
# Notice on Agreements to Reduce Capacity

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**The Competition Authority**
An tÚdarás Iomaíochta

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## 1. EXECUTIVE SUMMARY

1.1 In January 2011, the Competition Authority (the "Authority") reached a settlement in respect of its long-running proceedings against the Beef Industry Development Society Ltd. (the "BIDS case").

1.2 This settlement was reached at a time when the BIDS case had been referred back to the High Court by the Supreme Court after the European Court of Justice had decided that an agreement between competitors to reduce capacity in the Irish beef processing industry was prohibited by Article 101(1) of the Treaty on the Functioning of the European Union ("TFEU").

1.3 As a result of this settlement, the Beef Industry Development Society Ltd. withdrew its High Court proceedings whereby it was seeking to claim that the BIDS agreement satisfied all four conditions under Article 101(3) TFEU.

1.4 This Guidance Notice reflects the substance of the decisions of the various courts involved in the BIDS case and thereby provides guidance on the application of section 4 of the Competition Act, 2002 (the "Act") and/or Article 101 TFEU to businesses considering entering into agreements or any form of coordination to reduce capacity in specific industries in Ireland.

## 2. INTRODUCTION

2.1 The Authority is responsible for enforcing Irish and Community competition law. The purpose of competition law is to prevent behaviour that deprives consumers of the benefits of competition. Competition law is intended to be applied at all times, including times of economic recession or declining demand when industries may suffer from overcapacity. A recession can facilitate strong growth in long term productivity. Unlike a boom, when inefficient players may survive and even grow, an economic downturn will tend to drive out the less efficient market players. This process leaves a stronger and more efficient supply base, thus driving innovation and productivity growth in the next period of expansion.

2.2 Agreements to reduce capacity, like all types of collaboration among competitors, must be examined under section 4 of the Act or under Article 101 TFEU where the agreement is capable of affecting trade between Member States. As the BIDS case shows, an agreement between competitors to reduce capacity including features such as those in the BIDS agreement will always have the object of preventing, restricting or distorting competition, and will therefore be prohibited by section 4(1) of the Act and Article 101(1) TFEU. The critical question therefore will be whether the agreement meets the four cumulative conditions required in order to be exempted from prohibition under section 4(5) (or Article 101(3)).

2.3 This Guidance Notice, firstly, sets out the legal and historical context relevant to agreements aimed at reducing capacity in specific industries. Secondly, it describes the main features of the agreement at issue in the BIDS case and summarizes the conclusions of the courts involved in the proceedings in respect of the BIDS agreement. Thirdly, it explains the effect of the BIDS case in respect of the application of section 4(1) of the Act and Article 101(1) TFEU to agreements to reduce capacity in specific industries. Finally, it outlines the Authority's views on the application of section 4(5) and/or Article 101(3) to anti-competitive agreements.

## 3. LEGAL CONTEXT

3.1 This section will give an overview of the main features of section 4 of the Act and Article 101 TFEU. While section 4(1) and Article 101(1) prohibit certain types of conduct that restrict competition, section 4(5) and Article 101(3) set out the conditions for an exemption from the prohibition. Article 101(3) should be interpreted in accordance with the Commission's Guidelines on the application of Article 101(3)[1] (the "Guidelines") and since the wording of section 4(5) is identical to that of Article 101(3), the Authority considers that the Guidelines are equally useful in interpreting section 4(5) of the Act.

### Section 4(1) and Article 101(1)

3.2 Section 4(1) of the Act and Article 101(1) TFEU prohibit agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition within the State (in the case of section 4(1)) and the common market (in the case of Article 101(1)) and, in particular, those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development or investment;

(c) share markets or sources of supply,

(d) apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage;

(*e*) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which by their nature or according to commercial usage have no connection with the subject of such contracts.

3.3 It is important to understand the significance of the words "object or effect" under these provisions. An agreement may be restrictive of competition either by its object or effect, or by both. It is clear that these are alternative, and not cumulative, requirements for a finding of an infringement[2]. Once it appears that an agreement has as its object the prevention, restriction or distortion of competition, it will be prohibited by section 4(1) and/or Article 101(1) without any need to consider its effects. Therefore, such an agreement will only be permitted where it satisfies the requirements of section 4(5) of the Act or Article 101(3) TFEU.

3.4 Restrictions of competition by "object" (commonly known as "hard-core" restrictions) are those that by their very nature have the potential of restricting competition[3]. The assessment of whether an

[1] Guidelines on the application of Article 81(3) of the Treaty, OJ 2004/C 101/08.
[2] See, e.g. Costen and Grundig v Commission [1966] ECR 299, p. 343; Société Technique Minière v Maschinenbau Ulm GmbH [1966] ECR 235, p. 249 and Commission v Anic Partecipazioni [1999] ECR I-4125.
[3] Guidelines, para. 21.

agreement includes restrictions by object is based on a number of factors including, the terms of the agreement, the context in which the agreement is applied and the actual conduct and behaviour of the parties on the market. In this regard, the parties' subjective intention to restrict competition is a relevant factor but is not a necessary condition[4].

3.5 There is no exhaustive list of agreements restricting competition by object. However, there are some categories of agreements which are regarded by the European Courts and the Commission as being anti-competitive by object, such as agreements to fix prices, to share markets or customers and to limit output[5]. These types of agreements are considered to be the most harmful to consumer welfare because they directly interfere with the outcome of the competitive process.

3.6 Even if an agreement does not have the object of restricting competition, it may have that effect[6]. According to the Commission, for an agreement to be restrictive by effect, it must be capable of affecting competition to such an extent that negative effects on prices, output, innovation, or the variety or quality of goods and services can be expected on the relevant market with a reasonable degree of probability[7]. When determining whether an agreement has such an effect, the agreement must be considered in the market context in which it is to be applied.

## Section 4(5) and Article 101(3)

3.7 Section 4(5) of the Act and Article 101(3) TFEU provide for an exemption from the prohibition contained in section 4(1) and Article 101(1) against anti-competitive agreements. These provisions are aimed at ensuring that agreements which are found to have restrictive elements are not condemned where they generate overriding efficiency gains. To benefit from the exemption an agreement must satisfy four conditions. In particular, the agreement:

(a) must contribute to improving the production or distribution of goods or provision of services or to promoting technical or economic progress;

(b) must allow consumers a fair share of the resulting benefit;

(c) must *not* impose on the undertakings concerned terms which are not indispensable to the attainment of those objectives; and

(d) must *not* afford undertakings the possibility of eliminating competition in respect of a substantial part of the products or services in question.

3.8 These four conditions are cumulative so that if any of them is not satisfied, the agreement is prohibited. The burden of proof lies on the undertaking(s) seeking to defend an agreement to demonstrate that it satisfies these conditions.

4 Guidelines, para. 22.
5 Guidelines, paras 18 and 25.
6 Case 23/67 Brasserie de Haecht v Wilkin ECR 407; Case C234/89 Delimitis v Henninger Brau AG [1991] ECR I-935.
7 Guidelines, para. 24.

## 4. HISTORICAL CONTEXT

4.1 The issue of how competition law should be applied to agreements or other forms of cooperation between competing undertakings to reduce capacity in specific industries is not new. In the past, the Commission has reviewed agreements aimed at addressing difficulties arising in the context of industries suffering from overcapacity in times of economic recession and/or declining demand. For example, in *Synthetic Fibres*[8] the Commission dealt with an agreement notified by the main European producers of synthetic fibres to reduce capacity in the synthetic fibres industry. In *Stichting Baksteen*[9] (also known as the *Dutch Bricks* case) the Commission dealt with an agreement providing for a collective reduction in capacity in the Dutch bricks industry.

4.2 The Commission's traditional approach to the application of competition law to this type of agreement has been to draw a distinction between cyclical overcapacity and structural overcapacity.

4.3 Cyclical overcapacity is the result of the drop in demand that occurs during a business cycle downturn. In such circumstances, supply and demand can be brought into equilibrium relatively quickly through the normal play of market forces, with the least efficient players leaving the market either by their own choice or as a result of insolvency.

4.4 Structural overcapacity exists in industries with more long lasting overcapacity problems due to, for example, technological changes in the market, or in industries where firms have been substantially overinvesting for a prolonged period of time. For instance, such difficulties could arise in industries that have been granted state aids for a long time, or where state control prevented the closure of plants because of overriding social or other political factors, such as unemployment[10].

4.5 The Commission's decisions in the *Synthetic Fibres* and *Dutch Bricks* cases imply that agreements between market participants to reduce capacity in the context of structural overcapacity could satisfy the conditions for exemption set out in Article 101(3) TFEU[11].

4.6 However, as is further explained below, the Authority is of the view that the analysis conducted by the Commission in the past in respect of cases dealing with agreements to reduce capacity (including the *Synthetic Fibres* and *Dutch Bricks* cases) is inconsistent with the current approach of the Commission as reflected in the Guidelines and that the distinction between cyclical overcapacity and structural overcapacity should no longer be considered relevant.

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[8] Synthetic Fibres, OJ [1984] L 207/17.
[9] Stichting Baksteen, OJ [1994] L 131/15.
[10] In the past, the Commission explained in its Annual Report on competition policy for 1982 that "*structural overcapacity exists where over a prolonged period all the undertakings concerned have been experiencing a significant reduction in their rates of capacity utilisation and a drop in output accompanied by substantial operating losses and where the information available does not indicate that any lasting improvement can be expected in this situation in the medium term*", Twelfth Report on Competition Policy, point 38.
[11] Being the same conditions as appeared in the corresponding Article of the EC Treaty (numbered Article 81(3) initially and later Article 85(3).

## 5. THE BIDS CASE

### The BIDS Arrangements

5.1 The origin of the BIDS arrangements was a report published by McKinsey & Company in 1998 (the "McKinsey Report") following a market study of the Irish beef industry. The McKinsey Report recommended the rationalisation of the Irish beef processing industry (i.e., the slaughter of cattle and de-boning of meat). The implementation of the rationalisation proposals of the McKinsey Report gave rise to the creation of a corporate vehicle, the Beef Industry Development Society ("BIDS"), in May 2002. The membership of BIDS was open to all beef processing companies in Ireland. At the time of its creation, 10 beef processing companies became members of BIDS.

5.2 Within the umbrella of BIDS, a number of decisions were adopted in order to achieve a 25% reduction of capacity in the Irish beef processing industry. These decisions of BIDS, and/or the agreements between processor members of BIDS to reduce capacity, constitute the BIDS arrangements.

5.3 Under the BIDS arrangements, it was decided, and/or it was agreed, that:

- Some members of BIDS would leave the industry (the "goers") and some members would stay in the industry (the "stayers").
- The stayers would pay a €2 levy (per head of cattle slaughtered within their usual volume of production) and a €11 levy (per head of cattle slaughtered above their usual volume of production).
- The monies obtained from the levies would be used to financially compensate the goers.
- The goers would:
  - (a) decommission their plants;
  - (b) sell their equipment used for primary beef processing only to stayers (for use as back-up equipment or spare parts) or else to purchasers outside the island of Ireland;
  - (c) refrain from using their lands for beef processing for five years; and,
  - (d) enter a two year non-compete clause in relation to the processing of cattle on the island of Ireland.

### Court Proceedings

5.4 The Authority took the view that the BIDS scheme was incompatible with both section 4 of the 2002 Act and Article 101 TFEU and initiated civil proceedings before the High Court in 2003. The BIDS case has been a long-running saga involving a High Court trial, an appeal to the Supreme Court and a request for a preliminary ruling to the Court of Justice of the EU. The judgments of these courts are summarised below.

*High Court Proceedings (phase 1)*

5.5 The High Court proceeding consisted of an 11 day hearing and a judgment delivered in July 2006[12].

5.6 The High Court found that that the case was "an Article 101 case and not one requiring independent consideration under section 4 of the 2002 Act"[13] since the defendants had conceded that the scheme was liable to have an appreciable effect on trade between Member States[14].

5.7 The High Court dismissed the Authority's application for a ruling that the BIDS scheme infringed Irish and EU competition law. The Court held that the Authority had not demonstrated, on the balance of probabilities, that the proposed scheme had the object or effect of restricting competition in the upstream market for the purchase of cattle for slaughter and the de-boning of meat or in the downstream market for the sale of processed beef.

*Supreme Court Appeal (phase 1)*

5.8 The Authority appealed the High Court decision to the Supreme Court in October 2006. The appeal was suspended in March 2007 when the Court decided to refer a question to the Court of Justice under the preliminary ruling procedure in Article 267 TFEU[15].

5.9 In essence, the Supreme Court asked the Court of Justice whether agreements with features such as those of the BIDS arrangements were to be regarded, by virtue of their object alone, as being anti-competitive and prohibited by Article 101(1) or whether it was necessary, in order to reach such a conclusion, first to demonstrate that such agreements had anti-competitive effects.

*Court of Justice Ruling*

5.10 In its judgment[16], the Court of Justice pointed out that it was settled case law that there is no need to take account of an agreement's actual effects once it appears that its object is to prevent, restrict or distort competition within the common market. That examination must, however, be made in the light of the agreement's content and economic context.

5.11 Having reviewed the arguments of the parties, the Court of Justice said in respect of the BIDS arrangements that:

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[12] Competition Authority -v- Beef Industry Developments Society Limited & anor [2006] IESC 294.

[13] Paragraph 33.

[14] According to Article 3 of Council Regulation (EC) No. 1/2003 on the implementation of the rules of competition laid down in Articles 81 and 82 of the Treaty (OJ L1 2003), where the competition authorities of the Member States or national courts apply national competition law to agreements, decisions by associations of undertakings or concerted practices which may affect trade between Member States, they shall also apply Article 101 to such agreements, decisions or concerted practices.

[15] Formerly Article 234, EC Treaty.

[16] Case C-209/07, Competition Authority v. Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd, ECR 2008 I-08637.

"it is apparent […] that the object of the BIDS arrangements is to change, appreciably, the structure of the market through a mechanism intended to encourage the withdrawal of competitors"[17].

"The BIDS arrangements are intended […], essentially, to enable several undertakings to implement a common policy which has as its object the encouragement of some of them to withdraw from the market and the reduction, as a consequence, of the overcapacity which affects their profitability […]. That type of arrangement conflicts patently with the concept inherent in the [TFEU] provisions relating to competition, according to which each economic operator must determine independently the policy which it intends to adopt on the common market. Article [101(1) TFEU] is intended to prohibit any form of coordination which deliberately substitutes practical cooperation between undertakings for the risks of competition[18]."

5.12 It also said that the means put in place to attain the objective of the BIDS arrangements include restrictions whose object is anticompetitive[19].

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

"An agreement with features such as those of the standard form of contract concluded between the 10 principal beef and veal processors in Ireland, who are members of the Beef Industry Development Society Ltd, and requiring, among other things, a reduction in the order of 25% in processing capacity has as its object the prevention, restriction or distortion of competition within the meaning of Article [101(1) TFEU]"[20].

*Supreme Court Appeal (phase 2)*

5.14 Following this ruling of the Court of Justice, the matter returned to the Supreme Court for the application of the ruling to the specific facts of the case. On 3 November 2009[21], the Supreme Court delivered its decision through the judgments of Mr. Justice Kearns and Mr. Justice Fennelly.

5.15 Mr. Justice Kearns noted that, in light of the Court of Justice's judgment, the parties accepted that the only issue which remained to be determined was whether or not the BIDS arrangements could benefit from an exemption under Article 101(3). It therefore referred the case back to the High Court for determination of this question.

5.16 Mr Justice Fennelly agreed with Mr. Justice Kearns's decision to refer the case back to the High Court for an assessment under Article 101(3). However, Fennelly J. emphasized that the High Court would need to consider this issue *de novo*, having regard, in particular, to the terms of the Court of Justice's judgment in which the very object of the BIDS arrangements was found "to conflict patently with the concept inherent in the Treaty regarding competition"[22].

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[17] Paragraph 31.
[18] Paragraphs 33 and 34.
[19] Paragraph 36.
[20] Paragraph 40.
[21] Competition Authority -v- Beef Industry Developments Society Limited & anor [2009] IESC 72.
[22] Competition Authority -v- Beef Industry Developments Society Limited & anor [2009] IESC 72, paragraph 3.

*High Court Proceedings (phase 2)*

5.17 In the second High Court proceedings, the onus was on BIDS to prove that all four conditions under Article 101(3) were satisfied to avail of the exemption under this provision.

5.18 At this stage of the proceedings the Commission decided to submit written observations to the Court pursuant to Council Regulation (EC) No 1/2003[23]. The Commission considered that the BIDS case raised issues on the coherent application of EU competition law. In the context of the current economic downturn, a number of undertakings in various industries across Europe are seeking to justify agreements restricting competition by invoking capacity problems or economic crises in their respective sectors. The Commission was of the view that these cases raise a number of important questions with respect of the application of Article 101(3). Moreover, the Commission acknowledged that there are limited precedents available on these issues since the adoption of the Guidelines.

5.19 In January 2011, BIDS withdrew its claim before the High Court in respect of the application of Article 101(3). Consequently, the High Court did not reach any decision on the application of this provision to the BIDS agreement. As a result, the BIDS agreement remains prohibited, as it has the object of preventing, restricting or distorting competition.

[23] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 001, 04/01/2003 P. 0001 – 0025.

## 6. ANALYSIS OF THE COMPETITION AUTHORITY

6.1 This section explains the effect of the BIDS case on the application of section 4(1) of the Act and/or Article 101(1) TFEU to agreements or any form of coordination to reduce capacity in specific industries. It also explains the current approach followed by the Commission in respect of the application of section 4(5) and/or Article 101(3) to anti-competitive agreements.

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

6.2 The BIDS case is of direct relevance to illustrate the application of section 4(1) of the Act and/or Article 101(1) TFEU to agreements to reduce capacity in a specific industry.

6.3 The distinction between "object" and "effect" contemplated in these provisions was a relevant issue in the BIDS case. The Authority contended that the BIDS agreement contained obvious restrictions of competition of such nature that they should be regarded as restrictions by object, thus making it unnecessary to assess the effects of the BIDS agreement. This view was subsequently supported by the Court of Justice. The precise wording of its conclusion was as follows:

> "An agreement with features such as those of the standard form of contract concluded between the 10 principal beef and veal processors in Ireland, who are members of the Beef Industry Development Society Ltd, and requiring, among other things, a reduction in the order of 25% in processing capacity has as its object the prevention, restriction or distortion of competition within the meaning of Article [101(1) TFEU]" [24].

6.4 In light of the conclusions of the relevant courts in the BIDS case, an agreement between competitors to reduce capacity, including features such as those in the BIDS agreement, will have as its object the restriction of competition and, therefore, will fall under the prohibition of section 4(1) and/or Article 101(1) TFEU.

6.5 Therefore, the only assessment necessary for such an agreement will be an assessment under section 4(5) and/or Article 101(3) to see whether the conditions necessary for an exemption are satisfied.

### Application of Section 4(5) and Article 101(3)

6.6 This section sets out the Authority's views concerning the application of section 4(5) and Article 101(3) to agreements to reduce capacity in a specific industry prohibited by section 4(1) and/or Article 101(1). These views are consistent with the Guidelines.

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

6.7 The four conditions under Article 101(3) must be satisfied at the time at which it is proposed to implement the agreement. The evidence and data used to demonstrate that the four conditions are satisfied must be valid at the date of implementation of the agreement, not at some earlier date.

6.8 Paragraph 44 of the Guidelines provides:

[24] Paragraph 40.

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

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

6.10 In light of the above, an agreement to reduce capacity, such as the BIDS agreement, must meet the four conditions of Article 101(3) as of the date of its proposed implementation. This had important implications in the BIDS case. The BIDS agreement had not been implemented pending the outcome of the litigation to determine the legality of the agreement. This meant that the BIDS agreement would have to meet the four conditions contained in Article 101(3) as of the date of the final hearing by the Court of the case and not when the agreement had been signed. Given that the facts of the case may have changed from the time when the agreement was first made, this may have entailed BIDS adducing further evidence to support their claim that the four conditions in Article 101 (3) TFEU were met.

*Commission's decisions in Dutch Bricks and Synthetic Fibres*

6.11 As indicated above, the Commission dealt with agreements to reduce capacity in the synthetic fibres and Dutch bricks industries in the Synthetic Fibres[25] (1984) and Dutch Bricks[26] (1994) cases, respectively. In both of these cases the Commission granted an exemption under Article 101(3) TFEU[27]. However, both cases were decided long before the adoption of the Guidelines and, in the Authority's view, should no longer be regarded as indicative or representative of the Commission's current approach to the application of Article 101(3) to agreements to reduce capacity for the following reasons.

6.12 First, the Commission decisions contain little analysis under Articles 101(1) and 101(3): the Synthetic Fibres decision consists of 55 short paragraphs and the Dutch Bricks decision consists of 45 short paragraphs.

6.13 Second, both cases are based on the Commission's traditional distinction between cyclical overcapacity and structural overcapacity, emphasising that it is only where an industry is suffering from structural overcapacity that agreements to reduce capacity could satisfy the conditions under Article 101(3). In the Authority's view, it is irrelevant in applying competition laws to crisis cartels to determine whether the crisis is (a) cyclical, being a result of a temporary drop in demand, or (b) chronic, being a product of a low level of demand coupled with a chronic excess productive capacity. There is a significant risk inherent in this distinction. This is that it may encourage an assumption (for example, by national courts) that agreements to reduce capacity are generally acceptable in situations of

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[25] Synthetic Fibres, OJ [1984] L 207/17.
[26] Stichting Baksteen, OJ [1994] L 131/15.
[27] Formerly, Article 81(3), EC Treaty.

structural overcapacity and that their assessment under Article 101(3) TFEU in such cases should be a generous and relatively benign one. The approach adopted by the Commission in its Guidelines, which insists on a rigorous economic analysis of the compliance of such an agreement with the conditions in that Article, shows that such an assumption would be quite wrong.

6.14 Third, the economics-based approach adopted in the Guidelines in respect of the application of Article 101(3) is absent in both cases.

6.15 Fourth, neither case is cited in the Guidelines.

6.16 Finally, both cases contain inaccurate statements of the law on Article 101(3), particularly on the interpretation of the indispensability criterion (further discussed below). In both cases, the Commission seemed to consider that the third condition is satisfied where the restrictions are indispensable to the objective of capacity reduction and not, as the text of Article 101(3) makes clear ought to be the approach, to the objectives of attaining efficiencies while providing a fair share of them to consumers[28]. As the Guidelines point out at paragraph 74:

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

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

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

6.18 The purpose of the first condition of Article 101(3) is to ascertain the pro-competitive benefits, i.e., efficiency gains, resulting from the agreement at issue. The efficiency gains that are claimed to flow from the agreement must outweigh its anti-competitive effects. Accordingly, all efficiency claims must be substantiated. This involves verification of the following matters[29].

- First, it must be demonstrated that the claimed efficiencies are of objective value.

- Second, a causal link between the agreement and the claimed efficiencies must be demonstrated. This normally requires that the efficiencies result from the economic activity that forms the object of the agreement. Furthermore, the causal link must be sufficiently close.

- Third, the likelihood and the magnitude of each claimed efficiency must be demonstrated. The undertaking(s) seeking the benefit of Article 101(3) must, as accurately as reasonably possible, calculate or estimate the value of the efficiencies and describe in detail how the amount has been computed. They must also describe the methods by which the efficiencies have been or will be achieved. The data submitted must be verifiable so that there can be a

[28] Synthetic Fibres, paras. 42 to 47 and Dutch Bricks, paras. 32-37.
[29] Guidelines, paras. 50 and 51.

sufficient degree of certainty that the efficiencies have materialised or are likely to materialise and the undertaking(s) involved must explain how and when each claimed efficiency will be achieved.

- Fourth, the undertaking(s) seeking the benefit of Article 101(3) must substantiate any projections as to the date from which the efficiencies will become operational so as to have a significant positive impact on the market.

6.19 Mere speculation or general statements on cost savings are not sufficient to discharge the onus under the first condition under Article 101(3).

6.20 In the context of agreements to reduce capacity under which a number of undertakings will leave the industry, knowing the identity either of the undertakings leaving the industry or the undertakings staying in the industry is essential to estimate the likely efficiency gains (if any) with the degree of accuracy necessary for the purposes of Article 101(3).

6.21 Any calculation of cost savings requires knowing the output produced by the undertakings leaving the industry and the costs of producing that output. Similarly, one would need to know which of the undertakings staying in the industry will increase output consequent upon implementation of the agreement, the amount of such increase in output and the cost of producing the additional output. In this scenario, there may be economic benefits through an increased capacity utilisation rate by the remaining players[30]. If the agreement contains limitations on output increases, then serious questions arise as to whether pro-competitive benefits can be obtained.

6.22 Cost savings are more likely to be achieved if an agreement reducing capacity ensures that inefficient capacity will exit the industry. If the restructuring agreement does not ensure that inefficient plants are decommissioned, then any plant, including efficient plants, may exit the market. This situation would fail to achieve economic benefits.

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

6.23 According to the second condition under Article 101(3), consumers must receive a fair share of the efficiencies resulting from the restrictive agreement.

6.24 The Guidelines explain that the term "consumers" encompasses both direct and indirect users of the products covered by the agreement[31].

6.25 The concept of "fair share" implies that the pass-on of efficiencies must at least compensate consumers for the negative effects of the agreement, i.e., consumers must not be worse off as a result of the agreement[32]. This condition, therefore, requires conducting a balancing exercise of the efficiency gains and the negative effects of the agreement. This balancing exercise implies, as has already been

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[30] Guidelines, para. 68 ("Efficiencies in the form of cost reductions can also follow from agreements that allow for better planning of production, reducing the need to hold expensive inventory and allowing for better capacity utilisation").
[31] Guidelines. para. 84.
[32] Guidelines. para. 85.

indicated in the section dealing with the first condition under Article 101(3), that the efficiency gains must be quantified.

6.26 According to the Guidelines, if the efficiency gains generated by an agreement are substantial and the restrictive effects are relatively limited, then it will not normally be necessary to carry out a detailed analysis of the passing on of benefits to consumers provided that the other three conditions of Article 101(3) are fulfilled. Conversely, if the agreement's restrictive effects are substantial and the cost savings insignificant then it is unlikely that the agreement will fulfil this second condition.

6.27 In cases where it is not immediately obvious that the competitive harms exceed the benefits to consumers or vice-versa, a careful analysis of the pass-on may be necessary. The analytical framework for assessing consumer pass-on and the balancing of cost efficiencies is outlined in paragraphs 95 to 101 of the Guidelines. Factors such as the characteristics and structure of the market, the nature and magnitude of the efficiency gains, the elasticity of demand and the magnitude of the restriction of competition should be taken into account.

6.28 It is also important to note that consumers are more likely to receive a fair share of the resulting pro-competitive benefits in the case of reductions in variable costs than in the case of reductions of fixed costs[33]. This is because profit maximising firms are expected to price at a point where marginal revenue equals marginal costs. Marginal revenue is the revenue gained by selling an additional unit of output. Marginal cost is the incremental cost of producing that unit and is a function only of variable costs (fixed costs are not affected by output). Therefore, as a general rule, output and pricing decisions of a profit maximising firm are normally not determined by fixed costs but by its variable costs.

6.29 In cases where capacity reduction is to be achieved through the exit from the market of certain undertakings, but where the undertakings staying in the industry must pay a levy linked to their output levels, it is important to bear in mind the effect of this levy on marginal costs as it could result in reduction in output which could lead to higher prices to consumers. This needs to be examined on a case-by-case basis.

*Third condition: Indispensability of the Restrictions*

6.30 The third condition under Article 101(3) is that the agreement does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of the objectives of improving the production or distribution of goods or to promoting technical or economic progress. In other words, the restrictions must be indispensable to achieving the claimed efficiency gains.

6.31 It is particularly important to note that the third condition under Article 101(3) will be satisfied if the restrictions are shown to be indispensable to achieve the claimed efficiency gains, and not, as is sometimes thought, to attaining the goals intended by the parties to the agreement.

[33] Guidelines, para. 98.

6.32 This is clear from the Supreme Court judgment of Mr. Justice Fennelly, in the BIDS case, which says:

> "Finally, compliance with Article 81(3)(a) requires it to be demonstrated that the restrictions imposed by any arrangements being examined under the provisions be "indispensable to the attainment of these objectives," **i.e., the objectives whose attainment enables them to survive Article 81(1)**."[34] [Emphasis added]

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

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

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

- First, it must be shown that the overall arrangement itself is necessary[35]. In order to prove this, it must be shown that the efficiencies are specific to the arrangement and that there are no other economically practical and less restrictive ways of achieving them; and

- Second, it must be shown that each individual restriction flowing from the arrangement is necessary in order to achieve the efficiencies[36]. The restrictions must be clearly explained, because if they are indeterminate, the Court will not be in a position to assess whether they are indispensable[37].

6.35 In the case of agreements aimed at reducing capacity, one important question is whether market forces could have solved within a reasonable period of time the problem of overcapacity without the collective intervention of individual undertakings being necessary. A general rule in a well-functioning free market economy is that market forces alone should remove unnecessary capacity from a market. It is for each undertaking to decide for itself whether, and at which point in time, its overcapacity becomes economically unsustainable and to take the necessary steps to reduce it. Hence, it is important to consider whether competition would itself correct overcapacity problems and would, within a reasonable period of time, bring the market back to equilibrium, without any need for coordination between the undertakings on the market.

6.36 However, there may be situations where problems of overcapacity are not likely to be remedied by market forces alone within a reasonable time. In this situation, it would need to be assessed whether there is a credible possibility that excess capacity could not be reduced by way of mergers or specialisation agreements.

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

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[34] Paragraph 7.
[35] Guidelines, para. 73.
[36] Guidelines, para. 73.
[37] Joined cases T-528/93, T-542/93, T-543/93 and T-546/93, Metropole television SA and Reti Televisive Italiane SpA and Gestevision Telecinco SA and Antena 3 de Television v Commission [2006] ECR II-649.

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

6.38 As the Guidelines explain, notwithstanding the possibility of exemption for agreements that would otherwise offend Article 101, ultimately priority must be given to the protection of rivalry and the competitive process over efficiency gains arising from anti-competitive agreements[38].

6.39 In assessing whether this condition applies, undertakings must consider both actual and potential competition, and must examine the state of existing competition. The question that must be decided is whether there is a possibility of elimination of competition in a substantial part of the market. The fact that competition remains in the rest of the market is not relevant to satisfy the requirement.

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

> "a realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered"[39].

6.41 As the Guidelines highlight, this condition is not fulfilled if competition with respect to an important dimension is eliminated.

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

[38] Guidelines, para. 105.
[39] Paragraph 108.

## 7. CONCLUSION

7.1 In light of the conclusions of the relevant courts in the BIDS case, an agreement between competitors to reduce capacity including features such as those in the BIDS agreement amounts to a restriction of competition by object and is prohibited by section 4(1) and/or Article 101(1) TFEU. Therefore, the only assessment necessary for such an agreement will be an assessment under section 4(5) and/or Article 101(3) to see whether the conditions necessary for an exemption are satisfied.

7.2 The purpose of this Guidance Notice is to help undertakings carry out themselves an informed assessment of their agreements and practices under section 4 of the Act and/or Article 101(3). Undertakings must self-assess the legality of their actions in such a way as to enable them to take an informed decision on whether to go ahead with an agreement or practice and in what form.

7.3 This Guidance Note does not purport to give legal advice.

7.4 The judgments from the Irish Courts referred to in the Guidance Notice can be found at www.tca.ie.

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