils, *The Optimal Enforcement of EC Antitrust Law*, Kluwer, 2002, 188-237. The discussion in this chapter has clearly benefited from this contribution.

<sup>5</sup> Judgement of 12 July 1985 in Case 170/83 *Hydroterm v. Compact* [1985] ECR 3016 at para. 11.

<sup>6</sup> Article 23(5) Regulation 1/2003.

## BOX 9.1.

### CRIMINAL SANCTIONS IN NATIONAL COMPETITION LAWS

In the United Kingdom, the Enterprise Act 2002 introduced prison sanctions, fines and director disqualifications for infringements of the national competition law. Cartel offences will be the subject of a trial by a jury in a criminal court. To impose criminal sanctions, a narrowly focussed prohibition is needed. Hence, the UK cartel offence is not a copy of Article 81 of the EC Treaty, since the wording of this article (referring to all restrictions of competition) is much too broad and not appropriate for criminalisation. The cartel offence (Section 188 Enterprise Act) is a separate crime and applies only to obvious, “hard core” agreements (price fixing, limitation of supply or production, market sharing, bid rigging). Conversely, the UK cartel offence does not apply to vertical agreements. Also abuses of a dominant position are not criminalised. A commission of the cartel crime requires dishonesty, a concept which has two elements. As an objective matter, the jury will have to assess whether the defendant acted dishonestly according to the standards of reasonable people. As a subjective matter, it must be investigated whether the defendant realised that his behaviour was dishonest by those standards. Individuals who are found guilty of a cartel offence may be penalised with prison sanctions up to five years and unlimited fines. Besides from the cartel offence, the Enterprise Act has also introduced company director disqualification for any infringement of the national competition law (Section 200).

Also in Ireland, price-fixing and related “hard core” cartel behaviour have been criminalised. Conviction on indictment may result in a maximum corporate and individual fine of €4,000,000 or 10 per cent of the turnover during the prior financial year. Individuals may also be sentenced to a maximum of five years imprisonment. (Section 8, Competition Act, 2002) Economically, these sanctions can be seen as additional sanctions for hard core violations of Article 81 of the Treaty.

A third difference is the severity of sanctions. The European Commission is empowered to impose on undertakings or associations of undertakings fines not exceeding 10 per cent of the world-wide turnover in the preceding business year of each of the undertakings participating in the violation. The criminal sanctions in the United States are more severe. Corporations risk heavy criminal fines. After two amendments of the Sherman Act (in 1974 and 1990) and the passing of an alternative Fine Statute, the maximum fine has been ultimately increased by the Antitrust Criminal Penalty Enhancement and Reform Act of 2004. The fine that can be imposed on an organisation now amounts to \$ 100 million or, alternatively, twice the gross gain to the offender or twice the gross loss to the victims of the conspiracy.<sup>7</sup> Relying on the twice the gain/loss formula, the Antitrust Division of the Department of Justice obtained criminal fines of up to \$ 500 million. The maximum sentence for individuals is ten years imprisonment and a fine that is the greatest of \$ 1 million, twice the gain to the cartel, or twice the loss suffered by the victims. In recent years, the Antitrust Division imposed substantial fines on individuals. In the period 1990-1999 the average fine on

convicted individuals was almost \$ 90.000. At the same time, antitrust offenders were being sent to jail with increasing frequency and for longer periods of time. In the nineteen-nineties the average actual prison term was almost 9 months, in 2002 a record jail sentence of 36 months was imposed in a case of bid rigging.<sup>8</sup>

### 1.1.2. Guidelines on imposing fines

For a long time, the Commission's fining policy was not based on specific criteria. In practice a certain percentage of turnover in one year of the different participants in the relevant market, usually the sales of the product in the Community, was taken as the basis for administrative fines in cartel cases. One author found that the fines varied roughly between 2 and 4 per cent of the turnover in the European Community<sup>9</sup>; more recent cases showed fines amounting to 9 per cent for the ringleaders and 6 per cent for the foot soldiers.<sup>10</sup> In 1998, to ensure "transparency and impartiality" the Commission published Guidelines for calculating fines.<sup>11</sup> The method of determining the fine starts from a "basic amount" fixed by reference to the gravity and duration of the infringement. Infringements are put into one of three categories: minor infringements (vertical restrictions with a limited impact), serious infringements (horizontal restrictions, vertical restrictions with a wider impact, abuses of a dominant position), and very serious infringements (price cartels and market sharing quota's, partitioning of national markets, clear-cut abuses by virtual monopolists). Likely fines for minor infringements vary from €1000 to €1 million; they amount to a figure between €1 million and €20 million for serious infringements, and will be above €20 million for very serious infringements. The Guidelines do not provide precise indications of how the start point for the calculation is determined; the amounts of "likely fines" are indications of the overall fine.<sup>12</sup> The start point is chosen in assessing the gravity of the infringement by taking account of "its nature, its actual impact on the market, where this can be measured, and the size of the relevant geographic market". The Commission may use the product turnover in setting the fine base and amend this figure through a multiplier to make sure that it has a sufficient deterrent effect, taking account of the

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<sup>7</sup> Antitrust Procedures and Penalties Act of 1974 § 3, Pub. L No. 93-528, 88 Stat. 1706; Antitrust Amendments Act of 1990 § 4, Pub. L No. 101-588, 104 Stat. 2879, 18 U.S.C. § 3571(d). TO BE UPDATED

<sup>8</sup> See: A Summary Overview of the Antitrust Division's Criminal Enforcement Programme, 2003, to be downloaded from the DOJ's website. For figures on total fines obtained in the years 2001-2003, see J.S. Magney and R.C. Anderson, "Recent Developments in Criminal Enforcement of US Antitrust Laws", *World Competition*, 2004, p. 102.

<sup>9</sup> M. Reynolds, EC Competition Policy on Fines, *European Business Law Review*, 1992, p. 263

<sup>10</sup> Cartonboard, 1994 OJ L 243/1

<sup>11</sup> Guidelines on the method of setting fines, O.J., C 9, 14.)1.98, p. 3

<sup>12</sup> J.M. Joshua and P.D. Camesasca, "EC Fining Policy against Cartels after the Lysine Rulings: The Subtle Secrets of x", *The European Antitrust Review*, 2004, p. 6

firms' size and resources.<sup>13</sup> The fine base, which reflects the gravity of the infringement, must be adjusted to mirror the duration of the infringement: for example, the amount set for gravity may be increased up to 50 per cent for infringements of between one and five years. The "basic amount" (determined by taking into account the gravity and duration of the infringement) may be adjusted upwards for aggravating circumstances (for example, leading role in a cartel or repeated infringement) or downwards for attenuating circumstances (for example, passive role in a cartel set-up or termination of the infringement as soon as the Commission intervenes). Further adjustments may have to be made to ensure that the imposed fine does not exceed the maximum ceiling of 10 per cent of the world-wide turnover of the company or the "ability to pay in a specific social context". Eventually, the last step in the calculation of the fine is the application of the percentage reduction as provided for in the Leniency Notice if the requirements of the latter (see 1.1.3) are satisfied.

In its recent case law, the European Court of Justice made it clear that not the total turnover but the turnover on the relevant market (i.e. the affected commerce) is an appropriate benchmark to assess the gravity of the infringement.<sup>14</sup> Whereas the former figure indicates the size of the firm and its economic power, the latter gives a proxy of the seriousness of the infringement. The Court expressed the principle that a fine must be proportionate to the level of sales of the product which is the subject of the infringement. Moreover, in complex cartel cases involving many firms, the specific weight of each firm on the infringement has to be assessed. The scale of the infringement cannot be assessed by relying on the total turnover figure (which is an imprecise guide) but rather by calculating the share of the affected commerce held by each undertaking.<sup>15</sup> Figures about the volume of the affected commerce and the relative shares held by the participating firms are thus crucial for calculating fines that are proportionate to the impact of the prohibited cartel agreement.

The American Sentencing Guidelines use 20 per cent of the volume of affected commerce as the base fine level for convicted organisations. In drafting these Guidelines, the Sentencing Commission relied on estimates that the average overcharge from price fixing is 10 per cent of the selling price.<sup>16</sup> Since the Commission believed that the loss to society is larger than the excess profits gained by the cartel members, this percentage was doubled to set the start point for the fine calculation. Depending on culpability factors and other circumstances, the fines for organisations

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<sup>13</sup> The Court of First Instance has recently stated that in fixing the multiplier the Commission may take into account the deterrent effect that fines must have. See Judgment of the Court of First Instance, Case T-31/99, *ABB Asea Brown Boveri Ltd v. Commission*, E.C.R. [2002] II-1881.

<sup>14</sup> Case T-61/99 *Adriatica di Navigazione SpA*, 11 December 2003

<sup>15</sup> Case T-224/200 *Archer Daniels Midland Company v. Commission* [2003] (Lysine case), para. 196

<sup>16</sup> Recent research has shown that this figure may seriously underestimate the price increases caused by cartels.

may be increased up to 80 per cent of the volume of affected commerce and thus reach a level that is 8 times the assumed overcharge from price fixing.

### 1.1.3. Leniency programmes

Public enforcers often lack sufficient evidence to prove a violation of the competition rules. This is particularly worrisome in the case of hard core cartels (such as price fixing and agreements to share markets), which may result in increased prices and reduced choices for consumers without any redeeming virtue. Leniency programmes aim at increasing the rate of detection by granting favourable treatment to companies willing to inform the antitrust authorities about serious infringements and to put an end to their participation in these secret cartels. In order to improve the chances that secret cartels are detected and punished, the Antitrust Division of the American Department of Justice started an amnesty programme already in 1978. Under that programme, cartel members who reported their illegal activity before an investigation was underway were eligible for complete immunity from criminal sanctions. The grant of amnesty, however, was not automatic and the Antitrust Division retained a large margin of discretion in the decision making process. This first programme was not successful: only few amnesty applications were filed and no single international cartel was detected.

In 1993, three major revisions were made to the American Leniency Programme. First, amnesty is now certain when a corporation comes forward prior to an investigation and meets the programme's requirements. These conditions include duties to promptly terminate the participation in the illegal activity, to fully co-operate with the Antitrust Division and to make restitution to injured parties. Amnesty will only be granted if, at the time the corporation comes forward with evidence, the Antitrust Division has not yet received information about the illegal activity from another source. Second, amnesty may still be available even if co-operation with the Antitrust Division starts after the investigation is underway. Third, if a corporation qualifies for automatic amnesty, then all officers, directors and employees who co-operate are equally protected from criminal prosecution. These dramatic extensions of the Amnesty Programme<sup>17</sup> have clearly raised the incentives for companies and individuals to report criminal activities. In recent years, the United States' Corporate

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<sup>17</sup> Here, it may be added that the recent Antitrust Criminal Penalty Enhancement and Reform Act of 2004 has further increased the effectiveness of the Leniency Program by excluding the possibility that, if the conditions for amnesty are satisfied, individual claimants may collect treble damages for infringements of the antitrust laws (see on treble damages, section 2.3. of this chapter). This 'detrebling' provision in the case of a company that cooperates with private litigants against other members of a cartel has removed a major disincentive for submitting amnesty applications.

Leniency Programme has been responsible for detecting and cracking many hard core violations, in particular international price-fixing cartels.

The European Commission started a leniency programme in 1996. In spite of the American experience that was already available at that time, the European amnesty programme took a timid start. Under the first Leniency Notice, full immunity from fines was not guaranteed. Even the first firm willing to co-operate with the Commission by providing information about the infringement could nevertheless be penalised up to 25 per cent of the otherwise imposed fine. It was also required that the leniency applicant came forward with “decisive evidence” proving the existence of the cartel. The 2002 Notice<sup>18</sup> has made co-operation with the Commission much more attractive by making it possible to grant full immunity from fines for the first company which co-operates with the Commission and by replacing the “decisive evidence” requirement by two different evidential thresholds for obtaining full leniency in different situations. In addition, firms that were not the first to come forward with the required evidence and, therefore, cannot profit from full immunity are still eligible for a reduction of the fine.

The Commission will grant an undertaking immunity from any fine if the undertaking is the first to submit either (1) evidence which may enable the Commission to adopt a decision to carry out an investigation procedure (commonly a surprise investigation: a so-called dawn raid), or (2) enable it to find an infringement of Article 81. Immunity will only be granted if the Commission did not have, at the time of the submission, sufficient evidence to take one of both mentioned actions. A company will receive a conditional grant of full immunity as soon as it discloses the required evidence. This conditional grant will be confirmed at the end of the procedure (assuming a decision is eventually adopted) if the company fulfils three additional requirements: (1) it must fully and continuously co-operate with the Commission, (2) it must have ended its involvement in the cartel at the time when it submitted the required evidence, and (3) it may not have coerced other undertakings to join the cartel. It should be noted that American antitrust law does not require that the applicant meets an evidential burden to be conditionally admitted to the US Justice Department’s Programme, provided the violation is reported with candour and completeness.

Another novelty of the 2002 Notice (not existing under the American leniency programme) is the sliding scale, whereby companies that do not qualify for full amnesty are still eligible for reduction in fines ranging from 20 to 50 per cent. In contrast with the American “the winner takes it all”

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<sup>18</sup> Notice on Immunity from Fines and Reduction of Fines in Cartel Cases [2002] OJ C45/3

approach, undertakings may be granted a reduction of fines if they submit evidence, which represents “significant added value” with respect to the suspected infringement, provided they end their involvement in the cartel no later than the time at which the evidence is submitted. The reductions in fines may reach a maximum of 50 per cent. Timing is crucial: the first company to cooperate may get a cut of fines between 30 and 50 per cent, the second will be able to get a reduction of between 20 and 30 per cent, and the reduction for all others is limited to a maximum of 20 per cent. The precise percentage reduction a company will get within the category to which it is allocated will depend on the nature of the submitted evidence (the Commission prefers evidence originating from the period to which the facts pertain to evidence subsequently established and direct over circumstantial evidence), the extent and continuity of the co-operation.

## 1.2. An economic assessment

### 1.2.1. Introductory remarks: different enforcement goals and ways to achieve them

The most relevant feature of an enforcement system from an economic point of view is its ability to deter violations of the law. Consequently, an economic analysis of the sanctions described above necessarily requires an assessment of whether they will be effective in preventing infringements of Articles 81 and 82 of the Treaty. Fines imposed for reasons of deterrence should be sufficiently high to make it unprofitable for firms to engage in anti-competitive practices. For antitrust conspiracies where the probability of detection is low (such as price fixing), it is necessary to require the payment of the multiple of profits to achieve deterrence. If a multiplier in inverse proportion to the probability of detection and punishment of the violation needs to be applied, the resulting fine may be extremely high and exceed the ability to pay of the antitrust offender. When such a “judgement proof“ problem arises, competition law should provide for the possibility of alternative sanctions, such as imprisonment of the individual decision-makers (e.g. directors of companies) who decided to commit an antitrust violation.

Besides from the focus on deterrence, the analysis below will also investigate whether the current sanctioning policy achieves non-economic goals, in particular corrective and proportional justice. This extension of the analysis is necessary to get a more complete understanding of the current enforcement mechanisms, which are not exclusively based on deterrence goals. Sending corporate managers to jail may seem a very harsh sanction in countries lacking a competition culture. Even though such an approach may be necessary to achieve deterrence, it may conflict with other notions

of adequate punishment, such as proportional justice. Under the latter approach, only fines may be considered as appropriate sanctions. These fines may be lower than the amount required for effective deterrence if their purpose is only to guarantee that a committed wrong is corrected by forcing the wrongdoer to pay a sum of money that is an adequate compensation for the harm caused. Alternatively – from a perspective of corrective justice –, one may also consider it “just” to disgorge the profits realised by the infringement of the law. Again, this will have an impact on the amount of the monetary sanction implying that it may be lower than the sum needed to achieve deterrence. A simple example can illustrate that fines imposed for reasons of deterrence may be (much) higher than sanctions imposed for reasons of corrective justice. If the profit achieved by a price-fixing cartel equals 10, the harm caused to society in terms of dead-weight loss amounts to 20, and the probability of detection is 15 per cent, the fine to achieve deterrence should be above 66. Conversely, the fines to compensate for the harm (20) or to make sure that profits are disgorged (10) are both considerably lower.

From the above discussion, it should be clear that policy makers must make a number of choices, depending on the goals they are willing to achieve. In making these choices, they should realise that different policy goals may be inconsistent with each other and should find ways to reduce the ensuing tensions or carefully make inevitable trade-offs. The policy choices relate to the type and severity of sanctions and the resources to be spent on detection. These decisions will have an effect on the expected fine. Since the pursuit of deterrence will always imply administrative costs for both law enforcers and offenders, an optimal enforcement regime will investigate possible antitrust violations only as long as the goal of deterrence is worth the cost of attaining it. Optimal enforcement requires an efficient mix of enforcement expenditures and fines (and/or imprisonment). The choice of a sanction and the way in which it is determined have an effect on the enforcement costs. For example, imprisonment is clearly more costly than imposing fines; for the calculation of the fines, it is easier to estimate the gains of an antitrust violation than to assess the harm caused. Because enforcement is costly, full deterrence may not be efficient.<sup>19</sup> The upper ceiling of the enforcement costs is given by the deadweight loss and the losses of dynamic efficiency and rent seeking; beyond this limit the enforcement of antitrust rules is welfare reducing. Consequently, a low level of collusive activity will remain and will not be challenged by the enforcement agencies because it would be too costly compared to the social benefits that can be obtained. Similar conclusions will be reached when the goal of enforcement is corrective justice through

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<sup>19</sup> K.G. Elzinga and W. Breit, *The Antitrust Penalties. A Study of Law and Economics*, 1976, p. 9; S. Souam, “Optimal Antitrust Policy with Different Regimes of Fines”, *International Journal of Industrial Organization*, vol. 19, 2001, pp. 1-26.

compensation: again the presence of enforcement costs will imply that full compensation is not optimal.

### 1.2.2. Enforcement mechanisms to achieve deterrence

In a deterrence approach, the sanctions imposed for infringements of the competition rules must achieve a genuine dissuasive effect and ensure that firms have an incentive to avoid any kind of unlawful anti-competitive agreement or practice. In a seminal contribution, Nobel Prize laureate Gary Becker has shown that criminal fines can be understood as prices attached to certain forms of undesirable conduct. If the price is too high, rational people will refrain from engaging in such behaviour. Alternatively, crimes will be committed if the expected benefits exceed the expected costs, which equal the statutory fine discounted by the probability of detection and punishment.<sup>20</sup> Becker's view on criminal sanctions is most relevant for the enforcement of the cartel prohibition. Whereas the assumption of rational behaviour may be criticised with regard to "irrational crimes" (such as murder), calculating behaviour is a rather realistic scenario for "white collar crimes". Antitrust violations generally result from calculating business decisions.<sup>21</sup> Firms will engage in price fixing if the gains derived from this activity are higher than the costs, both adjusted for the probability that they will materialise. From a viewpoint of deterrence, the relevant parameters are the expected fine and the expected gain from an antitrust violation. The expected gain is the additional profit the lawbreakers will obtain, compared to the situation if no infringement of the competition rules is committed. The expected fine is the fine imposed if the violation is detected and punished, multiplied by the probability of detection and punishment. In cases of *per se* prohibitions and easy qualification of the act as an infringement of the law, the main enforcement problem is the detection of the infringement. In other cases, the standard of proof allowing to impose punishment will be more burdensome. For the latter reason, it seems that the Becker model of the rational criminal is most suitable for naked cartel abuses.

A standard argument in the Law and Economics literature is that a combination of a low probability of detection and high fines is best in terms of efficiency.<sup>22</sup> It is indeed very costly to control all kinds of behaviour in order to detect infringements and important resources can be saved by keeping the probability of detection low. Moreover, the scope for raising the Commission's

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<sup>20</sup> G.S. Becker, "Crime and Punishment: An Economic Approach", *Journal of Political Economy*, 1968, pp. 169-217.

<sup>21</sup> The results of a survey by Feinberg confirm that disregard for the law in pursuit of profits is an important source of EC antitrust violations. See: R.M. Feinberg, "The Enforcement and Effects of European Competition Policy: Results of a Survey of Legal Opinion", 1985,

<sup>22</sup> E. Eide, *Encyclopedia of Law and Economics*

resources is limited in practice, since enforcement budgets are fixed and cannot be easily changed. It follows from the economic analysis that optimality can still be achieved when fines are increased so as to compensate for a low probability of detection. Nevertheless, it is difficult to choose an increase in fines that is exactly proportionate to the decrease in the optimal amount of resources spent on detection.

The comparison of the European and American enforcement regimes has shown that fines can be calculated either on the basis of turnover or by referring to the gains to the lawbreakers or the losses caused by the infringement of the competition rules. From a deterrence perspective, the turnover is not a sound basis for calculating the fine if it does not allow undoing the gains of the infringement. It is clear that cartels cause more harm to society than gain for the participants, since only part of the losses are recovered through transfer to the cartels. The harm of such antitrust infringements is difficult to assess, since it does not simply equal the consumer surplus transferred to the producer but also consists of the additional loss of consumer welfare (deadweight loss), the harm in terms of productive and dynamic efficiencies as well as the costs of the rent seeking efforts. To achieve deterrence, however, it is sufficient to know the size of the gains, since this amount multiplied in inverse proportion to the probability of detection and punishment enables the enforcement agency to set the fine above the expected profit.<sup>23</sup> The gain equals the mark up times the volume of the affected commerce. Figures on sales are not difficult to obtain given the broad availability of market studies. It may be more difficult to determine the mark-up, since this requires the identification of a benchmark of the competitive price in the absence of collusion. Still, compared to the difficulties in determining the harm (which *inter alia* requires information on the elasticity of demand and supply and the size of the rent seeking efforts), the determination of the gain is easier to assess. This explains why with regard to the determination of sanctions more attention is paid to the financial benefits of the infringement than to the harm caused.<sup>24</sup>

### 1.2.3. The European sanctions: no effective deterrence

Both the choice of sanctions (in particular the exclusive use of fines on companies) and the Guidelines of the Commission for calculating the fines have been criticised from different angles. Competition lawyers have argued that the goal of legal certainty is not achieved: in particular, the

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<sup>23</sup> Compare A.M. Polinsky and S. Shavell, "Should the Liability Be Based on the Harm to the Victim or the Gain to the Injurer?", *The Journal of Law, Economics and Organization*, vol. 10, 1994, p. 436.

<sup>24</sup> M. Van Oers and B. Van der Meulen, "The Netherlands Competition Authority and its Policy on Fines and Leniency", *World Competition*, vol. 26, 2003, p. 28 with reference to enforcement systems making use of a gain based sanction.

Commission has not clarified the way in which the start point of the calculation (gravity of the infringement) is chosen. From the standpoint of economic analysis of law, the central question is whether the goal of deterrence is reached. This question will be addressed below. In the next subsection, some comments will be made from other perspectives: both issues of corrective justice and proportionality will then be briefly addressed. Thereafter, the European Leniency Programme will be assessed.

Four reasons may be advanced why the current enforcement of European competition rules is not optimal from a deterrence perspective. First, the use of qualitative criteria to classify infringements in different categories (very serious, serious, minor) impedes an easy calculation of the expected fine. Second, the total turnover as a criterion to fix the maximum fine is not related to the gains of the infringement. Third, the maximum fine may be too low to deter. Fourth, in case the lawbreakers cannot pay the fine (“judgement proof” problem) no alternative sanctions are available. If one compares the European with the American system of enforcement, it seems that the latter is better able to achieve a sufficient level of deterrence.

To achieve the deterrence goal, quantitative criteria are more appropriate than qualitative criteria. By reference to objective elements in assessing the sanction, the discretion of the competition authority is greatly reduced. Consequently, it becomes easier to assess the amount of the expected fine and this will increase the level of deterrence. According to its 1998 Notice, the Commission takes into account the gravity and duration of the infringement, as well as aggravating or attenuating circumstances. The Guidelines on calculating fines are rather opaque concerning the criteria to assess the gravity of the violation. They state that “account must be taken of its nature, its actual impact on the market, where this can be measured, and the size of the relevant geographic market”. In the past the Commission calculated fines as a percentage of turnover of products involved in the infringement within the European Community. Consequently, the annual sales volume of the goods affected by the price increase was a relevant criterion. From a viewpoint of deterrence, the new approach, as contained in the Guidelines, seems to be a step in the wrong direction. Since there is no clear reference to the quantity of goods affected by the price increase imposed by the cartel members, there is a risk that the fine is chosen regardless of the position of the companies in the relevant market. Consequently, the profitability of potential infringements will not be the decisive criterion to engage in anti-competitive practices or not. It is noteworthy that the European Court of Justice has censured decisions of the Commission that took not account of the affected commerce

and has reduced the fines imposed. In this way, the Court has provided guidance in fixing fines that will ultimately lead to more effective deterrence.

The total turnover is not an appropriate benchmark for the determination of the fines, since it indicates the absolute size of the firm rather than the volume of affected commerce, i.e. the quantity of goods whose prices are influenced by the infringement. To determine the efficient fine, that is the fine bringing the highest deterrent effect at the lowest cost, one must calculate the gain brought about by the infringement of the competition rules and then multiply this amount in inverse proportion to the probability of detection and punishment. To calculate the gain, not the overall turnover but the share of the affected commerce held by each participant is the suitable criterion.

Another feature of the current enforcement regime limiting its deterrent effect is the maximum fine that can be imposed for a violation of the competition rules. Taking a price cartel as an example, the gain which the cartel members obtain will depend on the turnover in the products concerned by the violation, the price increase caused by the cartel, the price elasticity of demand faced by the cartel members, and the duration of the cartel. In the literature, calculations of the efficient fine were based on the assumptions that, on average, cartels raise prices by 10 per cent and that the cartel duration is 5 years.<sup>25</sup> If a price increase of 10 per cent leads to an increase in profits of 5 per cent of turnover, the cartel lasts 5 years, and the probability of detection and punishment is 16 per cent<sup>26</sup>, a fine in the order of no less than 150 per cent of the annual turnover would be needed to effectively deter a price cartel from being implemented.<sup>27</sup> The most recent research shows that the appropriate multiplier may be much higher than the last figure. Focusing on the period post-1990, Connor and Lande found that the overcharge is 15-16 per cent for domestic U.S. cartels and 25 per cent for international cartels. In addition, they note that cartel duration is likely longer than 5 years: cartels may last between 7 and 8 years. If only the adjustment for the underestimated overcharge is made, fines would have to be in the range of 225-375 per cent of annual turnover to deter. Such high fines are far above the percentage figures that can be deduced from the Commission's sanctioning practice. Up until 1998, fines were in the range between 2 and 9 percent of the turnover in the products concerned by the violation. Fines have considerably increased after the publication

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<sup>25</sup> These figures are based on American studies. Figures on road-building bid-rigging cases suggest that the conspiracies increased price by at least 10 percent. See W. Wils, 2000 with further references. Own-price elasticity of demand is supposed to be - 2.

<sup>26</sup> This figure is again based on an American study, estimating the probability of a successful prosecution of a price cartel at most between 13 and 17 percent. See: P.G. Bryant and E.W. Eckhard, "Price Fixing: The Probability of Getting Caught", *Review of Economics and Statistics*, 73, 1991, 531-536.

<sup>27</sup> W. Wils, cited note ..., p. 201

of the Guidelines<sup>28</sup>, but, - since the maximum level of 10 percent of the annual world-wide turnover has not been adjusted upwards - may still be too low to effectively deter serious infringements of the European competition rules.

Finally, the European enforcement regime does not provide a remedy for the “judgement proof” problem. There is indeed a risk that the financial position of firms, which violated the competition rules, will not allow them to pay the fines imposed. The deterrence goal will not be achieved if no alternative sanctions to cure the judgement proof problem, such as imprisonment, are available.

Comparing the American and European enforcement systems, it becomes clear that deterrence goals can be better realised in the former than in the latter jurisdiction. The first reason is the level of sanctions. The changes to the Sherman Act, increasing the fines up to \$ 100 million or twice the gain/loss resulting from the conspiracy clearly reflect a goal of deterrence.<sup>29</sup> Conversely, an increase of the level of sanctions has been left out of the European debate on the modernisation of the enforcement system. Even though the Guidelines mention that fines for very serious infringements can be above €20 million, there will be no possibility to impose such very high fines if the limit of 10 per cent of overall turnover is exceeded. Moreover, there is no guarantee that the fines that can be imposed on multi-billion Euro corporations within the limit of 10 per cent of overall turnover will be sufficiently high to achieve deterrence. In addition, imprisonment of corporate directors is not available as an alternative sanction in cases where the imposed fine exceeds the ability to pay of the law offenders. Proposals to criminalise European competition law are discussed in Box 9.2. The second reason is that the European criteria for calculating the sanction are not linked to the deterrence goal. The Guidelines pursue a qualitative approach, stressing that this “will make it possible to apply differential treatment to undertakings according to the nature of the infringement committed”<sup>30</sup> By contrast, the American Sentencing Guidelines accept that it is possible to estimate the gains achieved by a cartel as a percentage of the selling price. The price increase caused by the cartel can thus be estimated and multiplied by the volume of affected business. If it is assumed that 10 per cent of the price is the price increase caused by the cartel, the gain to the cartel can be estimated as 10 per cent of the turnover (quantity times price increase).

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<sup>28</sup> Record fines have been imposed for hard core cartels, such as Polypropylene, Cartonboard, and Vitamins.  
REFERENCES TO BE ADDED

<sup>29</sup> The goal of deterrence was also clearly embraced by the American Congress: “The committee believes that increasing the maximum fines for criminal violations of section 1 is necessary and appropriate to deter the most flagrant and abusive forms of antitrust crimes (...) Particularly with respect to corporate offenders, fine levels are simply too low to deter effectively antitrust conspiracies and courts have been reluctant to impose maximum fines even for wilful violations” (Senate Report to the Antitrust Amendments Act of 1990, Senate Report No. 101-287, 1990 U.S. Code Congress. And Admin. News, at 4111).

<sup>30</sup> Section 1.A, sixth consideration.

This amount should then be multiplied to account for low probabilities of detection. The US Federal Sentencing Commission model takes as the start point 20 per cent of the total volume of affected commerce, but allows to adjust this upwards to no less than 80 per cent. This is ten times the percentage of turnover which was imposed by the European Commission in the period before the Guidelines were issued.

#### BOX 9.2

##### MUST EUROPEAN COMPETITION LAW BE CRIMINALISED ?

In a critical evaluation of the current system of enforcement, Wils proposes to make use of individual penalties, including imprisonment, in combination with corporate sanctions. He advances several arguments why increasing the fines on companies above the current limit of 10 per cent of the worldwide turnover will not cure the problem of underdeterrence. First, the fines required for effective deterrence would often exceed the firms' ability to pay. Profits are usually not retained and, in any case, would count for only a fraction of the fine; moreover, liquidating the assets would not generate sufficient revenues if the annual turnover exceeds the assets.<sup>31</sup> Second, imposing very high fines would force companies into bankruptcy, causing undesirable social costs (losses to, among others, employees, creditors and tax authorities). Third, even below the level of inability to pay, the imposition of high fines is administratively costly and may have undesirable side-effects. Creditors will suffer a diminution in the value of their securities, salaries of employees may be cut down, tax receipts will be reduced, and the costs may be passed on to consumers in the form of higher prices. Finally, the fines required for effective deterrence may raise fundamental objections of proportional justice.

Besides from the fact that fines needed for effective deterrence are impossibly high, corporate sanctions do not always guarantee adequate incentives for responsible individuals within the firm. First, firms have often only a limited ability to discipline their agents: the greatest sanction available (dismissal) may not sufficiently deter and monitoring of employees to avoid antitrust violations can be very costly. Second, firms may be management controlled, so that fines will not sufficiently affect shareholders to give them incentives to control the managers' behaviour. Third, managers may have left the firm by the time their violation is detected.

According to Wils, deterrence can be best increased by threatening the accountable decision-makers within the firm with fines. The effectiveness of this sanction may be limited by the individuals' ability to pay, but this problem can be overcome by using prison sanctions as well. Antitrust authorities will be better able than firms to control the individual decision-makers by threatening severe punishment. Prison sanctions are a very effective deterrent and carry a strong moral message. Sanctions imposed on individuals should not only be of a monetary kind but include the possibility of imprisonment for an additional reason. Firms may compensate managers *ex ante* for taking the risk of committing antitrust violations or indemnify them *ex post*, thus taking away the deterrent effect of fines. Imprisonment avoids such circumventing behaviour.

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<sup>31</sup> It should be added that the Commission takes the bad financial situation into account when setting the amount of the fine. See: European Commission, Guidelines on the method of setting fines, OJ, C 9, 14.01.1998, p. 3, para.5(b).

The next question is for which types of violations imprisonment should be imposed as a sanction. Wils suggests to limit its use to hard core cartels: horizontal price-fixing, bid rigging and market allocation schemes. Imprisonment should not be used for other horizontal agreements, vertical restraints and infringements of Article 82. This proposal invites some comments. Price fixing is a comparably profitable and easy to hide violation. Consequently, it would be unacceptably costly to increase the level of certainty in detection and imprisonment will be an adequate deterrent. Also the risk that errors<sup>32</sup> are made is low: price-fixing is a clear-cut violation of the competition rules. The latter is no longer true when it must be assessed whether vertical restraints harm competition or a firm in a dominant position commits an abuse. If deterrence was the only criterion to assess the efficiency of law enforcement, a case could be made for criminalising also the less serious infringements of competition law. However, if imprisonment is used as a sanction, the error costs (in particular type I errors) may be high and outweigh the benefits of deterred anti-competitive practices. In addition, reserving imprisonment for horizontal price-fixing, bid rigging and market partitioning is a choice that can be justified on grounds of proportional justice.

#### 1.2.4. The European sanctions from a perspective of corrective justice

Contrary to the American vision of things, in European competition law the view that punishment should effectively deter harmful conduct in the future is not explicitly accepted as the major goal of imposing fines. Regulation 1/2003 seems to reflect requirements of proportional justice rather than deterrence. As explained above, the upper ceiling expressed as 10 per cent of the worldwide turnover of the undertaking, which committed an antitrust violation, is ill suited to achieve deterrence. Its only function seems to be the determination of the limit above which the size of the fine is deemed to be dangerous for the existence itself of the undertaking and, hence, not proportional. The maximum fine thus reflects the degree of disapproval of the behaviour. In Europe there is not (yet) a competition culture comparable to the American one and people still tend to consider infringements of competition rules less serious than other forms of disapproved conduct sanctioned by criminal fines. Very high fines (such as 300 per cent of the annual turnover of the products concerned by the violation) imposed to achieve deterrence may be disproportionate to the degree in which society disapproves the harm caused and thus conflict with goals of proportional justice.<sup>33</sup> A similar concern seems to underlie the Guidelines on the imposition of fines. Deterrence does not strictly require that the calculation of fines confirms with criteria such as the culpability of the antitrust offenders and the duration of the infringement. However, such criteria may be seen as indispensable from a corrective justice approach. Also, qualitative criteria (such as the nature of the infringement and the distinction between minor, serious and very serious infringements) are inadequate from a deterrence perspective since they do not allow an easy calculation of the

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<sup>32</sup> Clearly error costs are higher with imprisonment than with monetary sanctions.

expected fine. However, they may again be appropriate from a perspective of proportional justice. In the 1998 Guidelines, the emphasis seems to be on the latter goal, rather than on deterrence.

However, emphasizing justice goals is no easy way to stop the criticisms on the current European system of enforcement. Besides from their ineffectiveness in deterring violations of the competition rules, the current sanctions may be criticised for not achieving corrective justice either. From a corrective justice perspective, the sanction should be linked to the harm caused. The 1998 Guidelines' criterion of "impact on the market" should be more precisely defined as the losses suffered by consumers (transfer of consumer surplus to the producers) the dead-weight loss and the other costs (losses in terms of productive and dynamic efficiency and rent seeking). Again, the relevant start point to calculate the monopoly profits (harm to consumers) is not the total turnover but the volume of business affected by the cartel agreements. The latter amount should be discounted by a percentage reflecting the price increase caused by the cartel. To this effect, empirical estimates of the overall harm (price overcharges) in markets affected by the illegal agreement can be used.

Calculating damages from a corrective justice perspective is not an easy task. Compensation of the harm poses serious problems since it is very difficult, if not impossible, to identify all victims. The primary victims are those who would have bought the product at a lower price; the costs of identifying these buyers are prohibitive. It is also difficult to identify the secondary victims, who bought at the cartel price. There may be several tiers in the distribution chain between the manufacturer and the consumer and particular buyers should be awarded compensation only if the overcharge was passed on to them. Often this is not an easy inquiry. Not only buyers of the high priced goods but also suppliers of a cartel may be harmed. These tertiary victims should also be entitled to compensation if they can show that they are injured as a result of decreased sales associated with the reduction in output. In sum, compensation of persons injured will be difficult to implement in practice.<sup>34</sup> Besides from the harm caused to the different categories of victims identified above, also the losses of dynamic efficiency and the costs of rent-seeking are part of the social costs of cartels. These costs may exceed the maximum ceiling of 10 per cent of the worldwide turnover, so that the application of Regulation 1/2003 will not achieve the goal of corrective justice. This may be a reason to allow private damages actions besides the infringement

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<sup>33</sup> Art. 49(3) CFREU

<sup>34</sup> See for further analysis: T. Calvani, "Competition Penalties and Damages in a Cartel Context: Criminalisation and the Case for Custodial Sentences", 2005. This author also discusses the requirements and limitations that courts have imposed on plaintiffs willing to recover damages for antitrust infringements

proceedings initiated by the competition authorities. Whereas public enforcement may be better suited to achieve deterrence, private enforcement may play a complementary role in achieving corrective justice (see for further analysis, 2.3).

#### 1.2.5. Economic assessment of Leniency Programmes

Leniency programmes may significantly contribute to the efficiency of law enforcement. By guaranteeing a lenient treatment for the cheaters and making it profitable to deviate from the collusive path, these programmes aim at destabilising cartels. Leniency programmes not only bring direct benefits, resulting from lowering the costs of detection in cases of hard core violations but also indirect benefits. Since antitrust authorities can devote more resources to cartels that are not revealed, the detection rate of the latter may also increase.

The leniency programme has a clear underlying economic logic: it increases the probability of detection and punishment by placing the cartel members in a prisoners' dilemma.<sup>35</sup> All cartel members have an interest that the cartel cannot be proven (not to confess) but mistrust among the cartel members creates a race to be the first to confess. In a prisoner's dilemma, each player can be better off by defecting from the 'not confess' to the 'confess' strategy. Hence, the cartel members may decide to confess, even though it is in their common interest not to do so. Consider the very common situation when a cartel first learns that it is under investigation. Each member of that cartel knows that any of its co-conspirators can be the first to come forward in exchange for total immunity from fines. Such a decision will seal the fate of all other cartel members. Clearly, it would be in the common interest of the cartel members that nobody decides to cooperate with the antitrust authority, thus depriving the latter of the evidence needed to prove an infringement. However, the amnesty for the first one in the antitrust authority's door creates tension and mistrust among the cartel members.

In the theoretical literature several useful insights for designing optimal leniency programmes can be found. This literature also shows that positive rewards may deter collusion in a more effective way than reduced fines. Motta and Polo demonstrate that it can be efficient to reduce fines even when an antitrust investigation is already under way, but the competition authority has not yet obtained evidence of an infringement. Reduced fines are a second best instrument in cases where the budget of the competition authority is not sufficiently high to intervene often enough to fully

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<sup>35</sup> For a description of the traditional prisoners' dilemma, see chapter 5 of this book, at ...

deter collusion.<sup>36</sup> The 2002 Notice of the European Commission is in line with this theoretical insight, since it admits cartel members to join the leniency programme even after an investigation has started, when the incentive to cheat is stronger and the cartel more unstable. Another paper by Spagnolo assumes that cartels are convicted after detection and thus allows to focus on cartels that are not already under investigation. Spagnolo shows that an efficient outcome is reached when the competition authority offers a positive award equal to the sum of the fines paid by the convicted firms to the first party that reports. Provided that the maximum fine is high enough, such a reward policy can achieve full deterrence at no cost.<sup>37</sup> Aubert, Rey and Kovacic demonstrate that positive rewards have a larger deterrence effect than reduced fines and that rewards for individuals can be more effective than corporate ones. In particular rewards to employees can be very effective, provided they are high enough to compensate the employee for the anticipated reduction in future earnings, since being a whistle-blower is likely to end the insider's career with his employer and possibly with the entire industry. These authors also discuss remedies for potential adverse effects of reward programmes, such as introducing fines for false denunciations in order to avoid restrictions of efficient exchanges of information between competing firms.<sup>38</sup> The latter insights from theory have not yet found their way into antitrust practice; up until now leniency programmes are not complemented by reward programmes.

A potential problem of leniency programmes is that overall fines will be lower, since companies that come forward with relevant evidence will get immunity. In the literature<sup>39</sup>, two different effects of leniency programmes have been identified: on the one hand there is a negative impact on deterrence *ex ante* since the expected fine will be lower given the possibility of a fine reduction for law offenders who have cooperated with the antitrust authorities. On the other hand, leniency programmes increase law compliance *ex post*, since after its collapse the cartel will not be restored given the loss of confidence among the participants. If *ex ante* deterrence is already achieved, leniency programmes should not be used; otherwise they are an important enforcement mechanism. Possible negative effects on deterrence may be cured by raising the maximum fine and through limiting conditions for full immunity. As to the first response, European competition law seems to be in need of stiffer sanctions (in particular imprisonment) to effectively deter. The second remedy is already included in the European leniency programme since full immunity is only available to the first company who reveals information making it possible to establish an infringement.

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<sup>36</sup> M. Motta and M. Polo, "Leniency Programs and Cartel Prosecution", *International Journal of Industrial Organisation*, vol. 21, 2001, pp. 347-379.

<sup>37</sup> G. Spagnolo, "Optimal Deterrence Mechanisms against Cartels and Organized Crime", mimeo, Mannheim, 2003.

<sup>38</sup> C. Aubert, P. Rey and W.E. Kovacic, "The Impact of Leniency and Whistleblowing Programs on Cartels", 2005

<sup>39</sup> M. Motta and M. Polo, cited above, note 36.

The experience with the American amnesty programme teaches that leniency programmes are successful when three conditions are met. First, antitrust laws must provide the threat of firm sanctions for hard core infringements. Second, antitrust offenders must perceive a significant risk of detection by antitrust authorities if they engage in illegal conspiracies. Third, antitrust authorities must publish transparent leniency programmes so that prospective co-operating parties can predict with a high degree of certainty whether they will get immunity. Since these conditions are met to a lesser extent in Europe, the Commission's leniency programme risks being less successful than its American counterpart. Exposure to criminal sanctions may be the driving factor in the decision of American firms to co-operate with the antitrust authorities. If competition law infringements are not of a criminal law nature, a number of investigative techniques will not be available, thus reducing the perceived risk of detection. Finally, the European Commission keeps a margin of discretion that is not at the disposal of the American Antitrust Division. In Europe, the applicant must meet an evidential burden that is not required under the American amnesty programme. Companies will be reluctant to come forward for leniency if they fear that this evidence will not enable the Commission to order a "dawn raid" or to find a cartel infringement (points 8(a) and 8(b) of the Notice). Moreover, companies which did "take steps to coerce other undertakings to participate in the infringement" (see the Notice, at 11(c))b) do not qualify for full immunity. Discretionary powers to assess the role of companies in the offence may be defensible for corrective justice reasons. However, if companies cannot predict how "coercion" will be interpreted, they may decide against co-operation and existing cartels will remain unreported and unpunished.

## **2. Public and/or private enforcement**

### **2.1. A brief comparison: Europe – United States**

Both in Europe and in the United States, enforcement actions can be initiated by public authorities and private parties. The way in which public enforcement of the competition rules is organised differs. At the European (quasi) federal level, a single administrative body (the European Commission) has been empowered to enforce the competition rules. After the modernisation of the system of enforcement introduced by Regulation 1/2003 (which entered into effect on May 1, 2004), Articles 81 and 82 are also enforced by a network of national competition authorities and national judges. In the United States, the competence to enforce federal antitrust law is shared by

the Antitrust Division of the Department of Justice and the Federal Trade Commission. The European Commission is both prosecutor and judge: it combines investigative, prosecutorial and adjudicative powers.<sup>40</sup> Conversely, in the United States the Department of Justice must seek a court judgement to prohibit a violation of sections 1 and 2 of the Sherman Act. The Federal Trade Commission combines prosecutorial and adjudicative powers, but a complex system of internal checks and balances has been built into the FTC procedure.

In Europe, public enforcement has traditionally played a dominant role, both at the Community level and in national legal systems. Whereas the enforcement in Europe relies heavily on administrative acts, private law suits play an important role in the American system of enforcement. In practice, 90 per cent of antitrust cases in the United States are private actions. The recent change of the European Regulation on enforcement seems to have increased somewhat the role of private parties by granting national judges the power to apply Article 81 in its entirety. However, private enforcement through national courts will have effects that remain far behind the impact of private action in the United States. There exist important institutional differences between the two legal systems, which makes private action in the United States much more attractive. In the remainder of this section the differences between the European and American systems of enforcement will be further explained and an economic assessment of the respective strengths and weaknesses of both systems will be provided.

## 2.2. The combination of investigative, prosecutorial and adjudicative powers

In Europe all stages of the procedure (notification, investigation, negotiation, decision and political review) are assigned to the European Commission. In the United States, the Department of Justice has extensive powers to investigate potential violations of Sections 1 and 2 of the Sherman Act but has not any power to adopt decisions finding an infringement and imposing sanctions. To that effect suits must be brought in court; district courts may impose fines on companies and fines and prison sentences on individuals. Unlike the Department of Justice, which has only investigative and prosecutorial functions, the Federal Trade Commission has also adjudicative powers. Under the Federal Trade Commission Act, it can issue cease and desist orders to stop unfair methods of competition, including violations of Sections 1 and 2 of the Sherman Act. The initial decision, which is taken by an administrative law judge, may be appealed to the Commission. When deciding

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<sup>40</sup> In US antitrust terms "the Commission combines the functions of prosecutor, judge and jury" (I. Van Bael, "The Antitrust Settlement Practice of the EC Commission", *Common Market Law Review*, 23, 1986, 61.) In reaction to complaints about this improper combination of functions, a Hearing Officer has been appointed within DG COMP.

on the appeal, the Commissioners sit as judges and hear directly both sides of the case. This is different from the European enforcement system, since in the latter jurisdiction there is no independent initial adjudicator and the Commissioners decide on the proposal of the Competition Commissioner, who has been briefed by the competition officials dealing with the case.

The question whether it is preferable to separate the adjudicative function from the investigative and prosecutorial functions should be answered by assessing the strengths and weaknesses of the alternative systems in terms of accuracy and administrative costs. If the European Commission combines all functions, enforcement errors caused by overly active competition officials may be more frequent than in a system in which Community judges take the ultimate decision. Conversely, administrative costs may decrease by combining the investigative, prosecutorial and adjudicative functions. Wils has argued that, theoretically, there are three possible sources of prosecutorial bias.<sup>41</sup> First, competition authorities may hold the initial belief that a violation is likely to be found and search for evidence, which confirms rather than challenges this belief (confirmation bias). Second, officials may be psychologically motivated to avoid discovering that there is no case for a prohibition decision (hindsight bias) or may desire to justify past efforts, thus pre-empting complaints about inefficient use of scarce resources. Third, competition authorities may wish to show a record of numerous infringements and high fines, in order to demonstrate that they are fulfilling their task well (desire to show a high level of enforcement). All these risks can be contained by internal checks and balances (such as the recently introduced peer review panel system in Article 82 cases) and frequent judicial review. However, such controlling mechanisms will decrease the savings in administrative costs. Therefore, on balance it seems that an alternative system in which the European Commission would prosecute before the Community courts is superior for Article 81 and Article 82 cases.<sup>42</sup>

### 2.3. The role of private parties in enforcing competition law

In the United States, the attractiveness of private action is due to a number of factors. The most important reasons include the following<sup>43</sup>. First, successful plaintiffs are entitled to so-called treble damages, entitling them to claim three times the actual damages (section 4 Clayton Act). Such

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<sup>41</sup> W. Wils, "The Combination of the Investigative and Prosecutorial Function and the Adjudicative Function in EC Antitrust Enforcement: A Legal and Economic Analysis," *World Competition*, 2004, pp. 205-224.

<sup>42</sup> In merger cases, only the hindsight bias seems relevant, whereas there is no risk for confirmation bias or a too high level of activity since mergers must be notified by the parties concerned and most mergers are found to be unproblematic.

<sup>43</sup> For a more complete list, see J.S. Venit, *Common Market Law Review*, 2003, 572.

private antitrust lawsuits are likely after a successful criminal prosecution, since a criminal conviction constitutes *prima facie* evidence that the defendant violated the antitrust laws in any subsequent civil litigation.<sup>44</sup> The prospect to collect treble damages is a powerful incentive for private parties to take legal action against their competitors. The fact that the volume of case law on predatory pricing in Europe is minor compared to the United States may be due to this important institutional difference between both legal systems. Second, contrary to the laws of many Member States of the European Union, in the United States contingency fee arrangements are legal. Attorneys at law may conclude an agreement with their clients stating that the lawyer only has to be paid if he wins the case. The fee is usually a fraction of the awarded damages, but the lawyer receives nothing if the case is lost. Under a contingency fee system, the client thus bears no trial risk. Third, the possibility of antitrust class action suits may be an appropriate remedy if private parties lack incentives to sue because their individual damages are relatively small compared to the costs of litigation (e.g. in price-fixing cases). Class actions allow a plaintiff to obtain damages not only for the harm he suffered himself but also for the harm suffered by other victims. Finally, problems of proof faced by private parties are mitigated by American procedural law. Whereas in European civil proceedings the relevant information has to be supplied by the parties, in the United States courts can order the defendant to supply all relevant information in a pre-trial discovery procedure. In Europe, only competition authorities enjoy investigative powers to force companies to submit the relevant evidence.<sup>45</sup>

European law does not provide similar incentives for private parties to become active as antitrust enforcers. The prospective damages award may be too small: there is no right to treble damages and punitive damages are not feasible under national procedural laws. The risk to lose the case may act as a further deterrent, since procedural costs cannot be spread over several victims and information costs to cure problems of proof may be prohibitively high. Up until now, Community law has been largely invoked as a “shield” to justify non-performance of a contractual obligation on the grounds that the contractual provision in question infringes the cartel prohibition (so-called “Euro defences”). The use of European competition law as a “sword” to obtain injunctive relief to prevent harm or to obtain damages has been limited.<sup>46</sup> This state of things is understandable if one takes into

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<sup>44</sup> See §5(a) Clayton Act, §16(a) 15 U.S.C.

<sup>45</sup> The European Commission and national competition authorities can threaten to impose a fine in case not all or incorrect information is supplied (see Art. 23(1) Reg 1/2003). Furthermore, competition authorities have the right to collect evidence by entering the premises of an undertaking without its consent; these are so-called dawn raids. (See Art. 17-22 Reg 1/2003).

<sup>46</sup> J.S. Venit, 570-571

account the lack of incentive mechanisms as far as private enforcement of the competition rules is concerned.

Unlike American antitrust law, the EC Treaty does not include any express provision on the question of damages that successful plaintiffs may receive. Regulation 1/2003 has facilitated the invocation of the nullity defence, since national courts can now apply themselves the four conditions of Article 81(3) instead of having to suspend their proceedings and wait for a decision of the Commission. However, the new Regulation contains no rule that directly encourages the development of damage actions.<sup>47</sup> Rather than from the European legislator, the support for private enforcement has come from the Court of Justice, which in its *Courage* judgement of 2001 has enunciated a Community law-based right in damages.<sup>48</sup> The Court has stated that private actions for damages before the national courts will help to ensure the full effectiveness of the competition rules, and in particular the practical effect of the cartel prohibition. Private enforcement can thus “make a significant contribution to the maintenance of effective competition in the Community”.<sup>49</sup> Since the modernisation of the Regulation on enforcement does not include any harmonisation of sanctions or remedies at the national level, it remains for the domestic legal systems of each Member State to determine the remedies and procedures for claiming damages, provided that these rules meet the requirements of equivalence and effectiveness.<sup>50</sup> In spite of the fact that it seems premature to conclude that private parties will soon become full players in the enforcement of competition rules, the recent case law of the European Court of Justice favours such a development. This raises the question whether private enforcement is desirable.

At the outset, it should be made clear that private actions can be no substitute for enforcement by competition authorities. Private parties may be unaware of the harmful effects of horizontal restraints; they may lack financial incentives to bring suit or fear retaliation by the accused parties. From the viewpoint of deterrence, public enforcement clearly dominates private enforcement. Wils

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<sup>47</sup> For reasons of completeness, it must be added that private actions for damages are available through the national courts.

<sup>48</sup> Case C-453/99, *Courage Ltd. V. Bernard Crehan*, [2001] ECR I-6297. For a comment, see A.P. Komninos, “New Prospects for Private Enforcement of EC Competition Law: *Courage v. Crehan* and the Community Right to Damages”, *Common Market Law Review*, 39, 2002, pp. 447-448.

<sup>49</sup> Para 34

<sup>50</sup> The principles of equivalence and effectiveness imply that the damage remedy for infringements of European law must be comparable to the corresponding sanction imposed for an infringement of national law, and that the remedy must effectively compensate the harm suffered.

has advanced two sets of reasons to support the inherent superiority of public enforcement over private enforcement<sup>51</sup>.

First, competition authorities are better at discovering and proving antitrust infringements since they have wider investigative powers than private parties. In cases of hard core cartels (such as price-fixing) private parties may not even realise that they are harmed. Without the investigative powers of competition authorities, these very serious infringements will remain undiscovered and unpunished. Moreover, even if it was possible to identify all victims – including not only consumers who paid above competitive prices but also those who would have bought the product at a lower price – , problems of underdeterrence would persist. Damages awarded to victims do not cover the entire harm caused by restrictive practices: at most harm to individual consumers would be compensated and the dead-weight loss will remain outside of the calculation of the damage award. Damages awarded to private parties will be computed by reference to lost profits, which bear no relationship with the offender's gain or the social loss. Due to the nature of antitrust offences, the expected benefit of enforcement for each single individual is smaller than the expected individual cost, even though on an aggregated level (summing up the costs and benefits of all victims involved), law enforcement may be efficient. Multiple damages are needed to offset the problems that only a limited number of victims decide to go to court and the impossibility to consider the entire welfare loss in damage calculation. The trebling of damages in the United States could be considered as trying to address this problem, but it remains doubtful that three is the correct multiplier. Moreover, actions by private parties may produce perverse effects, since damages exceeding the actual harm make law enforcement into a gain promising activity. Applying a multiplier in inverse proportion to the probability of detection and punishment may be necessary for deterrence reasons, but could be done more easily by public authorities.

Second, private interests diverge from the general interest. Since potential plaintiffs are driven only by the private gains and expenses of their claims, they will have insufficient incentives to invest in detecting and litigating meritorious cases. It is likely that the majority of private actions will involve alleged exclusionary practices, which may have a pernicious effect on the development of competition law if judges are unable to draw the border line between anti-competitive and pro-competitive behaviour. In this case, private actions will not only fall short of guaranteeing deterrence but may also be used in a counterproductive way. In the American experience, the problem of unmeritorious actions has been identified as the major counterproductive consequence

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<sup>51</sup> W. Wils, "Should Private Antitrust Enforcement Be Encouraged in Europe?", *World Competition*, 2003, pp. 473-

of private antitrust enforcement.<sup>52</sup> Similar problems have arisen in European countries, where private plaintiffs have used competition rules to protect competitors from competition.

The analysis cannot stop here, since a number of counter-arguments can be advanced to support the desirability of private enforcement. Wils takes the strong position that there is no need for supplementary private enforcement to provide additional sanctions or to bring additional cases. However, the policy debate is not a choice between public enforcement only and private enforcement only.<sup>53</sup> Wils' argument relies on a perfect public enforcement system, in which antitrust authorities initiate an optimal number of proceedings in all types of antitrust cases and impose optimal sanctions. In the real world, which is far from being perfect, private enforcement may continue to play a role. First, private actions draw private resources into the enforcement process and thus complement public enforcement, which is unable to deal with all attention-worthy cases. This is particularly important when private parties have better access to information than the public authority: for instance, with respect to the harmful effects of vertical restraints.<sup>54</sup> Enabling any civil court in the European Union to deal with a competition law case dramatically increases the number of law enforcers. Private enforcement may thus generate an important deterrent effect, particularly if companies are more likely to avoid infringements of the competition rules when they risk having to pay damages to their competitors. Second, private damages may be defended from a corrective justice perspective. Public fines and private damage awards do not necessarily have the same purpose: it can be argued that the major goal of the former is deterrence, whereas the latter can be seen as crucial instruments to achieve corrective justice through compensation. Even if compensation is not perfect, it seems difficult to deny citizens the possibility of protecting rights granted under the EC Treaty (principle of direct effect). This point of view does not weaken the relevance of Wils' criticisms on the private enforcement system, such as inadequate compensation and the risk of abuses. The solution to these problems is to improve the quality of judicial decision-making with respect to both the establishment of infringements and the calculation of damages. Economic analysis will remain very helpful in finding the correct antitrust doctrine that mitigate these problems.

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<sup>52</sup> See e.g.: R. Posner, *Antitrust Law*, 2d. ed., Chicago, 2001, p. 275; E.A. Snyder and T.E. Kauper, "Misuse of the Antitrust Laws: The Competitive Plaintiff", *Michigan Law Review*, vol. 90, 1991, pp.551-

<sup>53</sup> C.A. Jones, "Private Antitrust Enforcement in Europe: A Policy Analysis and Reality Check"

<sup>54</sup> Even though they are not protected from retaliation (such as exclusion from a selective distribution system) and may, therefore, be reluctant to initiate proceedings. See: G. Di Federico and P. Manzini, *op.cit.*, at 158.

### 3. Ex ante or ex post control: authorisation regime or legal exception regime?

#### 3.1. From *ex ante* control to *ex post* assessment

The Treaty itself does not set out how the competition rules are to be enforced. Appropriate regulations have to be laid down by the Council on a proposal from the Commission and after consulting the European Parliament (Article 83). From 1962 until 2004 the relevant provisions concerning enforcement were contained in Regulation No 17.<sup>55</sup> This Regulation was replaced by Regulation No 1/2003, which entered into force on May 1, 2004. With respect to cartel agreements (Article 81), the old notification and authorisation system has been replaced by a directly applicable exception system. In the former regime, a decision on the lawfulness of an agreement, a decision by an association of undertakings or a concerted practice may be taken in advance (*ex ante* control). In the latter regime, no enforcement action is taken in advance; firms are free to decide whether they commit the contemplated action, but they will be sanctioned if a violation of the competition rules is established afterwards (*ex post* control).<sup>56</sup> In the old regime, authorities empowered to apply Article 81 of the Treaty were the European Commission, national judges and, to some extent, also national competition authorities. However, the Commission had the sole power to grant exemptions (Article 81 (3) of the Treaty). From May 1, 2004 on all national competition authorities (including those of the new Member States) and national judges are empowered to apply the competition rules of the Treaty. Under the new regime, the Commission, all national competition authorities and national judges will apply Article 81 to its full extent, including also the possibility to grant individual exemptions.

Enforcement of Article 82 has always been essentially *ex post*; exemptions from the ban on abuse of a dominant position are not possible. Undertakings enjoying a dominant position decide, eventually after having sought private legal advice, whether they engage in a certain action or not. If the Commission is of the opinion that the action constitutes an abuse, it can order its termination and impose substantial fines. Also national competition authorities and judges can enforce Article 82 of the Treaty.

The remainder of this section will explain the system change in somewhat greater detail and will then continue with an examination of the efficiency of the different rules concerning the timing of the intervention. The choice between *ex ante* monitoring and *ex post* control, in particular the

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<sup>55</sup> Council Regulation No. 17 [1962] O.J L13/204.

desirability of a notification and authorisation system, is the central question of this analysis. The discussion on the desirability of decentralised enforcement (giving more powers to national competition authorities and judges) will follow in the next section of this chapter.

### 3.2. The “modernisation” of the enforcement regime

To allow for an evaluation of the system change, it is useful to recall the main characteristics of the old enforcement regime. In the past, undertakings could notify their agreements to the European Commission thereby seeking either a negative clearance and/or an individual exemption. Negative clearances were formal decisions (without conditions and obligations) certifying that, on the basis of the facts in its possession, the Commission saw no grounds under Article 81(1) for action on its part in respect of an agreement or practice. If a restriction of competition within the meaning of Article 81(1) is found, the only way to escape from the prohibition is by profiting from an exemption, provided that the four cumulative conditions of Article 81 (3) are satisfied. To obtain an individual exemption under Article 81(3), notification was compulsory.<sup>57</sup> Exemption decisions could not take effect at a date earlier than the date of notification. Only the Commission had the power to grant exemptions in individual cases. The Commission had full discretion to grant a decision and was – contrary to the strict time schedules that apply in merger cases - not bound by time limits.

According to general principles of European law, Articles 81 and 82 of the Treaty produce direct effects in relations between individuals and thus create direct rights in respect of the individuals concerned which the national courts must safeguard.<sup>58</sup> This implies that, together with the Commission, national courts have jurisdiction to apply these Articles, with European law taking precedence over national law. Under the old regime, the Commission could take one of the following actions: a negative clearance decision if there was no infringement of Article 81(1); an infringement decision by which the undertakings were found in breach of Article 81(1) and could be fined; and an individual exemption decision under Article 81(3). Negative clearances did not protect the firms concerned from later contrary decisions by national competition authorities or courts, or even by the Commission itself when new facts emerged. Exemptions were binding on national courts and national competition authorities. Judicial review of the Commission's decisions was possible before the European Courts (European Court of Justice and Court of First Instance).

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<sup>56</sup> W. Wils, p. 110

<sup>57</sup> The condition of prior notification did not apply to some relatively unimportant horizontal agreements (Article 81(1) Regulation 17) and all vertical agreements (Council Regulation No. 1216/1999, OJ 1999, L148/5)

When Regulation No 17/62 was adopted, a centralised notification and authorisation system was favoured because it would allow the Commission to create a culture of competition and to ensure uniform application of the competition rules in order to further the integration of national markets. Already in the early days of European competition law, it became clear that the Commission would not be able to deal with the bulk of notifications. The Commission became quickly overwhelmed with cases submitted by parties seeking legal certainty about the validity of their agreements. Only four years after Regulation 17 came in force, more than 37.450 cases were pending. As noted in the White Paper, the *ex ante* control mechanism “resulted in undertakings systematically notifying their restrictive practices to the Commission which, with limited administrative resources, was very soon faced with the impossibility of dealing by formal decision with the thousands of cases submitted.”<sup>59</sup> Numerous steps have been taken to alleviate the burden of notification. First, the concept of “appreciable effect” on competition has been created in order to ignore minor cases. The *de minimis* Notice sets quantitative thresholds below which also horizontal restraints are assumed to have a negligible effect on competition.<sup>60</sup> Second, an increasing number of interpretative Notices, clarifying the Commission’s view on the validity of agreements, have been published. Third, for different categories of agreements block exemptions have been enacted. To enact such block exemptions, governing entire categories of agreements, the Commission must be empowered by Council Regulations. The respective Regulations determine under which conditions agreements will not violate the cartel prohibition. Agreements that do not come within the scope of a block exemption must be exempted on an individual basis. To reduce the huge administrative workload of individual exemptions, the instrument of block exemptions has become increasingly popular for dealing with categories of agreements that are frequently concluded in business practice. Finally, an informal enforcement practice developed: instead of taking a formal decision, in the majority of cases<sup>61</sup> the Commission instead issued a so-called comfort letter. This was not a formal decision, but just a letter stating that the Commission considered that the agreement did not restrict competition or was of a type that qualified for exemption. These informal decisions allowed to avoid the delays due to the publication of formal decisions in all official languages in the Official Journal of the European Communities. However, comfort letters were not binding on national

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<sup>58</sup> Case 127/73, *BRT v. SABAM* [1974] E.C.R. I-62, para 16.

<sup>59</sup> White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty, OJ 1999, C 132/1, para. 24

<sup>60</sup> Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community, OJ C 368, 22.12.2001, pp. 13-15.

<sup>61</sup> From 1993 to the end of 1997 no more than 19 exemption decisions were adopted by the Commission.

courts<sup>62</sup>, so that they could not give parties the legal certainty they were seeking when they decided to notify their agreements. At the end of the twentieth century, after more than 35 years of existence, it was considered that Regulation No. 17 needed a modernisation. Even though the number of notification requests had become relatively stable and formal decisions were increasing, more than ninety percent of cases were closed in an informal way. Moreover, between 1995 and 2000, only 0.5 percent of the notifications led to a prohibition, suggesting that the Commission could use its scarce resources in a better way. All these facts led to a dramatic reform.

The new regime is different from its predecessor in many respects. First, the notification and authorisation system is replaced by a system of legal exception. Article 1(1) of Regulation No 1/2003 states: “Agreements, decisions and concerted practices caught by Article 81(1) of the Treaty which do not satisfy the conditions of Article 81(3) of the Treaty shall be prohibited, no prior decision to that effect being required.” The last part of this sentence introduces the legal exception system. Consequently, from May 2004 on, the system of prior control under which agreements and restrictive practices are prohibited unless expressly permitted by the European Commission is replaced by a regime under which firms are freed from the necessity of notifying agreements to ensure their legality. In other words, a switch from an *ex ante* to *ex post* control has been implemented. Second, the Commission has lost its monopoly to grant exemptions. All national competition authorities (NCAs) and judges now are empowered to apply Article 81 in its entirety, including its third paragraph. Regulation 1/2003 is based on a system of parallel competences in which all competition authorities have the power to apply Articles 81-82 of the Treaty and are responsible for an efficient division of work. Together the NCAs and the Commission form a network called European Competition Network (ECN). Under this system of parallel competences, cases can be dealt with by a single NCA, several NCAs acting in parallel, or the Commission. Also national judges can apply the European competition rules in full. Third, the Commission’s and the national competition authorities’ powers of investigation have been extended. Besides from requests for information (Art. 18), the Commission may take statements (Art. 19) and conduct all necessary inspections (Art. 20), including inspections in private homes (Art. 21). The competition authority of a Member State may in its own territory carry out investigations on behalf and for the account of the competition authority of another Member State in order to establish infringements of Articles 81-82 of the Treaty. In the next paragraphs, the new regime will be discussed in more detail as far as this is necessary for a proper economic assessment of the system change.

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<sup>62</sup> The Court of Justice has held that Articles 81 (1) and 82 tend by their very nature to produce direct effects in relations between individuals and that they thus create direct rights in respect of the individuals concerned which the national courts must safeguard (Case 127/73 *BRT v SABAM*, ECR, 1974, 62, at 16).

### 3.3. Economic analysis of the new enforcement system

An economic analysis of the switch from a centralised notification and authorisation system to a system of legal exception (with decentralised enforcement) requires an investigation of its effects on two types of costs: information costs and incentive costs. A first set of questions relates to the impact on information costs: How will the change affect the information about the existence of harmful cartels? What will be the effect on the level of legal certainty available to the affected parties? A second set of questions relates to the impact on incentive costs. How will the switch affect the incentives of companies to enter into agreements? Will an *ex post* control sufficiently deter welfare reducing agreements? Will the system change encourage welfare improving agreements to be signed? Clearly, the effects on information costs and incentive costs are interrelated, and the introduction of a more decentralised enforcement system has an effect on the overall costs of the system reform as well. However, for reasons of expositional clarity, in this section the different cost categories will be discussed separately. The discussion of the welfare effects of decentralisation is postponed to the next section of this chapter.

#### 3.3.1. Information costs

##### a. Information on contents and effects of restrictive practices

In a perfect world, all actors (companies, law enforcers and third parties, including competitors and consumers) have perfect information with respect to both the contents and effects of restrictive practices. If, furthermore, effective sanctions can be imposed on law breakers at zero cost, no rational undertaking would commit an infringement of the competition rules since the latter is perfectly observable by the law enforcer. Reality is far from being perfect, for the following reasons.<sup>63</sup> First, there exists an information asymmetry between the companies that enter into restrictive agreements and the law enforcement agencies. Only the former have perfect information about the details of their agreements, whereas the latter have to gather this information through a costly procedure. Second, a similar information asymmetry exists between the cartel participants and third parties, such as competitors and consumers. In both cases, the information asymmetry does not concern only the precise contents of the agreements but also other issues, such as market

characteristics and the availability of substitutes, which may have an impact on the assessment of the legal validity of the concluded agreements. Third, since most substantive legal rules are not clear-cut, a costly information gathering and information processing procedure must be conducted in order to assess whether a certain practice constitutes an infringement or not and whether it may profit from an exemption. These costs fall on both the companies and the law enforcers. The latter may commit two types of error: either they prohibit a practice that satisfies the conditions for an exemption (type I error) or they erroneously grant an exemption (type II error).<sup>64</sup> Since these errors have a negative impact on the incentives to engage in welfare improving behaviour or abstain from welfare reducing conduct (incentive costs), optimal law enforcement should reduce the different types of information costs.

What are the effects of the modernisation of the enforcement system on the information costs indicated above?<sup>65</sup> A distinction must be made between hard core cartels and other anti-competitive practices. Public authorities face information deficiencies with respect to both the existence and effects of restrictive practices. A notification system will lead to lower costs of information gathering for the law enforcers if the undertakings voluntarily reveal the existence and contents of restrictive practices. This will not occur in cases of hard-core cartels. Therefore, a switch from *ex ante* monitoring to *ex post* control has no detrimental effect on the information about the existence of those cartels. In addition, in the case of hard core restraints *ex post* intervention may be defended since the public authority already has information about their actual effects: horizontal restraints normally produce anti-competitive consequences without redeeming virtues (and may be admitted only when they are ancillary to legitimate goals). Hence, a legal exception regime does not increase the information costs, neither with respect to the existence of hard core cartels, nor with respect to the analysis of the effects of such restrictive practices.

The picture is different in the grey area, where there exists a great deal of uncertainty about whether a practice infringes the law or not. Whereas hard core cartels will be kept secret, companies may wish to reveal the existence of agreements, the legality of which is difficult to assess in order to obtain legal certainty. Vertical restraints are a good example. Also, the legality of vertical restraints

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<sup>63</sup> See M. Pirrung, "EU Enlargement Towards Cartel Paradise? An Economic Analysis of the Reform of European Competition Law," *Erasmus Law and Economics Review* ([www.eler.org](http://www.eler.org)), 2004, pp. 88-89.

<sup>64</sup> It should be noted that allocative efficiency can be achieved only if all welfare decreasing agreements and practices are prohibited and companies are not hindered from engaging in welfare increasing agreements or practices. The way in which the conditions of Article 81 (3) are interpreted does not necessarily guarantee such outcomes (see Chapter 3). Hence, if allocative efficiency is accepted as the sole goal of the competition rules, error costs may also occur if Article 81(3) is applied in conformity with the leading case law.

<sup>65</sup> See M. Pirrung, 90-91,93

is difficult to assess without having access to information about their likely effects. Again this information may become more readily available under a notification system. If the antitrust authority has limited information about the actual effects of a certain type of conduct, *ex ante* intervention seems more appropriate since it permits the authority to acquire the relevant data for such an appraisal. A notification system may reveal important information to the competition authorities that is very costly (or impossible) to acquire under a legal exception regime. This loss of information also affects competitors and consumers. If they are informed about the existence of welfare reducing agreements, they can take action against such harmful practices more timely and effectively. For the latter reason, it is to be deplored that the idea to set up a registration system for restrictive practices, which was contained in the draft of the new Regulation, has been abandoned in the final text.<sup>66</sup>

In sum, the switch from an authorisation system to a legal exception system seems to be efficient for hard core restraints since an *ex ante* control is not able to provide the competent authority with more information than it already possesses. Conversely, for other restraints of competition having no clear-cut consequences for economic welfare, the system change may increase information costs.

#### b. Impact of the system change on legal certainty

In the legal literature, the system change has been criticised because of the loss of legal certainty for undertakings.<sup>67</sup> In economic terms, this argument may be rephrased as an increase in information costs. Under a notification and authorisation regime, undertakings do not have to assess themselves whether anti-competitive agreements satisfy the requirements for exemption. If the antitrust authority grants a formal exemption, companies are entirely freed from the risk that the agreement may be considered illegal. Obviously, experience has shown that an authorisation system creates a workload that a competition authority cannot manage. Formal decisions were taken only in a very limited number of cases. However, under the previous regime, companies could at least get a relative certainty by obtaining a comfort letter from the European Commission. An additional loss in terms of legal certainty follows from the risk that within the Network of Competition Authorities opinions on the legality of agreements and restrictive practices may differ. Since national competition authorities may act in parallel, there is a risk of conflicting decisions in the same case. Under the new system, also national judges may apply Article 81 in its entirety, and this further

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<sup>66</sup> Compare Art. 4, par. 2 of the proposal and the final text of Art. 4 of Regulation 1/2003.

increases the risk of divergent decisions. Inconsistencies in the application of the EC competition rules impose major costs on businesses that are active in several Member States. A partial relief for such companies is the possibility that, if national competition authorities envisage conflicting decisions in the same case, the Commission may initiate proceedings (after consulting with the NCAs), which relieves the competition authorities of their competence to apply Articles 81 and 82.<sup>68</sup>

For assessing the impact of the system change on legal certainty, again the distinction between hard core cartels and other anticompetitive practices (which may have redeeming virtues) is useful. In the former case, companies know that they commit a clear violation of the competition rules and risk heavy fines. In the latter case, however, clear answers as to the legality of the agreements are not easily available. Also the publication of Notices by the European Commission may have left many questions unanswered. Under the new regime, companies have no more right to get an official evaluation and they have to rely purely on their own assessment of their practices. The external information concerning market characteristics affecting the effects of their practices on each of the conditions for exemption required by Article 81(3) may be difficult to acquire for private parties who have no investigative powers of an antitrust authority and may require costly external advice by economic experts. The validity of a restrictive practice will only be checked when it is challenged by a competition authority or by third parties before a court. Even the best legal and economic experts will have difficulties to predict how law enforcers will evaluate whether the restrictive practice infringes Article 81. The legal certainty provided by an individual exemption cannot be perfectly substituted by expert advice. As a consequence, information costs will be higher under a legal exception regime than under a notification and authorisation system.

### 3.3.2. Incentive costs

As it was explained above, the shift from an authorisation system to a legal exception system tends to increase information costs. In turn, this change may be expected to affect firms' incentives to perform certain actions. From an economic welfare point of view, the system change can only be welcomed if it neither prevents firms from implementing beneficial agreements nor leads to an increase in the number of harmful agreements (minimisation of type I and type II errors).

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<sup>67</sup> See for example W. Moschel, „Change of Policy in European Competition law, *Common Market Law Review*, 2000 at 497, A. Bartosch, Von der Freistellung zur Legalausnahme – Der Vorschlag der EG-Kommission für eine neue Verordnung 17, *Europäische Zeitschrift für Wirtschaftsrecht*, 2001, at 105

<sup>68</sup> Article 11(6) Regulation 1/2003; Commission Notice on cooperation within the Network of Competition Authorities, O.J., C 101, 27.04.2004, p. 3, at para 54.

To assess the efficiency of the alternative regimes the decisive question is under which system an optimal number of agreements will be signed. A preventive policy (notification) makes it possible to stop harmful agreements at an early stage. By contrast, in a repression regime with fines (legal exception) the competition authority analyses the agreements after they have been signed and partially implemented. Di Federico and Manzini argue that an *ex post* enforcement system reduces the number of controls by antitrust authorities and therefore requires the possibility to apply higher sanctions.<sup>69</sup> Unfortunately, as discussed above, Regulation 1/2003 has left the maximum amount of the fine unchanged. In a theoretical paper, assuming that cartel authorities do not commit errors, Hahn shows that the system of *ex ante* control is superior to *ex post* control because the law enforcement has a greater deterrent effect when notification is required.<sup>70</sup> This literature warns that the system change will decrease welfare if it leads to a higher number of harmful agreements, which are not scrutinised by the competition authorities. Moreover, the switch to a legal exception regime will decrease welfare if beneficial agreements are no longer entered into because of the high information costs.

Theoretical economic literature, which models the behaviour of firms, allows for a better understanding of the possible outcomes of the system reform. This literature focuses on the impact of the modernisation on the type of agreements that firms might implement. Does the new regime cause firms to enter into more harmful agreements or will only beneficial agreements be signed? A crucial factor having an important effect on the outcome of the analysis is the distribution of information discussed above. If firms are uncertain on whether the agreement is harmful or not, the new regime may be welfare reducing. By contrast, if firms are aware of the status of the agreement and the quality of the evaluation by the competition authority is high enough, an optimal outcome can be reached. The systems also differ with respect to the degree of legal certainty, leading to divergent outcomes on welfare due to differences in information costs. Whereas under a notification regime firms may seek an opinion from the competition authority on the validity of their agreements, under a legal exception regime firms have to consider themselves whether their agreements infringe the competition rules but may benefit from an exemption. The consequence may be that firms will take less risk, which may result in a lower number of beneficial agreements. Whether these theoretical outcomes will materialise is ultimately an empirical question: it all

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<sup>69</sup> G. Di Federico and P. Manzini, A Law and Economics Approach to the new European Antitrust Enforcing Rules, *Erasmus Law and Economics Review*, 2004, at 149-151.

<sup>70</sup> V. Hahn, "Antitrust Enforcement: Abuse Control or Notification?", *European Journal of Law and Economics*, vol. 10, 2000, pp. 69-91.

depends on the relative importance of the effects predicted by the theoretical literature in real-life markets.

Barros<sup>71</sup> considers identical firms and focuses on the impact of the reduced legal certainty created by the removal of the notification and authorisation regime. He shows that, on the one hand, firms might be tempted to sign more restrictive agreements, since the probability of audit is reduced in the *ex post* regime. On the other hand, as legal uncertainty increases, firms may take less risk. Barros shows that the latter effect is more likely to prevail, implying that the reform should result in a lower number of restrictive agreements. Neven<sup>72</sup> considers heterogeneous firms and focuses on the incentives created by the elimination of the notification regime. *Ex post* monitoring leads to higher information costs, thus inducing firms to sign agreements that are more likely to be cleared by the competition authority. The consequence is that some beneficial agreements are no longer implemented. From this perspective, the argument that the notification system was counterproductive, because it forces the Commission to spend scarce resources on cases raising only minor if any competition concerns<sup>73</sup>, must be reassessed. The consequence of the reform may be that beneficial agreements are no longer signed, for lack of legal certainty. Moreover, Neven argues that the removal of the notification regime induces some anti-competitive agreements, which would have been notified otherwise, to be implemented and not monitored. The level of *ex post* enforcement should be high to limit these errors.

The paper by Bergès-Sennou, Loss, Malavolti-Grimal and Vergé<sup>74</sup> starts from different assumptions: firms are aware of the status of the agreement and the audit gives the competition authority an imperfect signal on this status. They show that the notification regime only dominates when the quality of the assessment by the competition authority is fairly poor. The competition authority has prior beliefs concerning the impact of agreements on welfare, which it may revise when it analyses a case after having received information (signal). Priors may be good (e.g. joint research and development agreements) or bad (e.g. horizontal market sharing or resale price maintenance). The signal may be more or less accurate: when the signal is weakly accurate, the decision of the competition authority will be based on its prior beliefs. The authors show that the notification regime is preferred for intermediate values of the priors when the signal is not accurate,

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<sup>71</sup> P. P. Barros, “Looking behind the Curtain- Effects from Modernization of European Competition Policy”, *European Economic Review*, vol. 47, 2003, pp. 613-624.

<sup>72</sup> D. Neven, “Removing the Notification of Agreements: Some Consequences for *ex post* Monitoring”, in: Meny, von Bogdandy and Mavroidis (eds), *Liber Amicorum in Honour of Claus-Dieter Ehlermann*,

<sup>73</sup> W. Wils, 212

<sup>74</sup> F. Bergès-Sennou, F. Loss, E. Malavolti-Grimal and T. Vergé, “European Competition Policy Modernisation: From Notification to Legal Exception”,

whereas the exception regime dominates when the priors are not too high and the signal is sufficiently accurate. When the priors reach extreme values, either a block exemption regime is preferred when the priors are extremely good or a black list regime dominates when the priors are extremely bad and the signal is not accurate. On the basis of these findings, the authors explain a possible motivation for the change from *ex ante* to *ex post* control. When prior beliefs are not extreme and the signal's accuracy increases, a move away from an authorisation regime to an exception regime is justified. It is reasonable to assume that the European Commission has improved its knowledge and that the quality of the decisions is much higher than in 1962. After this learning period, an *ex post* control is optimal. This is due to the fact that if the signal is sufficiently accurate, the legal exception regime reaches an equilibrium, in which only beneficial agreements are signed.

#### 3.3.4. Overall assessment

What are the main results of the economic analysis of the switch from an authorisation system to a legal exception system? Generally a notification and authorisation system (*ex ante* enforcement) will be preferable if firms have limited knowledge about whether the action they are contemplating will violate the competition rules or not. Under such circumstances, a legal exception regime (*ex post* enforcement) will impose information costs on firms, which may prevent that beneficial agreements are signed. The fact that information costs increase also for competition authorities and third parties due to the absence of notifications is a further argument against a legal exception regime. On the contrary, if firms are well informed, *ex post* enforcement may be superior provided that the quality of the assessment by the antitrust authority is high enough. If the second scenario is closer to reality than the first, one may welcome the change of enforcement regime. In the opposite case, welfare losses may occur.

To improve upon efficiency, two requirements must thus be satisfied. First, there should be sufficient information on the side of companies that envisage to sign agreements. Second, the quality of the assessment of the competition authority must be sufficiently high so that type I and type II errors will be minimised. Are these requirements satisfied in the enlarged European Union?

With respect to the first requirement, it seems clear that firms will only have perfect knowledge about prohibited practices if they are put on a black list (*per se* illegality), which makes further analysis superfluous and notification redundant. In all other cases, some uncertainty on substantive

issues will always remain. Here the system change increases information costs by eliminating the possibility of a “safe harbour notification” for agreements in the grey area (no hard core restraints). This negative effect will, however, be mitigated when firms can rely on the interpretations given in (an ever increasing number of) Notices. However, these Notices cannot possibly provide an answer to all real-life problems, as the Notice on Vertical Agreements – in spite of its considerable length – illustrates. At this point, the question arises whether it would not have been advisable to keep the notification system for contracts that may generate important benefits and risk not to be concluded under a legal exception regime. Examples include vertical restraints above the 30 per cent market share threshold, and agreements on research and development above the thresholds in the respective block exemption Regulation. To minimise the risk that beneficial agreements will not be concluded, reducing the scope of the notification system rather than abolishing it entirely seems to be the preferable option.

A similar reasoning applies with respect to the second condition. It seems reasonable to assume that after more than forty years of experience, the European Commission has gathered sufficient knowledge to adequately analyse the cases. The new Regulation has also expanded the Commission’s fact-gathering and inspection powers, even though they still fall far short of those of the American antitrust authorities. For an optimal *ex post* enforcement there must be certainty of detection, prosecution, and imposition of a sanction in case of violation, and certainty that no sanction will be imposed in case of non-violation. An *ex ante* intervention coupled with relatively mild sanctions was a reasonable solution at the time when Regulation 17 was drafted. However, an *ex post* enforcement regime reduces the overall number of controls by competition authorities and therefore requires higher sanctions to compensate for the lower probability of detection of antitrust infringements. If the level of sanctions is not increased (as it is the case with Regulation 1/2003) efficient outcomes can be reached only when detection expenditures are increased in a way that is proportional to the reduction of the expected fines perceived by potential infringers.

A final remark is appropriate. The new Regulation enters into force at the same time as the European Union adds a significant number of new Member States. The conditions for an efficient system change indicated will be satisfied to a (much) lesser extent in the latter States: companies will face greater information problems than their counterparts in the old Member States. Hence, it can also be argued that it would have been better to keep the *ex ante* control in the new Member States, at least during a period of transition until information on the contents and application of the competition rules has become sufficiently wide-spread. Moreover, it may be doubted whether the

quality of assessment by the competition authorities of the new Member States is sufficiently high. Without sufficient experience, competition authorities may not have acquired the relevant knowledge and the quality of control may be jeopardised. In sum, in the new Member States the combination of lack of information on the side of market parties and the relative inexperience of the competition authorities do not seem to support the introduction of a legal exception regime.

#### **4. How much (de)centralisation?**

##### 4.1. The evolution towards more decentralisation

The debate on whether in a (quasi) federal structure competition policy should be centralised has two aspects. In the first place, it is conceivable that different local governments enact competition laws, the contents of which are different from the rules that are established at the central level. If the contents of the substantive rules of the Member States differ, there is scope for “competition between competition laws”. In the second place, besides from the substantive law, attention must be paid to the allocation of tasks in the field of enforcement. Even if cases are governed by central rules, decentralisation remains possible by entrusting the enforcement to local agencies. The first aspect was discussed in chapter 3 of this book.<sup>75</sup> In the last section of this chapter the focus will be on the advantages and disadvantages of decentralisation of law enforcement.

Already under the old system, steps to decentralise the enforcement of the Community competition rules were taken.<sup>76</sup> The Commission's desire to see greater decentralised application of the European competition rules was clearly expressed in its 1993 and 1997 policy documents on cooperation between national competition authorities and the Commission in handling cases falling within the scope of Articles 81 and 82 of the Treaty.<sup>77</sup> In the latter Notice, it was stated that the Commission itself intends to concentrate on those matters which have “particular Community interest.”<sup>78</sup> According to the Commission, national judges had to apply European competition rules when clear infringements could be established or solving the case required the answer to technical

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<sup>75</sup> See also an earlier publication: R. Van den Bergh, *International Review of Law and Economics*

<sup>76</sup> Two important judgements of the European Court of Justice, Case C-234/89, *Stergios Delimitis v. Henniger Bräu AG* [1992] E.C.R. I-935; and Case T-24/90 *Automec v. Commission II* [1992] E.C.R. II-2223, paved the way for the Commission's own policy document on decentralisation, the Notice on co-operation between national competition authorities and the Commission in handling cases falling within the scope of Articles 85 and 86 of the EC Treaty [1997] OJ C 313/3.

<sup>77</sup> Notice on co-operation between national competition authorities and the Commission in handling cases falling within the scope of Articles 85 and 86 of the EC Treaty [1997] OJ C 313/3. Compare also the earlier Notice on co-operation between national courts and the Commission in applying Articles 85 and 86 of the EEC Treaty [1993] OJ C 39/1.

legal questions only. Straightforward cases are those where there is a clear violation of the cartel prohibition or where the cartel prohibition is not applicable because of a block exemption.<sup>79</sup> In cases of doubt the judge could ask the Commission for advice. Under the new system, the participation of national institutions has been widened.<sup>80</sup> All national competition authorities and judges are empowered to apply the prohibitions of the Treaty in full. The European Competition Network should ensure an efficient division of work and an effective and consistent application of Articles 81 and 82 of the Treaty.<sup>81</sup>

The major justification of the change of the system of enforcement, given by the European Commission, is that decentralisation follows from reasons of administrative efficiency. The inadequate resources of the Commission in general, and of the Directorate-General for Competition in particular<sup>82</sup>, would necessitate that responsibility for the enforcement of competition law within the European Union is shared by the European Commission and national competition authorities and judges. From an economic point of view, different reasons may be advanced why national authorities should prosecute violations of Articles 81 and 82 EC Treaty. The reason indicated by the Commission, namely lack of resources, is not very convincing since increasing the resources of the Commission's Directorate-General for Competition may achieve the same result. More persuasive reasons flow from the economic analysis of decentralisation.

#### 4.2. Economic analysis of decentralised enforcement

Several arguments favouring divergent competition laws are also relevant to decide whether law enforcement should be decentralised. First, decentralisation makes it possible to profit from information advantages at lower levels of government. Second, competition between enforcement agencies enables learning processes: enforcement by both European and national authorities is likely to be more creative and innovative.<sup>83</sup> The counter-arguments, which point at the

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<sup>78</sup> Notice on co-operation between national competition authorities and the Commission in handling cases falling within the scope of Articles 85 and 86 of the EEC Treaty [1997] OJ C 313/3, para. 26.

<sup>79</sup> Block exemptions, which have been used since 1967, are an early example of decentralisation at work. They free the Commission from having to deal with exempted agreements and pass on the responsibility to national judges to ensure compliance with the block exemptions.

<sup>80</sup> See already White Paper on Modernisation of the Rules Implementing Articles [81] and [82] of the EC Treaty, O.J., 1999, C 132/1; and compare below, at 2.3.2.

<sup>81</sup> Commission Notice on cooperation within the Network of Competition Authorities, O.J., C 101, 27.4.2004, p. 43 at para 3.

<sup>82</sup> The Commission's DG COMP has a total staff of approximately 400 persons, approximately half of whom being professional lawyers and economists. See L. Ritter, W.D. Braun and F. Rawlinson, *European Competition Law: A Practitioner's Guide*, 2d ed, 2000, 805.

<sup>83</sup> The third advantage of decentralisation, i.e. its ability to satisfy a larger number of diverging preferences, is mostly relevant for the formulation of the substantive rules of law but not for their enforcement.

disadvantages of decentralised enforcement, follow from the important insight that competition on the market for law enforcement, as in any other market, may not function properly because of market imperfections. The relevant market failures include the problem of interstate externalities and the risk of a “race to the bottom”. Finally, an economic analysis of decentralised enforcement is incomplete if insights from Public Choice are neglected. Private interests of industry groups and bureaucrats, rather than the public interest, may be the driving force behind decentralisation. To allow a better appreciation of the desirability of decentralised enforcement, the relevance of each of the above arguments will be discussed consecutively.

#### 4.2.1. Arguments in favour of decentralised enforcement

A preference for decentralisation follows from the need to cope with **informational asymmetries** between regulatory agencies and regulated firms. Other things being equal, decentralisation is the more efficient the more valuable local information is for appropriate law enforcement. The asymmetry of information between regulatory authorities and regulated firms may be analysed as a principal-agent problem. Regulatory authorities have an information disadvantage vis-à-vis the firms they have to control: the former may be seen as the principals and the latter as the agents. Out of self-interest the agents may be unwilling to reveal all the information needed by the principals. A related danger is the communication of false information. It may be argued that it is more difficult for firms to hide or misrepresent information to decentralised agencies than to a more remote agency. Information provided by firms may be cross-checked against information from competitors, consumer organisations and official sources. If such cross-checking is difficult, local agencies will still have a better view of the market than a supranational agency. Decentralisation may thus be advocated, because it reduces the principal-agent problem. There are, naturally, also intermediate solutions between full decentralisation and full centralisation.<sup>84</sup> Decentralised information gathering can help to remove much of the information asymmetry faced by central regulatory agencies. An obvious alternative for the choice between centralisation and decentralisation is the co-existence of national and supranational enforcement procedures.

A first step to overcome information asymmetries is cooperation between competition authorities. Already before the modernisation project contained in Regulation No 1/2003 came into effect, Member States had an obligation to cooperate with the investigation procedures of the Commission.

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<sup>84</sup> Compare D. Neven, R. Nuttall and P. Seabright, *Merger in Daylight. The Economics and Politics of European Merger Control*, 1993, 198; K. Gatsios & P. Seabright, *Regulation in the European Community*, 5 OXFORD REV. ECON. POL. 37 (1989).

The Commission was empowered to obtain all necessary information from both governments and competition authorities of Member States, as well as from undertakings and associations within those Member States (Article 11(1) Regulation No 17). Moreover, the competent authorities of Member States could be asked to carry out on-the-spot investigations on the Commission's behalf (Article 13 (1) Regulation 17). When the Commission carried out its own investigations, it could require the assistance of national authorities (Article 14 Regulation 17).

If the information asymmetries are very serious, a further step may be necessary. Regulation 1/2003 has given full powers to all national competition authorities and judges to apply Articles 81 and 82 of the Treaty. Compared to the enforcement monopoly of the European Commission, the application of Article 81 (3) EC Treaty by many national competition authorities and courts allows better access to the relevant information. National competition authorities and judges can more easily take a closer look at the markets and firms to be controlled. Their information advantage will be the greatest when the anticompetitive effects of agreements manifest themselves mainly within the territory of a single Member State. National competition authorities are generally better placed to assess effects that are concentrated on their particular state and are thus better placed to control these transactions.

The Commission Notice on cooperation within the Network of Competition Authorities states that a competition authority can be considered to be well placed to deal with a case if three cumulative conditions are met: (1) the agreement or practice has substantial direct actual or foreseeable effects on competition within its territory, is implemented within or originates from its territory; (2) the authority is able to effectively bring an end to the entire infringement; and (3) the authority can gather the evidence required to prove the infringement.<sup>85</sup> The first and third condition reflect the information advantages of national competition authorities; in this respect the Notice gets support from the economic criteria in favour of decentralisation. The harmony with the economic analysis is not complete, however. If agreements or practices have effects on competition in more than three Member States, the Commission is seen as particularly well placed to deal with the case. This rule cannot unreservedly be supported by information advantages on the side of the European Commission. For example, a supranational competition authority may face greater information problems than the national competition authorities to establish dominance in four different national markets. Centralised enforcement will only save on costs if the information gathered for one market is also relevant for the other markets. Co-existence of supranational and national enforcement

procedures, allowing several NCAs and the Commission to act in parallel, seems better suited to profit from information advantages where they exist. The exclusion of parallel action seems to be inspired by other reasons, such as the wish to avoid inconsistent decisions and to increase the legal certainty for firms. However, if the savings brought about by greater legal certainty are outweighed by the increase in information costs, the centralised enforcement may be inefficient.

A second argument in favour of decentralised enforcement is that it allows for **learning processes**, which are particularly important in a fields of law, such as competition law, that are plagued by great uncertainties in designing the most appropriate substantive rules and methods of enforcement. The benefits of learning through trial-and-error for the design of substantive rules of competition law have been highlighted in chapter 3 of this book. The first section of this chapter has made clear that current systems of enforcement differ with respect to the type of sanctions, the range of antitrust offenders that can be sanctioned and the magnitude of the sanctions. Some Member States (United Kingdom, Ireland) have criminalised the most serious infringements of the competition laws, whereas other Member States exclusively rely on administrative and civil sanctions. These differences in the legal systems of enforcement will allow for learning processes that may be very valuable for designing the optimal system of enforcement.

#### 4.2.2. Arguments against decentralised enforcement

The information advantages at lower levels of government and the potentially beneficial effects of learning processes are not the full story. Decentralisation of enforcement efforts also comes at a cost. Competition between legal orders may generate **negative interstate externalities**. If the costs of non-enforcement (or of a too lenient enforcement) of competition law in one of the Member States are borne by businesses and consumers in other Member States, centralised enforcement may be needed to ensure that these interstate externalities are internalised. Suppose that a restrictive agreement causes harm in three Member States and that only one of the three national competition authorities concerned establishes an infringement of the EC competition rules. If the action by this authority is not sufficient to bring the entire infringement to an end in all the Member States concerned, central enforcement will be needed to make sure that the costs of non-enforcement (or a too lenient enforcement) in one jurisdiction are not thrown upon other jurisdictions. The Commission Notice on cooperation within the Network of Competition Authorities does not consider the case of non-enforcement, but states that the Commission can initiate proceedings if the

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<sup>85</sup> Commission Notice on cooperation within the Network of Competition Authorities, O.J. C 101, 27.4.2004, p. 43, at

national competition authorities envisage a decision which is obviously in conflict with consolidated case law.<sup>86</sup> After the initiation of the proceedings by the Commission, the national competition authorities are relieved of their competence to apply the EC competition rules. Consequently, a decision can be taken which brings the entire infringement to an end in all Member States concerned and avoids that negative interstate externalities occur.

A popular argument against competition between legal orders (made possible through decentralisation) is that it may generate a “**race to the bottom**”. States may wish to outbid each other in designing lenient competition laws in order to attract business to locate in their jurisdiction. This argument was extensively discussed and criticised in chapter 3 of this book, where it was also contrasted with the opposite view that competition between legal orders may cause a “race to the top”. The view that divergent (applications of) competition laws may lead to “bad” rules did not have a prominent place in the debate on the modernisation of the system of enforcement. However, the text of Regulation 1/2003 shows that the Commission is concerned about divergent competition laws for another related reason, namely that such differences create unequal conditions of competition for firms active in the internal market and are at odds with the goal to create a “level playing field”. Simultaneous application of national competition laws and European competition law has been criticised since it may subject companies active in Member States having enacted strict rules to prohibitions that do not apply in Member States, where national competition laws are more lenient. In order to “create a level playing field for restrictive agreements “ Regulation 1/2003 has excluded such divergences when national competition laws are applied to agreements which may affect trade between Member States. In the latter case, national competition authorities and judges must also apply Article 81 of the Treaty. According to Article 3(2) of Regulation 1/2003, the application of national competition law may not lead to the prohibition of agreements, which do not restrict competition within the meaning of Article 81(1) or fulfil the conditions of Article 81 (3). The duty to simultaneously apply national competition law and European competition law (Article 82 of the Treaty) also applies in cases of abuses of a dominant position that have an impact on interstate trade. However, the national competition authorities and judges retain the possibility of applying stricter national rules to unilateral conduct. As specified in the recitals of Regulation 1/2003, these stricter national laws may include provisions which prohibit or impose sanctions on abusive behaviour towards economically dependent undertakings.<sup>87</sup> On top of the convergence

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para 8.

<sup>86</sup> Commission Notice on cooperation within the Network of Competition Authorities, O.J. C 101, 27.4.2004, p. 43, at para 54(b)

<sup>87</sup> Regulation 1/2003, O.J. L 1, 4.1.2003, p. 1 at para 8 *in fine*. Several Member States have enacted laws protecting economically dependent firms from abuses by firms enjoying market power in relation with specific customers (in

rule, national competition authorities cannot –when ruling on agreements and practices under Article 81 and 82 of the Treaty which are already the subject of a Commission decision - take decisions, which would run counter to the decisions adopted by the Commission (Article 16(2) Regulation 1/2003).

#### 4.2.3. A Public Choice perspective

Finally, an economic analysis of (de)centralised enforcement is incomplete without a Public Choice perspective. Centralised enforcement may be preferred if the risk of regulatory capture at lower levels of government is higher. National competition authorities may be inclined to favour national interests. Officials of a central antitrust authority are more remote from the firms they have to control and may thus act in a more independent way, making them less vulnerable to regulatory capture. However, also the achievement of these advantages at the central level requires that several conditions are satisfied. Regulators should be responsible for the consequences of their decisions; they should be independent from the interest groups they are supposed to control and decision processes should be transparent to outside observers.

With respect to competition policy, Neven, Nuttall and Seabright<sup>88</sup> indicate three different responses to the problem of regulatory capture: accountability, independence and transparency. Mobility is one of the best guarantors of accountability: firms and individuals who are unhappy with substantive rules of law and/or their enforcement simply move to another jurisdiction. When mobility is limited, other devices are necessary to guarantee that regulatory agencies are held to account through the political process to the general public. The argument for political independence rests on the fact that compared to the voting public at large special interest groups can more easily influence politicians. A competition agency can only be truly independent if it is not forced to take account of political arguments in the assessment of anticompetitive practices. Real independence requires that political modifications of decisions are taken by a separate agency. A division between the decision stage and the stage of political review may contribute to the independence of the antitrust agency. Finally, transparency may reduce the informational asymmetries, aid regulatory agencies to commit themselves to a given regulatory policy and cope with unequal costs of gathering information. A division between the decision stage and political review may also contribute to transparency. It would be naive to think that political arguments will not be considered

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German: “relative Marktmacht”). See Gesetz gegen Wettbewerbsbeschränkungen (Germany), ..... (France) and .... (Italy).

if they are not explicitly mentioned in the relevant antitrust provisions. The advantage of a division of functions is that political modifications can only be made after the decision by the competition authority. If this decision is previously published, the political arguments for changing the decision will have to be spelled out clearly.

Differences as to the degree of political independence of the competition authorities, which are active at different levels of government, may again weaken the argument in favour of centralised enforcement. At the European level, the competition agency is more directly under political control than in most of the Member States. The heads of the competition authorities in the Member States are either civil servants or administrative law judges. Political independence is further guaranteed by rules imposing incompatibilities between membership of the competition authorities and leading functions in firms or professional associations.<sup>89</sup> On the contrary, European Commissioners are politicians. Although they are required to forswear national allegiances on joining the Commission, it would be naive to think that there is no risk of national capture. This risk has even been institutionalised in the enforcement procedures. Before taking formal decisions under Articles 81 and 82 of the Treaty, the Commission is required to consult the Advisory Committee on Restrictive Practices and Dominant positions. This Committee is composed of representatives of the Member States' competition authorities. The meetings of the Committee are not open to the public. The Committee's opinion is attached to the draft decision when it is sent up to the Commissioners for approval, but it is not published or made available to the defendants.<sup>90</sup> Although the Committee's opinion is not binding, it is clear that the decision procedure with respect to Articles 81 and 82 of the Treaty has many features, which allow for capturing by national interests.

The discussion of regulatory capture has recalled that private interests, rather than social welfare, may be the driving force behind regulatory reform. The “modernised” system of enforcement of Articles 81 and 82 may equally be explained from a Public Choice perspective. For a good understanding of the division of work between the European Commission and national courts and competition authorities, economic theory on bureaucracies is highly illuminating. Obviously, the growth of centralisation increases the workload of the central authorities. Bureaucrats motivated by self-interest may want to maximise the budget of the bureau<sup>91</sup> or try to achieve higher status, while

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<sup>88</sup> D. Neven, R. Nuttall and P. Seabright, *Merger in Daylight. The Economics and Politics of European Merger Control*, 1993, 164-165

<sup>89</sup> See Section 51 (5) GWB (Bundeskartellamt) and Section 45 (3) GWB (Monopolkommission).

<sup>90</sup> L. Ritter, W.D. Braun and F. Rawlinson, *European Competition Law: A Practitioner's Guide*, 2d ed, 2000, 872..

<sup>91</sup> W. Niskanen, *Bureaucracy and Representative Government*, 1971.

at the same time making work more agreeable.<sup>92</sup> The latter option, reducing the workload while at the same time gaining more prestige, is not inconsistent with the different phases in the system reform. In a first phase, a reduction of the workload was achieved by leaving the treatment of the 'simple' cases and the purely technical legal questions to national judges. As soon as matters became more complicated and especially when economic and political arguments could influence the ultimate decision, the Commission kept the last word. With the exception of the granting of exemptions, the Commission's advice on legal issues was not binding. However, given their unfamiliarity with competition law, many national judges followed the Commission's advice in most cases.<sup>93</sup> Consequently, the Commission's ability and willingness to help poorly qualified national judges added to its prestige. Under Regulation 1/2003, the Commission has kept a guiding role: it may give advice on difficult cases, intervene before national courts, or withdraw an important case from a national authority. This new division of work adds to the prestige of the Commission and makes its work more agreeable.

## Concluding remarks

In this chapter an economic framework was used to compare American and European rules on enforcement of competition law. Regulation 1/2003, which is without doubt one of the most important reforms in the history of European competition policy, has aligned the European rules on enforcement with their American counterparts as far as the timing of intervention is concerned. In addition, the increased role of national judges brought about by the decentralisation of the enforcement system is another feature that has reduced the differences between the enforcement of European competition law and American antitrust law. Since May 2004, the important role of private enforcement and the imposition of criminal sanctions, including imprisonment of individuals, remain the principal differences between both systems of enforcement. In general it may be doubted whether single system components of one regime can simply be exchanged with the other regime's counterparts without adjusting the other components as well. *Ex post* enforcement reduces the number of controls by antitrust authorities and may lead to underdeterrence if the level of sanctions is not simultaneously increased.

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<sup>92</sup> P. Dunleavy, *Bureaucracy and Public Choice. Economic Explanations in Political Science*, 1991.

<sup>93</sup> "What would be the point of such opinion if the Commission does not expect that they will be followed by national courts?", citing J. Bourgeois, *EC competition law and the Member State Courts*, in: FORDHAM CORP. L. INST. 1993, 493 (B. Hawk ed., 1994).

Optimal enforcement of the competition rules requires that companies are deterred from engaging in welfare reducing restrictive practices and that they keep incentives to sign agreements that are socially desirable. In other words, enforcement can only be optimal if no type I or type II errors are made. Moreover, enforcement costs must be minimised. These costs include information costs of all relevant actors (companies that agree on restrictive practices, antitrust enforcers and third parties, in particular competitors and consumers) and the costs of the legal proceedings (administrative expenses of antitrust authorities and judges).

From a viewpoint of deterrence, the expected fine should exceed the expected benefit resulting from infringements of the competition rules. The expected fine is the probability of a conviction multiplied by the imposed sanction. Several reasons can be indicated why the goal of deterrence may not be achieved in the current European enforcement regime: the use of qualitative criteria for fixing fines, which impedes an easy calculation of the expected fine, the too low level of the fines and the absence of a cure for “judgement proof” problems of companies. Regulation 1/2003 has neither changed the exclusive reliance on corporate sanctions, nor increased the ceiling of the fine and introduced individual sanctions (imprisonment) to cope with the judgement proof problem. Consequently, the expected fine can be raised only by increasing the rate of detection. It remains to be seen whether the latter goal can be achieved by a more efficient use of the Commission’s resources and cooperation between the Commission and national competition authorities in the framework of the European Competition Network. To achieve an efficient level of deterrence at the lowest possible cost, policy makers should also realize that the different elements of the enforcement system interact with each other in a complex way. For example, the amount of fines and damages must be coordinated with the amnesty grants under leniency programmes. In the absence of such co-ordination, it will not be possible to strike an optimal balance between the deterrence objective and the detection of hard core cartels.

The economic evaluation of the switch from an authorisation system to a legal exception system crucially depends on the availability and quality of information possessed by both companies and competition authorities. Regulation 1/2003 has increased the information costs for antitrust authorities, companies and third parties in the grey area of agreements, which have both anti-competitive and beneficial effects. The previous notification system signalled the existence of such agreements and could prevent that restrictive practices whose ultimate benefits did not outweigh their costs would be implemented. The information costs and the associated risk costs imposed on private companies may also negatively affect their willingness to engage in welfare enhancing

practices. It is to be deplored that the danger of counterproductive effects has not been contained by reducing, rather than completely abolishing, the notification system and/or the establishment of a Register of agreements, which may reduce competition.

The system change from *ex ante* control to *ex post* assessment can be better supported in the old Member States than in the new Member States. In the latter states, companies will face greater uncertainty with respect to the legality of agreements and the quality of analysis by competition authority may not yet have reached the same standards of quality as in the old Member States. Decentralisation, which goes hand in hand with a move from *ex ante* to *ex post* control may be poorly suited for the new Member States

The general lesson from economics is that decentralisation is the more efficient the less important local law is for the central authority with respect to federal welfare and the more valuable local information is for appropriate rule-making. National competition authorities are generally better placed to assess matters that are concentrated on their particular state. On the other hand, the risk of regulatory capture at lower levels of government may be higher. Therefore, efficiency can be achieved only by an optimal mix of centralised and decentralised enforcement.