

The London School of Economics and Political Science

# **EU Competition Law and the Rule of Law: Justification and Realisation**

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# Declaration

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# Abstract

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This thesis explores the justification for and realisation of the formal rule of law ideal in EU competition law. It argues that the form of market intervention for determining the legality of business conduct matters, although European enforcement has not always appreciated its significance. It defends aspirations towards the formal rule of law in the fundamentally economic endeavour of competition policy: determining lawfulness through the application of generalised, equally-applicable, and comprehensible norms, subject to robust judicial review. While this less-discriminating form of market intervention is necessarily imperfect when compared with conduct-specific evaluations of competitive consequences, thus inaccurately prohibiting the efficient and permitting the inefficient, more restrained and structured determinations of legality facilitate the realisation of other important values.

Part I justifies efforts to approximate the formal rule of law ideal in competition policy. Both the Chicago School of antitrust and German Ordoliberalism indicate support for enforcement through the application of generalised norms that are administrable and comprehensible to businesses. Their perspectives on the legitimate form of market intervention are woven into broader works of jurisprudence, liberal constitutional theory, and institutional economics, thereby demonstrating the political *and* economic significance of the formal rule of law ideal for competition enforcement. Part II evaluates its mixed realisation in EU competition policy. On the one hand, the Commission has often prioritised the effective pursuit of its ends to make markets work “better”, seeking to maximise the scope for discretionary interventions as it deems necessary and perhaps facilitated by deferential judicial review. On the other hand, certain presumptions and multi-stage tests for determining legality in EU competition law incorporate efficiency considerations *ex ante* into generalised norms that afford normative certainty to firms. Albeit imperfect, these are interpreted as admirable attempts to optimally reconcile economically-accurate ends and a means approximating the formal rule of law.

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# Introduction

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Scholarly interest in EU competition policy derives from its location at the intersection between law and economics, which brings together a suite of contrasting concepts and methods to make markets work “better”. Most decisions of the European Commission or judgments of the EU Courts pursuant to Articles 101 and 102 TFEU<sup>1</sup> can be interpreted as complex, sometimes tense, interdisciplinary syntheses. Exploring such frictions has been a perennial occupation of competition scholars.

Since the inclusion of competition provisions within the Treaty of Rome, countless commentators have considered the *substantive* relationship between law and economics in the field. For example, how should the economic goal/s pursued by EU competition law be understood? Do particular decisions, cases, and legal doctrines cohere with economic learning? Does economics reveal “gaps” where anticompetitive conduct escapes legal prohibition? In these enquiries, law is an empty vessel. As it lacks an essential substantive content of its own,<sup>2</sup> the question is the extent to which EU competition law has accurately absorbed contemporary economic thinking.

Alternatively, scholars have also routinely addressed the appropriate *form* of market intervention: of how the economic goal/s of competition policy ought to be realised through the medium of law. Consider two reflections:

*“...competition policy cannot be based on economics alone. The rule of law is a pillar of the constitutional system: it makes the enforcement of competition policy predictable and allows economic actors to adapt their behaviour.”<sup>3</sup>*

*“...traditional lawyers remain reluctant to use economic analysis since it may make the outcome of real-life cases less predictable and thus fly in the face of legal certainty... The lack of flexibility resulting from the use of traditional legal concepts makes it impossible to profit fully from important economic insights.”<sup>4</sup>*

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<sup>1</sup> Article 101 Treaty on the Functioning of the European Union (“TFEU”) (prohibiting agreements, concerted practices, and decisions of trade associations with the object or effect of restricting competition); Article 102 TFEU (prohibiting the abuse of a dominant position).

<sup>2</sup> It could be argued that rights of defence and due process are necessary “legal” elements, but these procedural requirements are not in conflict with an economically-informed substance.

<sup>3</sup> Evans and Grave [2005] 136.

<sup>4</sup> Van den Bergh [2002] 34-35.

Albeit offering different analyses, both extracts point to a particular tension within competition policy. Although substantively empty, rival understandings of the appropriate form of competition law – on the “rule of law” and legal certainty versus flexibility – have an impact upon how economics is incorporated into enforcement, for better (Evans and Grave) or worse (Van den Bergh). In short, *the legal form of market intervention matters.*

This disagreement on the appropriate form of competition law has animated European scholarship since its inception. René Joliet was an early critic of legalistic assumptions about the legitimate form of law restricting the effectiveness of realising the economic aims of market intervention. In 1967 he argued that the fledgling EU enforcement regime had already adopted a Germanic conceptualisation of law that prioritised the promulgation of generalised norms which clearly delineated the boundary between legality and illegality.<sup>5</sup> But applying mechanistic, rigid presumptions, abstracted from the specific context to ensure legal certainty, was a mistake; effective enforcement required ‘a thorough factual analysis, on a case-by-case basis, in the light of economic investigation.’ Although occasionally acknowledging the value of certainty,<sup>6</sup> his overall conclusion was that limiting the legal form of competition enforcement to applying generalised, comprehensible norms was inappropriate in this specific field:

*“...some uncertainty appears to be a fair price to pay for an effective antitrust policy. It is inherent in the nature of such policy not to rely on abstract legal criteria, but to discriminate between significant and insubstantial restraints of trade.”<sup>7</sup>*

Although many scholars since have similarly suppressed the idea of an inherently legitimate legal form to thereby maximise the economic effectiveness of competition enforcement, the degree and nature of such criticism has varied. Like Van den Bergh and Joliet, some have directly challenged at a conceptual level the value of a form for determining lawfulness that approximates predictability.<sup>8</sup> More common has been the promotion of deciding legality through *ad hoc*, subject-specific economic analysis of the competitive effect of particular business conduct, thereby implicitly undermining aspirations towards generalised and clear legal norms.<sup>9</sup> This formal recommendation

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<sup>5</sup> Joliet [1967] 117.

<sup>6</sup> *ibid* 10, 63.

<sup>7</sup> *ibid* 190.

<sup>8</sup> Holley [1992] 693; Forrester [2000] 102-103 (cf [2004] 169).

<sup>9</sup> eg Schechter [1982] 13, 19; Jeanrenaud [1986] 36; Korah [1986a] 92-93; [1993] 148, 188-189; D Waelbroeck [1987] 56-57; Pathak [1989] 261; Holley [1992] 693; Hawk [1995] 974-976, 984-986; Bright [1996] 555; Lugard [1996] 167, 177; Siragusa [1997] 547-549; Bishop [2000] 58, 64; Forrester [2009].

has been tied to the on-going process of rendering EU competition law “more economic”.<sup>10</sup> Although making limited exceptions for presumptions of illegality against hardcore cartels under Article 101 TFEU,<sup>11</sup> it is especially pronounced in scholarship critical of the law on abuses of dominant position pursuant to Article 102 TFEU.<sup>12</sup> Other imperfect generalisations intended to foster normative certainty for businesses – block exemptions regulations conferring legality,<sup>13</sup> guidelines indicative of decision-making factors –<sup>14</sup> have also been dismissed as formalist, legalistic, “pigeon-holing”,<sup>15</sup> ignoring the actual economic consequences of the agreement or conduct on the market in question.

Despite its prevalence and longevity, the argument that effective, economically-literate competition enforcement necessitates marginalising the value of generalised and predictable legal norms is problematic for a number of reasons. To begin, it fails to explain why legal certainty is unimportant in competition policy. Although many cited above were arguing against excessive formalism by the Commission to thereby maximise its discretion,<sup>16</sup> the logical – though perhaps unintended - consequence of their offensive is that *any* predictable generalisation undermines the economic pedigree of the law as it is unable to sift between individually “good” and “bad” in the specific market context. But isn’t the resultant normative uncertainty itself detrimental to the functioning of economic forces?<sup>17</sup> Furthermore, what other risks and costs are introduced into competition law when legality is determined via a “flexible” form of market intervention? In addition, it is not obvious that the economically “ineffective” legal form of generalised, certain norms and case-by-case decision-making should be presented as a binary choice. Would intermediate forms be able to realise the best of both worlds?<sup>18</sup> Are there other methods by which EU competition enforcement can become “more economic”? Many of the scholars cited above do not address these points. But such omissions are themselves important. They suggest that this decades-

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<sup>10</sup> For a general overview of the rise and EU realisation of the “more economic” approach: Witt [2016].

<sup>11</sup> eg Hawk [1995] 987-988; Bright [1996] 558-559; Siragusa [1997] 548.

<sup>12</sup> eg Ridyard [2002] 296-297, 302; Sher [2002] 482; Martinez Lage and Allendesalazar [2003] 344-346; Kallaugh and Sher [2004] 263, 271, 279; CLFA82RG [2005] 180-183; EAGCP [2005] 2-3, 5-6; D Waelbroeck [2005] 171; Bishop and Marsden [2006] 1-4; Akman [2009b] 76-7.

<sup>13</sup> eg Lugard [1996] 173; Siragusa [1997] 550; Bishop [2000] 56; Van den Bergh [2002] 37-38.

<sup>14</sup> eg Hawk [1995] 986; Akman [2009b] 78.

<sup>15</sup> A label often associated with: Hay [1984].

<sup>16</sup> See Chapter V, Section II.

<sup>17</sup> See Chapter IV, Section IV.

<sup>18</sup> See Chapter VI.

long discussion of the appropriate legal form for competition policy has not been sufficiently theorised.

In criticising the form of EU competition law, these scholars have avoided the customary label for their target: *the formal rule of law*, the aspiration towards determining legality through generalised, equally-applicable norms that are comprehensible to subjects, rather than *ad hoc*, subject-specific decision-making. Direct appeals to this legal aspiration have, until recently, been few and far between in EU competition scholarship, though occasional praise for certainty and administrability vis-à-vis unstructured effects-based analysis can be interpreted as supportive.<sup>19</sup> However the formal rule of law has become more visible in EU commentary since the mid-2000s for two reasons. First, numerous scholars have challenged the notion that realising generalised, predictable norms, and economically-sophisticated enforcement are mutually exclusive. Commonly labelled a “Neo”-Chicago approach, they advocate the incorporation of economic learning *ex ante* into the design of rules, presumptions, and structured tests, thereby aiming to optimally reconcile accurate economic outcomes with approximating the formal rule of law ideal.<sup>20</sup> The second impetus has been the growth in competition enforcement by the Commission through commitment decisions, the settlement of investigations with often far-reaching remedial conditions.<sup>21</sup> Many have lamented the loss of legal certainty owing to the Commission pursuing novel theories of harm via one-to-one negotiations, thereby lessening the guidance afforded to businesses by the authoritative case law of the EU Courts on the interpretation of Articles 101 and 102.<sup>22</sup> The disproportionality of the remedies secured is also said to violate the formal ideal,<sup>23</sup> and the CJEU’s reluctance to incisively scrutinise such outcomes has been condemned as a dereliction of the judicial role to uphold the rule of law.<sup>24</sup>

While seemingly differing in opinion on the appropriate form of enforcement, such direct and indirect support for the rule of law in EU competition policy suffers a similar

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<sup>19</sup> eg Alexander [1973]; Caspari [1987] 356; Whish and Sufrin [1987]; Jenny [1998]; Nicolaides [2000]; Schaub [2000].

<sup>20</sup> eg Evans and Grave [2005]; Evans and Padilla [2005]; Evans [2005]; Vickers [2005] F260; Röller [2005] 11, 21; Maier-Rigaud [2006] 99-100; Bruzzone and Boccacio [2009] 466-468.

<sup>21</sup> Council Regulation 1/2003 on the Implementation of the Rules on Competition laid down in Articles [101] and [102] of the Treaty [2003] Article 9.

<sup>22</sup> eg Cengiz [2011] 132-133; Wagner-Von Papp [2012] 931, 966; [2013]; Bottemann and Patsa [2013] 363; Gerard [2013] 22-24; Dunne [2014] 401, 415-416; Jenny [2015].

<sup>23</sup> eg Moullet [2013] 86.

<sup>24</sup> eg Schweitzer [2008] 576-577; Cengiz [2011] 128-129, 150-151; Wagner-Von Papp [2012] 930-931; Jenny [2015].

defect to case-by-case champions: its theoretical roots are insufficiently substantiated and justified.<sup>25</sup> Why is the predictable application of generalised, equally-applied norms a valuable aspiration in a field concerned with markets and the promotion of economic goods? If the ends of enforcement are most effectively pursued through *ad hoc* determinations of legality – whether unstructured effects-based analysis or administrative discretion – what is lost? How do concerns for remedial proportionality and thorough judicial oversight relate to formal considerations of normative abstraction and comprehensibility? It cannot simply be assumed in this field that the formal rule of law is a universally accepted aspiration as competition enforcement is unavoidably an economic, market-focused endeavour. In failing to articulate its value within this specific setting, there is a real risk that legitimate concerns about the appropriate form of intervention can be easily dismissed as stereotypical legal qualms by opposing commentators and ends-driven authorities alike. Perhaps more than any other legal field, references to the formal rule of law, certainty, generalised norms, judicial scrutiny, etc., require close, careful, and context-specific justification.

Both perspectives on the appropriate form of EU competition law within the literature are deficient in their failure to meaningfully engage with foundational questions of legal, political, and economic theory. On the one hand, those who stress the effectiveness and economic accuracy of determining legality through case-by-case, conduct-specific analysis do not adequately address the negative consequences of eschewing normative certainty and generality. Nor do they consider intermediate positions between the (*prima facie*) absolutes of realising perfect economic ends and approximating the means of the formal rule of law. On the other hand, those who apparently champion this ideal vis-à-vis administrative discretion and unstructured effects-based analysis struggle to persuasively advance beyond instinctive, unsubstantiated legalism. The importance of aspiring to the formal rule of law is assumed, without clearly articulating the value of its constituent parts, how they fit together, and, most damaging of all, without situating the ideal within the particular context of competition enforcement, the societal pursuit of *economic goods*.

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<sup>25</sup> One notable exception is Christiansen and Kerber [2006], though this analysis is still relatively concise (219-220, 229-235).

This thesis addresses and remedies such deficiencies in routine debates within EU competition law scholarship on the appropriate form of market intervention. It has two research questions.

The first is theoretical: *to which form for determining the legality of business conduct should the fundamentally economic endeavour of competition policy aspire?* After briefly recounting the indeterminacy of competition microeconomics on this issue (Chapter I), the response advanced in Part I is that there is considerable merit in aiming to realise the formal rule of law in this field: market intervention in the form of applying generalised, comprehensible norms, subject to close judicial oversight. Instead of going directly to theory, Part I first proceeds inductively by examining underappreciated responses offered by two – supposedly – “rival” bodies of thought on competition policy: the Chicago School of antitrust (Chapter II) and German Ordoliberalism (Chapter III). Although reached by differing routes and varying intellectual lineages, they provide very similar conceptualisations of and justifications for determining legality in a manner which aspires to realise the formal rule of law ideal. These claims are then woven into a systematic justification for the political *and* economic desirability of approximating the formal rule of law in competition policy (Chapter IV). Determining legality through *ad hoc*, subject-, context-, and market-specific evaluations may allow for enforcement of utmost efficacy, freed from the administrative restraint and rigidity of applying generalised legal norms. But attempting to realise the formal rule of law is to accept more modest means for the centralised pursuit of societal ends, to thereby attain other significant values.

This theoretical justification leads to the second, practical research question: *do the substantive norms, enforcement practices, and institutions of EU competition law realise the formal rule of law?* Although far from comprehensive, it will be shown that the record and contemporary nature of EU competition law is mixed on this formal front. At times, the realisation of ends – however conceptualised – with maximum effectiveness has been through means simply antithetical to the formal rule of law (Chapter V). Albeit with sincere intentions of making markets work “better”, the Commission has occasionally sought to expand its discretion by avoiding the restraint and rigidity of applying generalised, comprehensible norms. The EU Courts may have contributed to such significant deviations from the formal rule of law ideal, through operating an unpredictable standard of review, and sometimes failing to prospectively formulate

structured, comprehensible tests for determining legality. Nevertheless, many other aspects of EU competition law can be interpreted as respectable attempts to optimally (and, necessarily, imperfectly) realise both economically-sophisticated ends *and* the virtues of endeavouring towards the application of generalised, comprehensible norms (Chapter VI). These examples can be understood as falling along a sliding-scale between “more” and “less” generalised/certain forms for determining legality and, inversely, forms “less” and “more” discerning of the economic effects of the specific conduct in question. Returning to the divide in the literature introduced above, this is just as the “Neo”-Chicagoans recommend. In adopting a form which attempts to offer abstracted and clear norms where possible (presumptions, structured tests), it also explains the distaste of those who, since Joliet, have stressed that economically-sophisticated enforcement necessitates case-by-case, subject-specific determinations of legality. But in light of the response to the first research question, having explored the political and economic importance of approximating the formal rule of law ideal, both the undesirable consequences of such a form of market intervention and the appeal of optimally reconciling ends and means can be better understood.

The focus of this thesis will be far-reaching, both in terms of its disciplinary scope and level of abstraction, ranging from theoretical discussions of law, politics, and economics, to the minutiae of contemporary enforcement at the coalface. Its distinct intellectual contribution will be to synthesise divergent concepts, approaches, and foci into a systematic exploration of whether the legality of business conduct in the unavoidably economic endeavour of competition policy should be determined by a means aspiring to the formal rule of law ideal, and whether EU competition enforcement has realised this form of market intervention in practice. Regardless of the actual answers offered, the broader significance of this thesis is to reiterate a theme already discernible from the scholarly literature above: the *form* of competition law matters.

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<sup>36</sup> Council Regulation 139/2004 on the Control of Concentrations between Undertakings [2004] L24/1.

<sup>37</sup> Article 107 TFEU.

<sup>38</sup> Article 263 TFEU.

<sup>39</sup> Article 267 TFEU.

# Chapter I: Competition Policy: Economic Orthodoxy and Formal Indeterminacy

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## I. Introduction

There is a tension at the core of economic policy. On the one hand, many countries have recognised that the spontaneous operation of free markets, unencumbered by excessive governmental intervention, may better serve and benefit society than state direction of the economy.<sup>1</sup> On the other hand, it is recognised by all but the most absolutist libertarians that a policy of total economic laissez-faire would not guarantee the beneficial operation of the spontaneous market order; even in the absence of state hindrance - price-setting, production quotas, restricted entry - the optimal performance of markets through decentralised coordination by businesses can be stalled by those wishing to secure a potentially quieter, more profitable life. The friction at the heart of economic policy is therefore that although markets are considered more efficient than centralised direction, intervention is still necessary against endogenous disturbances that are similarly detrimental. Essentially, the void occasioned by the retreat of *public* bulwarks to the benefits of free markets should not be filled with *private* distortions that also harm consumers.

Understanding the rationale behind this specific category of market interventions - *competition policy* - is the purpose of this short chapter. Given its focus upon the free economy and market conduct, conceptualising competition policy is fundamentally and necessarily a question for economics.<sup>3</sup> As a discipline, economics is a broad church of divergent methods and policies. As the prevailing contemporary account of the concepts and value of competition policy, Section II will outline the basics of neo-classical microeconomic theory (or “price theory”). Although furnishing a justification for market intervention and indicating a few business practices that may be problematic, Section III

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<sup>1</sup> eg OECD [2017] (on Mexican telecommunications liberalisation reducing mobile broadband prices up to 75 per cent, permitting 50 million more users).

<sup>3</sup> Posner [2001] 1; Peepkorn and Verouden [2014] 3; Niels, Jenkins, and Kavanagh [2016] 2.

will explore the limits of microeconomic theory as a basis for enforcement. In particular, it will situate price theory within the wider body of contemporary competition microeconomics, which stresses that context is key for determining whether specific practices are likely to have a positive or negative market impact.

But the most important point of this overview of the economics underpinning competition policy concerns what is *not* seen. Although providing a range of theoretical concepts and practical tools for anchoring the *substance* of market intervention, ordinary competition economics is either silent on or makes unsubstantiated suggestions about the desirable *form* for determining the legality of potentially problematic commercial conduct. This is a question of shifting from the domain of substantive competition policy towards its actual pursuit via the medium of competition *law*. Section IV therefore reiterates the research question to be explored throughout Part I: *to which form for determining the legality of business conduct should the fundamentally economic endeavour of competition policy aspire?*

## II. Basic Microeconomic Price Theory and the Need for Market Intervention<sup>4</sup>

Despite several intuitive meanings in common use,<sup>5</sup> the definition of “competition” is not self-evident. One could suggest that competition policy aims to maintain business *rivalry*. A suspicious eye might be cast over concentrated markets with few actors or horizontal mergers between competitors, thus advocating substantial industrial fragmentation. But how much rivalry is enough rivalry, and how is this to be measured? Would antagonism towards concentration hold even when larger firms with fewer rivals could bring the same product to market at a lower cost and price for consumers? And without cooperation between businesses operating at different levels of the market, would many products reach consumers at all? Another intuitive definition might view competition policy as guaranteeing the *opportunity to freely enter and operate in markets*. Yet if such freedom is defined as a guaranteed commercial existence, should exclusion from the market owing to consumer dissatisfaction and better rival products

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<sup>4</sup> This section is based upon several similar accounts: Mankiw [2012]; Peeperkorn and Verouden [2014] 10-24; Jones and Sufrin [2016] 3-10; Niels, Jenkins, and Kavanagh [2016] 7-14; Whish and Bailey [2018] 4-8.

<sup>5</sup> Bishop and Walker [2010] 17-19.

be illegal? Is the sale of goods by one firm to a customer classed as an illegal impediment to a second firm's ability to sell to the same customer?

As ultimately futile efforts to capture the essence of "competition", both definitions are defective as they fail to enlighten the purported *value* of rivalry or the guaranteed opportunity to trade. Only by articulating the envisaged "good" of a programme for market intervention is it possible to delineate the boundary of state action in the economy, and to benefit from a metric for consistently evaluating potentially undesirable business practices.<sup>6</sup> The tendency of competition treatises to swiftly introduce neo-classical microeconomics<sup>7</sup> reflects the consensus that basic price theory provides the most useful expository framework for introducing key concepts and understanding the value of competition policy.<sup>8</sup>

Microeconomics traces its roots back to Adam Smith's *The Wealth of Nations*, notable for its focus upon how systemic forces alone may coordinate decentralised market action.<sup>9</sup> Its core tenet was that the self-interest of individuals in the marketplace sees them behave as if 'led by an invisible hand', unwittingly producing an economically-superior outcome than could be achieved through governmental direction.<sup>10</sup> Smith nevertheless recognised that this beneficial interplay between supply and demand was not guaranteed. His rudimentary concerns for monopoly pricing<sup>11</sup> and cartels<sup>12</sup> indicated a basic need for the state to police malfunctioning markets brought about by endogenous conduct, thus furnishing an early justification for competition policy. Neo-classical price theory built upon Smith's approach by highlighting how costs influence a firm's decision to produce at a certain quantity of output, subsequently impacting the final price paid by consumers. With the advent of economic marginalism towards the end of the nineteenth century in the writings of William Jevons and Alfred Marshall,<sup>13</sup> neo-classical scholars focused upon how the cost of, or revenue derived from, producing one additional unit of output affected rational pricing decisions.

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<sup>6</sup> Bishop and Walker [2010] 20-21; Fuchs [2012] 54.

<sup>7</sup> eg Posner [2001]; Hovenkamp [2008]; Jones and Sufrin [2016]; Niels, Jenkins, and Kavanagh [2016]; Whish and Bailey [2018].

<sup>8</sup> But far from perfect. See Section III.

<sup>9</sup> Viner [1927] 198-199; Stigler [1976].

<sup>10</sup> Smith [1776b] 32. See also: [1776a] 119 ('It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.').

<sup>11</sup> Smith [1776a] 164.

<sup>12</sup> *ibid* 232.

<sup>13</sup> Hovenkamp [2008] 15-16; Peepkorn and Verouden [2014] 5.

Modern microeconomic theory is the study of how economic units (consumers, firms) make decisions and interact with each other on the market.<sup>14</sup> Through a duo of stylised models, neo-classical price theory introduces a toolkit of concepts - efficiency, supply and demand, marginalism - for understanding the societal value of competition, for justifying a programme of centralised market interventions, and for abstractly comprehending the basic logic of rational business behaviour.<sup>15</sup> The two models are the “good” of perfect competition and the “bad” of monopoly power.<sup>16</sup> Together they illustrate the common argument that efficiency is the desirable consequence of free markets and a value to be protected through a programme of competition policy.<sup>17</sup>

The value of *perfect competition* derives from the theory that it produces the greatest possible distribution of societal welfare; no alternative configuration could better realise the combined welfare (or “surplus”) of producers and consumers. It assumes a market with an infinite number of producers of homogenous goods that act with complete rationality, possess perfect information, have no transaction costs, and can enter or exit markets without loss or delay. The demand for and supply of products have an inverse relationship: the lower the product output, the higher the demand. As Smith himself recognised,<sup>20</sup> the valuable dynamic of perfect competition is logical and intuitive. If supply is scarce, higher prices result in profits for producers and unmet consumer demand. In response to this, rational producers will enter the market, thereby increasing supply to reduce demand and, ultimately, prices. But if there is oversupply, where demand is so low that products can only be sold at a price below costs, producers will rationally respond by exiting the market, decreasing output and thus raising the market price. Through repeated entry and exit, a perfectly competitive market will eventually reach equilibrium, optimising *allocative efficiency*. This means that society’s scarce resources have been used to meet the demand of consumers to the greatest extent possible with the least detriment to producers, and *vice versa*.<sup>25</sup> The equilibrium of perfect competition also displays the highest level of *productive efficiency*, with fierce rivalry influencing firms to fetch goods to market at the lowest possible cost and thus resultant price for consumers. In this way, microeconomic theory suggests that a

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<sup>14</sup> Gellhorn and Kovacic [1994] 44; Mankiw [2012] 29.

<sup>15</sup> Gellhorn and Kovacic [1994] 57-58; Niels, Jenkins, and Kavanagh [2016] 2-3.

<sup>16</sup> Niels, Jenkins, and Kavanagh [2016] 2.

<sup>17</sup> This is a highly contentious claim: Chapter II, Section II.B.ii, and especially the criticisms cited in fn 59.

<sup>20</sup> Smith [1776a] 159-160.

<sup>25</sup> Ibid 161 (the market ‘naturally aims at bringing always the precise quantity thither which may be sufficient to supply, and no more than supply, the demand.’).

perfectly competitive market optimises total efficiency through the spontaneous, decentralised reaction of firms to the information signalled by prices to increase or decrease output.<sup>27</sup>

If the model of perfect competition illustrates the valuable efficiency of free markets, the microeconomic model of monopoly indicates the negative consequences of substantial market power. When the assumption of infinite producers is replaced with a single firm, the monopolist itself chooses the quantity produced and resultant market price. Their quandary is that every additional unit of output reduces demand and thus lowers the price charged for all units.<sup>28</sup> The rational profit-maximising response to diminishing marginal returns is to produce at a lower output than under perfect competition, and therefore at a relatively higher price. This constitutes a transfer of wealth from consumers that is commonly the lay aversion to monopolies and was criticised by Adam Smith as an 'absurd tax'.<sup>32</sup> Monopoly is the most extreme manifestation of market power - the ability to influence prices and derive supra-competitive profits without challenge - which is often posited as the main target of competition policy.<sup>33</sup> But from an economist's perspective, the question of whose pocket the Euros line is not the most critical consequence of substantial market power.<sup>34</sup> Instead, the concern is for the monopoly profit and higher consumer price being the result of *allocative inefficiency* when compared to the outcome under perfect competition.<sup>35</sup> This is the "deadweight loss" to consumer welfare for those who despite being willing to pay the above-or-at-cost competitive price, do not have their demand met in a monopolistic market owing to higher prices. Monopoly may also be a source of *productive inefficiency*.<sup>36</sup> Freed from the pressure of a competitive climate where businesses are forced to operate at lowest cost and price or lose all custom, there may be a significant degree of managerial slack and a failure to pursue cost-improving methods.<sup>37</sup> Substantial resources may also be expended by businesses vying for a monopolistic position that only the successful firm may be able to recoup.<sup>38</sup> The waste occasioned by such *rent-seeking* is especially visible where a position of market power is

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<sup>27</sup> Lyons [2009] 2.

<sup>28</sup> In the absence of perfect price discrimination: Mankiw [2012] 314-317.

<sup>32</sup> Smith [1776a] 164.

<sup>33</sup> Motta [2004] 40-41; Peepkorn and Verouden [2014] 9.

<sup>34</sup> Posner [2001] 13.

<sup>35</sup> Hovenkamp [2008] 13-14.

<sup>36</sup> cf Posner [2001] 18-19 (a rational, profit-maximising monopolist will be productively efficient).

<sup>37</sup> That the scale of such inefficiency may dwarf the allocative inefficiency of monopoly: Leibenstein [1966].

<sup>38</sup> See generally: Posner [1975b].

politically bestowed.<sup>39</sup> When these further forms of possible inefficiency are combined with the allocative deadweight loss, the detrimental economic impact of monopoly vis-à-vis perfect competition could be potentially substantial.

In this way, basic microeconomics provides a justification for adopting competition policy. The invisible hand is a valuable mechanism for efficient economic coordination but is not invulnerable. An absolute laissez-faire stance towards the economy leaves market forces susceptible to hindrance by firms with substantial market power, whether unilaterally or in combination. The role of the state is to intervene to ensure the continuing operation of free markets through a programme of competition policy. Its function has been likened to that of a sports referee, ensuring no ‘foul play’ on the market and letting the best competitors win customers, by appraising ‘tackles so that the competition is robust and exciting without breaking down into lethargy, match fixing or kicking the other side off the field.’<sup>42</sup>

Through simple extrapolation from the basic concepts introduced by microeconomics, it is clear that market power could be acquired, defended, and deployed to the detriment of efficiency in a variety of possible ways. If anything, such disturbances ought to be expected: as Adam Smith recognised, the common interest in the benefits of competitive pressure commonly clashes with the allure of supra-competitive profits derived from market power.<sup>43</sup> Even absent legally-guaranteed monopolies, firms may enjoy a position of power through the creation of substantial barriers to new entry (eg through long-term contracts) or via conduct that excludes actual and dissuades potential rivals (eg aggressively pricing below production costs). Competitors may merge to create a more powerful entity or even a monopolist. Supra-competitive profits through limitations of market output could also be achieved via less permanent forms of coordination between businesses, especially but not necessarily limited to cartel agreements.<sup>44</sup> The general scope of competition policy is therefore often divided into three forms of potentially anticompetitive market practices: i) unilateral conduct to exercise or acquire substantial market power; ii) coordination between independent businesses; and iii) mergers and acquisitions.

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<sup>39</sup> Rent-seeking is discussed in Chapter IV, Section IV.B.ii.

<sup>42</sup> Lyons [2009] 10.

<sup>43</sup> Smith [1776a] 358.

<sup>44</sup> *ibid* 232 (‘People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.’).

Thus microeconomic theory provides foundations for understanding the value of competition policy and gives some indication as to the possible focus of enforcement attention.

### **III. The Limits of Neo-Classical Price Theory and Contemporary Competition Microeconomics: Context is Key**

The models of neo-classical price theory are important for understanding the purported benefits of free markets and for justifying centralised interventions to ensure their continuing operation. But microeconomic theory alone is not a concrete blueprint for the practical, day-to-day enforcement of competition policy. This is for several reasons.

#### ***A) Necessarily Unrealistic Assumptions***

The explanatory power of microeconomic theory derives from a methodological reliance upon assumptions (eg rationality, perfect information, costless entry/exit).<sup>45</sup> Models are used to analyse the causal relationship between a few variables with all other factors assumed to be fixed.<sup>46</sup> Rather than a foundational defect, assumptions are a necessary ingredient for microeconomics to introduce concepts that are valuable tools for orientating competition policy.<sup>47</sup> Albeit derived from stylised models, they constitute an invaluable common language for lawyers, economists, and enforcers that avoids the need to repeatedly address foundational justifications (“why is competition valuable?”) with every proposed market intervention.<sup>48</sup>

But while acknowledging the utility of these assumption-laden models, it is still obvious that perfect competition is an ideal that has perhaps never been approximated in reality. Nor is the absolute market power of the theoretical monopolist a common phenomenon. The vast majority of industries are somewhere between the two.<sup>49</sup> All companies have some effect on price and thus meet the microeconomic definition of

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<sup>45</sup> Peepkorn and Verouden [2014] 4. For a staunch defence of general assumptions if they reasonably predict behaviour: Friedman [1953].

<sup>46</sup> Singer [1981] 2.

<sup>47</sup> Posner [1977b] 12-13 (a theory necessarily lacks realism or it would be a complex empirical description); Jones and Sufrin [2016] 10.

<sup>48</sup> Stigler [1957] 14.

<sup>49</sup> Bishop and Walker [2010] 16; Geradin, Layne-Farrar, and Petit [2012] 69; Jones and Sufrin [2016] 10; Whish and Bailey [2018] 9.

market power; the question becomes one of the *degree* that competition policy is willing to tolerate before taking action.<sup>50</sup>

*B) Important Considerations Excluded*

Even if the microeconomic model of perfect competition were a realistic and deliverable blueprint for the enforcement of competition policy, there are still strong justifications for questioning it.

For example, as a static model focusing upon prices, it says nothing of dynamic efficiency and the societal benefits resulting from competition on innovation.<sup>51</sup> Whether more or less concentrated markets better stimulate innovation has been the subject of considerable economic debate.<sup>52</sup> Furthermore, although one ingredient of perfect competition's efficiency derives from the homogeneity of goods, everyday experience suggests that consumers appreciate product differentiation, avoiding the dullness of everybody wearing the same clothes and driving the same car.<sup>53</sup>

Perhaps the strongest reason to doubt the simplicity of neo-classical price theory as an illustrative guide for competition policy enforcement is the allocative/productive efficiency trade-off.<sup>54</sup> The assumption of an infinite number of competitors all optimising both allocative *and* productive efficiency in the model of perfect competition obscures a complex possible relationship between the two. Although the market structure of many sellers may promote allocative efficiency, fewer firms with substantial market shares may be necessary to *realise* productive efficiencies (eg economies of scale)<sup>55</sup> or be a *result of* such efficiencies in the face of strong competitive pressure (the best product, superior technology, effective management).<sup>56</sup> And if the economic justification for free markets and competition policy is societal efficiency, it may be the case that productive efficiencies outweigh the resultant loss of allocative efficiency from other firms exiting the market. Replicating the structural conditions of perfect competition does not necessarily optimise efficiency; deploying competition policy as a tool for industrial deconcentration could deny consumers lower prices resulting from

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<sup>50</sup> Motta [2004] 41.

<sup>51</sup> Kerber [2008] 98-100; Hovenkamp [2008] 95-96; Whish and Bailey [2018] 10.

<sup>52</sup> Peeperkorn and Verouden [2014] 37-40.

<sup>53</sup> Singer [1981] 3-8; Niels, Jenkins, and Kavanagh [2016] 14.

<sup>54</sup> For the seminal economics paper on this trade-off: Williamson [1968].

<sup>55</sup> Peeperkorn and Verouden [2014] 15-17; Niels, Jenkins, and Kavanagh [2016] 10-11.

<sup>56</sup> The Chicagoan approach to productive efficiency, avoiding attempts to calculate the maximum number of firms on a market: Posner [1976] 89-90; Bork [1978] 105-106.

cost savings occasioned by economies of scale or punish dominant companies that achieve their position from successfully and efficiently giving customers what they want.<sup>57</sup>

C) Contemporary Competition Microeconomics: Context is Key

More generally, the limit to basic price theory alone providing a concrete guide to competition policy is that its illuminating foundational generalisations and concepts are ‘possible only if its subject-matter is made abstract to the point of telling us little or nothing about actual behaviour’.<sup>58</sup> *Neo-classical price theory* is one necessary but insufficient element of the broader church of contemporary competition microeconomics.<sup>59</sup> In particular, *industrial organisation economics* (“IO”) has sought to understand ‘actual behaviour’ and its competitive impact for the purposes of enforcing competition policy.<sup>60</sup> Although their respective domination of competition microeconomics has waxed and waned throughout the twentieth century, the two complementary methodological strands exist in a dialectic tension between abstract simplification and practical complexity: neo-classical price theory retains its pre-eminence as the foundational theoretical justification and conceptual toolbox for understanding business behaviour in the abstract; and IO provides the means for practically quantifying, contextualising, and ultimately complicating competition policy’s engagement with and understanding of real-life markets. Essentially, they represent the division between theory and application within microeconomics. Since the late 1980s the latter strand has rapidly expanded in its endeavour to comprehend the real efficiency consequences of business practices.<sup>61</sup> In particular, the “new” IO economics has incorporated insights regarding strategic behaviour and oligopolistic coordination from game theory,<sup>62</sup> plus the sophisticated empirical methods of econometrics that attempt to quantify actual or potential economic effects of specific market practices.<sup>63</sup>

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<sup>57</sup> See Chapter II, Section II.B.ii.

<sup>58</sup> Knight [1922] 475.

<sup>59</sup> There is no strand called “competition economics”, but it is a combination of various branches: Niels, Jenkins, and Kavanagh [2016] 4.

<sup>60</sup> Peepkorn and Verouden [2014] 4 (describing it as ‘applied microeconomics’ which investigates ‘real-world markets and company behaviour.’); Niels, Jenkins, and Kavanagh [2016] 4.

<sup>61</sup> C Shapiro [1989] 127; Sullivan [1994] 669-670; Geradin, Layne-Farrar, and Petit [2012] 76 (introducing ‘the complexity of the economic realities into competition analysis’); Peepkorn and Verouden [2014] 8. This is often referred to as the “Post-Chicago” School: see Chapter II, text accompanying fn 158-161. For the related development of New Institutional Economics: Chapter IV, Section IV.

<sup>62</sup> Geradin, Layne-Farrar, and Petit [2012] 75-76; Peepkorn and Verouden [2014] 8, 26-28; Samuelson [2016]; Jones and Sufrin [2016] 22, 652-654.

<sup>63</sup> Peepkorn and Verouden [2014] 8, referring to Einav and Levin [2010]; Niels, Jenkins, and Kavanagh [2016] 5-6.

The perceived need for competition microeconomics to address behavioural economics' critique of the foundational assumption of rationality is also growing.<sup>64</sup> IO economics has thus been something of a sponge for approaches and methods that in various ways blur the simple elegance of neo-classical price theory.<sup>65</sup>

Situating the theory within this wider, multifaceted body of methods and techniques of application highlights a central tenet of contemporary competition microeconomics: in determining whether actual business behaviour has a positive or negative impact on market efficiency, *context is crucial*.<sup>66</sup> For example, exclusive dealing agreements may have anticompetitive effects in one particular market where they constitute a dense network of relations hindering new entry, but not in a different scenario.<sup>67</sup> Rebates might be a method of fierce competition and the result of productive efficiency when adopted by a small company, but a damaging means to exclude competitors when introduced by a firm with substantial market power.<sup>68</sup> A merger between the same two businesses would have differing effects on competition if two or twenty rivals remained. In other words, *it is nigh-on impossible to claim that a particular form of market practice is inherently pro- or anticompetitive, always efficient or inefficient*. This is perhaps also an inevitable consequence of the disciplinary focus of economics upon markets and business practices; as evidenced, for instance, by recent research on how pricing for online sales differs from sales in person,<sup>69</sup> competition economics will always be forced to reconsider received wisdom in light of commercial and technological innovations in the marketplace. Of course, basic predictions or common preconditions can be formulated as to the *likelihood* that conduct will have negative efficiency consequences.<sup>70</sup> But in contemporary competition economics it is suspect to claim that every manifestation of a certain action regardless of its specific context is irrefutably in/efficient or will inevitably have a detrimental/beneficial impact.

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<sup>64</sup> Peepkorn and Verouden [2014] 8; Thaler [2016]; Walker [2017].

<sup>65</sup> This is not to suggest that IO does not employ theory and models, as are particularly prevalent in game theory, though the assumptions employed tend to be more context-specific.

<sup>66</sup> Geradin, Layne-Farrar, and Petit [2012] 76 ('individualistic evaluations, entirely dependent upon the circumstances at hand in a particular case'); Peepkorn and Verouden [2014] 4 ('In individual cases, it will be necessary first to find the concepts and model that best fit the actual market conditions of the case and then proceed with the analysis of the actual or possible competition consequences.'), 8 (anticompetitive effect 'typically depends on the precise circumstances of the case'); Whish and Bailey [2018] 2 ('Competition law is about the economic analysis of markets... each case will depend on its circumstances').

<sup>67</sup> See: Chapter V, Section II.B.ii.

<sup>68</sup> See: Chapter V, Section III.

<sup>69</sup> Gorodnichenko and Talavera [2017].

<sup>70</sup> Peepkorn and Verouden [2014] 4. Chapters II and VI will consider Chicagoan and "Neo"-Chicagoan advocacy of this method.

Despite furnishing authorities with a justification for intervention and tools for understanding the practical consequences of business conduct, competition microeconomics does not, therefore, provide a clear roadmap for the practical enforcement of competition policy.

#### IV. The Unanswered Question: What Form of Market Intervention?

Every competition law treatise recognises the key role played by microeconomics in articulating the justification for systematic interventions to improve the spontaneous operation of market forces and prevent endogenous distortions. In other words, competition policy is positively framed as a thoroughly economic endeavour. So too do they acknowledge the limits of neoclassical price theory, and situate its conceptual devices within the broader toolbox of competition economics that seeks to understand the actual impact of business behaviour on specific markets. The preceding discussion represents an uncontroversial recounting of the prevailing economic theory which underpins competition policy.

This thesis, however, is inspired by an important foundational question that is *absent* from contemporary competition microeconomics or its periodic restatement by academic authorities of competition law: *to which form for determining the legality of business conduct should competition policy aspire?* The economics justifying and informing market intervention clearly makes formal claims. In particular, the prominence of IO methods since the 1980s and a focus upon context have frequently led to claims that modern competition economics rightly prioritises ‘assessment of the facts of the case (case-by-case approach)’.<sup>72</sup> But just as with the examples of EU competition scholarship considered in the Introduction which see a “more economic” approach as necessarily requiring *ad hoc*, subject-specific determinations of legality, the implications of these claims about the legitimate form of market intervention are not explored in detail. Yet this is a fundamental discussion that goes to the heart of competition policy’s liminal existence at the intersection between economics and law, at the juncture between decentralised market order and centralised normative order. This theoretical enquiry cannot simply be dismissed as an esoteric venture. On the contrary, exploring the appropriate form of market intervention addresses thoroughly practical questions

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<sup>72</sup> Peeperkorn and Verouden [2014] 8. See fn 60-66.

of, for example, the construction of particular legal tests, the role of judges in reviewing decisions based on economic expertise, or procedural choices for investigating and closing cases where economic analysis is on the side of the competition authority, but precedent is not.

The purpose of the next two chapters is to closely analyse two important schools of competition thought to understand their preferred means for market intervention. Although often cast as rival economic approaches to competition policy, the Chicago School of antitrust and German Ordoliberalism both signal a surprisingly harmonious appreciation for a certain conceptualisation of the legitimate form for determining the legality of business conduct in pursuit of the goal/s of competition policy. Together they begin to reveal political and economic justifications for aspiring to realise the formal rule of law ideal in competition enforcement.

## **Part I**

# **Competition Policy and the Rule of Law: Justification**

# Chapter II: The Chicago School of Antitrust: An Economic ‘Subordination’ of Law?

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## I. Introduction

Every competition lawyer is familiar with the Chicago School of antitrust. Whether considered a ‘much needed corrective’<sup>1</sup> or a bunch of ‘neoconservative Darwinists’,<sup>2</sup> their influence upon US antitrust law and scholarship is undeniable.<sup>3</sup> Even in historical accounts of EU competition law’s theoretical evolution, the Chicago School is often afforded a central, almost messianic, role. Legal folklore suggests that after decades of being led astray by Ordoliberal economic illiteracy,<sup>4</sup> Chicagoan emphases upon the goal of efficiency and resilient market self-correction made European inroads during the 1990s, ushering-in a period of “modernisation” towards a “more economic” approach to EU competition law.<sup>5</sup>

To suggest that the Chicago School has been, and continues to be, divisive in competition law scholarship is an understatement. A recent portrayal depicts them as so obsessed with ensuring that antitrust law maximised market efficiency that their approach can ‘hardly be seen as proper interdisciplinarity’.<sup>6</sup> Instead, the author characterises Chicagoan antitrust as the economic ‘subordination of the law’.<sup>7</sup> This is not only a judgement as to their preference for the *substance* of antitrust law being guided by faithful deduction from the assumptions of neo-classical price theory. It also goes to the idealised *form* of Chicagoan market intervention: their determination to ensure

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<sup>1</sup> Hovenkamp [2008] 2. Similarly: [2001] 258 (‘the most coherent and elegant ideology that antitrust has ever experienced.’).

<sup>2</sup> Adams and Brock [1987] 1117.

<sup>3</sup> Duxbury [1995] 349.

<sup>4</sup> This common portrayal of Ordoliberalism is disputed in Chapter III, Section III.

<sup>5</sup> eg Weitbrecht [2008] 82-85.

<sup>6</sup> Andriychuk [2017] 65.

<sup>7</sup> *ibid.*

efficient business practices are not prohibited by overbroad application of *per se* rules supposedly rendered lawyerly qualms about legal certainty ‘overruled’.<sup>8</sup>

The Chicago-inspired revolution in US antitrust from the late 1970s undoubtedly involved both: on the basis of *substantive* economic arguments about the efficiency of business conduct, the US Supreme Court shifted the *form* for determining the legality of specific practices one-by-one from rule-based prohibitions *per se*, to a conduct-specific analysis of their particular competitive impact on the market (the “rule of reason” standard).<sup>9</sup> As a result, it has been routinely suggested that the Chicago School of antitrust advocated market intervention ideally conceptualised as ‘assessing a suspect agreement’s anti- and pro-competitive effects in every individual case, instead of inferring its nature from its form’.<sup>10</sup>

That was indeed a *consequence* of judges absorbing Chicagoan arguments on the overbroad substantive reach of US law, but the resultant form of market intervention was *not* a core tenet of their approach. On the contrary, *ad hoc*, subject-specific, determinations of legality were the exact opposite of the Chicago School’s conceptualisation of the ideal form that enforcement should take. Despite a reputation for dogmatic adherence to neo-classical microeconomic theory and efficiency-driven enforcement, this chapter argues that the Chicago School of antitrust nevertheless had a clear concern for the desirable form of market intervention.<sup>11</sup> Rather than the economic ‘subordination’ of law, the Chicago School’s proposed method for antitrust represents an attempt to reconcile an economically-informed normative substance with formal desiderata often associated with the rule of law ideal - general and equally-applicable norms that delineate the boundary between legality and illegality in a manner comprehensible to legal subjects.<sup>12</sup>

Section II provides a brief overview of the history, approach, and substantive implications of the Chicago School for US antitrust law. The subsequent two sections systematically analyse their writings to develop a clearer picture of the envisaged form

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<sup>8</sup> *ibid* 62.

<sup>9</sup> Discussed in Section III.A.

<sup>10</sup> Witt [2016] 67. See also: 65, 68 (it ‘convinced the US Supreme Court to move away from presumptions of illegality and to assess most business conduct as to its actual effects’); Niels, Jenkins, and Kavanagh [2016] 4. This was more implicit in older accounts: see fn 105.

<sup>11</sup> For rare recognition: Lande [1988] 436-438; Wright [2009] 7, 12; [2012] 247-249.

<sup>12</sup> Chapter IV deductively conceptualises the rule of law in greater detail; this chapter and the next proceeds inductively to tease-out elements suggestive of this conceptualisation.

that market intervention ought ideally to take. Section III considers the Chicago School's negative response to various calls for determining antitrust legality through subject-specific decision-making (effects-based analysis or the rule of reason standard). Instead, it will be argued that they preferred a conceptualisation of market intervention where sophisticated economic wisdom was incorporated *ex ante* into the design of generalised norms - rules, presumptions, structured tests - that were administrable and comprehensible to businesses. Section IV explores whether this may be attributable to a deeper faith in the formal rule of law. Indications of such in later Chicagoan writing can be substantiated either by tracing the ideal back to the more metaphysical writing of earlier Chicago School economists, or via Posner's economic analysis of the rule of law as the optimal form for incentive calibration. A brief conclusion sketches the limits of the Chicago School for justifying a particular formal conceptualisation of market interventions, thus signalling the way to German Ordoliberalism.

## II. The History, Approach, and Implications of the Chicago School of Antitrust

There are pitfalls aplenty in attempting to trace the contours of schools of thought.<sup>13</sup> Frequently they invite 'slovenly stereotype[s]' that disregard heterogeneity.<sup>14</sup> Such reservations are justified in the instance at hand: accurately and faithfully portraying the Chicago School of antitrust is far from straightforward. It of course pivots upon the output of scholars directly affiliated with the University of Chicago Law School, particularly Robert Bork, Richard Posner, and Frank Easterbrook, especially from the 1950s to the 1980s. But it also has roots in the related Chicago School of Economics stretching back to the 1920s, implicating many figures less familiar to competition scholars. The geographic pull of Illinois for Chicagoan ideas was also rather weak: many lawyers and economists based at other US universities contributed to its intellectual development.<sup>15</sup> Furthermore, the concrete policy recommendations offered by Chicago School writers for US antitrust were far from homogenous.<sup>16</sup>

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<sup>13</sup> Crane [2009] 1915.

<sup>14</sup> Stigler [1962] 70. On abandoning labels altogether: Wright [2012].

<sup>15</sup> Samuels [1976] 6; Crane [2009] 1915.

<sup>16</sup> Williamson [1983b] 211-213; Kovacic [2007] 10; Kobayashi and Muris [2012] 154, 171-172; Wright [2012] 244. Posner disagreed with key Chicagoan arguments: [1974] 506 (their disbelief in exclusionary practices by a dominant firm was 'overstated'); [1976] 171; [2001] 4; Kovacic [2007] 10-11; Crane [2009] 1917-1918;

Such caveats noted, this section A) provides a brief account of the historical development of the Chicago School, B) depicts the nature of their approach, and C) highlights the major substantive implications of their writing for competition law.

A) A Brief History of the Chicago School<sup>17</sup>

The Chicago School of *antitrust* was an offshoot from the body of interwar scholarship often referred to as the Chicago School of *economics*.<sup>18</sup> From the 1920s Chicago developed a reputation as the 'extreme vanguard'<sup>19</sup> of the kind of neo-classical price theory that formed the basis of the previous chapter. This was largely the result of scholarship by Frank Knight,<sup>20</sup> Jacob Viner,<sup>21</sup> and Henry Simons.<sup>22</sup> Knight and Simons were particularly prominent guardians of the price mechanism against the growing advocacy of central economic direction and eager intervention. Knight's concretisation of a Chicagoan 'style' of neo-classical microeconomic analysis deeply influenced his Nobel laureate students Milton Friedman and George Stigler.<sup>23</sup> The latter's work on industrial concentration, oligopoly theory, and barriers to market entry provided especially important economic foundations to the later legal writing of the Chicagoan antitrust scholars. Simons' importance for the subsequent Chicago School of antitrust – as well as "law & economics" generally - was more organisational. As the first economist at the Chicago Law School, he set an interdisciplinary precedent for years to come.<sup>24</sup> He was also instrumental in the appointment of another economist, Aaron Director, to the Law School in 1946 through a recommendation to Friedrich Hayek who had secured funding for a new institute.<sup>25</sup>

Aaron Director was arguably the most important protagonist in the development of the Chicago School of antitrust,<sup>26</sup> acting as the intellectual bridge between the old Chicago School of economics and a series of influential publications that would fundamentally

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Kobayashi and Muris [2012] 154, 167. Posner particularly disputed the permissive approach to predation, highlighting the importance of strategic consequences: [1974] 516-517; [1976] 185-186; [1979] 939-940.

<sup>17</sup> For historical accounts: Kitch [1983]; Coase [1993]; Duxbury [1995] chapter 5.

<sup>18</sup> For accounts of the Chicago School of *economics*: Miller [1962]; Samuels [1976].

<sup>19</sup> Samuels [1976] 3-4.

<sup>20</sup> eg Knight [1922]; [1923].

<sup>21</sup> eg Viner [1927]; [1931].

<sup>22</sup> eg Simons [1936]; [1941]; [1945].

<sup>23</sup> Duxbury [1995] 333-334.

<sup>24</sup> Katz [1946] 2-3; Coase [1993] 242-243; Duxbury [1995] 335.

<sup>25</sup> On Director's involvement in the US publication of Hayek's *The Road to Serfdom* and later appointment at Chicago: Coase [1993] 246; Duxbury [1995] 342.

<sup>26</sup> Posner [1979] 925 (It is Director to whom the 'basic features of the Chicago School of antitrust analysis are attributable.')

alter opinions of US law. Legend goes that Director used his invitation to the antitrust law course as an opportunity to demonstrate to students that overbroad legal prohibitions made little economic sense.<sup>27</sup> Over many years he recruited a generation of young legal scholars to follow his clarion call that ‘the conclusions of economics do not justify the application of the antitrust laws in many situations in which the laws are now being applied.’<sup>28</sup> Although publishing very little himself, Director provided the inspiration behind several seminal articles written by his students from the 1950s to the 1970s,<sup>29</sup> many in the *Journal of Law & Economics* that he founded in 1958. The disparate pieces on various economically-problematic facets of US antitrust policy were woven into comprehensive recommendations of a distinctive Chicago “School” with the publication of two monographs towards the end of the 1970s: Richard Posner’s *Antitrust Law* and Robert Bork’s *The Antitrust Paradox*.<sup>30</sup> The latter has come to be regarded as the ‘most orthodox’ account of the Chicago School of antitrust,<sup>31</sup> and is perhaps the most influential book in the history of competition law scholarship.<sup>32</sup>

Despite initially appearing as ‘little better than a lunatic fringe’,<sup>33</sup> these articles and monographs eventually had a tangible influence upon the law. Following the US Supreme Court’s watershed *Sylvania* [1977] ruling removing non-price vertical restraints from the ambit of *per se* illegality,<sup>34</sup> decades-old precedents were sequentially re-evaluated by judges who had clearly absorbed the scholarly output of Chicagoan authors.<sup>35</sup> The 1981 appointment of William Baxter, a Chicago adherent, to head the Antitrust Division also saw reduced prosecutions by the Department of Justice for practices viewed benignly by the Chicago School.<sup>36</sup> In the same year Bork brazenly declared that the ‘intellectual war has been won’, a ‘final and irreversible’ victory.<sup>37</sup> This

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<sup>27</sup> Duxbury [1995] 344. For a first-hand account: Bork [1993a] xii.

<sup>28</sup> Director and Levi [1956] 282.

<sup>29</sup> Peltzman [2005]; Kobayashi and Muris [2012] 151. Director’s inspiration is often explicit in the acknowledgements: Bowman [1957] 19 (Director encouraged interest, provided the theory, and an application); McGee [1958] 138 (Director suggested a logic-based argument which McGee investigated with a specific case); Telser [1960] 86 (Director recommended the case study and provided assistance); [1965] 488; Bork and Bowman [1965] 366; Posner [1973a] xi; Bork [1978] xv (‘the seminal thinker in antitrust economics’).

<sup>30</sup> Posner [1976]; Bork [1978] (the main elements of this were settled in the late sixties, though delayed by personal matters and Bork’s appointment as Solicitor-General).

<sup>31</sup> Posner [1979] 926.

<sup>32</sup> eg Kovacic [1990] 1416-1417; Priest [2014] S1, S7. For a critical take: Baker [1989].

<sup>33</sup> Posner [1979] 931.

<sup>34</sup> *Continental Television v GTE Sylvania* (1977) 433 US 36 (“*Sylvania* [1977]”).

<sup>35</sup> Crane [2009] 1911-1912; Priest [2014] S1 (on the *Antitrust Paradox* as the most influential work upon the US Supreme Court in any field of law).

<sup>36</sup> Crane [2009] 1912.

<sup>37</sup> Bork [1981] 181.

was a rather premature claim as with influence came resistance.<sup>38</sup> Their most prominent bulwark was professor and judge Frank Easterbrook, who fiercely defended the Chicago School approach throughout the more hostile academic environment of the 1980s. Notwithstanding such opposition, since the 1990s it has become clear that ‘there exists very little in the way of contemporary antitrust theory which has not been inspired to some degree by Chicago economic analysis.’<sup>39</sup> Whether this inspiration is more as friend or foil is an open question.<sup>40</sup>

*B) The Chicagoan Approach: Economic Method and Legal Motivation*

Reading *The Antitrust Paradox*, one would think that before the Chicago School US antitrust law and scholarship was devoid of economic underpinnings.<sup>41</sup> This is, of course, far from correct.<sup>42</sup> Rather than a novel “discovery” of economics, the influential change brought about by the Chicagoan approach consisted of: i) an economic method that put much greater emphasis upon the explanatory power of the theoretical assumptions of neo-classical price theory; and ii) an exclusive reliance upon total economic welfare (ie efficiency) as the motivation behind market intervention.

*i) Economic Method: Trust Assumptions*

The previous chapter highlighted the dialectic tension within competition microeconomics between abstract neo-classical price theory and practical industrial organisation economics (“IO”). Post-war the pendulum had very much swung towards an inductive and descriptive form of antitrust IO. This “Harvard School” style relied heavily upon empirical data to ‘take account of the richness of the real world’.<sup>43</sup> In contrast, since the 1920s economics at Chicago under Knight and Viner maintained faith in orthodox neo-classical price theory,<sup>44</sup> ie deductions based upon simple assumptions of rationality, profit maximisation, downward-sloping demand, and so on.<sup>45</sup> This methodological commitment was continued by Aaron Director, deployed to deconstruct

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<sup>38</sup> See Section III.C.

<sup>39</sup> Duxbury [1995] 349.

<sup>40</sup> For a critical collection: Pitofsky [2009].

<sup>41</sup> eg Bork [1978] 6-7 (the need to read antitrust ‘in light of the disciplines of law and economics’); [1993a] xvi (‘Chicagoans applied economic analysis more rigorously than was common’), xiii (‘Few economists ever looked seriously at antitrust’).

<sup>42</sup> Kaplow [1987] 184; Hovenkamp [1985] 217-223; [2002] 1-3. As recognised by: Director and Levi [1956] 282 (‘the antitrust laws have been greatly influenced by economic doctrine’, albeit wrong).

<sup>43</sup> Peeperkorn and Verouden [2014] 5. For a Chicagoan take: Posner [1979] 928-929, 931 (a ‘microscopic examination of the idiosyncrasies of particular markets.’).

<sup>44</sup> Stigler [1974] 170; Samuels [1976] 3-4, 11.

<sup>45</sup> Posner [1979] 931.

and discredit numerous *per se* rules of antitrust prohibition throughout the 1950s and 1960s.<sup>46</sup> Bork's *Antitrust Paradox* was explicit in its adoption of neo-classical price theory as he found it the only body of knowledge capable of separating anticompetitive business practices from those that are efficient;<sup>47</sup> in this way, the 'simple ideas' of microeconomics were also the most 'powerful'.<sup>48</sup>

The Chicagoan embrace of neo-classical price theory as the primary method for understanding the nature and scope of competition policy is often legitimately highlighted as a core element of the School.<sup>49</sup> But they arguably did themselves few favours by proclaiming such blanket statements, inviting facile criticism of themselves as theoretical daydreamers, idly drawing curves and ignoring business behaviour at the coalface.<sup>50</sup> In reality, the Chicago School take on neo-classical price theory was intended to be empirically-substantiated and practically focused, addressing issues of organisation and market behaviour albeit from a *prima facie* abstract and deductive perspective.<sup>51</sup> Chicagoan scholars regularly engaged in empirical research, whether to test the veracity of or inductively build their theoretical arguments.<sup>52</sup>

The Chicago School method of invoking neo-classical price theory is perhaps best understood as a renewed faith in the explanatory power of these empirically-grounded economic assumptions: if businesses are rational profit maximisers, what reasons do they have to engage in conduct X?<sup>53</sup> If rivals and potential entrants are also rational profit maximisers, and inelastic consumers respond to price increases by purchasing elsewhere, how safe is an inefficient monopolist, and will attempts to exclude more

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<sup>46</sup> *ibid* 928 ('Director's conclusions resulted simply from viewing antitrust policy through the lens of price theory.');

Bork [1993a] xii.

<sup>47</sup> Bork [1978] 117 ('To abandon economic theory is to abandon the possibility of rational antitrust law').

Similarly: Posner [1979] 932 ('the proper lens for viewing antitrust problems is price theory.').

<sup>48</sup> Bork [1978] 90.

<sup>49</sup> Wright [2009] 10.

<sup>50</sup> eg Fox and Sullivan [1987] 936-937 (a 'sweeping set of theoretical assumptions' out of touch 'with the changing business environment').

<sup>51</sup> Friedman [1953] (defending assumptions if they are reasonable predictions of reality); Stigler [1959] 529-530 (dismissing the 'completely formal theorist' and advocating the 'empirical study of economic life'); Samuels [1976] 4, 8 (quoting Friedman on Chicagoan use of theory to analyse "concrete problems, rather than as an abstract mathematical structure of great beauty but little power").

<sup>52</sup> On empirically testing their theories: Samuels [1976] 8 (quoting Friedman: Chicago "insists on the empirical testing of theoretical generalizations and [rejects] alike facts without theory and theory without facts."); Easterbrook [1984b] 151 ('At Chicago no economic model is worth much without testing.');

[1986] 1701; Wright [2009] 11; Kobayashi and Muris [2012] 152.

<sup>53</sup> Posner [1979] 928, 931; Peltzman [2005] 329.

efficient competitors be successful?<sup>54</sup> Taking assumptions seriously generated a method of antitrust analysis profoundly sceptical of claims that certain types of behaviour ought to be necessarily deemed illegal, lacking in pro-competitive explanation or the potential for remedial market self-correction.<sup>55</sup>

*ii) Legal Motivation: Allocative and Productive Efficiency*

A second aspect of the Chicago School's approach was a belief that antitrust policy should be animated solely by the goal of maximising overall efficiency.<sup>56</sup> Although (deliberately?) obscured by the language adopted by Bork,<sup>57</sup> this meant the *total* societal welfare of neo-classical price theory, ie the combination of *allocative efficiency* (resources optimally directed to outputs most desired by consumers) and *productive efficiency* (eg low production costs, consumer benefits). Advocacy of efficiency as the sole motivation for market intervention has been a long-standing aspect of the Chicagoan approach to competition policy.<sup>58</sup> And despite continual resistance from certain scholars,<sup>59</sup> achieving widespread support for this proposition is perhaps the Chicago School's key legacy.<sup>60</sup>

The case for efficiency-animated antitrust was most forcefully advanced by Bork. Synthesising various aspects of an argument that he had been making since the mid-1960s,<sup>61</sup> in *The Antitrust Paradox* he strongly asserted that the 'only legitimate goal of American antitrust law is the maximization of consumer welfare',<sup>62</sup> ie the total combination of allocative and productive efficiency.<sup>63</sup> His main foils were various US court judgments deciding antitrust liability on the basis of the economic freedom of atomistic markets or supporting the welfare of small competitors:<sup>64</sup> Justice Peckham's 'small dealers and worthy men' in *Trans-Missouri* [1897];<sup>65</sup> Judge Hand's protection of

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<sup>54</sup> Duxbury [1995] 344-345 (summarising Director); Hovenkamp [2002] 3. Also: Easterbrook [1986] 1701 ('Competition is harder than you think. The desire to make a buck leads people to undermine monopolistic practices').

<sup>55</sup> Easterbrook [1986] 1701; Peltzman [2005] 328-329.

<sup>56</sup> Bork [1993a] xi.

<sup>57</sup> On his questionable use of "consumer welfare": Lande [1988] 434-435; Fox [1986b] 1715; Priest [2014].

<sup>58</sup> eg McGee [1971] 137; Posner [1971] 505-506; [1976] 4, 18-22; Easterbrook [1986] 1703-1704.

<sup>59</sup> Pitofsky [1979] 1051; Rowe [1984]; Fox [1986a]; [2002] 77; Fox and Sullivan [1987]; Adams and Brock [1987] 1116-1117.

<sup>60</sup> Hovenkamp [1985] 234; Kovacic [1990] 1450. For self-congratulation: Bork [1993a] xiv; Posner [2001] ix.

<sup>61</sup> Bork and Bowman [1965] 365; Bork [1965b] 831.

<sup>62</sup> Bork [1978] 50-51. See also: 89, 405.

<sup>63</sup> *ibid* 405.

<sup>64</sup> *ibid* 7. Against academics advancing the same: Bork [1965a] 413-415.

<sup>65</sup> *US v Trans-Missouri Freight Association* 166 US 290 (1897) ("Trans-Missouri [1897]").

minor firms 'for its own sake and in spite of possible cost' in *Alcoa* [1945],<sup>66</sup> or Justice Warren's 'protection of viable, small, locally-owned businesses' in *Brown Shoe* [1962].<sup>67</sup> For Bork, these were political judgments, 'an ugly demand for class privilege'<sup>68</sup> or 'uncritical sentimentality about the "little guy"',<sup>69</sup> entirely overlooking the *total* efficiency implications. While judicial protection of small businesses may promote *allocative* efficiency, they failed to give due weight to *productive efficiency*.<sup>70</sup> Only by adopting total efficiency as the single 'common denominator' by which to evaluate business practices, jettisoning incommensurable romantic political ideals of artisan craftsmen, was it possible for market intervention to be coherent.<sup>71</sup> Solely through affording equal weight exclusively to the combined trade-off between allocative and productive efficiency could the law avoid the paradoxical outcomes that gave Bork's book its title. This aspect of the Chicagoan approach has been so persuasive that even a noted critic warned advocates of multiple enforcement goals 'to proceed very careful if antitrust is not to become a meaningless hodge-podge of conflicting, inconsistent, and politicized mini-policies.'<sup>72</sup>

### C) Legal Implications of the Chicago School Approach

The Chicago School's approach of combining a method that took seriously the assumption of rational business profit maximisation from neo-classical price theory with an exclusive concern for market intervention to foster overall efficiency had substantial implications for the law: generally it was over-inclusive in adopting rule-based, *per se* prohibitions.<sup>73</sup>

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<sup>66</sup> *US v Aluminum Co of America* 148 F 2d 416 (2d Cir 1945).

<sup>67</sup> *Brown Shoe Co Inc v US* 370 US 294 (1962) ("*Brown Shoe* [1962]"). Similarly: Posner [1976] 104 (a 'social objection' to mergers).

<sup>68</sup> Bork and Bowman [1965] 370. For other allegations of "political" antitrust: Posner [1971] 505-506; [1976] 18-22; Easterbrook [1986] 1703-1704. Questioning efficiency-focused antitrust as apolitical: Fox [1986a]; [1986b]; Fox and Sullivan [1987] 957.

<sup>69</sup> Bork [1978] 54.

<sup>70</sup> *ibid* 7-8, 135 ('Considering only one vector in a two-vector situation'), 405 ('probably the major reason for the deformation of antitrust's doctrines.').

<sup>71</sup> *Ibid* 79, 405. See also: Bork [1965b] 832; Posner [1971] 506; Easterbrook [1986] 1703.

<sup>72</sup> Hovenkamp [1985] 234.

<sup>73</sup> Hovenkamp [2002] 3 (Chicagoans 'pointing out the economic nonsense').

i) *Market Structure*

On the structure of markets, Chicagoans argued that the frequent prohibition of horizontal mergers<sup>74</sup> and proposals for industrial deconcentration<sup>75</sup> overlooked the possible connection between size and efficiency.<sup>76</sup>

Suspicion of large firms throughout the 1950s and 1960s was based upon empirical studies in the tradition of the Harvard School's IO microeconomics, finding that oligopolistic markets persistently secured supra-competitive profits, perhaps through the parallel limitation of output.<sup>77</sup> This approach to the nefarious effect of market concentration reflects the "structure-conduct-performance" paradigm: because a concentrated market structure determined the conduct of actors, and their conduct determined the competitiveness of the market, a highly concentrated market structure therefore logically also determined market performance; the actual conduct of businesses thus falls away from the concern of competition policy as a mere inevitability of concentration.<sup>78</sup>

Application of Chicago School thinking sought to make Harvard's fascination with deconcentration 'intellectually bankrupt'.<sup>79</sup> Methodological critique and rival empirical research by the wider Chicago School of economics - especially Yale Brozen, Harold Demsetz, and George Stigler - challenged the common distrust of market concentration.<sup>80</sup> Rather than presuming anticompetitive conduct, large profits and market share expansion to even very high levels could be the result of efficiency, whether substantial economies of scale to operate at lowest production costs, managerial talent, technological superiority, or simply giving consumers the best

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<sup>74</sup> eg *Brown Shoe* [1962]. See: Posner [1976] 100-105; Bork [1978] chapter 9 (probably the 'worst antitrust essay ever written').

<sup>75</sup> In 1968 a Task Force on Antitrust Policy recommended new legislation for divestiture where fewer than four firms together held market shares of over 70 per cent: Brozen [1970]; McGee [1971].

<sup>76</sup> This trade-off was noted in Chapter I, Section III.B. The Chicagoan economists of the 1920s to 1940s had a more varied perspective on concentration: Miller [1962] 65. Knight was in line with later scholars: [1944] 361-362; [1960] 98. Simons was more willing to intervene: [1936] 70-71 ('a breaking down of enormous integrations'); [1941] 205-206; Davenport [1946] 6 (quoting Simons on 'gigantic corporations' as the 'great enemy of democracy'). For discussion: Kitch [1983] 178; Coase [1993] 241.

<sup>77</sup> Brozen [1969a] 124-125; [1970] 279; Duxbury [1995] 352-354; Hovenkamp [2008] 35-37; Peepkorn and Verouden [2014] 5.

<sup>78</sup> Hovenkamp [2008] 36-37; Peepkorn and Verouden [2014] 7.

<sup>79</sup> Bork [1977a] 874. Director and Levi had defended the efficiency of monopoly in the absence of barriers to entry: Director and Levi [1956] 285.

<sup>80</sup> Peepkorn and Verouden [2014] 6-7. For empirical refutation of Harvard: Brozen [1970]; [1974].

product.<sup>81</sup> To legally condemn this success was to suggest that 'firms should compete but should not win'.<sup>82</sup> Chicagoans argued that it was natural for firms incapable of rivalling these efficiencies to be excluded from the market.<sup>83</sup> And as barriers to potential entry by new firms had been overstated by Harvard economists,<sup>84</sup> if market share and profits were not based on efficiency they would invite new entrants. In other words, the problem would be self-corrected by market forces.<sup>85</sup>

Translated into concrete competition policy, the Chicago School of antitrust suggested a hands-off approach to horizontal mergers lest productive efficiencies occasioned by size and success be threatened through over-eager fragmentation.<sup>86</sup> In essence, 'whenever monopoly would increase efficiency it should be tolerated, indeed encouraged'.<sup>87</sup> Vertical mergers were also considered overwhelmingly pro-competitive phenomena that ought to be subject to little oversight as fears of competitor foreclosure or more difficult entry were overstated.<sup>88</sup> This relaxed stance towards integration between different levels of the market was largely derived from Coase's theory that the boundaries of firms were determined by whether it was more efficient to contract under the price mechanism or internalise processes to avoid higher market transaction cost.<sup>89</sup>

### *ii) Business Conduct*

In terms of policing collusive or unilateral business conduct, the Chicago School dismissed antitrust's lazy legal stance of *prima facie* 'inhospitality' towards any behaviour that might injure or exclude competitors.<sup>90</sup> Greater recourse to the assumption of rational profit maximisation, the robustness of market forces (consumers,

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<sup>81</sup> Brozen [1969a] 125-131; [1969b] 6; [1974] 390-391; Demsetz [1968]; [1973] 1-5; [1974]; [1976] 372-375; McGee [1971]; Posner [1973a] 129-130; [1976] 22; Peltzman [1977]; Bork [1977a] 878.

<sup>82</sup> Brozen [1969b] 7. See also: Demsetz [1973] 3 (on the importance of the incentive for short-term monopoly profit for driving competition); [1974] 179; [1976] 383; McGee [1974] 95.

<sup>83</sup> Brozen [1969b] 6; Bork and Bowman [1965] 375; Bork [1978] 49, 136-137.

<sup>84</sup> Posner [1979] 946. This was largely based on the regulatory theory of: Stigler [1971]. Chicagoans commonly found the most pervasive barriers to entry to be governmental at the behest of businesses: Demsetz [1974] 164-165, 181-182; Epstein [1997]. For public choice theory: Chapter IV, Section IV.B.ii.

<sup>85</sup> Stigler [1958a] 55-56 (his 'survivor technique' for finding the optimal size of firm as that which resisted actual and potential rivals); Brozen [1969b] 8-9; [1970] 284; McGee [1958] 142 ('Entry is the nemesis of monopoly'); [1971] 136; [1974] 91-94; Demsetz [1973] 1; [1992] 213-214; Posner [1971] 528-529; [1979] 945-946; Bork [1978] 179, 196.

<sup>86</sup> Demsetz [1973] 4-5; [1974] 179; [1976] 375; Posner [1973a] 129-130; [1976] 89-91; Peltzman [1977] 262-263; Bork [1978] 56 ('a tax upon consumers for the benefit of some producers'), 179 ('If dissolution would destroy significant efficiencies, the cure may be worse than the disease').

<sup>87</sup> Posner [1976] 22.

<sup>88</sup> Bork [1954]; [1978] 226-227; Posner [1976] 196-201.

<sup>89</sup> Coase [1937]. Developed by: Williamson [1968] 32-33; [1977].

<sup>90</sup> Easterbrook [1984a] 4-7.

rivals, potential entrants), and the prevalence of productive efficiencies again led the Chicago School to instead advocate a lesser scope for *per se* prohibition.

Perhaps their most influential claims related to vertical restraints in contracts between, for instance, a manufacturer and independent retailers relating to price, location, store display, and so on. The Chicago scholars argued that these terms should be generally outside legal condemnation.<sup>91</sup> Restrictions on sellers are *prima facie* counterintuitive for many manufacturers as self-imposed limitations hinder the sale of more products, which might suggest malevolent intent. But building upon Director's method of taking the assumption of rational profit maximisation seriously, vertical restraints were reconceptualised by Chicagoans as positive means to ensure additional sales services that customers valued by avoiding non-compliant dealers free-riding on the efforts of others.<sup>92</sup> Restraints on *intra-brand* competition between distributors were argued to enhance *inter-brand* competition through facilitating greater non-price product differentiation.<sup>93</sup> And as all forms of vertical restraints were substitutes, this Chicagoan claim was to apply across-the-board,<sup>94</sup> including to resale price maintenance.<sup>95</sup>

Similar scepticism was cast upon supposed attempts by large firms to exclude rivals and cement their market position. In their 1956 article, Director and Levi laid the foundations for the Chicagoan approach to exclusionary conduct by arguing that the hardness of market forces made them unlikely to succeed.<sup>96</sup> Indeed, many condemned practices could actually be considered legitimate competitive practices for all firms, large or small, that excluded simply inefficient rivals whilst offering consumer benefits.<sup>97</sup> For instance, rather than an anticompetitive attempt to leverage power from one market to another, tying was a potentially efficient means to reduce the cost of providing complementary products, to ensure compatibility, and a consumer

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<sup>91</sup> Bork [1966]; [1978] 288-289; Easterbrook [1984b] 135; Demsetz [1992] 215-216. Posner agreed but highlighted their possible facilitation of cartels: Posner [1976] 147-166.

<sup>92</sup> This argument was initially developed for resale price maintenance (Bowman [1955]; Telser [1960] 91-92) but was expanded to account for all vertical restraints: Bork [1966]; [1977b] 180-182; [1978] 289-291; Posner [1976] 148; [1977a] 3-7; Demsetz [1992] 215-216.

<sup>93</sup> Bowman [1955].

<sup>94</sup> Bork [1966] 404-405.

<sup>95</sup> Bowman [1955]; Telser [1960]; Bork [1966] 453; [1967a] 731; [1977b] 173; Posner [1976] 283-285; Demsetz [1992] 216. cf Peeperkorn [2008] 205.

<sup>96</sup> Director and Levi [1956] 290. Followed by: Bork and Bowman [1965] 367 (prohibitions based on 'hearsay and legends rather than on reality.); Posner [1974]; [1976] 171; Bork [1978] 137 ('the theory of automatically exclusionary practices is entirely without merit.); Easterbrook [1986] 1701.

<sup>97</sup> Bork and Bowman [1965] 366; Telser [1965] 504; Bork [1978] 134-135 ('the infliction of injury upon rivals' is also a 'means by which productive efficiency is created').

convenience.<sup>98</sup> Even without pro-competitive efficiency explanations, it was unlikely to succeed.<sup>99</sup> Predatory pricing was also deemed improbable owing to the instigator sustaining much heavier losses than the prey that were unlikely to be recouped in the future, thus conflicting with the assumption of profit maximisation that would render direct acquisition a more rational course of action.<sup>100</sup> To be sure, the Chicagoan views of supposedly exclusionary practices were not impossibility theorems; sometimes firms *would* act irrationally.<sup>101</sup> But exclusionary conduct was improbable and unlikely to succeed, leaving market intervention perhaps not worth the effort.<sup>102</sup>

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In summary, the Chicagoan message was that antitrust condemned concentrations and conduct unlikely to have anticompetitive consequences owing to robust market forces and rational profit maximisation, whilst also chilling potential efficiencies beneficial to consumers. As a result, the scope of antitrust liability through *per se* rules ought to be substantially narrowed, and predominantly directed towards cartels and horizontal mergers to monopoly.<sup>103</sup>

### III. The Chicagoan Rejection of *ad hoc*, Subject-Specific Determinations of Legality

The foci of Chicagoan scorn were the numerous market practices subject to blanket, *per se* prohibition by antitrust law. As seen in the previous section, deductions from microeconomic theory suggested to the Chicago School that they were efficient at best, at worst subject to market self-correction. It is therefore understandable why the US Courts would absorb this *substantive* critique of the overbroad reach of legal prohibition and thus adopt a *form* of market intervention that facilitated closer scrutiny of their actual impact on the market for determining legality: *ad hoc*, subject-specific analysis of whether, on balance, the practice in question would reduce overall market efficiency.

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<sup>98</sup> Bowman [1957]; Telser [1965] 490; Posner [1976] 171-184; Bork [1978] 380-381.

<sup>99</sup> Peltzman [2005] 322-324.

<sup>100</sup> McGee [1958]; Telser [1965] 495; Bork [1978] 144-154; McGee [1980] 291-300; Easterbrook [1981b].

<sup>101</sup> Peltzman [2005] 318.

<sup>102</sup> eg Bork [1978] 154 (on predation).

<sup>103</sup> *ibid* 405 (also including 'deliberate predation'); Posner [1979] 928, 933 (this was the 'orthodox Chicago position'); Demsetz [1981] 24; Easterbrook [1986] 1701; Hovenkamp [2002] 3. Again, note the extent of disagreement on this, particularly from Posner: see fn 16.

Despite the ease of the mistake, this judicial response to their writing was simply not an accurate representation of the Chicagoan understanding of the relationship between law and economics in antitrust. On the basis of underappreciated views as to the legitimate *form* that antitrust law ought to take, A) Posner, B) Bork, and C) Easterbrook all explicitly rejected this means for determining legality as unworkable for decision-makers and unpredictable for businesses. What they proposed instead was *ex ante* incorporation of economic learning into general norms which, despite imperfectly distinguishing between efficient and inefficient conduct in every instance, overall reconciled efficiency-driven antitrust with the desiderata of legal certainty and administrability.

#### A) Posner's Response to *Sylvania*

The US Supreme Court's *Sylvania* [1977]<sup>104</sup> decision is often thought to be one of the Chicago School's most important victories.<sup>105</sup> Nevertheless, to understand their approach to competition policy it is crucial to note that this was a partial triumph: as the response of Posner clearly demonstrates, the Chicagoans agreed that they had (almost) won the battle on the substantive economic approach to vertical restraints, but not on the resultant form of market intervention.

*Sylvania* represented the US Supreme Court fundamentally altering the law's treatment of vertical restraints that had been resolutely negative only a decade previously in *Schwinn* [1967].<sup>106</sup> Citing Bork and Posner, it accepted the Chicago argument that vertical restraints were generally beneficial, stimulating inter-brand product differentiation through guaranteeing extra sales services by preventing free-riding.<sup>107</sup> As a result, the rule-based *per se* prohibition of non-price vertical restraints - in this instance, location clauses - was inappropriate and was thus overruled. There was some disappointment that resale price maintenance continued to be prohibited *per se*,<sup>108</sup> and a degree of initial hesitancy that US antitrust would really shake the overly broad application of automatic illegality.<sup>109</sup> Still, Bork and Posner were delighted with the

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<sup>104</sup> *Sylvania* [1977].

<sup>105</sup> eg M Waelbroeck [1985] 45 ('to a large extent attributable to the advent of the Chicago School'); Whish and Sufrin [1987] 9; Kovacic [2007] 61 ('*Sylvania* can be attributed chiefly to the Chicago School.');

<sup>106</sup> *US v Arnold, Schwinn & Co* 388 US 365 (1967).

<sup>107</sup> See text accompanying fn 91-95.

<sup>108</sup> Bork [1977b] 173; Posner [1981] 8-14. This derives from *Dr Miles Medical Co v John D Park & Sons Co* 220 US 373 (1911) and was overruled in *Leegin Creative Leather Products Inc v PSKS Inc* 551 US 877 (2007).

<sup>109</sup> Bork [1977b] 171.

economics underpinning the substance of the ruling and how it indicated a radical redirection towards efficiency-focused antitrust.<sup>110</sup>

Nevertheless, what has often been overlooked when considering *Sylvania* as a Chicagoan triumph is that Posner fundamentally disagreed with the proposed *form* of market intervention for determining legality. The Supreme Court removed non-price vertical restraints from the frying pan of *per se* condemnation and placed them into the fire of the “rule of reason” standard, as articulated by Judge Brandeis in *Chicago Board of Trade* [1918]:<sup>111</sup>

*‘The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.’*

The Supreme Court in *Sylvania* gave little indication as to how this standard was to be applied,<sup>112</sup> save for stating that ‘the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.’<sup>113</sup> In essence, legality depended upon an *ad hoc*, conduct-specific evaluation of the effects of the particular restraint in question.

Posner’s immediate response to this form of market intervention was overwhelmingly negative: it was ‘formless’, a ‘poor guide to the decision of restricted distribution cases’, and did not provide ‘usable criteria of illegality’.<sup>114</sup> Rather than case-specific analysis of pro- and anticompetitive consequences, he proposed a more administrable and predictable test comprising three consecutive rules.<sup>115</sup> Yet returning to this issue in 1981 he found even this test difficult to apply and therefore, as anticompetitive consequences were thought highly unlikely, he recommended a rule of *per se* legality to ‘lighten the burden on the courts and to lift a cloud of debilitating doubt’ for businesses unsure of

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<sup>110</sup> Posner [1977a] 5 ('good economics'), 12-13; Bork [1977b] 172; [1978] 287 (exhibiting a 'far higher degree of economic sophistication').

<sup>111</sup> *Chicago Board of Trade v US* 246 US 231 (1918).

<sup>112</sup> Posner [1977a] 13-14.

<sup>113</sup> *Sylvania* [1977] 432.

<sup>114</sup> Posner [1977a] 15-16.

<sup>115</sup> *ibid* 19 (1) small market share is legal; 2) large market share without presale services is illegal; 3) large market share with presale services is illegal if output subsequently fell).

their normative obligations.<sup>116</sup> The intervening years had also amplified his condemnation of determining legality via ‘broad-ranging assessment of all competitive, and perhaps all economic benefits and costs of the challenged practice.’<sup>117</sup> This ‘particularized case-by-case approach’ to lawfulness had fostered ‘considerable legal uncertainty’, thereby deterring efficient and pro-competitive use of vertical restraints.<sup>118</sup> Posner thus deemed the substantive economics underpinning the *Sylvania* decision to be sound, but its form of market intervention to determine legality highly problematic.

It is important to note how Posner’s two proposed alternatives incorporated presumptions from economic research on vertical restraints - the low likelihood of anticompetitive effects, the difficult and error-prone nature of sifting “good” from “bad” - into designing legal norms that were more comprehensible than the rule of reason. Indeed, in the first edition of *Antitrust Law* he suggested that his purpose was to see efficient business practices as outside *per se* prohibition but ‘*without having to compare directly the gains and losses from a challenged practice*.’<sup>119</sup> This can also be gleaned from his recommendations for merger control in the mid-1970s: strong presumptive legality for horizontal mergers below high combined market shares as they are ‘precise’, ‘workable’ and avoid ‘intractable subjects for litigation’;<sup>120</sup> abandoning legal prohibition of acquisition of potential competitors owing to the ‘impossibility of developing workable rules’;<sup>121</sup> and rejecting an efficiencies defence for mergers.<sup>122</sup> Similarly, Posner struggled with the appropriate legal test for predatory pricing owing to administrability issues.<sup>123</sup> His negative response to the form of market intervention introduced by the Supreme Court in *Sylvania* should therefore not have come as a shock. Indeed, two years earlier he claimed that satisfactory legal rules must be ‘reasonably precise’ to

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<sup>116</sup> Posner [1981] 21-23.

<sup>117</sup> *ibid* 7 (‘amorphous’, not ‘a workable standard of decision’), 8 (‘lacks content and so does not provide guidance’, the balancing of competitive effects ‘is infeasible and unsound’), 14 (‘unlimited, free-wheeling inquiry’) cf 15 (perhaps more administrable if applied by experts).

<sup>118</sup> *ibid* 22. See also: 15 (‘A standard so poorly articulated and particularized, applied by tribunals so poorly equipped to understand and apply it, places at considerable hazard any restriction’).

<sup>119</sup> Posner [1976] 22 (emphasis added). See also the second edition: [2001] ix (‘the design of antitrust rules should take into account the costs and benefits of individualized assessment of challenged practices relative to the costs and benefits of rule-of-thumb prohibitions’).

<sup>120</sup> Posner [1975a] 306-313.

<sup>121</sup> Posner [1976] 122. See also: [1975a] 323-324 (‘there is no way of translating this theoretical insight into an objective standard of illegality.’).

<sup>122</sup> *ibid*.

<sup>123</sup> Posner [1976] 188-189.

thereby limit the ‘discretion’ of decision-makers<sup>124</sup> and, pre-empting his critique of *Sylvania*, condemned the Supreme Court for:<sup>125</sup>

*“insensitivity to the practical limitations of the judicial process, which require rules to guide decisions rather than invitations to roam at large through masses of factual materials thrown up by the defense bar.”*

In this way Posner, the figurehead of the “law & economics” movement, refused to determine the application of antitrust law through conduct-specific analysis of economic effects. He was not alone amongst the Chicago scholars in condemning such a form of market intervention.

*B) Bork versus Williamson and his Peculiar Conceptualisation of the Rule of Reason*

Bork’s especial contribution to the Chicago School was to stress that the sole motivation for antitrust law, thus delimiting the scope of liability, was the maximisation of total welfare, the overall combination of allocative and productive efficiency. The overbroad application of *per se* rules of illegality did not take into account the latter efficiency of condemned practices, and therefore ought to be scaled back to primarily naked restraints that had few possible efficiencies.<sup>126</sup> For non-naked (‘ancillary’) restraints, the rule of reason was the appropriate form of antitrust inquiry. But what has not been adequately recognised is that Bork’s conceptualisation of the rule of reason was rather unusual: it certainly did *not* amount to appraising the legality of individual business practices through consideration of their specific pro- and anticompetitive effects.

Despite his notoriety as the doyen of efficiency-informed antitrust scholars, Bork’s aversion to *ad hoc*, conduct-specific determinations of legality should have been obvious from his early dispute with Oliver Williamson.<sup>127</sup> Williamson’s influential 1968 paper, ‘Economies as an Antitrust Defence’, gave graphical representation to the welfare trade-off in horizontal mergers, whereby the loss of allocative efficiency may be outweighed by the productive efficiency of realising economies of scale.<sup>128</sup> He thus proposed the adoption of a productive efficiencies defence for merging parties to show the particular

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<sup>124</sup> Posner [1975a] 282.

<sup>125</sup> *ibid* 325-326 (emphasis added).

<sup>126</sup> eg Bork [1966] 474 (‘misuse of the *per se* concept destroys efficiency’).

<sup>127</sup> For a summary: Heyer [2014] S23-S25. For Williamson’s contribution to New Institutional Economics: Chapter IV, Section IV.

<sup>128</sup> Williamson [1968] 21-22.

positive effects of the concentration counterbalancing any resulting loss of rivalry,<sup>129</sup> alongside a list of other factors for consideration.<sup>130</sup>

In *The Antitrust Paradox*, Bork borrowed Williamson's trade-off graph to explain the consumer welfare approach and to demonstrate how many antitrust problems lead to a reduction in allocative but an increase in productive efficiency.<sup>131</sup> Nevertheless, he was adamant that purely effects-based legal analysis was not the appropriate form that 'efficiencies are to be given weight by law'.<sup>132</sup> To determine legality on the basis of the efficiency consequences of a specific practice would be to demand the impossible of both antitrust decision-makers and subjects; Bork argued that thoroughly unpredictable and unworkable market intervention would be the result as it was impossible to reliably quantify efficiencies, even by defendant firms themselves.<sup>133</sup> Williamson refused to favour administrability over accurate sifting between pro- and anti-competitive conduct in each instance, accused Bork of overstating the volatility of directly addressing the inevitable efficiency trade-off, and rather baldly claimed that over time the courts would somehow work it all out.<sup>134</sup>

For Bork, the alternative to consideration of conduct-specific efficiency consequences for determining legality was to incorporate economic analysis *ex ante* into generalised norms – rules, presumptions, cumulative filters – that were therefore also administrable and comprehensible: the aim of *The Antitrust Paradox* was to 'show that rules can be devised which reflect and resolve the tension between productive and allocative inefficiency accurately enough for the law to confer a net benefit', to thus 'balance the tradeoff considerations through *general legal rules*'.<sup>135</sup> Bork's writing offers numerous examples. Predatory pricing was unlikely to be rational or effective, and therefore introducing potentially erroneous and 'unworkable' cost tests were not worth the

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<sup>129</sup> *ibid* 33-34.

<sup>130</sup> *ibid* 25-32 (timing, future expansion, incipient stalling of market-wide trends, social discontent, control of wealth, quality of life in a democracy, technological progress).

<sup>131</sup> Bork [1978] 107-110, 125.

<sup>132</sup> *ibid* 125. For the same argument with others: [1965a] 410-412.

<sup>133</sup> *ibid* 125-126 (courts would have to estimate efficiency and deadweight loss in the actual and hypothetical scenarios when 'Passably accurate measurement' of either 'is not even a theoretical possibility'). See also: [1965a] 410 ('the attempt to measure efficiencies directly would cause the trial process to denigrate into industry studies and economic extravaganzas that would clearly make the law largely unenforceable.); [1966] 386-397; [1977a] 879 (whilst the productive efficiency of economies of scale might better lend itself to this approach, superior products, technology, and management would not),

<sup>134</sup> Williamson [1968] 19, 24, 34; [1969]. For a partial concession: [1977] 734-735.

<sup>135</sup> Bork [1978] 129 (emphasis added). See also: [1965a] 411 ('It is enough to know in what sorts of transactions efficiencies are likely to be present and in what sorts anticompetitive effects are likely to be present. The law can then develop objective criteria....').

hassle.<sup>136</sup> It was impossible to rigorously prove that never, under any circumstances, would resale price maintenance have an anticompetitive effect, but the most rational explanation for its use on balance was to provide additional sales services, thus justifying an overall lack of legal concern.<sup>137</sup>

The most prominent example of such logic was the *per se* rule of illegality for naked price-fixing agreements. This Bork and Bowman considered a 'model' law, reconciling the economic consensus on cartels with delivery through a 'relatively clear, workable rule'.<sup>138</sup> That price-fixing or output-limiting agreements could generate productive efficiencies or might be doomed to failure through instability or a lack of market power was entirely irrelevant;<sup>139</sup> economics suggested that allocative inefficiency would result in the overwhelming majority of instances so there was no point, on balance, wasting resources abandoning the simple *per se* rule of prohibition.<sup>140</sup> The inevitably inaccurate overreach of responding via rule-based market intervention was therefore justified 'not only on economic grounds but also because of the rule's clarity and ease of enforcement'.<sup>141</sup>

But if Bork strongly argued against conceptualising the appropriate form of antitrust intervention as *ad hoc*, subject-specific decision-making, what is to be made of his clear support for the (purely economic)<sup>142</sup> rule of reason standard, where legality is dependent upon 'the effect [business] behaviour was likely to have, considering the market context'?<sup>143</sup>

It is crucial to note that Bork's advocacy of this means for determining legality was conditional upon his unorthodox understanding of what the rule of reason entailed. Rather than the formulation of Judge Brandeis from *Chicago Board of Trade* [1918] as

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<sup>136</sup> Bork [1978] 154-155.

<sup>137</sup> Bork [1967a] 732; [1968] 963-964.

<sup>138</sup> Bork and Bowman [1965] 366.

<sup>139</sup> *ibid.* cf Director and Levi [1956] 294-295 (questioning the *per se* condemnation of cartels that do not cover a substantial share of the market).

<sup>140</sup> Bork [1965a] 410; [1966] 384-385, 387; [1978] 286. This is why Bork considered the rejection of a 'reasonableness' standard by Justice Peckham in *Trans-Missouri* [1897] (cf Priest [2014] S7-S8 on historical inaccuracy) and Judge Taft in *Addyston Pipe & Steel Co v US* 175 US 211 (1899) for naked restraints to be very important: Bork [1978] 22-30. It also explains his displeasure with Judge Brandeis in *Chicago Board of Trade* [1918] implying that there ought to be no *per se* rules: Bork [1965b] 838; [1978] 44.

<sup>141</sup> Bork [1978] 268. He also supportively quotes Justice Marshall in *US v Container Corp* 393 US 333 (1969) on the benefits of rule-based 'arbitrariness' for countervailing administrative advantages that may outweigh considering individual instances: [1978] 18.

<sup>142</sup> Much of his criticism of the rule of reason is directed at suggestions that non-economic, political factors could be considered: Bork [1965b] 838, 840, 843; [1978] 41-47.

<sup>143</sup> Bork [1978] 18.

applied in *Sylvania* [1977],<sup>144</sup> he preferred Chief Justice White's earlier statement of the rule of reason as prohibiting business practices 'either because of their inherent nature or effect or because of the evident purpose of those acts'.<sup>145</sup> Bork thus considered the rule of reason a three-stage analysis of i) *per se* rules prohibiting naked agreements, ii) intent, and iii) effect upon the market.<sup>146</sup> Nevertheless, the latter part in Bork's reading is not as it seems; by placing emphasis upon the word 'inherent' to modify both 'nature' and 'effect' in White's formulation,<sup>147</sup> Bork argued that the effects-based analysis was not to involve 'the futile direct study of actual effects'<sup>148</sup> but 'applying *rules of thumb constructed with the aid of economic analysis*',<sup>149</sup> primarily market-share thresholds.<sup>150</sup> The avoidance of 'lengthy industry studies of actual performance'<sup>151</sup> and of having courts 'sift through endless data' at the effects-based stage rendered *Bork's* rule of reason administrable for courts and afforded 'predictability that businessmen and their counsel desire.'<sup>152</sup>

To summarise, Bork refused to countenance *ad hoc* efficiencies analysis to determine the legality of business conduct. Instead, he advocated generalised norms - *per se* rules, presumptions - to structure a very peculiar conceptualisation of the rule of reason that restrained decision-making and therefore gave greater normative certainty to businesses. Undoubtedly, the adoption of generalised norms meant that the absolute accuracy of prohibiting inefficient and permitting efficient practices was sacrificed. But to settle for the alternative and 'demand perfection', Bork claimed, was 'to demand the abolition of the law'.<sup>153</sup> This conclusion reveals the latent conceptualisation of "law" as the medium for market intervention in the Chicago School's approach to antitrust. It can again be glimpsed when *critics* began to demand economic perfection in antitrust law throughout the 1980s.

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<sup>144</sup> *Chicago Board of Trade* [1918]; *Sylvania* [1977].

<sup>145</sup> *US v American Tobacco Co* 221 US 106 (1911). Bork [1978] 18 ('its most perfect form').

<sup>146</sup> Bork [1965b] 803-804; [1966] 388; [1978] 36-37.

<sup>147</sup> Most clearly seen in: Bork [1965b] 804 ('If the word "inherent" in White's sentence modifies "effect", as seems likely, it may be that the test contemplated not an examination of actual effects but an inference of the effect from some other fact, probably from the market size or power of the party or parties.').

<sup>148</sup> Bork [1978] 37. See also: [1966] 390 (courts should not 'attempt to measure the efficiencies since measurement, for all practical purposes, is impossible.').

<sup>149</sup> Bork [1966] 389. See also: [1978] 37 ('the inference of bad effects from some fact additional to the character of the restraint.').

<sup>150</sup> Bork [1965b] 804; [1966] 389-390; [1978] 37, 267. The US courts had introduced such filters for the rule of reason, though Posner considered them to still be 'uncertain': Posner [1981] 16-17.

<sup>151</sup> Bork [1978] 34.

<sup>152</sup> *ibid* 276-277. See also: 34, 37.

<sup>153</sup> *ibid* 123.

### C) Post-Chicago Complexity and Easterbrook's 'Workable Antitrust' School

Whilst the 1970s represented the waxing of the Chicago School approach to antitrust, throughout the 1980s it waned in academic circles as its critics condemned how market intervention had been 'minimalized and trivialized'.<sup>154</sup> The coalition of counter-Chicagoan voices was broadly constituted: some were continuing adherents of older Harvard School scepticism of industrial concentration;<sup>155</sup> others rejected the exclusive focus upon efficiency as an impoverished foundation for antitrust.<sup>156</sup>

Yet the most interesting critics of the Chicago School were scholars that largely accepted their pure efficiency focus,<sup>157</sup> but challenged the veracity of their strong assumptions of rational profit maximisation and robust market self-correction. As alluded to in the previous chapter, the main contribution of this "Post-Chicago" or "new" industrial organisation approach was to incorporate the strategic considerations of game theory into dynamic models, thus arguing that business practices often had more complex effects than the simple Chicagoan assumptions suggested.<sup>158</sup> Strategic barriers to entry may be rife;<sup>159</sup> for example, fostering a reputation for predatory pricing might deter market entry much more effectively than engaging in such irrational conduct itself.<sup>160</sup> The vertical restraints between producers and distributors deemed harmless by Chicagoans may actually be problematic owing to their ability to raise rivals' costs.<sup>161</sup> In essence, the Chicago School was accused of being far too sanguine in its reliance upon the simple assumptions of neo-classical price theory which could not account for every possible anticompetitive eventuality, instead resulting in under-inclusive legal prohibition.<sup>162</sup> Shifting the methodological pendulum in competition microeconomics back from abstract and deductive price theory towards complex and inductive IO, the Post-Chicagoans advocated context-specific studies into the consequences of particular practices on the market in question to determine legality; only such '[i]ntense fact-

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<sup>154</sup> Fox and Pitofsky [1987].

<sup>155</sup> eg Shepherd [1986] (the 'old-time religion of bigness and virtuous monopoly should be as dead as the dodo'); Mueller [1986] 43-44.

<sup>156</sup> See fn 59.

<sup>157</sup> eg Hovenkamp [1985] 213; [1986] 1020; Kovacic [2007] 9.

<sup>158</sup> See generally: Hovenkamp [1985]; [2002] 3-5; Williamson [1987] 292-293; Baker [1989]; C Shapiro [1989]; Kovacic [1990] 1464-1466; Wright [2009] 8; Peepkorn and Verouden [2014] 8.

<sup>159</sup> Salop [1979] 335; Williamson [1979] 530.

<sup>160</sup> Williamson [1979] 528 (critiquing Bork on predation); C Shapiro [1989] 129.

<sup>161</sup> Krattenmaker and Salop [1986].

<sup>162</sup> Williamson [1983a] 293-294 ('myopic and simplistic'); Hovenkamp [1985] 284 ('too simple to account for or to predict business firm behaviour in the real world.); [1986] 1020 ('not complex enough to account for every situation in which the problem might occur'); Fox and Sullivan [1987] 945 ('reductionist paradigm'); Sullivan [1994] 690 ('Too many practices that, if analyzed with greater particularity, would be found harmful to competition pass through the Chicago screen.').

specificity anchors the law to reality'.<sup>163</sup> As summarised by Sullivan, the scope of Chicago School antitrust was premised upon 'generalizations', whilst 'the post-Chicagoan must determine purpose and effect by empirical inquiry and analysis'.<sup>164</sup> As argued in Chapter I, a central tenet of contemporary competition microeconomics is that context is key in evaluating whether conduct actually has, or will likely have, a negative or positive impact on specific markets.

It would have been possible for Chicagoan scholars to fight economic fire with economic fire, arguing that their recommendations actually *did* incorporate strategic considerations,<sup>165</sup> or that the Post-Chicagoan approach was defective in substance.<sup>166</sup>

But instead, Frank Easterbrook combatted the Post-Chicagoan charge on the grounds of administrability and normative predictability. Although similar concerns have been glimpsed in Chicagoan scholarship throughout this section, Easterbrook's distinctive contribution was to explicitly place institutional limitations and the comprehensibility of legal obligations for businesses at the centre of his analysis of the appropriate form of market intervention.<sup>167</sup>

His direct response to growing criticism that Chicago recommendations were too simple,<sup>168</sup> that they did not always prohibit the anticompetitive and permit the efficient in every instance, was that 'pursuit of the perfect is the enemy of the good'.<sup>169</sup> It was to fall foul of the 'nirvana fallacy' to believe that every possible imperfection in the reach of the law was actually worth the cost of remedying it.<sup>170</sup> This idealism was being spurred by the Post-Chicagoan creation of "existence theorems", complex models showing that *generally* pro-competitive conduct might lead to contrary outcomes in very *specific*

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<sup>163</sup> Fox and Sullivan [1987] 937 ('the law grows not by deduction from any sweeping set of theoretical assumptions but by an inductive process that stays in touch with the changing business environment and with the particular facts out of which specific disputes arise.); Sullivan [1994] 672 ('the post-Chicago approach invites detailed factual analysis.');

<sup>164</sup> Sullivan [1994] 678.

<sup>165</sup> On the Chicago School pre-empting Post-Chicagoan revelations: Kobayashi and Muris [2012] 147-148, 161. eg Posner on a strategic reputation for predatory pricing deterring entry: [1974] 516-517; [1979] 939-940. Chicagoans may have forewarned of vertical restraints raising rivals' costs: Director and Levi [1956] 290.

<sup>166</sup> This has been conducted by later defenders: Crane [2009] 1924-1926; Wright [2009] 29-30; Kobayashi and Muris [2012].

<sup>167</sup> Priest [2010] 8-9 (though underappreciating his similarity with other Chicagoans).

<sup>168</sup> Easterbrook [1986] 1700.

<sup>169</sup> *ibid* 1704.

<sup>170</sup> Easterbrook [1981a] 26; [1986] 1711-1712 (on the 'Nirvana Fallacy' – assuming that because a means for determining legality is more discriminating it should be adopted, ignoring the 'costs of administration and error' of prohibiting efficient conduct, especially as inefficient practices missed by an imperfect rule may be eroded by competition anyway).

circumstances.<sup>171</sup> To ensure that antitrust did more good than harm to overall efficiency, Easterbrook stressed that the formulation of legal norms had to incorporate economic research into the costs of likely errors (over- or under-inclusivity) and of their enforcement.<sup>172</sup>

Therefore, he argued that the virtue of *per se* rules was their simple *inaccuracy*: generality was appropriate for prohibiting practices that would be anticompetitive in the overwhelming majority of instances as administrative savings from ease of application and normative clarity for businesses counterbalanced rare condemnation of pro-competitive efficiencies.<sup>173</sup> The same logic of *per se* legality applied conversely for practices where the potential for negative consequences was thought to be minuscule and the costs of searching for a few bad apples substantial.<sup>174</sup>

Despite its potential for perfect legal accuracy in sifting anticompetitive from efficient, Easterbrook was a staunch critic of the *ad hoc*, subject-specific legal analysis conducted under the unstructured rule of reason standard, stressing its sizeable error and administrative costs. It was naïve to assume that legality could be determined via the rule of reason without error,<sup>175</sup> and the vagueness of its formulation failed to help businesses planning their conduct, thus inviting further wasteful litigation.<sup>176</sup> The pursuit of absolute antitrust accuracy had mistakenly fostered over-ready recourse to the rule of reason in decisions such as *Sylvania*.<sup>177</sup> Even for practices where the consequences were more complex, Easterbrook stressed that it was not a black or white choice between the form of *per se* rules or particularistic determinations of legality: the task of economic research was to assist antitrust to ‘use the economists’ way out’ by devising cumulative presumptive filters to structure analysis.<sup>178</sup> This would be of considerable

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<sup>171</sup> Easterbrook [1984a] 15, 11. See also: [1986] 1706-1707.

<sup>172</sup> Easterbrook [1981b] 335.

<sup>173</sup> *ibid*; [1984a] 9-10, 14-15, 39 (only really the case for naked agreements); [1986] 1704 ('Rules that do well on average are the best courts can produce and apply.').

<sup>174</sup> Easterbrook [1987] 310. An approach developed through his early consideration of predatory pricing: [1981b] 333-337.

<sup>175</sup> Easterbrook [1984a] 11-12 ('it is fantastic to suppose that judges and juries could make such an evaluation... A global inquiry invites no answer; it puts too many things in issue.').

<sup>176</sup> *ibid* 12-13.

<sup>177</sup> *ibid* 13-14, 39. This problematic form for determining legality went beyond antitrust: Easterbrook [1990] 779-781 (dismissing balancing tests as inconclusive 'laundry lists').

<sup>178</sup> *ibid* 14, 17, 39. For examples of filters: [1984a] 17-18; [1984b] 159. Although the rule of reason is kept as a last resort, the aim is to substantially reduce its use: [1984a] 18.

benefit not just for decision-makers but also for businesses to comprehend their obligations under antitrust.<sup>179</sup>

What renders Easterbrook's articulation of the various costs of antitrust enforcement distinctly Chicagoan is how he resolved the inevitable imperfections of generalised *per se* rules and presumptive filters. In the choice between substantive over-inclusion (false positives) and under-inclusion (false negatives), Easterbrook employed the Chicago School's foundational commitment to the robustness of market self-correction: imperfect rules and filters should err on the side of cautious acceptance of possibly detrimental practices as market forces themselves would probably act as a secondary disciplinary influence beyond legal condemnation. The alternative of erroneously prohibiting beneficial practices would have a greater chilling effect that extended beyond the instant conduct, causing wider societal inefficiency. Such legal false positives were thought much slower to self-correct, as demonstrated by the existence of ancient problematic precedents.<sup>180</sup>

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Easterbrook's countering of Post-Chicagoan calls for context-specificity and complexity in determining legality with administrability and normative comprehensibility was relatively successful.<sup>181</sup> But he also did not believe that his error-cost approach constituted much of a gloss upon the orthodox Chicagoan approach; so endemic was its concern for applicability and certainty in conceptualising the appropriate form of market intervention that Easterbrook thought it may as well have been rebranded the 'Workable Antitrust Policy School'.<sup>182</sup> The discussion of Posner and Bork's approach in this section provides substantial evidence for his proposal, as could other Chicagoan

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<sup>179</sup> *ibid* 14, 18.

<sup>180</sup> Easterbrook [1981a] 25 ('rival firms should outstrip courts in rectifying monopoly'); [1984a] 2-3, 15-16, 24-25 (markets are better than judges at penalising inappropriate conduct); [1986] 1701; [1987] 306-311. Similarly: Bork and Bowman [1965] 375 (poor judicial decisions are rarely corrected due to the political limitations upon Congress); Bork [1978] 133.

<sup>181</sup> eg Brodley [1994] 694 ('Post-Chicago economics can be effectively incorporated into legal policy' but will require 'workable legal rules.); Fox [2002] 77 ('for the sake of the rule of law and administrability of law, economics must be simplified and generalized', but says nothing further on this). Hovenkamp's damascene conversion on Post-Chicagoan inadministrability is notable: [2001] (Post-Chicago scholarship is limited if not committed to creating workable legal tests); [2008] 47-49. For more equivocal acceptance of Easterbrook's approach: Kaplow [1987] 195-196; Williamson [1987]; Lande [1988] 452.

<sup>182</sup> Easterbrook [1986] 1700.

protagonists.<sup>183</sup> Their ideal vision of the relationship between law and economics in antitrust was for sophisticated insights from the latter to be *ex ante* incorporated into generalised norms (rules, presumptions, structured tests) to thereby formally foster legal certainty and administrability.

But despite the clarity of their rejection of *ad hoc* determinations of legality – purely effects-based analysis, the unstructured rule of reason standard - their suggested conceptualisation of the most appropriate form of market intervention invites deeper enquiry. Beyond austere calculations of administrative cost-savings, why did the Chicagoans, the high priests of neo-classical price theory in competition law, believe there to be great virtue in determining legality through the form of generalised rules or presumptions?

#### **IV. The Chicago School and the Rule of Law**

The tell-tale sign of adherence to some conception of the rule of law is scholarship that refers to *intra vires* normative actions - statutory interpretation, precedential development, use of conferred powers - as still being “not really law”. They amount to suggestions that legal validity is necessary but not sufficient; to recognition that there are “legitimate” and “illegitimate”, “more legal” and “less legal” exercises of authority that are nonetheless constitutionally valid.<sup>184</sup>

It will be demonstrated A) that such signals of aspirations towards realising the formal rule of law ideal are common to the later scholarship of the Chicago School of antitrust. Bork and Easterbrook particularly indicate that legality should be determined through the enforcement of generalised norms of lawfulness and unlawfulness that afford legal certainty to businesses. To better understand the appeal of this means, two direct and more substantial engagements with the desirability of this form of market intervention will also be considered: B) the more metaphysical discussion of the older Chicagoan economists, who connected the formal rule of law to political liberty; and C) Posner’s economic analysis of the ideal as optimally recalibrating subject incentives to effectively deliver the goal animating market intervention, ie maximising efficiency

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<sup>183</sup> A further example is McGee’s return to predation and rejection of most tests proposed for being unworkable: McGee [1980]; Page [1989] 1244-1245.

<sup>184</sup> See Chapter IV, Section II.

#### A) Bork and Easterbrook: On “Good” and “Bad” Law

*The Antitrust Paradox* is not just one of the most important books on the economics underpinning competition policy. It is arguably also a fundamental work on the conceptualisation of antitrust in accordance with the formal ideal of the rule of law.

Bork’s intention was not simply to reorient US competition law according to the Chicagoan approach to *economics*, but also through considering ‘the virtues appropriate to law as law’.<sup>185</sup> Of course US antitrust was legal as a matter of constitutional validity; a number of statutes have been passed prohibiting various types of anticompetitive conduct and the US Supreme Court has the authority to interpret their meaning, thereby determining the normative obligations incumbent upon legal subjects. But as is clear from the earliest pages of *The Antitrust Paradox*, Bork believed that even valid law can take the form of “bad” law:<sup>186</sup>

“[Although] the very idea of the rule of law ... is not, and cannot be, nearly so highly developed as that of economics, law does have requirements that are distinctively its own. When these are ignored, as they increasingly have been in antitrust adjudication, law that is bad as law, quite apart from its substantive content, necessarily results.”

Bork stressed that antitrust was ‘not respectable as law’.<sup>187</sup> Throughout his writing, he suggested that realising competition policy through the medium of law comes with its own requirements, an ‘intellectual discipline of its own’.<sup>188</sup> The above reference to undesirability for reasons ‘quite apart from its substantive content’ emphasises that his concern was not with a *substantive* conceptualisation of the rule of law (eg rights of due process, access to justice)<sup>189</sup> but the *form* of market intervention for determining the legality of conduct, regardless of its economic merit. This is confirmed by reference to ‘attributes of rationality, efficacy, tolerable certainty’ as ‘characteristics of good law’.<sup>190</sup> Sometimes the formal rule of law ideal was couched by Bork in terms of responsible adjudication, which required antitrust decision-making:<sup>191</sup>

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<sup>185</sup> Bork [1978] 7 (emphasis in original).

<sup>186</sup> *ibid* 8. (emphasis added).

<sup>187</sup> *ibid* 418 (emphasis added).

<sup>188</sup> Bork [1985] 24 (Nobody listens to his claim that the case for consumer welfare rests on legal arguments too because they do not believe that ‘law has any intellectual discipline of its own.’). See also: [1965b] 780 (‘antitrust is law as well as economics, and law has its own claims, its own tradition and discipline.’); [1978] 8 (‘We are too little accustomed, however, to thinking of law as a science’).

<sup>189</sup> Though this boundary is somewhat blurred when he shifts into arguments based upon the constitutional separation of powers: [1966] 876; [1985] 24.

<sup>190</sup> Bork [1966] 876.

<sup>191</sup> Bork [1967b] 244. On the formal rule of law in terms of judicial responsibility: [1978] 72.

*“upon criteria which are judicially administrable, give fair warning to those required to obey the law, permit sufficient predictability so that desirable conduct is not needlessly inhibited, and permit rational explanation...”*

Furthermore, these requirements of “good” law could take precedence over even substantively sound economic theory.<sup>192</sup> And while more frequently expressed purely in terms of normative comprehensibility for businesses, at times Bork suggested that the form of generalised, ‘simple rules of substantive law’ is critical to realising this benefit.<sup>193</sup>

The clearest demonstration of Bork’s foundational faith in the virtues of the formal rule of law was actually his advocacy of efficiency as the sole goal animating antitrust. Chicagoan scholars unfailingly stressed the *economic* need to incorporate considerations both of allocative and productive efficiencies, excluding political preference for small businesses and atomised markets. But Bork also emphasised ‘only that goal permits courts to behave responsibly and to achieve the virtues appropriate to law’.<sup>194</sup> Indeed, this argument from the rule of law may have been his most important.<sup>195</sup> Bork’s proposition was that permitting the judiciary *discretion* to draw upon any political goal they wished to decide antitrust liability in an *ad hoc*, subject-specific fashion fostered hopelessly unpredictable decision-making, denying fair warning as to one’s normative obligations that hindered individual planning.<sup>196</sup>

*“No businessman can know what the law is if the “law” depends upon the sympathies and prejudices of any one of the hundreds of federal judges before whom he may find himself arraigned at some certain date in the future.”*

The use of quotation marks emphasises Bork’s belief that without efficiency as the singular goal of antitrust, the resultant form of market intervention is a degenerate normative order that ‘hardly deserves the name of law’.<sup>197</sup>

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<sup>192</sup> Bork [1965b] 781.

<sup>193</sup> Bork [1978] 81 (emphasis added). See also: [1965b] 780 (the rule of law requires one to ‘determine what rules can be properly laid down for the future’ with its ‘additional limits’ of ‘warning’); text accompanying fn 135-141 on *per se* rules.

<sup>194</sup> *ibid* 89. See also: [1966] 876; [1967b] 244 (‘Consumer welfare is the only legitimate goal of antitrust, not just because antitrust is economics, but because it is law.’).

<sup>195</sup> Bork [1967b] 246. For recognition of this underappreciated aspect: Lande [1988] 436-438; Kovacic [1990] 1462; Heyer [2014] S22.

<sup>196</sup> Bork [1978] 81. See also: Bork and Bowman [1965] 370 (‘prediction of the courts’ behaviour would become little more than a guessing game’); Bork [1965b] 832 (consumer welfare meets ‘the virtues appropriate to good law by becoming capable of giving fair warning to those who must obey, susceptible for principled administration by the courts that apply it’); [1978] 405 (‘Departures from that standard destroy the consistency and predictability of the law.’).

<sup>197</sup> Bork and Bowman [1965] 370. See also: Bork [1993b] 427 (judicial discretion as to the goals of antitrust made ‘anything resembling a rule of law impossible.’).

Easterbrook agreed with Bork's justification for consumer welfare based on legal certainty (and was also a fan of derisory quotation marks): for legal prohibition to be unforeseeably determined on the basis of any number of unknowable, incompatible goals in the particular discretionary decision at hand was 'not a power to enforce "law" at all'.<sup>198</sup> He too suggested that there are legitimate and illegitimate forms of market intervention, and was often much clearer than Bork in linking normative certainty with the decisional restraint of generalised, rule-based norms. This was particularly visible in his later writing. Developing his preference for cumulative presumptions in antitrust over the rule of reason, Easterbrook argued more generally that 'laundry lists' of factors constituting legal balancing tests<sup>199</sup> or 'plastic standards' defied regular application as they permitted decision-makers to 'go any which way'.<sup>200</sup> In such circumstances, where there are no norms of general scope, 'no rules of law', but only judicial discretion to impose particular outcomes, uncertainty not only fosters needless litigation,<sup>201</sup> but also fails to guarantee equality before the law. Normative orders reliant upon *ad hoc* determinations of legality under vague standards, facilitating differential outcomes from case-to-case and decision-maker-to-decision-maker, permitted personal idiosyncrasies and views of the worthiness of the individual subject to unpredictably influence results.<sup>202</sup> In contrast, Easterbrook argued that a commitment to law as generalised norms of equal application - formulated to be prospectively applied in the future, and applied in the present to guarantee continuity with the past - ensure restrained and regularised enforcement so that such decisions 'may be called law rather than will, rules rather than results'.<sup>203</sup> It is for these reasons that Easterbrook considered 'decision by rule [...] an objective of law' and 'a benefit that cannot be doubted'.<sup>204</sup>

It is therefore clear that Bork and Easterbrook subscribe to some formal understanding of the rule of law as a desirable ideal; that legitimate market intervention is conceptualised as generalised norms, which in their rigidity and restraint delineate the

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<sup>198</sup> Easterbrook [1986] 1703. See also: [1984a] 716 ('multi-goal antitrust policy is unpredictable and unprincipled... judges can reconcile any decision, in any case').

<sup>199</sup> Easterbrook [1990] 780.

<sup>200</sup> Easterbrook [1992] 349. Similarly: Posner [1975a] 282.

<sup>201</sup> Easterbrook [1990] 780-781.

<sup>202</sup> *ibid* 781 (with standards, judges focus on 'the facts before them and not on how rules affect future conduct. When there are no "rules" the tug of fair treatment is especially strong. Judges who have personal idiosyncrasies or ideologies may indulge them freely.); [1992] 350 ('the more discretion, the less "law" remains in the system.' Unstructured standards 'liberate courts from rules, license *ex post* appreciations and "fair" divisions of the stakes; concrete rules establish restraint discretion later on.').

<sup>203</sup> Easterbrook [1988] 422.

<sup>204</sup> Easterbrook [1992] 350.

boundaries between legal and illegal in a manner comprehensible to businesses (prospective, clear, public). The virtues justifying this aspirational form for determining legality seem to be the interconnected phenomena of administrative restraint and normative clarity. Still, this is rather vague. Bork and Easterbrook were not legal philosophers. Nevertheless, they were part of a movement that had amongst its ranks scholars – counter-intuitively, economists - who *did* engage with jurisprudential issues and regarded the formal rule of law to be a necessary component of political liberalism.

B) *The Chicago School of Economics and Liberal Political Theory*<sup>205</sup>

The historical account in Section I mentioned that the University of Chicago established a reputation in the inter-war period as a continuing devotee of liberal economic policy in an increasingly unreceptive climate favouring central direction. The scholars providing the microeconomic foundations to the subsequent Chicago School of antitrust were similarly animated by a belief in the efficiency of free markets.<sup>206</sup> But in contrast to later Chicagoans, they were also much more explicit in their being motivated by metaphysical considerations of individual freedom that further recommended a free market society. That ‘freedom itself is of transcendent importance as a condition of moral life’ was especially visible in the writings of Frank Knight<sup>207</sup> and Henry Simons,<sup>208</sup> though even Stigler, the later figurehead of empirical Chicago economics, also made unusually philosophical claims concerning freedom and the dignity of man.<sup>209</sup>

Economic freedom on the open market and the enjoyment of political freedom were often considered by Chicago economists to be two sides of the same coin.<sup>210</sup> The common potential threat to both was the overbearing state, whether as central planner of economic production or despotic tyrant of the polity.<sup>211</sup> Yet just as neo-liberal

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<sup>205</sup> The connection between political liberalism and the formal rule of law is analysed in Chapter IV, Section III.

<sup>206</sup> Notwithstanding the need for competition policy and disagreement as to what this entailed: fn 76.

<sup>207</sup> Knight [1944] 340. See also: [1951] 13. For discussion of Knight’s economic methodology unapologetically incorporating political values of liberty: Hirsh and Hirsh [1976] 61-62.

<sup>208</sup> Simons [1936] 68 (‘The preservation of freedom is, I submit, the most important end of policy’); Davenport [1946] 6 (Simons’ views ‘rested on the dignity and worth of the individual’; ‘individual liberty cannot be disassociated from the preservation of the free competitive market.’).

<sup>209</sup> Stigler [1958b] 172.

<sup>210</sup> eg Knight [1941] 201 (politics and economics ‘are so closely interrelated that they are ultimately little more than aspects of the same organisation’); [1960] 28; Simons [1945] 231 (the ‘implied political philosophy’ of freedom within classical economics.); Friedman [1962] (‘intimate connection between economics and politics’); Friedman and Friedman [1980] 1-3.

<sup>211</sup> eg Knight [1944] 340 (‘very “strong” government is more likely in the long run to be bad than good’); [1960] 14 (quoting Acton on absolute power); Friedman and Friedman [1980] 4 (Smith and Jefferson ‘had

economic policy both warns against and requires market intervention,<sup>212</sup> liberal political philosophy shares the tension that government is a necessary evil to guarantee individual freedom.<sup>213</sup> Whether its task is to prevent violence between citizens, enforce contracts, guarantee property rights, authoritatively adjudicate disputes, or prohibit cartels, there is a friction at the heart of liberalism, including the brand represented by the Chicago School: '[h]ow can we keep the government we create from becoming a Frankenstein that will destroy the very freedom we establish it to protect?'^214 Somewhat surprisingly for a group of economists, the two solutions were both legal.

The primary means to maintain individual political freedom vis-à-vis the state's monopoly of coercion was through *substantive constitutionalism*: restraining centralised power by only conferring a limited range of competences and powers to act with constitutional validity.<sup>215</sup> Naïve expectations that government could solve all ills and be trusted with greater constitutional competence ignored 'its evils and dangers.'<sup>216</sup>

However, many of the early Chicagoan economists also subscribed to *the formal rule of law* as an additional restraint; essentially a belt-and-braces limitation upon interference with individual freedom by state action that was nevertheless constitutionally valid. As precursors to the suggestions of Bork and Easterbrook above, prior Chicagoan scholarship is awash with conceptualisations of law as a generally-applicable framework of norms structuring individual conduct and restraining state power.<sup>217</sup> Indeed, a number of older Chicagoan scholars found the jurisprudential concept of the formal rule of law to be a concomitant ideal contained within broader political and economic visions

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seen concentrated government power as a great danger to the ordinary man; they saw the protection of the citizen against the tyranny of government as a perpetual need.').

<sup>212</sup> See Chapter I, Section I. Rather than the common contemporary pejorative, 'neo-liberalism' is used here in the historical sense to denote free-market advocates who rejected laissez-faire, supporting interventions to guarantee the operation of market forces.

<sup>213</sup> Knight [1941] 204 (government has to 'provide and enforce a framework of rules for securing freedom'); [1951] 13 ('governments have to set some limits to individual freedom'); [1960] 14 ('Liberals hold that men are not to be trusted, beyond necessity, with arbitrary power.); Davenport [1946] 6 (quoting Simons that the state should: "...maintain the kind of legal and institutional framework within which competition can function effectively..."); Director [1953] 2 ('economic liberalism has always assumed a well-established system of law and order designed to harness self-interest to serve the welfare of all.); Friedman [1962] ('The existence of a free market does not of course eliminate the need for government').

<sup>214</sup> Friedman [1962] 2.

<sup>215</sup> Knight [1944] 340, 369 ('a fairly narrow limitation of the functions of government'); Friedman and Friedman [1980] 4.

<sup>216</sup> Knight [1944] 340, 369 ('Such grants of power tend to become irrevocable and the power itself tends to grow beyond assignable bounds.') Similarly: Director [1953] 2, 9; Friedman and Friedman [1980] 4-5.

<sup>217</sup> eg Knight [1941] 204 (the role of government is to 'provide and enforce a framework of rules.); Director [1953] 2-3; Director and Levi [1956] 282; Friedman [1962] ('government is essential both as a forum for determining "rules of the game" and as an umpire to interpret and enforce the rules decided on.').

of the liberal state.<sup>218</sup> Requiring governmental intervention via generalised, equally-applicable norms was a formal restraint upon the discretion of the state to impose its own will in particular instances against individuals.<sup>219</sup> As a corollary of the increased certainty of eliminating an unknown quantity in the application of norms, such a formal conceptualisation of law was also respectful of individual rationality and freedom of action, thus facilitating planning as to how one wishes to live their life (or run their business). The ‘ethical character and import’<sup>220</sup> of the formal rule of law ideal in comparison to subject-specific, unpredictable imposition of the state’s will can be seen in Knight’s suggestion that:<sup>221</sup>

*“there is a vast difference in principle between general laws, of the nature of traffic regulations or rules of the game, and concrete prescription of where, when, and how to travel or what game to play.”*

Henry Simons most explicitly linked the formal rule of law ideal to antitrust in a review of Thurman Arnold’s *The Bottlenecks of Business*.<sup>222</sup> In much the same manner as Posner, Bork, and Easterbrook above, Simons poured considerable cold water on determining the legality of business conduct on the basis of subject- and context-specific decisions pursuant to vague standards, whether the US courts’ unstructured rule of reason or Arnold’s recommendation that the antitrust statutes be replaced with a simple prohibition of ‘unreasonable behaviour’.<sup>223</sup> For Simons this was ‘no law at all’. Instead, it amounted to a ‘perpetual witchhunt’, where decision-makers had the discretion to unexpectedly pick and choose which businesses to pursue, before finding ‘particular conduct lies outside or inside the moral pale as defined by emotive slogans’.<sup>224</sup> Simons feared this would transform the Antitrust Division into a ‘super-public-utility commission’ that would harass businesses into charging lower prices *ex*

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<sup>218</sup> eg Simons [1945] 231 (the classical economist sought ‘solutions which are within the rule of law’); Knight [1939] 62-63 (‘The liberal state is essentially “The Law.”’); Viner [1960] 48-49 (the rule of law as ‘an essential safeguard of economic and other freedoms’). More recently: Posner [1995] 20 (‘Along with a market economy and a democratic political system, which in fact it undergirds, [the rule of law] is a presupposition of modern liberalism.’). cf Knight’s scepticism that it was unlikely to be closely approximated: [1960] 115, 124, 164.

<sup>219</sup> Friedman and Friedman [1980] 299 (on law as equally-applicable ‘package deals’ preventing discrimination); Posner [2007] 266 (‘Generality increases the cost of persecution’ of individuals).

<sup>220</sup> Knight [1939] 62.

<sup>221</sup> Knight [1944] 364.

<sup>222</sup> Arnold [1940].

<sup>223</sup> Simons [1941] 208-210 (‘I do not like the rule of reason (either Mr Arnold’s or the Court’s)'). cf [1936] 71 (in antitrust ‘one finds here a reason for proposing the generally objectionable expedient of an administrative authority with some discretionary power’).

<sup>224</sup> ibid. Unusually, he thought the flexibility of the rule of reason allowed businesses to get away with anticompetitive behaviour owing to its ‘timorous squeamishness’.

post rather than prospectively stating what would be considered illegal.<sup>225</sup> Therefore, in keeping with his advocacy of rules-based monetary policy,<sup>226</sup> Simons stressed that the aspirational form for antitrust ought to be 'unambiguous rules of law'.<sup>227</sup> In a later dismantling of the *Beveridge Report*, he emphasised that advocacy of the formal rule of law ideal over 'discretionary authorities' was a bulwark against state tyranny that separated the economic liberals from the planners.<sup>228</sup> And the deontological nature of Simons' reason for faith in law conceptualised as general, restrained norms - *freedom* - was indicated by his argument that, even if 'omniscient and benevolent' state actors could better improve societal efficiency, it would not make any difference: 'some of us dislike government by authorities, partly because we think they would not be wise and good and partly because we would still dislike them if they were.'<sup>229</sup>

This is not to suggest guilt by association or scholarly osmosis: that because Knight, Simons et al explicitly advanced the political virtue of conceptualising market intervention in accordance with the formal rule of law ideal (ie general norms that are comprehensible to subjects) due to the imperative of freedom and enhanced state restraint, that Bork and Easterbrook agreed. Rather, at the very least, the ideas of the early Chicago School are recounted to demonstrate that when economic liberalism *does* address philosophical questions of the value of market-based society beyond efficiency, it may meet the formal rule of law ideal. It can be used to fill justificatory gaps in later, less conceptual work that signal an appreciation for a particular conceptualisation of the form that antitrust should take. But if scepticism vis-à-vis the Chicago School of economics results from its metaphysical arguments, jarring somewhat with the later emphasis upon neo-classical assumptions and societal efficiency, an alternative justification can be found: Posner's economic analysis of the rule of law.

### *C) Posner: The Rule of Law as Incentive Calibration and Effective Intervention*

Although it has been seen that Posner's antitrust writing rejected the form of particularistic market interventions and suggested a preference for generalised norms for determining legality that were comprehensible to businesses, linking this to a latent belief in the formal ideal of the rule of law in antitrust is slightly more complex. This is

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<sup>225</sup> *ibid* 211.

<sup>226</sup> Simons [1936] 69; [1945] 214; Davenport [1945] 8.

<sup>227</sup> Simons [1941] 210 (though admitting that this was an aspiration, as the rule of reason could not be entirely dispensed with).

<sup>228</sup> Simons [1945] 214.

<sup>229</sup> *ibid* 231.

not simply owing to the lack of tell-tale signals, akin to Bork or Easterbrook, that there are “good” and “bad” ways of “doing law”. It results instead from his explicit self-distancing from ‘rule-of-law conservatives’.<sup>230</sup> Outside the confines of antitrust, Posner has developed a pragmatist theory of adjudication<sup>231</sup> which takes as its starting-point that the concept of “law” has almost no autonomous virtue or epistemic logic.<sup>232</sup> Furthermore, the entire notion of law as ‘rules of the game’ is misplaced.<sup>233</sup> Instead, law is merely a prediction of what judges will decide,<sup>234</sup> largely based on an unscientific mixture of standard legal sources with pragmatic appeals to various values and policies.<sup>235</sup> Indeed, Posner suggests that incorporation of neo-classical price theory into US antitrust represents the nature of such anti-formalist pragmatic jurisprudence *par excellence*.<sup>236</sup>

The problem for Posner is that after thoroughly articulating pragmatism as profoundly sceptical of law being anything other than external policy or political sophistry, lacking method or desirable form, he finds himself painted into a corner with the legal realists and critical legal scholars to whom he also objects. With little sense of this, he proceeds to condemn them for downplaying the importance of distinctly legal constructs: the realists for eliding law with indeterminate judicial politics;<sup>237</sup> and the CLS authors for failing to recognise that the rule of law is a ‘genuine, indeed an invaluable, public good’.<sup>238</sup> Especially in his later articulations of pragmatism, Posner is careful to stress that judges ought not completely disregard ‘the social interest in certainty of legal obligation’<sup>239</sup> or act as an ‘unprincipled, *ad hoc* decision maker’.<sup>240</sup> Even where pragmatism strongly recommended normative change - including, for example, bringing antitrust closer to the learning of competition economics -<sup>241</sup> Posner accepts that it may

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<sup>230</sup> Posner [1990] 434.

<sup>231</sup> For a summary: Posner [1990] 26, 459-460.

<sup>232</sup> Posner [1990] 37-39, 226 (‘law has no nature, no essence’), 434-435 (rejecting ‘neo-traditionalist’ claims that ‘law is an art - the art of social governance by rules.’).

<sup>233</sup> *ibid* 49-50 (unlike law, rules of the game would never change *in media res*).

<sup>234</sup> *ibid* 26, 207 (‘Predictions of what the courts will do is really all there is to law.’).

<sup>235</sup> Posner [2000] viii (eg ‘policy, common sense, personal and professional values, and intuition and opinions, including informed or crystallized public opinion.’); [1990] 130 (‘fact-soaked, policy-bound’).

<sup>236</sup> Posner [2000] 228-229.

<sup>237</sup> Posner [1990] 39.

<sup>238</sup> *ibid* 467. Similarly: [1995] 20 (‘The rule of law, in the sense of a system of social control operated in accordance with norms of disinterestedness and predictability, is a public good of immense value.’)

<sup>239</sup> Posner [2000] 209. See also: 242 (‘well-founded expectations necessary to the orderly management of society’s business’), 263 (cannot ‘ignore the good of compliance with settled rules of law’).

<sup>240</sup> *ibid* 262.

<sup>241</sup> Posner [1995] 21.

still be necessary to maintain normative foreseeability<sup>242</sup> and, essentially, for the judge to act as a formalist.<sup>243</sup>

Unfortunately for the coherence of his theory of pragmatic adjudication, Posner has clearly done too much economic analysis of the formal rule of law ideal. No matter how much he attempts to resist, Posner remains an admirer of market intervention through generalised, comprehensible norms within the Chicago School of antitrust. Rather than based on lofty liberal philosophical concerns for freedom, individual planning, and the tyrannical state,<sup>244</sup> he reaches the same conclusion via a different route: the economic conceptualisation of effective law as accurate incentive-recalibration to realise consequentialist goods for society.

According to Posner, the basic function of law from an economic perspective is to 'alter incentives' to pursue societal goods.<sup>245</sup> In the second edition of *Economic Analysis of Law* he argues that it is a mistake to define any command backed by coercive power as law. To optimally achieve its animating purpose - deterring cartels, permitting pro-competitive conduct - it ought to satisfy various '*formal* characteristics of law itself [deduced] from economic theory':<sup>246</sup> it cannot command the impossible; it must be of general and equal application, treating like cases alike; there must be a mechanism to ensure that normative obligations are predictably enforced in practice;<sup>247</sup> and it must be prospective, public, and intelligible or there will be 'no effect on the conduct of the parties subject to it'.<sup>248</sup> Posner's economic perspective therefore suggests that effective market intervention, actually altering business incentives to avoid anticompetitive and continue pro-competitive conduct, will take the form of the rule of law ideal.

Although purporting to neutral articulation of respective benefits and costs, this is also implied by two general pieces considering the distinction between conceptualising law in the form of rules (eg the *per se* rule against price fixing) or standards (eg the rule of

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<sup>242</sup> Posner [2000] 242.

<sup>243</sup> *ibid* 209.

<sup>244</sup> Though there are elements of this. See fn 219.

<sup>245</sup> Posner [1977b] 190.

<sup>246</sup> *ibid* 189-191.

<sup>247</sup> *ibid* (if price fixers are punished at random, 'there will be no incentive to avoid price fixing.' Liability is the same, but actual price fixers get to keep their profits).

<sup>248</sup> *ibid*.

reason).<sup>249</sup> Unlike the flexibility of a standard that provides the potential for a perfect categorisation of each instance before the decision-maker as “legal” or ‘illegal’ *ex post*, generalisations that *ex ante* remove individual factors from consideration are necessarily imperfect.<sup>250</sup> Such imperfections may be exacerbated over time with societal and technological progress that necessitates their reformulation, unlike a dynamic open standard.<sup>251</sup>

Nevertheless, Posner suggests that aspiring towards the formal rule of law ideal - generalised and comprehensible (clear, predictable, prospective) norms - improves the efficacy of intervention by better influencing the incentives of legal subjects to cease detrimental conduct, thereby optimally realising the societal good animating intervention.<sup>252</sup> Such normative clarity also minimises the “chilling” of socially valuable behaviour by an uncertain law’, preventing positive conduct from being consumed by the ‘penumbra of a vague standard.’<sup>253</sup> And much like Easterbrook’s focus upon the wider cost of antitrust norms, this manner of enforcement is argued to reduce the risk of erroneous application and administrative expenditure in numerous ways.<sup>254</sup>

Therefore, despite Posner’s extended critique of formalism, his work can also be utilised to advance a separate justification for the advocacy of the formal rule of law ideal in Chicagoan writing: conceptualising market intervention as generalised, equally-applicable norms, that restrain and structure determinations of legality, thereby effectively realises the motivation behind such norms (eg efficiency) through better influencing the incentives of legal subjects. The particular language and author may give the impression that this is an approach to the rule of law peculiar to those of a “law & economics” persuasion. On the contrary, fellow Chicagoan Easterbrook, who did not engage in positive economic analysis of law, made comparable claims.<sup>255</sup> But more

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<sup>249</sup> Posner [1973b] (discussing strict liability rules or the negligence standard in accident liability); Ehrlich and Posner [1974]. Though note that through repeated decision-making or judicial review, a standard can gradually crystallise into generalised norms: see Chapter IV, text accompanying fn 168-174.

<sup>250</sup> Posner [1973b] 448-449 (‘The essence of a rule is that it abstracts one or a few factors from the totality of relevant circumstances and attaches controlling weight to them... it will not lead to correct results in all cases, and thus error costs will be generated.’); Ehrlich and Posner [1974] 268 (‘a set of rules must in practice create both overinclusion and underinclusion’).

<sup>251</sup> Ehrlich and Posner [1974] 277-278. Similarly: Landes and Posner [1976] (on the depreciation of precedents as sources of information over time).

<sup>252</sup> *ibid* 262, 275.

<sup>253</sup> Posner [1973b] 449; Ehrlich and Posner [1974] 263.

<sup>254</sup> Ehrlich and Posner [1974] 264-265 (cost-savings from ease of enforcement, fewer cases, lower litigation expenses). See also: Posner [1973b] 449-450.

<sup>255</sup> Easterbrook [1984c] 7 (‘When the Court tries to influence the conduct of actors in the economic sphere, the clarity of rules becomes more important... Muddy rules arising from a desire to accommodate the needs

generally, this instrumentalist take on the formal rule of law has close connections with a classic debate in legal philosophy.<sup>256</sup>

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This section has directly challenged the perception of the Chicago School of antitrust as advocating the ‘subordination’ of law or leaving concerns for normative comprehensibility ‘overruled’ through an insincere and unbalanced commitment to “interdisciplinary” scholarship.<sup>257</sup> On the contrary, it has been demonstrated that generations of Chicagoans frequently considered the appropriate *form* for determining legality. These basic justificatory arguments signifying the desirability of aspirations towards the formal rule of law can be situated within centuries of political and economic thought. Although revolutionaries in the field of US antitrust law, the Chicago School’s appreciation for market intervention in accordance with the rule of law ideal simultaneously casts them as quiet followers of well-known authorities on the rationality and restraint of liberal legalism.<sup>258</sup>

## V. Conclusion: The Chicagoan Form of Market Intervention and its Limits

This chapter has argued that the reputation of the Chicago School has distorted the reality of their scholarship for decades: while a *substantive* commitment to norms informed by rigorous deduction from the assumptions of neo-classical price theory is undeniable, their acute concern for the appropriate *form* of market intervention has often been overlooked. Far from advocating the determination of legality via *ad hoc*, subject-specific analysis of the particular efficiency consequences of instant conduct, the Chicagoans preferred to incorporate economic wisdom into the *ex ante* design of generalised norms - rules, presumptions, structured tests - to thereby rigidify decision-making and thus afford normative comprehensibility to legal subjects. As will be considered later, this conceptualisation of the relationship between law and economics

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of parties caught in a web of circumstance may have effects quite unanticipated by the judges.’), 11; [1986] 1709 (Without the assumption of rationality, ‘you have no reason to think that the threat of sanctions deters, or that the legal system can achieve anything useful.’); [1992] 350 (‘concrete rules establish incentives *ex ante* and restrain discretion later on.’).

<sup>256</sup> See Chapter IV, text accompanying fn 246-252.

<sup>257</sup> See fn 6-8.

<sup>258</sup> See Chapter IV.

in antitrust renders the “neo” prefix meaningless when applied to an indistinguishable brand of thought in contemporary competition scholarship.<sup>259</sup>

In this way, the Chicago School provides a number of fledgling arguments that can be substantiated to answer the question motivating the first half of this thesis: given the justificatory “gap” of modern competition microeconomics, what form of market intervention for determining the legality of business conduct should competition policy ideally adopt?

Nevertheless, there are limits to the Chicago School alone furnishing a justification for a particular form of market intervention. Theirs is an approach highly sceptical of the competitive good that can be achieved by antitrust: would a school of thought more comfortable with the state policing marketplace behaviour be so ready to restrain decision-makers and grant normative clarity to businesses, especially if often occasioned through imperfect rules of *per se* legality? Furthermore, to what extent is the Chicagoan critique of particularistic determinations of lawfulness grounded in the idiosyncratic institutional framework of US antitrust, where decisions are largely brought before generalist judges?<sup>260</sup> To address these limits, it is necessary to consider the form of market intervention advocated by another influential brand of competition thought: German Ordoliberalism.

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<sup>259</sup> Kobayashi and Muris [2012] 147, 155; Wright [2012] 250-251.

<sup>260</sup> Bork [1993b] 439 (praising EU competition law for its administrative institutional model).

# Chapter III: Ordoliberalism: Ambiguous Economics and the *Rechtsstaat* Tradition

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## I. Introduction

Ordoliberalism is one of the most contentious and least understood subjects within contemporary competition scholarship. Since its popular introduction to English-speaking commentators in the 1990s,<sup>1</sup> interest in this assemblage of liberals hitherto little known outside of Germany has increased exponentially. Many lawyers are now familiar with its orthodox historical narrative:<sup>2</sup> an economist, Walter Eucken, and two lawyers, Franz Böhm and Hans Grossmann-Doerth, met at the University of Freiburg in the early 1930s, soon discovered that they had similar analyses of crucial issues - the economic crises of the 1920s, the rise of National Socialism - and thus combined economic and legal thinking in pioneering interdisciplinary work that laid the foundations for Ordoliberalism. Aspects of this movement are often said to have influenced the reconstruction of West Germany under Economic Minister Ludwig Erhard, frequently credited with the post-war economic 'miracle'.<sup>3</sup>

Despite decades of antitrust enforcement across the Atlantic, the Ordoliberals were relatively unusual in mid-twentieth century Europe due to their shared commitment to the virtues of competition policy. They advocated not just classical liberal *negative* restraints to protect the operation of the price mechanism - no closed markets, privileges, price controls - but also a *positive* programme of market intervention against anticompetitive conduct. The inclusion of competition provisions within the Treaty of Rome has been attributed to their scholarship.<sup>4</sup> More controversially, so too has the frequently condemned substance and subsequent development of EU competition law.<sup>5</sup>

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<sup>1</sup> Gerber [1994]; [1998]. For criticism: Mestmäcker [2011]; Behrens [2015].

<sup>2</sup> An historical account will be provided in Section II.

<sup>3</sup> On Erhard's Ordoliberalism-inspired abolition of almost all rationing and price controls in 1948: Willgerodt and Peacock [1989] 3; Callison [2017] 53.

<sup>4</sup> Gerber [1994] 69-72. cf Akman [2009a]; Wigger [2017].

<sup>5</sup> ibid. Followed by, eg: Ahlborn and Grave [2006] 206; Weitbrecht [2008] 82-85; Mongouachon [2011] 70; Witt [2016] 83-86. cf Akman [2014]; Wigger [2017].

Perceptions of Ordoliberalism have been almost completely tainted by their humanistic concern for economic freedom, often conflated with the pre-Chicagoan obsession with industrial deconcentration in the US, sacrificing productive efficiencies for the sake of everybody's absolute right to compete freely on atomistic markets. If the role typically afforded to the Chicago School by EU competition law is somewhat messianic,<sup>6</sup> Ordoliberalism often represents its original sin. Whenever the law is condemned as too interventionist, overly-burdensome, stifling of business efficiency, the pejorative label of "Ordoliberal" is commonly found.

Sections II and III will challenge this frequent depiction within EU competition scholarship by separating the few elements that bind Ordoliberalism together as a singular movement from those upon which their writing demonstrates considerable heterogeneity. Although the Ordoliberals shared a set of conceptual tenets - a methodology, a broad societal vision, mechanisms for delivery - at the practical level of how competition policy ought to be *substantively* conceptualised, the extent of incoherence, disagreement, and development over time casts doubt on their simplistic contemporary depiction.

These important discussions are, however, secondary to the question of the legitimate *form* of market intervention envisaged by Ordoliberalism for determining legality. As suggested in concluding the last chapter, it is necessary to shift focus to the Ordoliberals for three reasons that set them apart from the Chicago School: first, although disputed in Section II, Ordoliberalism is *popularly* perceived to be a radically different, peculiarly European brand of market intervention; second, owing to their alleged influence upon EU competition policy, the subject matter of Part II of this thesis; and third, due to their advocacy of enforcement by an *administrative* monopoly office pursuing the goals of competition policy. If impartial experts of law and economics (eg the European Commission) are entrusted with market intervention, does that render subject-specific determinations of legality owing to resultant effects a more palatable form for enforcing competition policy? Is the virtuous restraint and comprehensibility of norms envisaged by the formal rule of law ideal an idiosyncratic requirement of US antitrust, determined by generalist judges rather than the technocratic enforcement of the Ordoliberal administrative agency?

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<sup>6</sup> See Chapter II, Section I.

Section IV will argue that, despite advocating administrative enforcement and rarely considering the rule of law explicitly, Ordoliberalism must be situated within the history of Germanic faith in the formal *Rechtsstaat* ideal traceable back to Immanuel Kant. Once this often latent expectation for the realisation of their societal vision is highlighted, it is possible to decipher numerous arguments from which it can be extrapolated that Ordoliberal competition enforcement would aspire to the form of generalised norms delineating illegality in a manner comprehensible to legal subjects. If, however, both the Chicagoans and Ordoliberals share an appreciation for this ideal means of enforcement, and if questions can be raised as to whether the latter *really* advocated freedom over efficiency, this might indicate that these supposedly rival competition schools perhaps have more in common than is often acknowledged.

## II. Ordoliberalism as a Family of Shared Concepts

As with the Chicago School, understanding and defining ‘Ordoliberalism’ is not straightforward. This section will A) briefly provide an historical overview of the main strands and protagonists of the Ordoliberal movement. The primary focus, however, will be upon B) articulating the shared concepts that appear to bind Ordoliberalism together as a coherent body of scholarship, despite divergent methodologies, times of writing, emphases, policy recommendations, and so on.

### A) Historical Account<sup>7</sup>

Ordoliberalism can be divided into *at least* three related bodies of scholarly sub-groups:<sup>8</sup> the ‘Freiburg School’, the ‘Sociological Neoliberals’,<sup>9</sup> and the ‘Social Market Economists’.

The *Freiburg School* was the intellectual catalyst for the overall Ordoliberal movement. The most prominent protagonists were: Walter Eucken (1891-1950), Professor of Economics at Freiburg from 1927; Franz Böhm (1895-1977) who taught law at Freiburg from 1933 and was later Professor of Civil and Economic Law at the University of Frankfurt; and Hans Grossmann-Doerth (1894-1944) who took a chair in law at Freiburg in 1933 after publishing a study into standard contractual terms in industrial

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<sup>7</sup> For more detailed overviews: Rieter and Schmolz [1993] 96-103; Gerber [1994]; Nicholls [1994].

<sup>8</sup> This division is similar to: Feld, Köhler, and Nientiedt [2015] 2 (distinguishing between the Freiburg School, the conservative Ordoliberals, and the social Ordoliberals).

<sup>9</sup> A label borrowed from: Sally [1996] 234.

agreements.<sup>10</sup> Together at Freiburg they commenced interdisciplinary work on law and economics and in 1936 provided a foundational mission statement for the wider movement (the “*Ordo Manifesto*”),<sup>11</sup> later establishing the journal *ORDO* as a platform for the group’s work on economic and legal order in 1948. Two of their immediate disciples have been of particular interest for competition lawyers:<sup>12</sup> Leonard Miksch (1901-1950), a student of Eucken credited for the controversial “as-if” standard for supervising monopolies;<sup>13</sup> and Ernst-Joachim Mestmäcker (b. 1926), Böhm’s post-war student who elaborated upon the Freiburg understanding of competition, and who was particularly influential in the formative development of EU competition law.<sup>14</sup>

The *Sociological Neoliberals*, a second strand of the wider Ordoliberal movement, consisted of close friends Wilhelm Röpke (1899-1966) and Alexander Rüstow (1885-1963) who both fled Germany in 1933 for the University of Istanbul. Rüstow returned to Germany with a chair at the University of Heidelberg from 1949, publishing his three-part magnum opus *Freedom and Domination* throughout the 1950s.<sup>15</sup> After Istanbul, Röpke spent the rest of his academic career at the Graduate Institute of International and Development Studies in Geneva. He was an internationally-renowned journalist and produced around 900 publications.<sup>16</sup> From affiliation with Eucken as part of the ‘German Ricardoans’ in 1926,<sup>17</sup> Rüstow and Röpke remained closely connected to the Freiburg scholars, frequently exchanging correspondence and cross-references in their work.<sup>18</sup> The methodology of this duo was, however, to view society in a more metaphysical light,<sup>19</sup> stretching ‘from legal-economic constitutionalism to the philosophy of history, historical sociology and a piercing cultural critique.’<sup>20</sup>

The *Social Market Economists* represent the branch thought closest to the programme of reform implemented in post-war West Germany and least typically “Ordoliberal”. The chief theorist was Alfred Müller-Armack (1901-1978), Professor of Economics at the

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<sup>10</sup> For an overview of his work on contractual terms as a vehicle for private economic might: Mongouachon [2011] 71.

<sup>11</sup> Böhm, Eucken, and Grossmann-Doerth [1936].

<sup>12</sup> They could be classed as a fourth category of the Ordoliberal movement. For a generational categorisation: Behrens [2015].

<sup>13</sup> Goldschmidt and Berndt [2005] 978.

<sup>14</sup> For an overview of his role in EU competition policy throughout the 1960s and 1970s: Behrens [2015].

<sup>15</sup> Rüstow [1950]; [1952]; [1957].

<sup>16</sup> Sally [1996] 244.

<sup>17</sup> Callison [2017] 52 (Led by Rüstow, challenging the German Historical School).

<sup>18</sup> Barry [1989] 107; Gerber [1994] 32; Sally [1996] 247.

<sup>19</sup> Barry [1989] 107; Gerber [1994] 32.

<sup>20</sup> Sally [1996] 244.

Universities of Münster and Cologne, who also served under Ludwig Erhard (1897-1977) in the Ministry of Economics from 1952-1963. The core tenets of the Social Market Economy explicitly built upon the Freiburg School's groundwork, though Müller-Armack placed greater emphasis upon the 'social' element of the label.<sup>21</sup> He envisaged a greater need for market interventions to pursue a policy of more equitably redistributing the benefits of a competitive economy.<sup>22</sup> For other Ordoliberalists, the acceptance of, for example, small business subsidies, co-determination, and full employment,<sup>23</sup> was incompatible with delivering an exchange-based economy; a 'Trojan horse' for interventionism, fiscal deficits, and public debt.<sup>24</sup> However for pragmatic politician Erhard this represented a more politically-palatable compromise.<sup>25</sup>

#### *B) Conceptual Account*

The problem with a purely historical account is that it obscures the core tenets that held Ordoliberalism together, making it possible to classify all three branches as part of a single, multifaceted movement. Ordoliberalism might better be understood as a 'family of ideas'<sup>26</sup> united by a common conceptual core, despite exhibiting otherwise substantial heterogeneity. This conceptual account can be divided into three shared tenets: i) a methodology, ii) a societal vision, and iii) twin means to guarantee the coherent realisation of a free market economy.

##### *i) Order-Based Method: Metaphysical and Interdisciplinary*

The most important aspect of Ordoliberalism is arguably its methodology of thinking in terms of pure economic orders. The initial trio of Freiburg scholars were perturbed by the German public's support in the 1930s for ever-increasing concentration and cartelisation of industry, uncritically accepted as part and parcel of a necessary trajectory of technological progress.<sup>27</sup> For many, economic liberalism and market competition amounted to little more than an 'ethereal 'professors' programme', a

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<sup>21</sup> For partial admission of this legacy: Müller-Armack [1965] 258.

<sup>22</sup> Grossekettler [1989] 42; Gerber [1994] 60; Nicholls [1994] 140; Sally [1996] 248-249; Joerges and Rödl [2004] 12-14; Vanberg [2004] 2.

<sup>23</sup> Sally [1996] 249.

<sup>24</sup> Dyson [2017] 96.

<sup>25</sup> Berghahn [1984] 179.

<sup>26</sup> Marquis [2007] xxxi. See also: Dyson [2017] 91-92 (on Ordoliberalism as a family resemblance).

<sup>27</sup> Böhm, Eucken, and Grossmann-Doerth [1936] 19; Eucken [1942] 94; Böhm [1947] 122; [1954] 149; Rüstow [1957] 405 (blaming 'Marxian dogma' for the popular 'blind faith in technical progress' as meaning cartelisation and concentration).

Canute-like resistance to the economically inevitable.<sup>28</sup> Walter Eucken blamed German economists for this perception. He argued that a dualism of economic approaches had been taken to extremes - the 'Great Antinomy'<sup>29</sup> - thus preventing either from meaningful analysis and public engagement.<sup>30</sup> The *German Historical School* could not see the wood for the trees: their hyper-realistic studies depicting every minutia overlooked how individual elements came 'together as a whole', and thus how individual phenomena – eg cartels – were of systemic detriment.<sup>31</sup> Yet German disciples of the Austrian *Theoretical School* of Carl Menger could not see the trees for the wood: their preoccupation with constructing overly-abstract models or purportedly rational deduction from woolly concepts ("capitalism", "socialism")<sup>32</sup> missed the importance of 'actual historical phenomena and of individual facts' for the lived experience of an economic system.<sup>33</sup>

Eucken's proposed solution was to engage in *order-based economic thinking* to synthesise the best qualities of both the inductive and deductive methods;<sup>34</sup> combining the 'facts now around us'<sup>35</sup> with how the economy 'hangs together as a whole'.<sup>36</sup> Just as the finite letters of the alphabet produce an infinite number of words,<sup>37</sup> in *Foundations of Economics* he argued that every economic system could be understood as a combination of two pure forms:<sup>38</sup> the *centrally-directed* or the *exchange-based* economic orders.<sup>39</sup> In the final chapters, Eucken proposed various mixtures of the two into three principle varieties of centrally-directed order<sup>40</sup> and one hundred possible combinations of supply and demand into differing markets,<sup>41</sup> thereby accounting for 'the economic system in every period and of every people'.<sup>42</sup>

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<sup>28</sup> According to Böhm, with hindsight: [1954] 154-155.

<sup>29</sup> Eucken [1950] 42.

<sup>30</sup> *ibid* 57.

<sup>31</sup> *ibid* 61-63. See also: Böhm, Eucken, and Grossmann-Doerth [1936] 21.

<sup>32</sup> Eucken [1948b] 192-193.

<sup>33</sup> Eucken [1950] 42. See also: Röpke [1935] 85 (theoretical economists neglect their professional duty if in the face of fascism 'they should persist, like Archimedes, in drawing their curves while the enemy threatens to invade the city'). For the argument that Menger *did* have concerns for institutional phenomena: Chapter IV, text accompanying fn 181.

<sup>34</sup> Meijer [2007] 172.

<sup>35</sup> Eucken [1950] 34.

<sup>36</sup> *ibid* 23 (emphasis in original).

<sup>37</sup> *ibid* 109.

<sup>38</sup> *ibid* 10.

<sup>39</sup> *ibid* 118.

<sup>40</sup> *ibid* 120-128.

<sup>41</sup> *ibid* 156.

<sup>42</sup> *ibid* 222.

This methodology is of crucial importance for understanding Ordoliberalism as it laid the foundations for their metaphysically-focused and interdisciplinary body of scholarship.

Even in its purely economic research, Ordoliberalism was not simply concerned with efficiency but also *metaphysical* considerations of individual freedom.<sup>43</sup> The most important economic question for Eucken was '[h]ow can modern industrialized economy and society be organized in a *humane* and efficient manner?'<sup>44</sup> Röpke similarly implored economists to fight 'for freedom, personal integrity, the constitutional State and morality which can only subsist in freedom.'<sup>45</sup> In many ways this metaphysical element to their work is comparable to the early Chicago economists,<sup>46</sup> but acquired a new urgency given the context: many Ordoliberals were writing during fascism, whether inside Nazi Germany or in exile; alternatively, their post-war work was mindful both of this recent history and the proximity of communist-socialism in East Germany. By reformulating Thomas Aquinas' philosophy of a singular, true order between God and humanity, the Ordoliberals sought to depict the perfect economic 'Ordo' between state and citizens for the twentieth century that would avoid the oppression of both lived realities.<sup>47</sup>

Ordoliberalism's methodological commitment to order-based thinking also explains their *interdisciplinary* perspective. Depicting the ideal economic order was impossible without considering its interdependence with law, governance, and society.<sup>48</sup> From his habilitation thesis in 1933 that endeavoured to translate neo-classical economics 'into the language of jurisprudence',<sup>49</sup> to work in the 1960s on the rule of law in a free market economy,<sup>50</sup> Böhm's writing particularly explored the interface between law and economics. The 1936 *Ordo Manifesto* to which he contributed chastised lawyers for only considering legal changes internally and doctrinally, thereby overlooking potentially

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<sup>43</sup> Willgerodt and Peacock [1989] 5; Schweitzer [2012a] 36.

<sup>44</sup> Eucken [1951] 27 (emphasis added). Similarly: Eucken and Böhm's foreword to the first *ORDO* in 1948 in Zweig [1980] 18 ("What kind of order is required for a human and economically successful life?"); Eucken [1949] 219 ('How can a functioning and humane order be given to the modern, industrialized economy?').

<sup>45</sup> Röpke [1955] 368.

<sup>46</sup> See Chapter II, text accompanying fn 207-209.

<sup>47</sup> Zweig [1980] 18-19.

<sup>48</sup> Eucken [1942] 93 ('contradictions and failures will arise' when the 'interdependence of all economic measures is not taken into account.); [1949] 231-232 ('all economic circumstances are related... every single economic policy intervention affects the economic process as a whole... and must therefore be coordinated with each other.')

<sup>49</sup> Böhm quoted in: Lenel [1996] 301.

<sup>50</sup> Böhm [1966]. See Section IV.

substantial implications for the economic order.<sup>51</sup> For example, the 1897 ruling of the German Reich Court that cartel agreements were legally enforceable may have raised few lawyers' eyebrows, but ought to have been recognised as of profound economic significance.<sup>52</sup> Rather than a passive spectator of the market, the law as shaped by legislators and judges directly influenced patterns of economic behaviour conducted within its normative framework. Lawyers had to consider the economic implications of legal norms, whilst economists also had to acknowledge the impact of the law upon their subject of study.<sup>53</sup>

Ordoliberalism was thus founded upon an order-based methodology that investigated economic efficiency and individual freedom in an interdisciplinary manner.

*ii) Normative Vision - between *Laissez-faire* and *Leviathan**

Despite Eucken's 'cautious neutrality' in presenting the two pure forms of order,<sup>54</sup> the Ordoliberals were in the same liberal economic policy camp as the Chicago School, unequivocally preferring the exchange-based order. Decentralised coordination through prices optimised allocative efficiency,<sup>55</sup> militating against governmental distortions via privileges, legal monopolies, and price-setting.<sup>56</sup> It was futile for state technicians in a centrally-directed economy to even attempt to emulate such efficiency.<sup>57</sup> But the virtue of free markets for Ordoliberals was not just their 'economic effect' but also the 'profound meaning for freedom'.<sup>58</sup> Central direction was said to leave individuals with 'no sphere of freedom or independence',<sup>59</sup> instead treating them as a 'tiny part in the anonymous, state-run economic machine'.<sup>60</sup> Alternatively, the exchange-based market order embodied freedom. It was an emancipating societal leveller as everybody was subjected to the same impersonal direction of the price mechanism,<sup>61</sup> and individual

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<sup>51</sup> Böhm, Eucken, and Grossmann-Doerth [1936] 18.

<sup>52</sup> Nicholls [1994] 18.

<sup>53</sup> This institutional approach to economics is considered in Chapter IV, Section IV.

<sup>54</sup> Johnson [1989] 49.

<sup>55</sup> Eucken [1948b] 189; [1948c] 27-28.

<sup>56</sup> Eucken [1952] 116, 119.

<sup>57</sup> Eucken [1932] 71; [1942] 83-84; [1948a] 94-96; Röpke [1936a] 320; Böhm [1947] 126; Rüstow [1957] 669 ('so obvious' that 'little more need to be said on the subject').

<sup>58</sup> Böhm [1954] 159. See also: Rüstow [1957] 669 (what a 'rare good fortune for humanity' that the only order compatible with freedom is also the most efficient); Schweitzer [2012a] 36 (Ordoliberalism continued the classical liberal tradition of seeing markets as necessarily for prosperity *and* freedom).

<sup>59</sup> Eucken [1950] 128.

<sup>60</sup> Eucken [1948c] 35. For an amusingly dramatic critique: Röpke [1948] 2 (considering the lack of liberty so overbearingly despotic that 3000 years of civilisation would be lost and 'every vestige of intrinsic worth and dignity would perish from the earth.').

<sup>61</sup> Grossekettler [1989] 41-42.

economic success was depoliticised, dependent upon flattering consumers rather than bureaucrats.<sup>62</sup> As ‘a force without masters or knaves’,<sup>63</sup> coordination by the prevailing price was the ‘nearly ideal social substructure for a democratic political order.’<sup>64</sup>

But the Ordoliberal predilection for free markets was not absolute. In rejecting nineteenth century ‘paleo-liberal’ absenteeism,<sup>65</sup> they sought to chart a new path somewhere ‘between laissez-faire and Leviathan’.<sup>66</sup> The desiderata of freedom and efficiency were not simply a ‘battle-cry to use against the State’ but necessitated a ‘positive substance’ of intervention.<sup>67</sup> Laissez-faire liberalism was argued to suffer from two fundamental defects.

The first was the facilitation of social inequity, with all three strands of Ordoliberalism acknowledging the need for some form of corrective social policy (‘Vitalpolitik’)<sup>68</sup> to address abject disparities resulting from the exchange-based order. As Röpke pithily stated, it was ‘economism to forget that people do not live by cheaper vacuum cleaners alone’.<sup>69</sup> Despite common contemporary portrayals as the fetishisation of austerity and budgetary responsibility, amounting to little more than trickle-down economics,<sup>70</sup> the question of how inequality was to be addressed was the most contentious issue within Ordoliberalism.<sup>71</sup> Although Eucken considered effective realisation of the exchange-based order to be the main engine for mitigating social ills,<sup>72</sup> he also accepted some form of redistribution ‘to fill gaps and soften hardship’.<sup>73</sup> Röpke advocated a radical policy of societal deconcentration to forestall the poor living conditions occasioned by industrialisation and urbanisation.<sup>74</sup> The Social Market Economy strand took the most expansive view, with Müller-Armack recommending a ‘multiform and *complete* system

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<sup>62</sup> Böhm [1947] 125-126 (‘Every individual is dependent upon an equally-impacting, impersonal and anonymous common will’); Röpke [1950a] 106.

<sup>63</sup> Böhm [1947] 128 (‘a form of power that does not violate the political, social or legal autonomy of those it acts upon.’)

<sup>64</sup> Böhm quoted in: Friedrich [1955] 511.

<sup>65</sup> Rüstow [1957] 670.

<sup>66</sup> Willgerodt and Peacock [1989] 4. Though not a middle way: Barry [1989] 108.

<sup>67</sup> Miksch [1937] 148. See also: Eucken [1949] 223-224 (‘the creation of the economic orders cannot be left to its own devices.’); [1950] 314 (‘economic system has to be consciously shaped’); [1952] 116; Foucault [1979] 121 (‘Government must accompany the market economy from start to finish’).

<sup>68</sup> Rüstow [1957] 670 (‘a policy for enhancing the quality of life’).

<sup>69</sup> Röpke [1960] 107.

<sup>70</sup> eg Bonefeld [2012]. cf the more nuanced account of: Berghahn and Young [2013].

<sup>71</sup> Kasper and Streit [1993] 19; Vanberg [1988] 20.

<sup>72</sup> Streit [1992] 697; Kasper and Streit [1993] 19.

<sup>73</sup> Eucken quoted in Streit [1992] 697. For discussion: Lenel [1989] 27-28.

<sup>74</sup> Röpke [1944] 190; [1948] 178; [1950b] 46; Dyson [2017] 97.

of social protection'.<sup>75</sup> Their comfort with subsidies for small business, vocational training, co-determination, and the pursuit of full-employment<sup>76</sup> to deliver the 'goals of social justice'<sup>77</sup> was divisive. It did however render Erhard's post-war programme of economic reform more appealing to the German public.<sup>78</sup>

The second defect of laissez-faire was, of course, its failure to protect market forces from endogenous distortions, ie the lack of competition policy: 'deliverance from the predominant power of the State', claimed Eucken, should not leave society at the 'mercy of private centres of power'.<sup>79</sup> Like Smith, he recognised the 'omnipresent, strong and irrepressible urge to eliminate competition and to acquire a monopolistic position'.<sup>80</sup> It was not 'sinning against the spirit of liberalism'<sup>81</sup> for state intervention to limit absolute business freedom. The blind faith of laissez-faire in spontaneous, inherent harmony was mistaken,<sup>82</sup> overlooking the need for an 'armed night-watchman' to ensure the 'life blood' of the competitive order<sup>83</sup> and thus defend "capitalism" against the "capitalists".<sup>84</sup> The uncertainty of what this entailed in practice will be discussed in Section III. Still, the recognition of requiring intervention to guarantee the beneficial operation of free market forces makes Ordoliberalism an unusual brand of inter-war European liberalism.

To summarise, in wholeheartedly supporting an exchange-based economy but fully aware of the deficiencies of laissez-faire, this second shared aspect of the Ordoliberal movement is neatly reflected in Eucken's maxim: 'policy to shape the economic system – yes; steering of the market process – no.'<sup>85</sup>

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<sup>75</sup> Müller-Armack quoted in: Lenel [1989] 27 (emphasis in original).

<sup>76</sup> Sally [1996] 249.

<sup>77</sup> Müller-Armack [1965] 258.

<sup>78</sup> Zweig [1980] 8.

<sup>79</sup> Eucken [1948d] 270. See also: [1942] 87.

<sup>80</sup> Eucken [1949] 222 ('Everyone espies possibilities of becoming a monopolist.); Böhm [1947] 124.

<sup>81</sup> Röpke quoted in: Nicholls [1994] 93.

<sup>82</sup> Miksch [1937] 148 (advocating 'corrective adjustments'). Similarly: Eucken [1949] 223-224; Rüstow [1957] 455, 459 (a 'pathological degeneration' of capitalism.)

<sup>83</sup> Böhm [1966] 51. cf the Sociological Neo-Liberals who thought such a phrase too weak: Megay [1970] 425 (Röpke on "government leading a shadow existence"); Rüstow [1957] 421.

<sup>84</sup> Röpke [1963] 237-237.

<sup>85</sup> Quoted in: Kloten [1989] 70. Similarly: Eucken [1942] (state intervention by 'indirect means, seeking to create and maintain a workable order.').

### iii) Coherent Realisation - the Economic Constitution and Institutional Independence

The Ordoliberals were realists rather than theoretical daydreamers.<sup>86</sup> A possible practical problem with their normative vision for society was that absolute standards – *no* state intervention under laissez-faire or *complete* state control under collectivism – are much easier to guarantee and consistently deliver. Given their sophisticated understanding of the interrelation between economics and law, the Ordoliberals were acutely aware of the potential for incoherent realisation of the exchange-based order over time.<sup>87</sup>

The novel solution was the logical device of an *economic constitution*. Rather than a free market equivalent to a political constitution,<sup>88</sup> an economic constitution was merely the ‘general political decision’ between an exchange-based or centrally-directed economy.<sup>89</sup> Its importance derived from *how* this choice was used by Ordoliberalism as a focal point; *every* norm, *every* institution, *every* market intervention, was to be checked for coherence with this quasi-Kantian categorical imperative of the exchange-based economic constitution.<sup>90</sup> The intention was to thereby achieve a consistent critical mass of market-supporting norms and interventions to optimally deliver the efficiency and freedom of a competitive order.<sup>91</sup>

The actual fleshing-out of the exchange-based economic constitution to deduce concrete guiding principles was a rather amorphous aspect of Ordoliberal writing. At the very least, it is possible to note two separate manifestations of the economic constitution in action to guarantee coherent implementation. The first concerned consistency between the free market order and the *normative framework provided by law*. Every legal norm – particularly in problematic fields such as intellectual property, corporate, tax, or bankruptcy law –<sup>92</sup> had to be individually audited for compliance with

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<sup>86</sup> Möschel [1989] 155.

<sup>87</sup> Eucken [1948c] 39 (the market as a purpose built machine rather than an arbitrary assemblage of parts); [1948d] 275 (likening the inconsistent mixture of free-exchange with central direction to expecting simultaneous playing by rival orchestras to harmonise); Müller-Armack [1978] 328 ('unsystematic mingling').

<sup>88</sup> Mestmäcker [2011] 41-42. The language of ‘constitutionalizing the economy’ (Gerber [1994]) may mislead.

<sup>89</sup> Böhm, Eucken, and Grossmann-Doerth [1936] 24. See also: Böhm [1937] 115-117 (a community decision on the economic and political system); Eucken [1950] 83 (the ‘decision as to the general ordering of the economic life of a community’).

<sup>90</sup> Grossekettler [1989] 51. See also: Böhm [1937] 115, 117 ('a single governing ideal, which guarantees its unity and utility.); Foucault [1979] 121 ('general index in which one must place the rule for defining all governmental action.').

<sup>91</sup> Gerber [1994] 42.

<sup>92</sup> Böhm [1961] 39; Röpke [1950a] 117; Eucken [1942] 92-93; [1949] 232, 236-237.

the economic constitution.<sup>93</sup> Prospectively this Ordoliberal ‘economic legislative theory’ was to ensure coherence with the free-market order whenever normative changes were considered.<sup>94</sup> Eucken was one of the only Ordoliberals to develop this,<sup>95</sup> concretising the auditing process by deducing a number of consequential, more tangible, ‘constitutive’ principles.<sup>96</sup> The second manifestation of the economic constitution as a device for coherence was in constraining the *positive programme of state intervention* (eg competition or social policy).<sup>97</sup> The logic was the same: is a particular act a ‘conformable intervention’ when checked against the economic constitution of a free market order?<sup>98</sup> Rüstow had similarly articulated ‘liberal interventionism’ as the appropriate market-based response to industrial decline: rather than doing nothing (ie *laissez-faire*), or disturbing the price mechanism (eg subsidies, import bans), the market-conforming solution was the provision of industrial retraining.<sup>99</sup> This evaluation of compatible and incompatible interventions afforded considerable scope for disagreement, as was especially the case with their divergent social policy recommendations.<sup>100</sup>

Guaranteeing the Ordoliberal vision was not, however, simply about ensuring that the state was wary of the unintended consequences of incoherent laws or interventions. Maintaining the exchange-based constitution required resilience vis-à-vis the ‘persistently dangerous influences exerted by interested parties’,<sup>101</sup> endeavouring inevitably to influence decision-makers and thus inhibit realisation of the efficient and free market economy.<sup>102</sup> These concerns justified a commitment to limited conferral of

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<sup>93</sup> Eucken [1949] 232 (to make ‘the establishment of a functioning price system of complete competition the essential criterion of every economic measure. This is the basic principle of the economic constitution.’)

<sup>94</sup> Grossekettler [1994] 15.

<sup>95</sup> Willgerodt and Peacock [1989] 7.

<sup>96</sup> For accounts of these principles: Zweig [1980] 21-23; Schmidtchen [1984] 59; Willgerodt and Peacock [1989] 7; Barry [1989] 114-115; Feld, Köhler, and Nientiedt [2015] 13-14. The most common elements are: absolute freedom of the price mechanism from governmental distortions; macroeconomic price stability; open markets (no legal monopolies and privileges); stability of economic policy; protection for private property; liability; and freedom, albeit not absolute, of contract.

<sup>97</sup> Röpke [1944] 189 (preventing ‘unprincipled interventionism which may then degenerate into a policy of collectivism.’)

<sup>98</sup> Röpke [1936a] 337; [1950a] 160.

<sup>99</sup> Rüstow [1932] 184-185.

<sup>100</sup> See text accompanying fn 68-78.

<sup>101</sup> Eucken [1949] 241.

<sup>102</sup> Eucken [1932] 56-57 (if the state and economy fuse, ‘entrepreneurs lay claim to state protection and promotion.’); Rüstow [1932] 185-186 (intervention ‘pulled apart by greedy self-seekers’); Röpke [1960] 143 (No state act ‘escapes the attention of the pressure groups and their frequently successful attempts to deflect the government’s action to their own advantage.’); Böhm [1961] 30 (decision-makers as ‘slot machines’ played by businesses). Comparing these claims to public choice theory: Kasper and Streit [1993] 13. On political interference being the main Ordoliberal concern with concentrated industries: Megay [1970] 433; Barry [1989] 116; Maier-Rigaud [2012] 142, 149; Vanberg [2014] 211.

discrete powers for the state to act rather than ‘blank cheques and power to the bureaucracy’, thus mitigating the risk of private steering.<sup>103</sup>

But a foundational aspect of Ordoliberalism was that the state *had to* intervene in markets in pursuit of competition policy. It was an especially vulnerable prey as exactly the kind of governmental conduct that powerful economic entities would wish to derail, rendering thorough enforcement perhaps the Achilles heel of successfully implementing the exchange-based economic constitution.<sup>104</sup> As a result, corrective market interventions by the state had to be ‘strong’, ‘impartial’, ‘powerful’, ‘standing above the melee of economic interests’ and, Röpke argued, committed to defending “capitalism” against the “capitalists”.<sup>105</sup> The Ordoliberal solution was for politically independent enforcement by an administrative monopoly office.<sup>106</sup> As the ‘guardian of the competitive order’,<sup>107</sup> it would have sole responsibility to pursue a policy that ensured ‘the bearers of economic power behave as if complete competition prevailed.’<sup>108</sup> The details of this recommendation were rather sparse,<sup>109</sup> though Eucken stressed the need for distance from the government to avoid ‘the pressure of interested parties’.<sup>110</sup> Of course, championing a decision-maker’s ‘inflexible will to exercise its authority’<sup>111</sup> excludes both powerful industrial lobbying *and* popular contestation. Ordoliberal faith in independent agencies has recently led to its condemnation as anti-democratic or even authoritarian.<sup>112</sup> As will be argued, such simplistic accusations overlook the additional restraint imposed by the often latent ideal of the formal *Rechtsstaat* in Ordoliberal writing.<sup>113</sup>

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<sup>103</sup> Böhm [1954] 159. See also: Rüstow [1932] 185-186 (the strong state as the vulnerable state); Röpke [1948] 93; [1950a] 192 (on giving ‘simple and straight forward tasks [to the bureaucracy to] keep temptations away from them’); [1960] 148; Böhm [1966] 58.

<sup>104</sup> Eucken [1932] 57; Miksch [1937] 150 (‘very doubtful’ that competition policy would be applied properly under pressure); Böhm [1947] 134-135; [1953] 364 (on the readiness of businesses ‘demand[ing] that the market system can go to hell so that special rules of the game, and a special slice of the cake, shall be cooked up for them’)

<sup>105</sup> Röpke [1963] 236-237.

<sup>106</sup> Eucken [1949] 241; Röpke [1950a] 234. For comment: Gerber [1994] 54; Grossekettler [1996] 321-322.

<sup>107</sup> Eucken quoted in: Vanberg [2004] 16.

<sup>108</sup> Eucken [1949] 241.

<sup>109</sup> For secondary accounts: Gerber [1994] 54-55; Grossekettler [1996] 321-322.

<sup>110</sup> Eucken [1949] 241.

<sup>111</sup> Röpke [1950a] 192.

<sup>112</sup> Megay [1970] 438-439; Bonefeld [2012] 636; Biebricher [2013] 339; [2014] 9; Wilkinson [2013] 543-544; Wörsdörfer [2014] 251.

<sup>113</sup> Section IV.

Order-based thinking, advocacy of liberalism with more intervention than laissez-faire, and coherent realisation via the economic constitution and institutional independence, are three conceptual elements binding Ordoliberalism together as a single movement, despite divergent protagonists, decades, methodologies, and disciplinary emphases. In comparison to the tighter, more focused portrayal of the Chicago School in the previous chapter, Ordoliberalism may appear rather vague; heavy on abstract concepts, lighter on concrete policies. As will be demonstrated by analysing the *substance* of Ordoliberal competition policy in Section III, once one bores-down through this general agreement to the practical coalface there are unmistakable cracks.<sup>114</sup> Beyond foundational tenets, Ordoliberalism was far from a coherent body of policy recommendations.

### III. The Ambiguous Substance of Ordoliberal Competition Policy

It is not the main purpose of this chapter to delve into the substance of Ordoliberal competition policy. Yet given its common simplification in contemporary EU competition scholarship and the ability to draw parallels with the supposedly “rival” Chicago School, the substantive controversy and complexity of Ordo competition policy will be briefly addressed.

Ordoliberal competition law prohibited “preventive” or “impediment” actions by businesses,<sup>115</sup> conduct that excluded competitors and facilitated the accumulation of market power via means other than on the merits of their performance.<sup>116</sup> Beyond this fuzzy theoretical distinction, Ordoliberal scholarship revealed very little about whether *specific types* of potentially anticompetitive conduct should be placed on one side of the divide or the other.<sup>117</sup> Of course cartels would be banned outright, not accepted as valuable agreements to stabilise markets vis-à-vis ruinous competition,<sup>118</sup> nor subjected to light-touch policing of their “abuse”.<sup>119</sup> Absolute freedom of contract had in reality amounted to the ‘freedom to choose how to define the rules of the game or the forms which the economic process takes’.<sup>120</sup> But beyond cartels, there was little indication as

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<sup>114</sup> Similarly: Dyson [2017] 91 (‘The tradition is held together by a general overlapping mesh of features, but with different features in specific cases’).

<sup>115</sup> Eucken [1949] 235, 242; [1952] 119.

<sup>116</sup> Gerber [1994] 53; Ahlborn and Grave [2006] 214-216; Mongouachon [2011] 76.

<sup>117</sup> Vanberg [2004] 13; Ahlborn and Grave [2006] 216; Schweitzer [2007] 14; Behrens [2015].

<sup>118</sup> For criticism of the 1897 ruling that cartel agreements were legally enforceable: Böhm, Eucken, and Grossmann-Doerth [1936] 18; Eucken [1950] 83; [1951] 31; Zweig [1980] 20.

<sup>119</sup> For criticism of the 1923 regulation overseeing cartel abuses: Eucken [1949] 238-239; [1951] 35; Böhm [1954] 144, 161; Mestmäcker [2011] 34-37.

<sup>120</sup> Eucken [1949] 227. See also: [1942] 90; [1950] 83; [1951] 31; [1952] 123-125; Böhm [1961] 39-40.

to the legal fate of other types of restrictive agreement, besides a few critical references by Eucken to exclusive dealing and resale price maintenance.<sup>121</sup> It is also clear that Ordoliberalism lacked a fully-theorised concept of unilateral abuse by dominant firms,<sup>122</sup> save for, again, Eucken's categorisation of predatory pricing, loyalty rebates, price discrimination, and excessive pricing as illegal 'preventive' competition.<sup>123</sup>

The substantive controversy of Ordoliberal competition policy instead appertains to its purported *goal for market intervention* and the resultant consequences for industrial concentration. Ordoliberalism has often been depicted as upholding economic freedom - rivalry for rivalry's sake - rather than maximising efficiency.<sup>124</sup> As discussed previously,<sup>125</sup> such an orientation invites a more critical approach to large market shares, merger control, and the exclusion of even inefficient rivals by bigger firms.<sup>126</sup> Whilst some champion Ordoliberalism as an anti-Chicagoan, peculiarly European approach specifically *because* it is argued to eschew efficiency,<sup>127</sup> others dismiss Ordo competition policy as anachronistic economic illiteracy.<sup>128</sup>

Both supporters and detractors can point to Eucken's advocacy of 'complete' competition<sup>129</sup> as a market context where industrial 'power disappears completely',<sup>130</sup> justifying a policy of intervention not simply to tame abuses by large firms, but targeted 'against their very existence'.<sup>131</sup> In the face of natural monopoly, Eucken followed Miksch's suggestion for governmental regulation to force firms to act "as-if" subjected to the constraints of complete competition,<sup>132</sup> including both equilibrium prices and the

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<sup>121</sup> Eucken [1949] 233, 235; [1952] 119.

<sup>122</sup> Behrens [2015].

<sup>123</sup> Eucken [1949] 235, 243; [1952] 119. For criticism: Ahlborn and Grave [2006] 215-216.

<sup>124</sup> eg Gerber [1994] 36 (suspicious of concentration and protective of the economic freedom of small businesses), 50-52; Venit [2005]; Ahlborn and Grave [2006] 214; Lovdahl Gormsen [2006]; [2007]; Akman [2009a]; [2014] 184-185; Andriychuk [2012] 374; Witt [2016] 83-84, 99; Prek and Lefèvre [2016] 70; Wigger [2017] 163.

<sup>125</sup> See Chapter I, Section III.B, and Chapter II, Section II.B.ii.

<sup>126</sup> For general discussion of the conflict between efficiency and economic freedom: Lovdahl Gormsen [2007]; Akman [2009a]; Witt [2016] 79-86.

<sup>127</sup> eg Gerber [1998] 418-420.

<sup>128</sup> eg Venit [2005].

<sup>129</sup> The commitment to '*vollständige Konkurrenz*' is commonly translated as complete, rather than perfect, competition as there was no desire for homogenous goods: Oliver [1960b] 82.

<sup>130</sup> Eucken [1950] 269-270.

<sup>131</sup> Eucken [1951] 35. See also: [1942] 90 ('The dissolution of monopolies is called for in markets where this can create the conditions of perfect competition.); [1949] 241 ('dissolving avoidable monopolies'); [1952] 130 ('dissolved wherever possible').

<sup>132</sup> Eucken [1942] 90-91; [1949] 241 (monopoly supervision should 'ensure that the bearers of economic power behave as if complete competition prevailed. The behaviour of the monopolists should be "analogous to competition."'). See also: Goldschmidt and Berndt [2005] 978 (quoting Miksch: 'the rigour which markets, organised in freedom, would practice themselves.').

pressure to be productively efficient.<sup>133</sup> Such “as-if” regulation has frequently been derided as ‘pie-in-the-sky’ thinking.<sup>134</sup> In a 1947 piece titled ‘*Decartelisation and De-Concentration*’, Böhm also connected the powerlessness of fragmented industry in complete competition to all market participants being ‘reckoned as a free man’.<sup>135</sup> Like Eucken, it was not the misuse but the ‘very emergence’ of large firms that threatened freedom, thus recommending a policy of ‘pitiless de-concentration of the private economy’.<sup>136</sup> The same policy prescription is discernible from his later argument that an exchange-based economy obliged intervention ‘to place any conceivable obstacle in the way of the establishment of economic power’; competition law was enacted not owing to concerns for efficiency, but rather the ‘serious dangers to freedom and justice’ posed by industrial concentration.<sup>137</sup> Röpke also disparaged ‘monopolism, concentration and capitalist gigantism’ which could not be considered a ‘genuine free market and system of competition’,<sup>138</sup> encouraging ‘radical’ interventions to abolish monopolies<sup>139</sup> and deconcentration by a ‘very painful process, to more reasonable proportions’,<sup>140</sup> thus guaranteeing market access for small- and medium-sized businesses.<sup>141</sup> Even if this resulted in the ‘sacrifice’ of societal efficiency,<sup>142</sup> it was a price worth paying.<sup>143</sup> Industrial concentration was simply ‘incompatible with ideals of freedom and justice’.<sup>144</sup>

Nevertheless, in the face of considerable heterogeneity within the movement, such passages of evidence alone cannot sustain the overall depiction of substantive ‘Ordoliberal competition law’ as *purely* about economic freedom, complete competition, and industrial deconcentration. As an increasing number of accounts have suggested, Ordoliberalism was far from coherent in its treatment of whether competition policy ought to be animated by economic freedom or efficiency.<sup>145</sup> Two dimensions of ambiguity on the substance of Ordoliberal competition policy are discernible.

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<sup>133</sup> Eucken [1949] 243.

<sup>134</sup> Sally [1996] 241. See also: Streit and Wohlgemuth [1997] 16.

<sup>135</sup> Böhm [1947] 122-125.

<sup>136</sup> *ibid* 130-131 (also advocating “as if” supervision of natural monopolies).

<sup>137</sup> Böhm [1961] 33.

<sup>138</sup> Röpke [1944] 188-190.

<sup>139</sup> *ibid* 188; Röpke [1948] 228.

<sup>140</sup> Röpke [1936b] 7.

<sup>141</sup> Röpke [1948] 169; [1944] 190. This is related to his desire for the dismantling of *all* forms of concentration - businesses, associations, cities: [1944] 190; [1948] 178; [1950b] 46.

<sup>142</sup> *Ibid* 221. For scepticism as to productive efficiencies: Röpke [1948] 169-170; Rüstow [1957] 458.

<sup>143</sup> *ibid* 174 (for ‘greater social contentment and the better mood of their workers.’).

<sup>144</sup> Röpke [1963] 161.

<sup>145</sup> Mestmäcker [2011]; Behrens [2015].

The first is *internal*: Eucken and Böhm were inconsistent. In *Foundations* Eucken stressed that market concentration and profits should not be conflated with economic power, revealing nothing as to whether there existed sufficient competitive constraint.<sup>146</sup> His categorisation of ‘unavoidable’ monopolies necessitating “as-if” supervision but *not* subject to deconcentration was also ambiguous,<sup>147</sup> including common microeconomic examples (eg gas pipelines, railway infrastructure) but also ‘a factory producing precision scales or medicinal equipment’ that may only *partially* dominate the market ‘on the basis of genuine cost advantages’, ie productive efficiency.<sup>148</sup> This coheres with Eucken’s suggestion that a dominant firm with smaller rivals ought to be supervised by the competition authority,<sup>149</sup> and later implication that it was possible and legitimate to come under its scrutiny through ‘becom[ing] a monopolist by using competitive means’.<sup>150</sup> These comments are difficult to square with the stark claims above. The same is true for Böhm.<sup>151</sup> Despite the strong support given to deconcentration in 1947, other aspects of this work were more equivocal, setting a relatively high threshold for finding a business dominant,<sup>152</sup> or stressing that complete competition was a mere theoretical concept: [t]he practical needs of daily economic life are generally satisfied where competitive conditions are only partially present’.<sup>153</sup> And although later depicting a struggle between democratic freedom and economic power, Böhm acknowledged efficiencies occasioned by greater size, refuting the need to emulate perfect competition.<sup>154</sup> Having earlier recognised that the optimum size of firms ought to be determined through the free market mechanism rather than administrative gut-feeling,<sup>155</sup> Böhm also accepted the efficiency of vertical integration<sup>156</sup> and the robustness of market self-correction in the absence of barriers to entry,<sup>157</sup> especially

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<sup>146</sup> Eucken [1950] 269-270.

<sup>147</sup> Eucken [1949] 241-244.

<sup>148</sup> *ibid* 238.

<sup>149</sup> *ibid* 241 (discussing a dominant supplier of ‘spiral springs’, not a typical natural monopoly).

<sup>150</sup> *ibid* 245 (also demonstrating a relatively relaxed approach to oligopolistic market structures: Ahlborn and Grave [2006] 205-206). Similarly: Mikscha [1937] 150 (concentration ‘relaxed inasmuch as this can take place without impairing the efficiency of the German economy.’); Rüstow [1957] 436 (prohibition was reserved for advantages occasioned ‘through means other than economic efficiency.’).

<sup>151</sup> Defending Böhm against allegations of putting freedom above efficiency: Mestmäcker [2011] 43-44.

<sup>152</sup> Böhm [1947] 122 (where a company can influence market price which ‘can only be achieved through possession of a very high percentage’ of the market share).

<sup>153</sup> *ibid* 126 (generally so long as there is no monopoly, partial monopoly, or oligopoly).

<sup>154</sup> Böhm [1961] 43. See also: [1954] 157.

<sup>155</sup> Böhm [1954] 158.

<sup>156</sup> Böhm [1961] 41.

<sup>157</sup> *ibid* 43.

against excessive pricing.<sup>158</sup> So, despite his radical calls for deconcentration, in the end Böhm's conceptualisation of competition policy was relatively modest:<sup>159</sup>

*"any competition whose effects will be felt by the holders of economic power, will suffice. And even if the struggle between the partial monopolist and any outsiders or between duopolists or oligopolists does not in any way have the regulating and controlling power characteristic for competition on really competitive markets, it nevertheless has the effect of weakening existing dominant positions and preventing their reinforcement."*

Perhaps the internal inconsistency of Böhm's later writing is explicable by reference to the second dimension of Ordoliberalism's ambiguity on the substance of competition law: *temporal development*. As Marquis warns, the controversial notions of replicating complete competition and "as-if" regulation were, at most, two early and 'unsuccessful "experiments'" that cannot be considered definitive elements of Ordoliberal competition policy through the decades.<sup>160</sup> Complete competition was little more than a stylised model, comparable to the role of perfect competition in modern microeconomic theory.<sup>161</sup> Secondary literature has also noted that as regards the controversial "as-if" standard of monopoly regulation, Miksch himself was aware of its limitations<sup>162</sup> and, despite frequent emphasis in contemporary commentary,<sup>163</sup> it was rapidly rejected.<sup>164</sup> More generally, any perceived opposition to economic concentration particularly softened throughout the 1950s and 1960s.<sup>165</sup> Rather than a failure to deliver Ordoliberal theory,<sup>166</sup> this temporal reformulation explains why the German delegation to the drafting of the Treaty of Rome – including Müller-Armack – pushed for *abuse control* rather than the French preference for *per se prohibition* of dominance.<sup>167</sup> It also casts light upon why Mestmäcker - disciple of Böhm and a modern Ordoliberal voice - defended acquisitions of efficiency-based dominance through internal expansion<sup>168</sup> and mergers<sup>169</sup> throughout the 1970s, like Bork<sup>170</sup> rejecting freedom-based competition law

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<sup>158</sup> *ibid* 37.

<sup>159</sup> *ibid* 43. See also: 38 (policing how firms 'first conquer and then defend and protect' their position through exclusionary practices).

<sup>160</sup> Marquis [2007] xlix.

<sup>161</sup> *ibid* xl ix. See also: Oliver [1960b] 82; Behrens [2015].

<sup>162</sup> Goldschmidt and Berndt [2005] 978.

<sup>163</sup> eg Gerber [1994] 52-53.

<sup>164</sup> Schweitzer [2007] 3; Marquis [2007] xxxvi; Mestmäcker [2011] 42-43.

<sup>165</sup> Behrens [2015]. eg Müller-Armack [1960] 53 (concentration was responsible for 'indisputable achievements' in living quality, and should be recognised as 'indispensable' when leading to lower prices); Berghahn [1984] 182 (on Erhard's acceptance of concentration short of monopoly).

<sup>166</sup> Akman [2009a] 284-285, 294-295; Wigger [2017] 175.

<sup>167</sup> Schweitzer [2007] 16; Behrens [2015]. cf Wigger [2017] 173-174 (on the Treaty of Paris).

<sup>168</sup> Mestmäcker [1972] 623-624.

<sup>169</sup> *ibid* 617, 623. See also: [1979] 340-341, 343.

<sup>170</sup> See Chapter II fn 68-69.

as 'mere protection for the middle classes'.<sup>171</sup> Furthermore, and as Böhm's later equivocation suggests, the clearest indication of a change in the Ordoliberal approach to the freedom/efficiency debate in competition law is how those writing over a number of decades adapted their economic perspectives. Compare Röpke of the 1930s, 1940s, and early 1950s on the need for painful deconcentration,<sup>172</sup> with his position in *Economics of the Free Society* from the 1960s.<sup>173</sup> In this he directly rejected replicating the structural model of perfect competition as it overlooked the 'dynamic reality of economic life', which required the 'incentives provided by the temporary advantages of market dominance' to galvanise 'the continuous striving of the producers for the favour of the consumers'.<sup>174</sup> Competition was only restricted where 'the "lead" becomes a permanent position of privilege and power', and intervention was therefore not appropriate where dominance 'is temporary and the leader is closely followed by competitors who are free to overtake him in turn'.<sup>175</sup> This conceptualisation of the substantive role of competition law, espousing the virtues of market self-correction and effective incentives to win, is very different not just from other earlier passages of Röpke's writing, but also the popular perception of 'Ordoliberal competition law' itself.

Ordoliberal ambiguity on the substance of competition policy, particularly with regards to the goal of intervention and the treatment of industrial concentration, really ought to come as little surprise. Their conceptualisation of legitimate market intervention was intended to be entirely dependent upon *economic wisdom*. The foundational *Ordo Manifesto* of 1936 called for lawyers to avail themselves of the 'findings of economic research' in deciding upon whether certain business practices ought to be illegal, therefore necessitating greater 'collaboration of the two sciences'.<sup>176</sup> If competition policy is underpinned by economic research rather than metaphysical dogmatism, such accumulated wisdom has never been unequivocal and is necessarily subject to substantial disagreement and development over time,<sup>177</sup> dynamically adjusted 'to practical experience and theoretical progress triggered by new economic insights'.<sup>178</sup> Exactly the same contestation and evolution of the common position was alluded to in the previous chapter: Henry Simons and Frank Knight of the older Chicago School

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<sup>171</sup> Mestmäcker [1979] 345. For an overview of his important role: Behrens [2015].

<sup>172</sup> See text accompanying fn 138-143.

<sup>173</sup> Röpke [1963]. cf fn 144.

<sup>174</sup> ibid 162.

<sup>175</sup> ibid. cf Eucken [1949] 228-229 (rejecting the 'battle for monopoly' as competition).

<sup>176</sup> Böhm, Eucken, and Grossmann-Doerth [1936] 24-25.

<sup>177</sup> Mongouachon [2011] 73-74.

<sup>178</sup> Behrens [2015].

profoundly disagreed with each other on the inevitability and desirability of economic concentration,<sup>179</sup> though the allocative/productive efficiencies trade-off became more widely accepted throughout the late 1950s and 1960s, thus affecting the nature of Chicagoan competition policy recommendations.<sup>180</sup> The economic consensus changed at Chicago. That Ordoliberalism remains trapped as a fossil from the 1930s and 1940s in contemporary scholarship without acknowledgement of its ambiguity, manifest internally even then, is simplistic and arbitrary.<sup>181</sup> Were Eucken exposed to the Chicagoan claims on, for instance, predatory pricing,<sup>182</sup> he may today remove it from the illegality category of 'impediment' competition; post-Chicagoan counter-claims based on strategic considerations may have reaffirmed his views.<sup>183</sup> More generally, it might be the case that if writing today, the early Ordoliberals would have few qualms with an exclusively efficiency-focused approach to competition policy.<sup>184</sup>

Essentially, condemnation of a singular Ordoliberal approach to competition law is questionable; attachment to the goal of economic freedom and industrial deconcentration rather than societal efficiency was never unambiguous and underwent considerable evolution from the 1950s onwards. Rather than 'economic freedom', the substantive orientation of "Ordoliberal competition law" should instead be generally understood as *intervention underpinned by current economic wisdom*, acknowledging that such learning necessarily represents a moving target.

#### **IV. The Form of Ordoliberal Competition Policy: Contextualisation and Extrapolation**

As with accounts of the substance of Ordoliberal competition policy, their alleged conceptualisation of the *form* of market intervention has been neatly portrayed for decades, both by neutral chroniclers<sup>185</sup> and contemporary critics<sup>186</sup> alike: Ordoliberalism is routinely said to aspire for competition enforcement through comprehensible (clear,

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<sup>179</sup> Chapter II, fn 76.

<sup>180</sup> Chapter II, Section II.B.ii and II.C.i.

<sup>181</sup> Marquis [2007] xxxi.

<sup>182</sup> See Chapter II text accompanying fn 100.

<sup>183</sup> See Chapter II text accompanying fn 160.

<sup>184</sup> Similarly: Mongouachon [2011] 78; Maier-Rigaud [2012] 162-163.

<sup>185</sup> Möschel [1989] 153-154; Streit [1992] 688-689; Watrin [1998] 18; Herrera Anchustegui [2015] 164-165.

<sup>186</sup> See many of the references in fn 124. This discussion has been reignited by the *Intel* saga: T-286/09 *Intel v Commission* [2014] ECLI:EU:T:2014:574; C-413/14P *Intel v Commission* [2017] ECLI:EU:C:2017:632. The General Court's presumption of illegality for exclusivity rebates has been attributed to Ordoliberalism: Venit [2014] 229; Rey and Venit [2015] 4. The CJEU's more nuanced stance has been welcomed as a rejection of Ordoliberal formalism: Batchelor and Jones [2017]; Petit [2017].

public, prospective) and generalised norms determining legality and illegality, militating against *ad hoc* decision-making that analyses the actual effects of specific conduct. The most commonly cited authority for this proposition is Möschel's 1989 '*Competition from an Ordo Point of View*', where Ordoliberalism is said to advocate a 'shaping of competition policy into a rule of law rather than a mechanism of discretionary decisions.'<sup>187</sup> This was motivated by notions of administrative restraint and normative certainty.<sup>188</sup> Although imperfect in sifting pro-competitive from anticompetitive conduct, the virtue of 'necessarily rough rules of thumb' lay in their administrability, abstracting workable factors as determinative of legality, but also in restricting the competition authority to the enforcement of foreseeable norms.<sup>189</sup>

Unlike the common depiction of the substance of Ordoliberal competition policy, the problem here is not that it is misleadingly simplistic. Instead, the issue is with how this happy consensus on their conceptualisation of the form of market intervention has been reached. For the critics of Ordoliberalism, it is perhaps flawed logic based on dubious premises: that i) as their competition policy was animated by economic freedom rather than efficiency, then ii) they must *necessarily* have advocated market intervention via overbroad, generalised norms of illegality. It has already been demonstrated that i) is partial<sup>190</sup> and previous discussion of Chicagoan antitrust shows that ii) does not necessarily follow i).<sup>191</sup> But even the more impartial or generous depictions of Ordoliberal competition policy as abstracted and equally-applicable obligations comprehensible to legal subjects, may struggle to locate firm foundations for their portrayal.<sup>192</sup> The Ordoliberals rarely considered jurisprudential matters of the rule of law or an ideal conceptualisation of legal norms in any great detail;<sup>193</sup> direct and extended theorising on the form of competition enforcement even less so.<sup>194</sup>

To reach these legitimate conclusions found in contemporary accounts of Ordoliberalism it is necessary to contextualise their scholarship and extrapolate from influential writing that preceded it. To fully understand the form of market intervention envisaged by the Ordoliberals, their thoughts must be situated within a tradition theorising the virtues of

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<sup>187</sup> Möschel [1989] 142, 152-153. Largely replicated at: Möschel [2001] 9-10.

<sup>188</sup> *ibid* 148 ('limitations inherent in the application of law').

<sup>189</sup> *ibid* 153-154.

<sup>190</sup> See Section III.

<sup>191</sup> Chapter II.

<sup>192</sup> eg Möschel [2001] 9-10 (no citations).

<sup>193</sup> Criticising this absence: Friedrich [1955] 518; Watrin [1979] 421-422.

<sup>194</sup> At least in the sources available in English.

the formal *Rechtsstaat* traceable to Immanuel Kant. Numerous commentators have highlighted that Ordoliberalism simply assumed delivery of its societal vision in accordance with this idealised relationship between the state and citizens.<sup>195</sup> Nevertheless, they omit A) an extended discussion of the meaning and origins of the *Rechtsstaat*, as well as B) a consideration of how it can be connected to and fill gaps within later Ordoliberal scholarship. This section addresses both omissions, thereby explaining why Ordoliberalism ought to be considered *another* school of competition policy aspiring towards determining the legality of market conduct in accordance with the formal rule of law ideal - generalised and equally-applicable norms comprehensibly delineating the boundary between lawful and unlawful.

#### A) Kant and the Rechtsstaat in German Constitutional Theory

The concept of the “*Rechtsstaat*” has had multiple conceptualisations throughout more than two-hundred years of Germanic theorising, waxing and waning in its popular desirability.<sup>196</sup> But rather than an empty slogan,<sup>197</sup> the common thread running throughout is the reconciliation of state power and individual freedom via generalised and clear legal obligations.<sup>198</sup> The classic definition of the *Rechtsstaat* is attributable to Friedrich Stahl from the middle of the 19<sup>th</sup> century:<sup>199</sup>

*“It shall precisely determine and unswervingly secure the paths and limits of its activity as well as the free spheres of its citizens in the manner of law, and it shall not, directly through the state, implement (enforce) moral ideals further than befits the legal sphere - that is to say, no further than the most essential fencing-round. That is the concept of the Rechtsstaat - not, for example, that the state simply runs the legal system without administrative objectives or fully protects only the rights of individuals. It certainly does not signify the object and substance of the state but only the manner of realising the same.”*

Although he did not use the term, the concept of the *Rechtsstaat* owes much to Immanuel Kant’s writings throughout the 1790s, especially his articulation of the *Doctrine of Right* in the *Metaphysics of Morals*.<sup>200</sup> These later works of political theory

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<sup>195</sup> eg Riha [1986] 37; Barry [1989] 117; Vanberg [1988] 23.

<sup>196</sup> Böckenförde [1991] 47-48; Nörr [1992] 146.

<sup>197</sup> Böckenförde [1991] 48. cf Loughlin [2010] 313-314.

<sup>198</sup> In directly theorising “the state” and viewing it as a benevolent guarantor of liberty, equating the *Rechtsstaat* ideal with the more antagonist English rule of law is overly simplistic. On the idiosyncrasies of the *Rechtsstaat*: Nörr [1992] 146; Rosenfeld [2001] 20; Bhat [2007] 66-68; Loughlin [2010] 313.

<sup>199</sup> Stahl quoted in: Böckenförde [1991] 54. Early appearances of “*Rechtsstaat*” include an 1808 lecture by Adam Müller, Carl Theodor Welcker’s book of 1813, and Baron von Artein’s 1824 treatise on constitutional monarchy. It entered popular discourse with Robert von Mohl’s 1829 constitutional law book: Krieger [1957] 253; Hayek [1960] 421; Böckenförde [1991] 48-49; Bhat [2007] 68; Loughlin [2010] 317.

<sup>200</sup> Kant [1793]; [1795]; [1797]. For recognition: Hayek [1960] 172; Byrd and Hruschka [2010] 25-27.

essentially concerned the innate right to ‘[f]reedom (independence from being constrained by another’s choice)’ and how it could ‘coexist with the freedom of every other’.<sup>201</sup> Kant’s proposed solution for delineating the boundaries of everyone’s freedom was through appeal to practical reason, especially by reference the Universal Principle of Right.<sup>202</sup> A norm was ‘right if it can coexist with everyone’s freedom in accordance with a universal law’.<sup>203</sup> Generalisability was thus the key determinant of rightfulness and legitimated coercion against contrary actions to thus guarantee freedom for all.<sup>204</sup> Although interpersonal relations of *private right* (contract, property, status) were conceivable without the state, centralised mechanisms were necessary to authoritatively promulgate universal laws reciprocally binding on all, to guarantee their enforcement, and to adjudicate disputes, thus recommending transition from the state of nature (a ‘state of externally lawless freedom’) for the civil condition of *public right*.<sup>205</sup> In this way, submission to the laws posited by the legislature in the rightful condition secured individual liberty; all that had been sacrificed was ‘wild, lawless freedom in order to find his freedom as such undiminished, *in a dependence upon laws*’.<sup>206</sup> And as the norms produced ought to meet the Universal Principle of Right - ie were capable of universalisation - the result was ‘a constitution in which law itself rules and depends on no particular person’.<sup>207</sup>

At the start of the 19<sup>th</sup> century, theorists of the *Rechtsstaat* articulated a “thick” conceptualisation, blending Kantian reasoning with inviolable liberties and notions of self-fulfilment through law.<sup>208</sup> In the latter half of the century the *Rechtsstaat* ideal largely shed these substantive requirements, revealing a more formalistic character of rule *through* law;<sup>209</sup> simply that the state ‘may not interfere in the realm of individual

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<sup>201</sup> Kant [1797] 393. External liberty was a relational phenomenon between individuals: [1793] 290; [1797] 451; Gregor [1963] 41; Weinrib [1987] 487; Waldron [1996] 1566; [2009] 641; Ripstein [2009] 15.

<sup>202</sup> Weinrib [1987] 472, 480-481; Bhat [2007] 84; Waldron [2009] 641.

<sup>203</sup> Kant [1797] 397 (‘whether the action of one can be united with the freedom of the other’). See also: [1793] 290.

<sup>204</sup> *ibid* 388-389.

<sup>205</sup> *ibid* 450-456. See also: [1793] 290 (on ‘public coercive laws, by which what belongs to each can be determined for him and secured against encroachment by any other.’); Waldron [1996] 1548-1550 (on the indeterminacy of the state of nature); Ripstein [2009] 23, 146, 191-192. These issues were solved through an ‘irreproachable’ sovereign legislator, an ‘irresistible’ executive to command obedience, and an ‘irreversible’ judicial authority: [1797] 456-460; Weinrib [1987] 496-498; Pogge [1988] 415; Ripstein [2009] 24, 146-147, 173-175.

<sup>206</sup> *ibid* 459 (emphasis added). See also: Gregor [1963] 26 (on coercion through law as necessary for freedom); Ripstein [2009] 9 (mutual freedom required ‘a public legal order.’).

<sup>207</sup> *ibid* 480-481.

<sup>208</sup> Böckenförde [1991] 48-50; Bhat [2007] 28-29; Loughlin [2010] 317-319 (though noting differences between Kant and Mohl).

<sup>209</sup> Böckenförde [1991] 58-59; Rosenfeld [2001] 29-31; Loughlin [2010] 319-321.

liberty either against a law (*contra legem*) or without a legal foundation (*praeter, ultra legem*).<sup>210</sup> This is visible in Stahl's above claim that adherence to the *Rechtsstaat* says nothing as to the 'object and substance of the state but only the manner of realising the same'.<sup>211</sup> With this positivistic shift, it came to be seen not as a beneficial *reconciliation* of individual liberty with state power but as a toothless restraint *legitimating* old omnipotent authority, repackaged for a revolutionary age.<sup>212</sup> As a consequence, post-war German conceptualisations of the *Rechtsstaat* have sought to introduce hard, substantive limitations upon state interference with liberty through constitutionally-entrenched basic rights derived from human dignity.<sup>213</sup>

Contemporary efforts to substantively "thicken" the *Rechtsstaat* ideal may be reconnecting with the pre-positivist conceptualisation from the early 19<sup>th</sup> century, but they do *not* re-establish contact with its Kantian origins: Kant made it very clear that the rightful exercise of state coercion 'concerns the *form* of what is laid down' rather than its substance,<sup>214</sup> a more austere stance that may have been somewhat obscured by his ethereal discussions of reason, innate right, freedom, and so on.<sup>215</sup>

Nevertheless, placing Kant within the same camp as the later, more positivistic conceptualisation of the *Rechtsstaat* without substantive limitation should not be hastily dismissed as meaningless constraint and authoritarian legitimisation. On the contrary, shorn of far-reaching questions on substantive limits to state authority and the scope of individual rights, it is possible to see that even the "thin", formalistic understanding of the *Rechtsstaat* is an ideal of considerable virtue.<sup>216</sup> As a prominent German judge has argued, the formal guarantees of the *Rechtsstaat*:<sup>217</sup>

*'show themselves to be institutions of liberty, having little to do with formalism and even less with positivism. The dismantling of liberty under totalitarian regimes begins not with*

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<sup>210</sup> Thoma quoted in: Böckenförde [1991] 58; Loughlin [2010] 321.

<sup>211</sup> See fn 199.

<sup>212</sup> eg Krieger [1957] 254-255 ('The *Rechtsstaat* was not univocally liberal; and it was concerned more with redefinition than with the limitation of the state', 'a new way of looking at the old state'); Hayek [1960] 208 (Germany positivism meant that it was there 'that the ideal of the rule of law was first deprived of real content.); Unger [1977] 191; Loughlin [2010] 318 ('an attempt to reconcile modern claims of liberty with traditional authoritarian governing arrangements').

<sup>213</sup> Rosenfeld [2001] 34-35; Tamanaha [2004] 108-110.

<sup>214</sup> Kant [1793] 292 ('concerns the form of what is laid down as right not the matter or the object in which I have a right'); [1797] 387.

<sup>215</sup> eg Rosenfeld [2001] 23-24 ('extremely weak' limitations). Similarly: Waldron [1996] 1563-1564 (on Kant's prioritisation of legal authority over rebellion).

<sup>216</sup> Raz [1977] 211 (making this argument with regard to the formal/substantive divide in Anglo-American rule of law theory). See Chapter IV, Section II.

<sup>217</sup> Böckenförde [1991] 67-68. See also: Nörr [1992] 146-147.

*the exploitation of formal guarantees and procedures but always with contempt of them in the name of a higher, material, pre-positive law’.*

The first aspect of the formal *Rechtsstaat* is the virtue of *generalised* norms rather than *ad hoc* determinations of legality. Universalisation was the core concept of Kant’s political theory, giving the law generated by the sovereign legislator its “publicness”.<sup>218</sup> Such abstraction produced end-independent norms to structure relations between individuals and with the state, otherwise affording freedom to do as one wished.<sup>219</sup> The *Rechtsstaat* aspiration towards norms universal in their scope is linked to formal equality in their application and enforcement, a common motif throughout the evolution of the ideal.<sup>220</sup> Ripstein has thus interpreted Kant as cautioning against the conferral of open-ended powers to determine the rights and obligations of citizens in a subject-specific manner.<sup>221</sup> Elements of this can be seen in his dismissal of equitable claims in legal proceedings as unstructured, subjective, discretionary appeals to the ‘court of conscience’.<sup>222</sup> The denial of privileges or discrimination through ‘status-based’ laws was a potent idea in Enlightenment Europe.<sup>223</sup> Formally preventing the state from singling-out individuals or groups through norms generalised in scope and equally-applied in the *Rechtsstaat* has therefore been defended as a crucial restraint on state coercion.<sup>224</sup>

The second element is the aspiration towards normative comprehensibility and clarity for legal subjects. Although this is less prevalent in Kant’s articulation of the rightful condition,<sup>225</sup> a number of commentators have extrapolated that this would improve the utility of the mutual “fences” between zones of private autonomy,<sup>226</sup> as well as optimising deterrence against prohibited conduct that Kant considered to be a rejection of the rightful condition.<sup>227</sup> Normative clarity was a more pronounced desideratum of

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<sup>218</sup> Kant [1795] 347 (discussing universalisation in terms of publicity vis-à-vis norms that are kept secret as their generalisation would generate resistance). Though note that the legislator is simply required to create norms in a self-disciplined manner that *could be* universally accepted by citizens: Kant [1793] 296-297.

<sup>219</sup> Kant [1793] 291. See also: Gregor [1963] 28, 37-38, 46.

<sup>220</sup> ibid 292-293; Von Humboldt [1854] 117; Böckenförde [1991] 50; Bhat [2007] 69.

<sup>221</sup> Ripstein [2009] 211-212 (discussing prerogatives, bills of attainder, factual determinations of legality, jury discretion to punish on extra-legal factors), 320 (criminal clemency).

<sup>222</sup> Kant [1797] 390-391.

<sup>223</sup> Rosenfeld [2001] 24. See also: Hayek [1960] 172; Ripstein [2009] 211.

<sup>224</sup> Böckenförde [1991] 53 ('the generality of law precludes selective invasions of the sphere of civil and social liberty').

<sup>225</sup> cf Byrd and Hruschka [2010] 29-31 (interpreting Kant on generalisability as publicity and preventing conduct that would have been kept secret for fear of disagreement as a requirement for public promulgation).

<sup>226</sup> Weinrib [1987] 499, 507; [2011] 196 ('Free persons must know what is legally permitted if they are to enjoy their rights.'). This argument is developed further in Chapter IV, text accompanying fn 65-75.

<sup>227</sup> Weinrib [1987] 499-500; Ripstein [2009] 307, 317-318. On the centrality of law for the equal freedom of all explaining Kant’s extreme stance on punishment: Ripstein [2009] Chapter 8.

later *Rechtsstaat* scholars, as with Stahl envisaging laws restraining the state through 'precisely' determining the 'free spheres of its citizens' and 'limits of its activity'.<sup>228</sup> Von Humboldt similarly rejected the popular notion of unclear criminal laws overcoming, essentially, the moral hazard of beneficial violations, advocating instead norms 'fully and clearly made known to citizens without distinction'.<sup>229</sup> This formal requirement would prevent 'the arbitrary trespass of all limits' through the enforcement of ill-defined laws and discretionary interventions.<sup>230</sup> The extension of this ideal to the burgeoning administrative apparatus of the 19<sup>th</sup> century state was one of the underappreciated successes of the later *Rechtsstaat* theorists,<sup>231</sup> advocating a comprehensible normative framework to thereby facilitate 'greater control over one's interest in a complex social setting' by formally restricting unforeseeable state acts (ie unclear, retrospective, secret, impossible normative acts) and the exercise of discretion.<sup>232</sup>

Therefore, despite lacking substantive bulwarks to state action thus guaranteeing freedom, even the most austere formal conceptualisation of the *Rechtsstaat* has particular virtues that ought not to be overlooked. It is possible to extrapolate from its advocacy in the 19<sup>th</sup> century to the Ordoliberals in the 20<sup>th</sup> century, who arguably shared this conclusion on the considerable virtue of the *Rechtsstaat* ideal, supporting general, equally-applicable, and comprehensible normative obligations.

But before situating the form of Ordoliberal competition law within the *Rechtsstaat* tradition, a brief word on Hans Kelsen, arguably one of the most influential legal philosophers of the twentieth century. The first version of Kelsen's *Pure Theory of Law*, published in 1934, was a product of the same political and economic upheavals afflicting Central Europe that contemporaneously inspired the early work of the Freiburg School.<sup>233</sup> His theory of a legal system may also be taken to exemplify the more formalistic, minimalist conceptualisations of the *Rechtsstaat*, noted above for their falling out of favour in the post-war period for supposedly legitimating, rather than

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<sup>228</sup> Stahl quoted in: Böckenförde [1991] 54.

<sup>229</sup> Von Humboldt [1854] 173. In terms of his view of the *substantive* competences of the *Rechtsstaat*, Von Humboldt's was a stringent and unrepresentative approach: Hayek [1960] 172-173; Böckenförde [1991] 49. <sup>230</sup> *ibid* 174.

<sup>231</sup> Böckenförde [1991] 54-55.

<sup>232</sup> Rosenfeld [2001] 31-33.

<sup>233</sup> Kelsen [1934]. Kelsen's time at the Graduate Institute of International Studies in Geneva before leaving for the USA in 1940 also overlapped with Röpke's arrival there from Istanbul in 1937.

limiting, the exercise of centralised power through law.<sup>234</sup> To achieve ‘true legal science’,<sup>235</sup> Kelsen thought it necessary to separate legal normativity from inherently contestable notions of morality or justice (*contra* natural law),<sup>236</sup> while also avoiding the reduction of law to mere facts that failed to appreciate their binding “oughtness” as norms (*contra* empirical legal positivism).<sup>237</sup> The pure theory instead conceptualised legal systems as a chain of hierarchical norms, from individual judicial determinations, through statutes and various iterations of the constitution, to the basic norm, a presupposition (or, in later works, a fiction)<sup>238</sup> upon which the validity and normativity of the entire system rests.<sup>239</sup> Fruitful similarities could probably be drawn between Kelsen’s basic norm and the Ordoliberal logical device of the economic constitution, both attributable to a common indebtedness to Kantian transcendentalism.<sup>240</sup>

Yet putting to one side temporal and geographic proximity, Kantian methods, and a connection to the *Rechtsstaat* tradition widely construed, Kelsen’s pure theory adds little to the questions explored in this chapter. This is for one simple reason: in consciously denying any distinction between the state and the law,<sup>241</sup> his conceptualisation of the *Rechtsstaat* was so broad and inclusive as to exclude any consideration of the desirable formal qualities for determining legality considered here (normative comprehensibility, generality, equal application, etc).<sup>242</sup> To be sure, there have been subsequent attempts to read into Kelsen’s austere articulation of the *Rechtsstaat* similar formal desiderata as are clearly recognisable above in Kant, Stahl, von Humboldt, and others.<sup>243</sup> Nevertheless, Kelsen’s “scientific” method for pinpointing the precise nature of legal normativity prevents such qualitative reflections. Whether by reason of substantive or formal deficiencies, to muse on the nature of a “true” legal

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<sup>234</sup> Van Klink and Lembcke [2013] 226. On the need to situate Kelsen’s theory within his wider work defending liberal constitutionalism and democracy: Vinx [2007].

<sup>235</sup> Kelsen [1934] 19.

<sup>236</sup> *ibid* 15-18.

<sup>237</sup> *ibid* 58; Paulson [1992] (on reading Kelsen as responding to a ‘jurisprudential antinomy’). For criticism: Pashukanis [1924] 52-53 (‘has absolutely no intention of fathoming reality’, ‘a waste of time’).

<sup>238</sup> eg Kelsen [1966] 6-7. For discussion: Duxbury [2008].

<sup>239</sup> Kelsen [1934] chapter 5.

<sup>240</sup> Paulson [1992] 322-332 (on Kelsen’s Neo-Kantianism).

<sup>241</sup> Kelsen [1934] chapter 8; 105 (‘every state must be a *Rechtsstaat* – if one understands by ‘*Rechtsstaat*’ a state that ‘has’ a legal system); [1960] 313; [1966] 4-5.

<sup>242</sup> cf Kelsen [1960] 313 (mentioning a narrower conceptualisation of the *Rechtsstaat* as including ‘democracy and legal security’, but not developing further).

<sup>243</sup> eg Vinx [2007] (arguing that Kelsen’s theory was about the full realisation of the rule of law, but using this phrase to mean validity, democracy, and liberal constitutionalism), 99 (claiming that Kelsen would accept Fuller’s version of the rule of law without any textual basis); Van Klink and Lembcke [2013] 238-241 cf 242-243 .

system... is a prejudice of natural law" which overlooks that, on Kelsen's definition,<sup>244</sup> every state necessarily satisfies the conditions to be designated a *Rechtsstaat*.<sup>245</sup> Thus, despite his jurisprudential statute, Hans Kelsen's pure theory does not enlighten the envisaged form of Ordoliberal competition law, nor their links to a conceptualisation of the *Rechtsstaat* which does incorporate considerations of the appropriate legal form.

*B) From the Formal Rechtsstaat to Freiburg*

The Ordoliberals rarely used the word "*Rechtsstaat*". Their general intellectual indebtedness to Kant was more visible, particularly in Eucken's conceptualisation of external freedom to act without coercion by others and the role of law in demarcating protected zones of individual liberty.<sup>246</sup> Where Kant is not explicitly mentioned, his influence is nevertheless tangible within the language and conceptual analysis of Ordoliberalism: Rüstow's discussion of formulating law as a process of rationalisation and the paramount importance of legal equality ('*isonomy*');<sup>247</sup> Miksch's comments on 'self-limiting freedom' and 'a just delimitation of the spheres of freedom';<sup>248</sup> or Röpke's vision of the constitutional state containing 'legal principles which offer security and protection to the individual not only in the face of the encroachments of other individuals, but also against the arbitrary interference of the state'.<sup>249</sup> But still, direct links between Kant, the *Rechtsstaat*, and the appropriate conceptualisation of law by 20<sup>th</sup> century Ordoliberalism may seem *prima facie* tenuous.

Nevertheless, extrapolating from this Kantian-*Rechtsstaat* tradition, making relevant connections and filling problematic gaps, renders Ordoliberalism a richer, more cohesive brand of liberal thought. Perhaps this is why a number of commentators have suggested that the Ordoliberals simply presumed that their societal vision would be realised in accordance with this Germanic jurisprudential tradition.<sup>250</sup> By situating the Ordoliberals within this intellectual context, it is possible to substantiate the common contemporary

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<sup>244</sup> Kelsen [1934] 105.

<sup>245</sup> This explains Hayek's dismissal of Kelsen's conceptualisation of the *Rechtsstaat*, shorn as it was of all substantive and formal requirements: [1960] 208-209; [1976] 214.

<sup>246</sup> eg Eucken [1952] 39 (citing Kant on freedom); Gerber [1994] 39-40 (quoting Eucken: "it is the responsibility of the state to find a form in which there is room for sociable coexistence... ", where absolute freedom is legally constrained to protect the freedom of others) For comparisons: Streit and Wohlgemuth [1997] 5, 7; Wörsdörfer [2010] 25-30; [2014] 252; Klump and Wörsdörfer [2010] 32, 48; Biebricher [2013] 340. Similarly: Mestmäcker [1979] 334-337 (citing Kant's *Doctrine of Right* to justify 'the resolution of social conflicts through rules').

<sup>247</sup> Rüstow [1950] 110-111.

<sup>248</sup> Miksch quoted in: Goldschmidt and Berndt [2005] 982-984.

<sup>249</sup> Röpke [1950a] 95-96. See also: [1950b] 39 ('the constitutional state based on the rule of law').

<sup>250</sup> see fn 195.

submission that their competition policy would adopt the *Rechtsstaat* form of generalised, equally-applicable norms that were comprehensible to legal subjects. A connection can be made through three justifications for this conceptualisation of law: i) the extra bulwark afforded against state coercion; ii) the more effective realisation of the exchange-based constitution through forestalling misguided and privately-motivated interventions; and iii) complementarity with the free market economy.

i) *Justification I: Extra Bulwark against State Coercion*

The first reason for believing that Ordoliberal competition policy would aspire to realise the *Rechtsstaat* ideal results from their recognition of its formalised restraint, thus better guaranteeing individual freedom vis-à-vis organs of the state.

The deployment of institutional independence as a technique of statecraft was seen to be a key element of Ordoliberalism, thus guaranteeing faithful implementation of the exchange-based constitution by shutting-out private interests.<sup>251</sup> Although vague on the specifics of the independent monopoly office, it was clearly expected as an agent of the economic constitution to maintain the ‘inflexible will to exercise its authority’<sup>252</sup> and to be staffed by a bureaucracy ‘enjoying life tenure, and answerable to itself’.<sup>253</sup> Although sometimes equivocating on whether insulated decision-makers *always* pursued the public interest,<sup>254</sup> it has been argued that Ordoliberalism lacked engagement with difficult questions of how administrative actors were to be restrained:<sup>255</sup> of how to keep ‘potential recalcitrants constantly in fear of the law’ whilst conferring ‘as little “arbitrary” power as is feasible’ to decision-makers.<sup>256</sup> Ordoliberalism may thus be accused of responding to its scathing critique of regulatory capture with a rose-tinted view of benevolent dictatorship by independent agencies such as the monopoly office.<sup>257</sup>

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<sup>251</sup> See Section II.B.iii.

<sup>252</sup> Röpke [1950a] 192.

<sup>253</sup> Rüstow [1950] 120. On their unusually positive portrayal of the administration compared to other economists: Kasper and Streit [1993] 16.

<sup>254</sup> eg Röpke [1948] 112 (on bureaucratic creep: ‘the tendency confirmed by all experience not only obstinately to maintain itself in being but also to develop its influence still further’); Rüstow [1950] 121 (concern for the ‘degeneration of bureaucracy’ from ‘responsible authority to an absolute domination [which] makes officials not servants of the people but masters’). See Chapter IV, Section IV.B.ii.

<sup>255</sup> eg Oliver [1960b] 83; Vanberg [1988] 24; [2004] 17; Leipold [1990] 60-61; Rieter and Schmolz [1993] 108.

<sup>256</sup> Oliver [1960a] 143.

<sup>257</sup> As summarised by: Grossekettler [1994] 22; Vanberg [2004] 16; and citations in fn 112. cf the more sympathetic analysis of: Sally [1996] 253.

This criticism would, however, overlook their appreciation for how conceptualising law as general, equally-applicable norms formally restrains authority, thereby echoing arguments supporting the *Rechtsstaat* ideal as an additional, politically-desirable bulwark against the necessary power of the state. In essence, general legal norms clearly delineating rights and obligations were preferable to *ad hoc* normative acts by the state owing to their protection of liberty.<sup>258</sup> In one of the few direct references to the concept, Rüstow argued that the importance of the *Rechtsstaat*'s elements for individual freedom through state restraint - 'even those of "merely formal" nature' - should not be taken for granted.<sup>259</sup> As opposed to subject-specific determinations of lawfulness, this ideal of generalised and equally-applicable norms was also for Röpke the greatest achievement of the 19<sup>th</sup> century: 'the conquest of arbitrary might through right'.<sup>260</sup> Adopting the familiar analogy of traffic control, he argued that conceptualising law in the form of general norms facilitated individual liberty as the driver could still choose their own destination.<sup>261</sup> This notion of law as universalised, end-independent obligations is unmistakably Kantian.<sup>262</sup> Indeed, it was the 'inflexible' quality of such norms that recommended them, formally forestalling particularistic and discretionary acts by the state.<sup>263</sup> This also relates to Eucken's brief discussion of predatory pricing, and how if it were to rest on 'nebulous notions' of 'fairness' or 'unfairness' there was 'no firm basis here for a judgment to rest on'.<sup>264</sup> Miksch's writing can also be interpreted as evidence for the Ordoliberal appreciation of the inflexible restraint of state action in the formal *Rechtsstaat*,<sup>265</sup> whilst its absence fostered what he called 'bureaucratic despotism'.<sup>266</sup> The solution to such a potential for tyranny for Miksch was therefore to 'replace the concrete power of man over man by the *abstract* power of law'.<sup>267</sup>

This connection between the formal *Rechtsstaat* and Ordoliberal thought was further refined in a 1979 piece by Willgerodt. His aim was to consider whether their conceptualisation of the administration changed dependent upon the choice between a

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<sup>258</sup> Oliver [1960a] 124 (on Ordoliberal aversion to 'substantial administrative discretion.); Riha [1986] 37; Möschel [1989] 152-153; Willgerodt and Peacock [1989] 4; Barry [1989] 117; Streit [1992] 693-694; Gerber [1994] 47; Streit and Wohlgemuth [1997] 8; Wörsdörfer [2010] 30; Biebricher [2013] 340.

<sup>259</sup> Rüstow [1950] 111.

<sup>260</sup> Röpke [1950a] 96. See also: [1960] 5 ('the state and society which safeguard freedom' and 'the rule of law' are 'fundamental conditions without which a life possessing meaning and dignity is impossible').

<sup>261</sup> Rüstow [1950] 185-186.

<sup>262</sup> Streit [1992] 684.

<sup>263</sup> Rüstow [1950] 227.

<sup>264</sup> Eucken [1950] 315.

<sup>265</sup> Goldschmidt and Berndt [2005] 983.

<sup>266</sup> Miksch quoted *ibid*.

<sup>267</sup> *ibid* 984 (emphasis added).

centrally-directed or exchange-based constitution.<sup>268</sup> This question is, of course, of great importance for understanding the role of the independent monopoly office in Ordoliberalism. Willgerodt argued that the unchanging Weberian depiction of administration (bureaucratic knowledge, auditing techniques, professionalism, incorruptibility) was not shared by Ordoliberals; the economic constitution *did* materially alter their view of how it could and should operate.<sup>269</sup> A centrally-controlled economy was closely associated with the mercantilist administrations of the pre-Enlightenment era, operating through ‘irregular and discretionary’ market interventions, with ill-defined powers that set no official limit on the reach of the state.<sup>270</sup> In contrast, Willgerodt claimed that the administrative action envisaged under an exchange-based economic constitution in Ordoliberal thought was reminiscent of the idealised civil service developed during the nineteenth century as a result of *Rechtsstaat* theorising. Rather than governance through ‘pragmatism and extemporization’, the Ordo interpretation of this idealised form of administration had ‘clear limits and circumscribed powers’.<sup>271</sup> Willgerodt thus found there to be considerable virtue to the ‘permanent and unambiguous demarcation between the sphere of private autonomy and the options of governmental intervention’.<sup>272</sup>

Essentially, the restraint of the formal *Rechtsstaat* ideal can be connected to Ordoliberalism as a further measure to realise individual freedom and rigidify the power of state organs.

#### *ii) Justification II: Preventing Misguided and Privately-Motivated Interventions*

The second argument for extrapolating from the formal *Rechtsstaat* ideal to Ordoliberal competition policy relates to its guaranteeing of the exchange-based economic constitution: aspiring to market intervention via generalised and equally-applicable norms formally prevents *ad hoc* interference in the economy, whether as a result of centralised error or external persuasion.

With regard to the state’s necessary powers to mitigate the omissions of *laissez-faire* (competition policy, social policy), Rüstow’s advocacy of liberal interventionism and

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<sup>268</sup> Willgerodt [1979] 160.

<sup>269</sup> *ibid* 161.

<sup>270</sup> *ibid*.

<sup>271</sup> *ibid*.

<sup>272</sup> *ibid* 162.

Röpke on conformable actions were both briefly discussed above.<sup>273</sup> In their cautious awareness of the possibility for the inconsistent realisation of the exchange-based economic constitution, they clearly envisaged the prevention of *substantively incompatible* interventions; the appropriate response to industrial decline, for example, was not subsidies and tariffs but workforce retraining.<sup>274</sup> But it is also plain from Ordoliberal writing that *ad hoc*, subject-specific interventions, as opposed to the rigidity of general norms delineating prohibited conduct, were considered *formally incompatible* with the market order, regardless of what they sought to achieve. In other words, the *Rechtsstaat* ideal facilitated the coherent realisation of the Ordoliberal societal vision by formally binding the state's hands, preventing particular means of interference that were deemed incompatible with a free market order. This is discernible from Röpke's comparison of general traffic rules with the police determining each individual's position on the road and directing every separate movement; the latter *form* of normative act 'would be an entirely incompatible intervention and thus akin to planned economy'.<sup>275</sup> To prevent arbitrary disturbances to the market order, the state should be restricted to the form of entirely 'inflexible' rules.<sup>276</sup> In short:<sup>277</sup>

*'it is advisable to base economic policy on definite rules and fixed principles and to restrict the sphere of arbitrary action as much as possible. The economic system must, so to speak, be an unbreakable toy – "fool-proof" is the telling English expression.'*

The possibility for discretionary intervention on an as-necessary basis was simply an invitation for foolish interference with market forces. Böhm suggested the same risk was visible in competition policy; if the state remedied individual anticompetitive practices in a subject-specific and unsystematic manner after their commission, there was a risk that authorities would actually meddle in everything in an 'amateurish and arbitrary manner'.<sup>278</sup> To lessen such potentially counterproductive interventions, the Ordoliberal vision would be better delivered if the state were restricted to *indirectly* improving competitive conditions through recalibrating the generalised rules shaping economic processes.<sup>279</sup> Indeed, it was this combination of free markets and the formal restraint of

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<sup>273</sup> See fns 98-99.

<sup>274</sup> See fn 99.

<sup>275</sup> Röpke [1950a] 186.

<sup>276</sup> *ibid* 227.

<sup>277</sup> *ibid* 192.

<sup>278</sup> Böhm [1961] 43.

<sup>279</sup> Vanberg [1988] 23; [2014] 208.

the *Rechtsstaat* together to prevent particular means of market intervention that Foucault found so novel about Ordoliberal governmentality.<sup>280</sup>

But the virtue of the formal *Rechtsstaat* for Ordoliberalism went beyond the prevention of misguided state interference with the economy; the inflexibility of generalised norms and their formulaic enforcement also forestalled the state's vulnerability to influence by powerful external actors. The Ordoliberal anxiety that industrialists would set politicians against competition policy was discussed above.<sup>281</sup> This led to their advocacy of an independent monopoly office isolated from direct political influence.<sup>282</sup> But as mere insulation from democratic contestation does not prevent private lobbying, the formal restraint of market intervention through generalised norms provides an additional bulwark to protect delivery of the economic constitution and prevent discriminatory economic privileges.<sup>283</sup> Essentially, this is an economic equivalent to the advocacy of the *Rechtsstaat* formally inhibiting discriminatory normative acts between citizens. This valuable consequence of the formal ideal was acknowledged by Böhm, who spent his entire career criticising the mere empowerment of officials to intervene against anticompetitive behaviour in a discretionary manner. From his early work on the 1923 law policing cartel *abuses*,<sup>284</sup> through his argument in the 1940s in favour of outright prohibition of cartel agreements rather than 'bureaucratic restraints',<sup>285</sup> to the formulation of the first comprehensive German competition policy enacted in 1957,<sup>286</sup> Böhm was sceptical as to whether extensive administrative discretion to determine illegality would ever see enforcement taken seriously. Of the latter development, he argued that even 'a very well-qualified office would, however, find it extremely difficult to administer a law which leaves to its own discretion the decision whether competition should be restrained in any particular case'.<sup>287</sup> Therefore, for the Ordoliberal vision to be guaranteed against political or private influences, mandating intervention in the form of generalised and equally-applicable norms, thus leaving 'no room for exceptions

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<sup>280</sup> Foucault [1979] 167-168, 171.

<sup>281</sup> See fn 102-101.

<sup>282</sup> See fn 106-110.

<sup>283</sup> Vanberg [2014] 209-211.

<sup>284</sup> Gerber [1994] 50.

<sup>285</sup> Nicholls [1994] 114.

<sup>286</sup> Böhm [1954] 164.

<sup>287</sup> ibid 164-165.

favouring single industries or companies',<sup>288</sup> would provide an additional safeguard beyond institutional independence to deliver the exchange-based order.<sup>289</sup>

*iii) Justification III: Effective Operation of the Free Markets*

One of the most fascinating aspects of Ordoliberalism is its claim that there exists a degree of complementarity between concepts associated with the formal *Rechtsstaat* and the optimal operation of an exchange-based economic order.<sup>290</sup> As a key normative frameworks shaping market transactions, this connection provides a third and final justification for characterising the form of Ordo competition policy as aspiring towards the *Rechtsstaat* ideal of determining legality through the equal application of generalised, comprehensible norms.

This virtuous economic complementarity was initially implicit in the writing of Eucken on the need for steady market conditions to facilitate business expectations and decision-making. One of his six constitutive principles deduced from the exchange-based economic constitution was the requirement of stable economic policy.<sup>291</sup> Eucken hypothesised that a previous failure to guarantee reliable conditions had contributed to unnecessary mergers to counteract risk, providing an example of market conduct that might not have been the same in steadier economic circumstances.<sup>292</sup>

That such stability was related to the *form* of state engagement with markets is revealed by considering Eucken's conceptualisation of the opposite to economic stability, as summarised by Schmidtchen: 'hectic, short-sighted, unpredictable fiddling with the levers of economic policy' and 'characterised by nervous restlessness'.<sup>293</sup> The legal system could 'give direction to the actions of the economic persons and set limits to them',<sup>294</sup> but would not in the form of *ad hoc* interventions.<sup>295</sup> As competition policy is a fundamental element of wider economic policy, it is reasonable to infer that Eucken

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<sup>288</sup> Watrin [1998] 18. See also: Lyons [2009] 17 ('In order not to be corruptible, ordo-liberals argued that policy should be implemented formulaically and without discretion').

<sup>289</sup> Gerber [1994] 46 ('legal principles that directed but also constrained government conduct'); Vanberg [2014] 217-218.

<sup>290</sup> Also noted by: Streit [1992] 684 (on universal rules stabilising expectations), 693 (law establishes and secures 'the autonomy of the economic agents as a precondition of self-coordination'). Ordoliberalism is an important precursor to New Institutional Economics: Chapter IV, Section IV. See: Schmidtchen [1984] 67; Grossekettler [1989] 65; [1996] 313-314; Kasper and Streit [1993] 12; Sally [1996] 252.

<sup>291</sup> See fn 96.

<sup>292</sup> Eucken [1952] 130.

<sup>293</sup> Schmidtchen [1984] 72.

<sup>294</sup> Eucken quoted *ibid* 63.

<sup>295</sup> Similarly: Willgerodt [1979] 164 (intervention 'in a haphazard fashion... accomplishes absolutely nothing apart from unsettling trade and industry.').

would expect its enforcement ideally via restrained and comprehensible general norms rather than particularistic and unforeseeable determinations of legality.<sup>296</sup> Röpke similarly stressed the importance of steady economic policy for fostering competitiveness and risk-taking,<sup>297</sup> as well as the complementary role of the rule of law in guaranteeing a level of ‘continuity which permits of making reasonable plans and dispositions’ on the market.<sup>298</sup> Business planning, especially of long-term investment choices, naturally meets considerable uncertainty, but the legal order ought not to exacerbate such risks by ignoring the need for comprehensible rights and wrongs, thus blurring the prospective boundaries of normative obligations.<sup>299</sup> According to Rüstow, it was therefore desirable to base economic policy ‘on definite rules and fixed principles and to restrict the sphere of arbitrary action as much as possible.’<sup>300</sup>

It was however Franz Böhm’s 1966 article, *Private Law Society and the Market Economy*, which contains the most sophisticated Ordoliberal analysis of the supposed interrelationship between the exchange-based market economy and a legal framework in accordance with the formal *Rechtsstaat*.<sup>301</sup> Böhm drew from classical conceptualisations of this as norms ‘in a general, abstract and negative sense, telling individuals what not to do and otherwise leaving them free to pursue their own interests and discover new actions.’<sup>302</sup> These formal characteristics were to be approximated whether norms were promulgated as statute or the product of judicial decision-making.<sup>303</sup> This resultant ‘uniform order’ of stable and comprehensible norms was rechristened by Böhm as the ‘private law society’, the framework of rights and obligations which enshrouded and shaped all interactions between private actors.<sup>304</sup> In a characteristically Ordoliberal fashion, he stressed that the virtue of this *Rechtsstaat* was not just desirable on its own terms, but owing to its necessity in an exchange-based economy: the optimal ‘functioning of the free market system presupposes the existence of the private law society’.<sup>305</sup> This resulted from the administrative restraint of the formal *Rechtsstaat* ideal facilitating economic planning under conditions of optimal

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<sup>296</sup> As argued by: Kloten [1989] 72; Lenel [1989] 32.

<sup>297</sup> Röpke [1950a] 95.

<sup>298</sup> Röpke [1959] 72.

<sup>299</sup> Lenel [1989] 32.

<sup>300</sup> Rüstow [1950] 192.

<sup>301</sup> Böhm [1966]. See: Vanberg [2009] 8.

<sup>302</sup> Sally [1996] 243 (summarising his conceptualisation).

<sup>303</sup> Böhm [1966] 55.

<sup>304</sup> ibid 49-50.

<sup>305</sup> ibid 54.

normative clarity.<sup>306</sup> The institutional context within which economic processes operated was critical. Just as the price mechanism of neo-classical microeconomics spontaneously influenced and coordinated action by market actors, Böhm argued that law was another ‘signalling’ system impacting upon individual economic decision-making.<sup>307</sup> To foster coherence and facilitate frictionless reactions to the price mechanism, the state was therefore tasked with ‘defining and maintaining the regulative framework’ via legislation and administrative measures that created ‘favourable conditions for the emergence of effective competition.’<sup>308</sup> As the ‘medium’ through which the state sent signals to individual market actors,<sup>309</sup> the legal certainty of rights and obligations envisaged by the *Rechtsstaat* rendered law at its most ‘extremely effective’ as an ‘instrument of social control’,<sup>310</sup> thereby influencing very ‘effectively, the selection of individual plans, their content and their accommodation to the plans of others’.<sup>311</sup>

This institutional perspective on how the form of law affects market decision-making is essentially a more sophisticated version of Miksch’s earlier writing on law, prices, and general economic policy as complementary mechanisms impacting coordination on the market.<sup>312</sup> A more recent manifestation of the same economic justification for the formal *Rechtsstaat* by a contemporary Ordoliberal is Mestmäcker’s dismantling of Posner’s pragmatic theory of adjudication.<sup>313</sup> Böhm’s student rejects the premise that law and economics exist as autonomous conceptual phenomena: Posner allegedly overlooks that ‘[a]bstract legal rules’ are critical elements for decision-making in the economic system, ‘providing information that makes a rational division of labour and allocation of resources possible.’<sup>314</sup> Posner’s theses on the separation of law from economics replicates the laissez-faire error of presuming that optimal resource allocation through exchange is guaranteed without state input, including the legal framework that it maintains.<sup>315</sup> On the contrary, Mestmäcker claims that:<sup>316</sup>

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<sup>306</sup> ibid 50.

<sup>307</sup> ibid 52-53.

<sup>308</sup> ibid 56-57.

<sup>309</sup> ibid 49-50.

<sup>310</sup> ibid 52.

<sup>311</sup> ibid 53.

<sup>312</sup> Goldschmidt and Berndt [2005] 980-982.

<sup>313</sup> See Chapter II, Section IV.C.

<sup>314</sup> Mestmäcker [2008] 15.

<sup>315</sup> ibid 17-18.

<sup>316</sup> ibid 37.

*[i]nstitutions [including legal rules] reduce the information we need to act rationally and stabilise expectations in complex societies [...] They are the legal foundation of market economies. Like the price system they enable individuals to make use of more information than they individually have and to organise their own economic affairs through participation in markets.'*

Furthermore, like Böhm before him, Mestmäcker stresses the *formal* desiderata that permit law to fulfil this economic good: the comprehensibility of norms to legal subjects is necessary for planning in the market economy as a key 'by-product' of the 'rule of law is expectations that people can rely on'.<sup>317</sup> He traces this affinity between the conceptualisation of the legal system and the free market order through the Ordoliberals to Adam Smith.<sup>318</sup> This lineage of institutional economics and its more recent manifestation will be discussed in the next chapter.<sup>319</sup>

To summarise, the third and final justification for considering Ordoliberal competition law as aspiring to the form of the *Rechtsstaat* is due to its supposed complementarity with the optimal operation of free markets.

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Despite the ease with which contemporary commentators attribute a particular form of market intervention to Ordoliberals for determining legality, it is actually rather difficult to find concrete evidence for this popular portrayal. Yet as has been argued, once placed within the context of Germanic theorising on the *Rechtsstaat* and their indebtedness to Kant is acknowledged, the envisaged form of Ordoliberal competition policy becomes more plausible. Their minimal engagement with questions of how to keep in check autonomous decision-making by independent agencies they advocate is also less problematic. The formal *Rechtsstaat* ideal is a foundational aspect that can be teased out of their scholarship, justified as a further bulwark against state coercion, as a means to prevent ill-considered or privately-motivated market interventions, and as a valuable complement to the efficient operation of free markets. As their proposed monopoly office is otherwise unconstrained, is still susceptible to lobbying, and acts as a key protagonist shaping the normative context within which the economy operates, it is reasonable to conclude that the Ordoliberals would have anticipated competition enforcement in accordance with the formal *Rechtsstaat* ideal. Notwithstanding their

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<sup>317</sup> ibid 40.

<sup>318</sup> ibid 18. See also: Hutchison [1984] 21-22; Leipold [1990] 47-48.

<sup>319</sup> See Chapter IV, Section IV.

status as progenitors of the EU's administrative system of competition policy, market intervention from an Ordoliberal perspective would nevertheless still amount to the 'provision, correction and enforcement of adequate "rules of the game"'<sup>320</sup> generalised, equally-applied normative obligations that restrained and rigidified determinations of lawfulness to thus afford legal certainty to businesses.

## **V. Conclusion: Rival Schools?**

Ordoliberal competition policy is characterised by a great deal of ambiguity, much more so than is admitted by their common depiction in contemporary scholarship, both in terms of its suggested substance and form.

With regard to their *substantive* conceptualisation of the goal underpinning intervention, Section III highlighted the heterogeneity of Ordoliberal writing on competition policy. Although there were undoubtedly freedom-extolling accounts of widespread industrial deconcentration and "as-if" regulation to replicate complete competition, Ordoliberalism was subject to considerable inconsistency, disagreement, and development over time. Owing to this divergence on the question of whether competition policy should promote freedom or efficiency, it was suggested that the original message of the *Ordo Manifesto* be heeded: that the substance of Ordoliberal competition policy were to be deduced from prevailing economic wisdom.<sup>321</sup> Rather than the anti-efficiency original sin of EU competition law, the Ordoliberal heritage may actually be more subtle and conceptual, manifest in ideas such as the 'special responsibility' of dominant firms, or a slightly more sceptical approach to market self-correction.<sup>322</sup>

The ambiguity in relation to the *form* of market intervention proposed by Ordoliberalism derived not from mixed messages, but rather a scarcity of deep engagement with such conceptual issues. It is difficult to trace any real consideration of the legitimate form of competition enforcement by the independent monopoly office. Nevertheless, the common contemporary perception of Ordoliberalism as aspiring towards generalised

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<sup>320</sup> Miksch quoted in: Vanberg [1988] 23.

<sup>321</sup> cf attempts to reconcile efficiency, economic freedom, and the rule of law ideal in Ordoliberalism, though invariably doing injustice to one of the elements: Schweitzer [2007] and Mestmäcker [2011] (on protecting the process of effective competition, though unclear on how the tension between freedom and efficiency is not to be repeatedly settled in favour of the former); Vanberg [2009] (placing freedom and efficiency at different constitutional 'levels', though conflating the former with formal legal equality).

<sup>322</sup> Larouche and Schinkel [2013] 12; Behrens [2015].

and comprehensible norms was substantiated by contextualising their scholarship and extrapolating from the formal desiderata of the Kantian-*Rechtsstaat* tradition. Conceptualising law as ideally market intervention in this manner is justified by the need to further limit centralised coercion (especially by independent agencies), to prevent erroneous or exogenously-influenced distortions, and to optimise the operation of free market forces by providing normative certainty for businesses.

By combining an economically-informed substance with a form akin to the *Rechtsstaat*, it has been suggested by some commentators that Ordoliberal competition policy might therefore advocate the incorporation of economic research on efficiency consequences into the *ex ante* design of generalised norms – rules, presumptions, multi-stage tests – to structure determinations of legality, and thereby afford normative clarity to legal subjects.<sup>323</sup> But if that is the case, there is little separating Ordoliberalism as a school of competition policy from its often posited transatlantic rival, the Chicago School of antitrust. Despite the common conflation of the Chicagoan focus upon efficiency as the goal of market intervention with *ad hoc*, subject-specific determinations of illegality, Chapter II explored their overlooked appreciation for the formal rule of law ideal. The arguments extolling the desirability of generality and normative certainty in the Chicago School's consideration of the appropriate form of market interventions share much in common with Ordoliberalism's connection with the *Rechtsstaat* in this chapter. The next will weave these strands together alongside liberal political philosophy, jurisprudence, and institutional economics, to justify why market interventions realising the goal/s of competition policy ought to aspire towards the formal rule of law ideal.

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<sup>323</sup> Möschel [1989] 153-154; Herrera Anchustegui [2015] 164-165.

# Chapter IV: The Rule of Law Ideal: Rationality, Restraint, and Robust Review

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## I. Introduction

The purpose of Part I has been to develop a response to the question latent within contemporary European scholarship and left unanswered by modern competition microeconomics: towards which *form* of market intervention for determining the legality of business conduct ought the enforcement of competition policy aspire? Despite their common portrayal as rival schools, close analysis of Chicago School and Ordoliberal scholarship has demonstrated a substantial degree of commonality, not just in terms of the substantive orientation of enforcement, but also in answering this question as to the ideal form. Albeit by different means and with varying emphases, both can be interpreted as advocating intervention via generalised and equally-applicable norms delineating the boundary between legality and illegality in a manner comprehensible to businesses (clear, prospective, public, etc). Furthermore, rudimentary justifications for this aspirational means have already been intimated through shared references to notions of, for instance, freedom, restraint, planning, market stability, independent decision-making, and so on.

This chapter shifts focus from the historical contexts of the Chicagoans and Ordoliberals, as well as the specific subject-matter of competition policy, towards the wider plane of legal, political, and economic theory. Its purpose is to weave together the hitherto disparate strands of appreciation for a particular form of market intervention into a singular, coherent justification for the aspirational ideal of the rule of law. Section II offers a three-part conceptualisation of the rule of law: i) generalised and equally-applicable norms; ii) that are comprehensible to legal subjects; and iii) that are subject to rigorous oversight by the courts. It also briefly justifies the use of this formal definition against thicker, more substantive accounts, and the critique offered by Marxist legal scholars. The following sections elaborate upon the many virtues of the formal rule of law, detailing justifications found in liberal political theory (Section III) and

New Institutional Economics (Section IV). Rather than an abstract ideal, this convergence of legal, political, and economic justifications ought to suggest that market interventions in pursuit of competition policy should take realisation of the formal rule of law seriously.

## II. A Tripartite Conceptualisation of the Formal Rule of Law

### Ideal and its Critique

The rule of law has maintained its position as a key idea of Western legal philosophy for millennia owing to its malleability and imprecision.<sup>1</sup> In recent decades it has been considered as at best an essentially contested concept,<sup>2</sup> and at worst a meaningless slogan.<sup>3</sup> But rather than rejecting the concept altogether, such warnings simply highlight the need to be very specific about the conceptualisation of the rule of law adopted from the extensive catalogue of formulations.<sup>4</sup>

As a concept, the rule of law is an aspirational ideal that goes beyond the mere requirement of legal validity, advocating more than the technical, constitutional “legality” of normative acts. For instance, a legitimately-enacted law may confer the discretionary power upon a decision-maker to compel behaviour as it “sees fit”, or to create normative obligations upon citizens that are incomprehensible, impossible, or completely secret. Such norms may be legal, but they would *not* be in accordance with the rule of law ideal.<sup>5</sup> It represents an additional, highly valuable “extra”, *beyond* bare legality.

The rule of law ideal, as conceptualised and justified in this chapter, is the aspiration towards normative obligations incumbent upon legal subjects realising principles (i) and (ii) below, within an institutional framework providing principle (iii). Their respective antitheses (-) have also been briefly given to clarify their positive requirements and provide a singular conceptual taxonomy. Furthermore, it is important to stress their

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<sup>1</sup> Hutchinson and Monahan [1987] 99 ('historical plasticity', 'the will-o'-the-wisp of constitutional history'); Waldron [2002] 140-141; Loughlin [2010] 312-313 ('the ubiquity of the expression 'the rule of law' is matched only by the multiplicity of its meanings').

<sup>2</sup> Waldron [2002] 159.

<sup>3</sup> Loughlin [2010] 312.

<sup>4</sup> For an overview of its historical development and varieties: Tamanaha [2004].

<sup>5</sup> Hayek [1944] 85-86 (distinguishing legality 'in the juridical sense' from realising the rule of law); [1960] 180 ('complete legality... is not enough,' the rule of law is 'more than constitutionalism: it requires that all laws conform to certain principles.'). For similar by Bork and Easterbrook: Chapter II, Section IV.A.

aspirational quality, as (i) and (ii) are incapable of perfect implementation.<sup>6</sup> Realising the formal rule as articulated in this thesis is therefore to progress along a sliding scale of legal forms – i.e. from “less” to “more” comprehensible and generalised - rather than a binary quality of norms.

- (i) *Norms are Comprehensible, Capable of Internalisation by Legal Subjects:* the first principle is that it is possible for legal subjects to comprehend the normative obligations upon them and to rationalise their actions in response.<sup>7</sup> This capacity for “internalisation”, “cognisability”, or “comprehensibility” is a catch-all for the variety of more specific formal characteristics that are frequently posited: publicity, prospectivity, clarity, consistency, constancy, possibility, and so on;
  - (-) *Incomprehensible Norms:* a norm that it is not possible for legal subjects to rationally internalise is described as *incomprehensible*. This may result, for instance, from it not being made publicly known, commanding the impossible, or from being thoroughly ambiguous in its requirements.
- (ii) *Generalised Norms of Equal Application:* the second principle encompasses two mutually-reinforcing ideals.<sup>8</sup> First, generality or universality relates to their *normative scope*: ideally, laws are abstracted away from the particular individuals and situations that can be brought within their ambit. Second, equal application concerns the *enforcement* of norms: when a specific instance falls within its scope, the norm is to be applied equally to all, consistent with past and future enforcement;
  - (-) *Ad hoc, Subject-Specific Normative Determinations:* the antithesis is to determine the legality of conduct on the basis of the specific individual and/or instance in question without a commitment to equal application. This is primarily achieved through the conferral of administrative discretion, whether specifically deciding the legality of acts or flexibility as enforcement activity. But there are other means to

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<sup>6</sup> See Section III.C.ii.

<sup>7</sup> Comparable to: Raz [1977] 214 ('find out what [law] is and act on it.').

<sup>8</sup> Radin [1989] 785.

the same end, especially determining lawfulness through considering the specific outcomes, consequences, or *effects* of the conduct in question.

(iii) *There is a Robust Mechanism for Independently Reviewing the Legality of Normative Acts:* the third principle is that when an individual is subjected to a normative determination, there must be some independent mechanism for checking the legal validity of their power and, if entrusted with pursuing certain societal goals (eg promoting “competition”), for reviewing the substantive compliance of normative acts with this condition of power-conferral. This is a task usually entrusted to the courts;

(-) *Deference:* A body with the power to make normative determinations that is not subject to close oversight regarding the legal source of its acts, reviewing its substantive compliance with the conferral and its individual exercise, enjoys *deference*, whether as to law, facts, or the legal characterisation of facts.

This account of the rule of law derives from the somewhat differing conceptualisations offered by Friedrich Hayek,<sup>9</sup> Lon Fuller,<sup>10</sup> and Joseph Raz.<sup>11</sup> Indeed, it also conforms to the version of the rule of law critiqued by Roberto Unger,<sup>12</sup> as well as Phillip Nonet and Phillip Selznick.<sup>13</sup> Hayek’s understanding of the rule of law is particularly important and will be a frequent point of reference for two reasons: first, his close interaction and affiliation with both the Ordoliberalists<sup>14</sup> and the Chicago School,<sup>15</sup> thus representing an

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<sup>9</sup> Hayek [1944] 75-76 (‘government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge’, with discretion ‘reduced as much as possible’); [1973] 116 (rules ‘applicable to an unknown number of future instances and containing prohibitions delimiting the boundary of the protected domain of each person’).

<sup>10</sup> Fuller [1969] 33-39.

<sup>11</sup> Raz [1977] 214-218.

<sup>12</sup> Unger [1977] 52-54, 176-177 (autonomy, neutrality, uniformity, predictability).

<sup>13</sup> Nonet and Selznick [1978] 53-54 (apolitical, rule-based, procedural, observed in practice).

<sup>14</sup> Hayek moved to the University of Freiburg in 1962. On his proximity to Ordoliberalism: Hayek [1960] 359-360 (including Eucken and Röpke among his formative influences); Streit [1992] 676; Gerber [1994] 32, 58.

<sup>15</sup> Hayek joined the University of Chicago in 1950. See: Hayek [1960] 359-360 (referencing Simons and Knight among his influences), 383-384 (considering Knight ‘the American economist who has done most to advance our understanding of a free society’).

intellectual bridge;<sup>16</sup> and second, his explicit synthesis of theorising on the rule of law with considerations of economic order.<sup>17</sup> Both render Hayek especially relevant when evaluating the ideal form for market interventions in pursuit of the economic goals of competition policy.

This conceptualisation of the rule of law is not substantive.<sup>18</sup> It casts no judgement upon the *content* of legal norms and the ends they pursue; they could still be “good” or “bad”, “moral” or “immoral”, and, more pertinently, economically-informed or illiterate. In Ronald Dworkin’s terminology, it is a ““rule-book”” rather than a ““rights””-based approach, which would further aspire towards realising substantive justice.<sup>19</sup> Its formal and judicial character also says nothing as to the nature of governance, in particular the democratic pedigree of legal norms. This contrasts with the discourse theoretic communicative constitutionalism of Jürgen Habermas, as most extensively developed in *Between Facts and Norms*.<sup>20</sup> His objective was to reconcile the centuries-old clash between liberal rights and democratic republicanism - Kantianism versus Rousseauism -<sup>21</sup> through pinning the normative legitimacy of law upon civic participation in the process of norm formulation:<sup>22</sup> legitimate legal obligations were those which could be agreed upon by all affected persons engaging in rational discourse in the public arena,<sup>23</sup> guaranteed by participatory rights.<sup>24</sup> Mere aspirations towards normative generality, comprehensibility, and judicial review clearly fall short of this ideal, and are compatible with the most undemocratic and elitist means for legislating.<sup>25</sup> It was the form of his decrees rather than their royal origin which prevented Fuller’s King Rex from realising the formal rule of law.<sup>26</sup>

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<sup>16</sup> On competition policy, the *Road to Serfdom* (Hayek [1944]) is close to early Ordoliberal thought, whilst his later works ([1960], [1973], [1976], [1979]) are more akin to the Chicago School.

<sup>17</sup> See Section IV. On the rule of law and economic freedom: Tamanaha [2004] 43-44.

<sup>18</sup> For discussion of substantive conceptualisations: Summers [1993] 135-138; Craig [1997] 477-487.

<sup>19</sup> Dworkin [1985] 11-13.

<sup>20</sup> Habermas [1996]. For a more accessible summary: Habermas [1995].

<sup>21</sup> *ibid* 99-103.

<sup>22</sup> *ibid* 83.

<sup>23</sup> *ibid* 3-5 (on communicative reason), 104 ('... the legitimacy of law ultimately depends on a communicative arrangement: as participants in rational discourses, consociates under law must be able to examine whether a norm meets, or could meet with, the agreement of all those possibly affected), 107-108 (on the discourse principle and its communicative conditions).

<sup>24</sup> *ibid* 104, 123, 170-171.

<sup>25</sup> Habermas [1995] 12 (on the rule of law without democracy in practice, but how theory should not separate the two); [1996] 102-103 (generalised, abstracted norms guaranteeing legal equality are illegitimate if not resulting from rational discourse: legitimacy is ‘not secured simply through the grammatical form of general laws but only through the communicative form, discursive processes of opinion and will-formation.’), 134 (comparing his theory of discursive legitimacy to the formal *Rechtsstaat*).

<sup>26</sup> Fuller [1969] chapter 2.

Individual rights and participation in the law-making process are undoubtedly core, foundational values of Western liberal democracies.<sup>27</sup> But rather than a failing, the deliberate minimalism of the understanding of the rule of law adopted in this thesis isolates the desirable consequences of the purely *formal* ((i),(ii)) and *institutional* ((iii)) principles themselves, without their being lost in broader visions of political theory and constitutional design.<sup>28</sup> Advocates of a wider, more substantive conceptualisation of the rule of law still frequently accept the desirability of these formal characteristics,<sup>29</sup> as will be evidenced by routine citations to Habermas below. If anything, his writing is a demonstration of how a genuine appreciation for the virtues of the formal rule of law, as is visible at countless junctures in his work,<sup>30</sup> can all too easily be marginalised in more far-reaching theorising on constitutional ideals. In any event, on a more conceptual level the argument that the formal and institutional desiderata of the rule of law *do* have discernible positive consequences, justifying it as an aspiration for market intervention, collapses the wholly artificial distinction between form and substance itself.<sup>31</sup> Articulating these valuable outcomes from approximating the rule of law ideal in practice is the purpose of this chapter. Section III develops its justifications found in liberal political theory, and Section IV argues that New Institutional Economics reaches very similar conclusions.

More problematic are claims which go beyond merely *supplementing* the formal rule of law ideal with other important principles, to directly *challenging* its desirability. Such denunciation has come most prominently from Marxist legal scholars. Marx himself did not systematically analyse the concept in his major writings on capitalist production,<sup>32</sup> though negative reflections can be pieced together from his early *Critique of Hegel's Philosophy of Right* and essay “On the Jewish Question”.<sup>33</sup> In both works, Marx advanced the idea of a separation between the abstracted political sphere, where

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<sup>27</sup> As reflected in Article 2 of the Treaty on European Union.

<sup>28</sup> Raz [1977] 211 (substantive conceptualisations include ‘a complete social philosophy’ where the form loses its independent value).

<sup>29</sup> eg Dworkin [1985] 13 (although ‘plainly not sufficient for justice’, ‘[s]ome high degree of compliance with the rule-book conception seems necessary for a just society.’).

<sup>30</sup> eg Habermas [1996] 82-83 (on the importance of universal, equal, and abstract legal liberties), 143-144 (citing Fuller that legal norms should be comprehensible, prospective, public etc. to stabilise expectations); 153-154 (on the general, abstracted form of legal norms), 168 (on normative coherence fostering legal certainty), 201 (dismissing realism for abandoning hope of legal certainty which ‘leads to the conclusion that the legal system must ultimately give up the idea of satisfying the very function of law, to stabilize expectations.’). For passages that could be taken as supportive of New Institutional Economics: [1996] 39-40, 488.

<sup>31</sup> Similarly: Summers [1993] 139.

<sup>32</sup> Balbus [1977] 575; H Collins [1982] 10; Fine [1984] 96-97.

<sup>33</sup> Marx [1843]; [1844]. See: Balbus [1977] 575.

individuals seemingly held generalised legal rights to formal equality in common with all, and the reality of civil society, where everyday life was marked by inequality and division.<sup>34</sup> The liberal notion of universal and equally-applicable legal norms was thus an illusion which masked and legitimated political, economic, and social discrimination in practice.<sup>35</sup> Briefly revisiting this topic in a later piece, Marx honed in on formal legal equality as the institutionalisation of inequality, as necessarily unequal individuals can only be treated the same through their viewing ‘from a certain side only,... everything else being ignored.’<sup>36</sup> This fledgling critique of normative generalisations and legal equality as legitimating real-life disparities was elaborated upon by a number of scholars throughout the twentieth century. Bolshevik jurist Evgeny Pashukanis attempted to more precisely connect formalism, universal norms, and abstracted legal subjects to the rise and legitimisation of capitalism.<sup>37</sup> Like Marx before, Pashukanis saw legal equality as a façade for inequality whereby, for instance, the law ‘qualifies all people as being equally ‘eligible for property,’ but in no way makes property-owners of them.’<sup>38</sup> The very notion of “law” ruling in the *Rechtsstaat* rather than “men” was instead a means of class subjugation behind the veneer of impartial norms equally-applicable to all.<sup>39</sup> Such critical themes - the false equality of abstract laws, the legitimating relationship between liberal legalism and capitalist power dynamics - were motifs of Marxist condemnation of the formal rule of law throughout the 1970s and 1980s.<sup>40</sup> Indeed, so successful was this offensive that such analysis found a new home in the broader Critical Legal Studies movement. In their respective characterisations of the formal rule of law noted above, both Nonet & Selznick and Unger detailed how aspirations toward “apolitical” legal equality, consistently applied and blind to material circumstance,

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<sup>34</sup> Marx [1843] 72-73, 77-78 (‘a separation of the political citizen, the citizen of the state, from civil society, i.e., from his own actual, empirical reality.); 116; [1844] 36 (man’s ‘double life’), 48; Fine [1984] 81.

<sup>35</sup> Marx [1843] 80-81 (‘...just as the Christians are equal in heaven yet unequal on earth, so the individual members of a people are equal in the heaven of their political world yet unequal in the earthly existence of society’ through money, education, and property), 137; [1844] 34-35 (‘the state can be a free state without the man being a free man’; also on how political freedom of religion, property, and work is an abstention from their continuing cleavages in civil society), 37-38, 43-46 (on individual rights not guaranteeing freedom in reality), 48.

<sup>36</sup> Marx [1875] 154.

<sup>37</sup> Pashukanis [1924] 68, 82-88, 93, 115 (on the separation between legal subject and reality, the ability to possess rights and to act), 120-121. See: Fine [1979] 34-35 (praising Pashukanis for focusing on legal form); [1984] 157-158 (a more mixed appraisal of his fidelity to Marx); H Collins [1982] 108-111.

<sup>38</sup> Pashukanis [1924] 127. Similarly: 147 (‘The free and equal owners of commodities who meet in the market are free and equal only in the abstract relation... In real life, they are bound by various ties of mutual dependence.’).

<sup>39</sup> Pashukanis [1924] chapter 5. cf 53-54 (claiming that his method avoids shallow reductions of law to class oppression).

<sup>40</sup> Balbus [1979] 575-577, 580; Horwitz [1979] 566; Picciotto [1979] 174; H Collins [1982] 136-140; Fine [1984] 111-112, 135-136, 144-146.

clashed with the post-war rise of bureaucratic decision-making by the social-democratic welfare state endeavouring towards substantive justice.<sup>41</sup>

The criticisms levied by Marxist scholars against the formal rule of law as recounted and applied in this thesis are serious but not fatal. This is for two reasons.

First, as has increasingly been acknowledged by authors in this tradition since the late 1970s, it is all too easy to overdo the Marxist assault. It is one thing to criticise the formal rule of law for masking and perhaps facilitating vast societal disparities; it is another to denounce all aspirations towards generality, legal equality, or normative certainty as fundamentally insidious, and thus to instead champion subject-specific, discriminatory, and prospectively incomprehensible determinations of legality animated by achieving “justice”. Although few Marxists would go so far as to consider the formal rule of law an unqualified human good,<sup>42</sup> a more nuanced middle-ground accepts the important consequences of struggles for basic legal equality by women and minority groups, albeit still recognising the formal rule of law can only go so far.<sup>43</sup> For this reason even Nonet & Selznick and Unger, who helped introduce the Marxist critique into the canon of Critical Legal Studies tenets, both had considerable reservations about dispensing with the formal ideal altogether in pursuit of subject-responsive, flexible, discretionary determinations of what would be the “just” outcome in the particular dispute at hand.<sup>44</sup>

The second justification for acknowledging but marginalising the Marxist critique of the formal rule of law relates to the theoretical foundations of the subject-matter in question: competition policy is inextricably linked to the ideological assumptions of liberalism. As the previous three chapters have demonstrated, it is a field of law indebted to: Adam Smith; nineteenth century economists; inter-war liberalism then unpopular on both sides of the Atlantic; and scholarship since the 1950s which, albeit often disagreeing over the goal/s and methods of US antitrust, is nevertheless united by a commitment to the societal superiority of market forces over centralised economic

<sup>41</sup> Unger [1977] 179, 192-199, 204-205; Nonet and Selznick [1978] 54, 57, 60-64.

<sup>42</sup> In the (in)famous words of Marxist historian E.P. Thompson. See: Horwitz [1977] 566; H Collins [1982] 144-146.

<sup>43</sup> eg Fine [1979] 30-32; [1984] 1-2 (wishing to go between absolute adoration and denunciation of liberal legalism); Young [1979] 23-26. cf H Collins [1982] 146 (on the rule of law being ‘inconsistent’ with Marxism). For a general overview of this divide: Young [1979].

<sup>44</sup> Unger [1977] 238-249 (‘the decline in the rule of law might endanger, or even destroy, individual freedom.’); Nonet and Selznick [1978] 82-83, 117 (‘a risk of regression from responsiveness to repression’). On Unger becoming less apprehensive in his later writing: Shklar [1987] 10.

direction. As will similarly be seen in Part II when the focus shifts to the European Union, despite scholarly wrangling over the merits of specific policies and decisions, EU competition enforcement has always been sincerely committed to making free market economic forces work “better”. Competition policy is a liberal endeavour, and the purpose of this chapter is therefore to explain in detail how aspiring to the formal rule of law in this field best facilitates the effective realisation of political and economic goals associated with that ideological foundation. If anything, it will indeed affirm Marxist critiques of the relationship between free market capitalism and law in the form of generalised, equally-applicable, certain norms, rather than *ad hoc*, subject-specific, flexible determinations of legality.<sup>45</sup> But as the existence and entire purpose of competition law is based upon an acceptance of economic liberalism and the potential benefits of capitalism, it is methodologically sufficient to focus upon those lawyers, economists, and political theorists of a similar orientation, rather than the criticism of those who do not share such a starting point. This isn’t just putting liberalism “in” and getting the liberal rule of law “out”; as will be seen, it is reaching that conclusion by starting with the general liberal assumptions and values *which underpin competition policy as a field of law*.

### III. The Rule of Law Ideal in Liberal Political Theory

The political theory of liberalism is built upon an inescapable tension between two constitutive tenets.<sup>46</sup> Their interpretation and unsolvable reconciliation is responsible for the countless varieties of liberalism that have been proposed for centuries. The first is the paramount importance of *individual liberty* (freedom, independence, autonomy), the ability to pursue one’s wishes without impediment by others.<sup>47</sup> This has been a recurrent conceptual starting-point throughout the first half of this thesis, coming to the surface in both the earlier writing of the Chicago School of economics,<sup>48</sup> and the metaphysical method of the German Ordoliberals.<sup>49</sup> The second is the unavoidable requirement for *common action by the state*, and derives its importance from the first: as everybody enjoys liberty and thus invariably represents a threat to the freedom of others, it is necessary for the state to guarantee zones of mutual autonomy and resolve

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<sup>45</sup> See Section IV.

<sup>46</sup> Similarly: Epstein [1998] 9; [2014] 4.

<sup>47</sup> eg Kant [1797] 220; Hayek [1973] 55 (‘a supreme principle which must not be sacrificed’), 59 (its defence must be ‘dogmatic and make no concessions to expediency’).

<sup>48</sup> See Chapter II, text accompanying fn 207-210.

<sup>49</sup> See Chapter III, text accompanying fn 43-47, 58-64.

normative disagreements. This is freedom *through* state law: the creation of legal rights and obligations that act as boundaries between free individuals, as well as mechanisms for adjudication and enforcement.<sup>50</sup>

The inescapable tension at the heart of liberal political theory is therefore that whilst common action through the state is a necessary *guarantor* of individual freedom, centralised empowerment simultaneously represents a sizeable *threat* to liberty.<sup>51</sup> Such a cautious perspective on state power was previously highlighted in early Chicagoan<sup>52</sup> and Ordoliberal scholarship.<sup>53</sup> These incidences are representative of a broader liberal conviction that recognition of the legitimate use of coercion to ensure mutual freedom cannot be conflated with the granting of *carte blanche* absolute authority. For centuries liberal political and legal theory has been considering alternative reconciliations of the tense relationship between the foundational commitments to individual freedom and restraining the state. A recurrent solution has been through a constitution that *substantively* delineates the limited powers of the state and the inviolable rights of legal subjects (property, conscience, expression),<sup>54</sup> often accompanied by the institutional separation of legislative, executive, and judicial functions to dilute the concentration of power.<sup>55</sup> Without substantive constitutional conferral and restraint, the freedom of

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<sup>50</sup> eg Locke [1690] 6 [S7], 29 [S57] (laws to ‘preserve and enlarge Freedom’), 43-44 [S87]-[S88], 63 [S124]-[S126] (on the desirable civil condition of a ‘known and indifferent Judge’ determining disputes, a ‘Power to back and support the Sentence... to give it due Execution’, and ‘establish’d, settled, known law’), 69 [S136] (on the security of property under a ‘standing Rule to bound it, by which every one may know, what is his.’), 109 [S222] (laws ‘as Guards and fences’ to private property); Kant [1793] 290; [1797] 450-460 (see Chapter III, text accompanying fn 201-207); Hayek [1944] 60-62 (‘autonomous spheres in which the ends of the individual are supreme’), 86 (‘no liberty without law’); [1960] 13, 19-20, 122-123; [1973] 102; [1976] 201-204; [1979] 496; Leoni [1961] 2-3. For similar claims by Chicagoan economists: Chapter II, fn 213.

<sup>51</sup> eg Locke [1690] 47 [S93] and 69 [S137] (disputing unrestrained sovereignty); Hayek [1979] 462; Epstein [1998] 322-323 (the ‘deadly embrace of unlimited state power’); [2003] 51 (‘state power is a necessary evil rather than an unqualified blessing.’), 57 (‘strong enough to provide for social order and constrained enough not to become a threat to the social order that it supports.’), 260-261; [2011] 191; [2014] 4, 17.

<sup>52</sup> See Chapter II, text accompanying fn 211, 214.

<sup>53</sup> See Chapter III, Section II.B.ii.

<sup>54</sup> Locke [1690] 65 S131 (legislative power substantively constrained by ‘the common good’); Hayek [1960] 92 (championing ‘things which nobody has power to do’); [1973] 2 (a constitution inaugurating omnipotent government serves no purpose); [1979] 347, 456 (constitutional courts ought to rule ‘that nobody at all was entitled to take certain kinds of coercive measures.’); Epstein [2003] 57, 261; [2011] 64. For older Chicagoan support: Chapter II, text accompanying fn 215-216. For Ordoliberal support: Chapter III, text accompanying fn 103. On constitutions as devices for managing political risk and a critique of excessive precaution: Vermeule [2014] 1-4.

<sup>55</sup> Montesquieu [1748] 198-199. Similarly: Locke [1690] 63 [S124]-[S126] (though fusing judicial and executive powers, with additional federative powers for external relations); Hayek [1973] 2; Epstein [2003] 260; [2011] 27.

individuals is otherwise conditional upon continued majority support which cannot be guaranteed.<sup>56</sup>

Movements towards realising the formal desiderata of the rule of law, as conceptualised in this chapter, offer *additional* tools for addressing the tension between individual freedom and state restraint that goes to the heart of liberalism. It will be argued: A) that more comprehensible norms respect the rationality of legal subjects and facilitate the freedom to plan one's life; and B) that aspiring to common action via generalised and equally-applied norms further restrains the state, facilitating legal certainty and preventing discriminatory treatment of individuals. These formal aspirations are, however guaranteed and facilitated by C) a mechanism for incisive review that ensures compliance and aims to gradually approximate the two formal principles. In this way, the rationality and restraint of the formal rule of law, facilitated by robust review, is of considerable value in liberal political thought.

#### A) Principle I - Comprehensible Norms: Respecting Rationality

The first tenet of the proposed conceptualisation of the rule of law concerns the importance of comprehensible norms. It ought to be possible for individuals to internalise the legal obligations upon them. This ideal is aided by the requirements often associated with Fuller's allegory of hapless King Rex in *The Morality of Law*: publicity, prospectivity, clarity, etc.<sup>57</sup> In liberal political theory, approximating this ideal is a means to respect the *rational autonomy* of legal subjects: by avoiding incomprehensible norms for delineating legal rights and obligations, the formal rule of law amplifies the meaningful exercise of individual freedom. In emphasising this rationality, it also facilitates the fair attribution of personal responsibility for violations of norms.

As noted above, a central tenet of liberalism is that freedom requires common action by the state to secure mutual zones of assured autonomy to do as one pleases.<sup>58</sup> For centuries it has been advocated that it is not just the mere *presence* of such 'Guards and

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<sup>56</sup> Hayek [1944] 74; [1960] 90-93 (on the liberty/democracy tension); [1973] 1 (against unlimited majoritarianism); [1979] 346-347 (on British parliamentary sovereignty), 363; Leoni [1961] 7. cf Hayek's support for democracy but need of limiting principles: [1960] 94-95; [1979] 349, 381.

<sup>57</sup> Fuller [1969] 33-39.

<sup>58</sup> See text accompanying fn 50.

fences' vis-à-vis other citizens and coercion by the state that facilitates optimal freedom to pursue one's ends,<sup>59</sup> but the *formal comprehensibility* of such boundaries.

The connection between normative comprehensibility and the amplification of freedom was present at the birth of political liberalism. John Locke viewed the ideal conceptualisation of the laws apportioning spheres of freedom to be as a '*standing Rule to live by*' rather than '*inconstant, uncertain, unknown*' acts.<sup>60</sup> Indeed, he went so far as to argue that the legal sovereign ought to be *bound* to act through the form of '*establish'd, standing Laws, promulgated and known to the People*'.<sup>61</sup> The justification for mandating law that is clear, stable, and public was noticeably linked to permitting the meaningful exercise of liberty. Without comprehensible norms, legal subjects lacked '*any measyres set down which may guide and justify their Actions*'; such formal desiderata for law were thus necessary so that they '*may know their Duty, and be safe and secure within the limits of the Law*'.<sup>62</sup> Montesquieu similarly claimed that the '*political liberty of the subject is a tranquillity of mind*' arising from the knowledge of the freedom afforded by clear laws.<sup>63</sup> As opposed to the normative chaos of despotic governance through princely whim, the law could be '*perfectly well known*' in more moderate states.<sup>64</sup> Although an exaggeration, Montesquieu thereby connected the comprehensibility of legal norms with the meaningful enjoyment of individual freedom under law in the formative period of liberal political philosophy.

The claim that the aspiration of the formal rule of law towards normative comprehensibility facilitates individual liberty is central to two of its most prominent accounts in the twentieth century. Repackaged as honouring rational autonomy to plan one's affairs, both Raz and Hayek situate the ability for citizens to internalise legal rights and obligations at the core of their respective definitions of the rule of law:<sup>65</sup>

*"It must be such that they can find out what [the law] is and act on it. This is the basic intuition from which the doctrine of the rule of law derives: the law must be capable of guiding the behaviour of its subjects."* (Raz)

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<sup>59</sup> Locke [1690] 109 [S222].

<sup>60</sup> *ibid* 13 [S22] (emphasis added). See also: [1690] 44 [S88] ('standing laws'), 63 [S124] ('establish'd, settled, known law'), 69 [S136] ('promulgated standing Laws').

<sup>61</sup> *ibid* 65 [S131] (emphasis added).

<sup>62</sup> *ibid* 70 [S137].

<sup>63</sup> Montesquieu [1748] 198.

<sup>64</sup> *ibid* 84.

<sup>65</sup> Raz [1977] 214; Hayek [1944] 75-76.

*“... government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge.” (Hayek)*

To enjoy the freedom to construct paths for action in pursuit of their own ends, it is claimed that citizens have to be able ‘to foresee some of the conditions of [their] environments and adhere to a plan of action.’<sup>66</sup> The formal rule of law was key to fostering such prerequisites for the ‘maximal certainty of expectations’.<sup>67</sup> The principle of comprehensible legal norms, facilitated by endeavouring towards desiderata of clarity, prospectivity, publicity, etc, aims to provide the clearest possible articulation of rights and obligations ‘between the *meum* and the *tuum*’ both horizontally and vertically.<sup>68</sup> With regard to relations between citizens, formally “good fences make good neighbours” and freedom is thus increased as individuals can rationally rely upon cognisable limits to the acts of others, adjusting their plans accordingly.<sup>69</sup> The same is true vis-à-vis the state, going to the heart of the unavoidable tension of liberalism between freedom and restrained common action. As the tenets facilitating normative cognition formally restrict retroactive, unstable, secret, obscure laws, unforeseeable exercises of state power are minimised.<sup>70</sup> In contrast, the aspiration towards comprehensible norms delineating the scope of the state’s powers respects the rationality of subjects as they are able to avoid its coercive force and do not have their plans thwarted by unforeseeable acts.<sup>71</sup> By stabilising the normative framework through a clearer delineation of one’s obligations and rights, legal subjects are thereby granted the dignified agency to freely plan their daily affairs with expectations that can be relied upon.<sup>72</sup> Similar analysis of the connection between comprehensibility and liberty can be deduced from Rawls’ argument that unclear norms delineating the boundaries of liberty leave individual freedom itself indeterminate, thus chilling autonomous conduct through fear of unknowing transgression.<sup>73</sup> Normative security is therefore eroded when legality is determined by recourse to ‘vague formulae’ such as ‘fairness’ and ‘reasonableness’

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<sup>66</sup> Hayek [1960] 118. Similarly: Habermas [1996] 143-144 (comprehensible norms stabilise ‘behavioural expectations’ and legal certainty permits subjects ‘to calculate the consequences of their own and others’ behaviour.’), 201.

<sup>67</sup> Hayek [1973] 103.

<sup>68</sup> *ibid* 102.

<sup>69</sup> *ibid*.

<sup>70</sup> Raz [1977] 219,224. This is especially the case for administrative authorities: Summers [1999] 1705.

<sup>71</sup> Hayek [1944] 76 (‘Within the known rules of the game the individual is free to pursue his personal ends and desires, certain that the powers of government will not be used deliberately to frustrate his efforts.’), 79; [1960] 137.

<sup>72</sup> Raz [1977] 220-222. See also: Waldron [1989] 84, 88; Summers [1999] 1705-1706.

<sup>73</sup> Rawls [1999] 208, 210.

that necessitate *ad hoc*, subject-specific evaluations.<sup>74</sup> It is owing to this connection between comprehensible norms and the exercise of individual freedom that political liberalism often seems to suggest that a substantively “bad” norm is to be preferred to no clear indication of rights and obligations at all.<sup>75</sup>

Respect for rational autonomy through aspiring towards comprehensible norms also relates to the complex relationship between free choices and the fair attribution of responsibility; acknowledging the rationality of legal subjects makes it possible to ‘assign both credit and blame to individuals for their own actions.’<sup>76</sup> A common motif of liberal writing is that individuals ought not to be penalised for norms that they could not foresee as prohibited and thus decide to comply with. As Hayek suggested in *The Constitution of Liberty*, this means of respecting the rationality of legal subjects could be considered an extension of the principle that there should be no punishment without a law (*nulla poena sine lege*).<sup>77</sup> Even if the law were technically valid, it would be an affront to individual autonomy and a violation of the rule of law to be disciplined on the basis of an incomprehensible norm.<sup>78</sup> John Rawls linked the first formal principle of the ideal to absolution of liability:<sup>79</sup>

*“Unless citizens are able to know what the law is and are given a fair opportunity to take its directives into account, penal sanctions should not apply to them. This principle is simply the consequence of regarding a legal system as an order of public rules addressed to rational persons in order to regulate their cooperation, and of giving the appropriate weight to liberty.”*

This may be a politically desirable consequence of aspiring to the formal rule of law but it raises difficult questions for judicially-created laws.<sup>80</sup> On the one hand, such a means of formulating norms may better facilitate the comprehensibility of rights and obligations: Dicey,<sup>81</sup> Leoni,<sup>82</sup> and *Law, Legislation, and Liberty*-era Hayek<sup>83</sup> all argued

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<sup>74</sup> Hayek [1944] 81. Though note the argument of Section III.C that this can be gradually ameliorated.

<sup>75</sup> eg Scalia [1989] 1179; Tamanaha [2004] 67.

<sup>76</sup> Epstein [2003] 140.

<sup>77</sup> For the more typical interpretation of this concept: Section III.C.

<sup>78</sup> Hayek [1960] 181 ('Certainly the principle would not be satisfied if the law merely said that whoever disobeys the orders of some official will be punished').

<sup>79</sup> Rawls [1999] 212. See also: 209.

<sup>80</sup> Similarly: Waldron [2008] 8-9, 59-60 (institutional aspects of the rule of law - ie resolving uncertainty before courts - is a disruptive process that changes norms and is predicated upon obligations *not* being as clear as the ideal suggests).

<sup>81</sup> Dicey [1915] 115-116, 121 (on the rule of law as the judicial formulation of individual rights rather than Continental constitutional codes). For discussion: Leoni [1961] 91; Shklar [1987] 5-6; Craig [1997] 473-474.

<sup>82</sup> Leoni [1961], especially 8-10 (cannot be ‘certain that the legislation in force today will be in force tomorrow or even tomorrow morning.’), 81 (the ‘short-run certainty of the law.’), 83-87 (praising the stability of Roman law and English common law).

<sup>83</sup> Hayek [1973] 78-81. On this change in his conceptualisation of the rule of law: Tamanaha [2004] 69-70.

that the common law afforded stability owing to its gradual evolution in comparison to the potentially fleeting existence of statutes and bills of rights.<sup>84</sup> Yet this long-term stability is conditioned upon courts responding to discrete instances of normative incomprehensibility concerning particular parties' rights and obligations.<sup>85</sup> How are the unforeseeable consequences of judicial resolution, where one party will be disappointed, to be reconciled with absolution for unforeseeable normative indiscretions?<sup>86</sup> If the principle of comprehensibility is to respect the connection between rationality and responsibility, the norm-producing dispute ought to result in no punishment.<sup>87</sup>

To summarise, the political virtue of the principle that norms be comprehensible to legal subjects is that it permits them to meaningfully exercise their rational autonomy and freedom to plan their lives. It also facilitates the fair attribution of responsibility. Such a formal method for attempting to minimise normative uncertainty is therefore considered a valuable endeavour within liberal political theory.<sup>88</sup>

#### *B) Principle II - Generalisation and Equal Application: "Belt-and-Braces" Restraint*

The second formal characteristic of the rule of law advocated in this chapter is that legality ought to be determined through norms of generalised scope and applied equally to all circumstances falling within their ambit. While the first principle was directed towards the foundational importance of rational autonomy, this second aspirational quality for norms focuses upon *restraining* the state.

More specifically, it addresses the tense relationship between freedom and the necessity of common coercion at the heart of liberalism by formally preventing *ad hoc*, subject-specific normative acts. Essentially, it celebrates rigid imperfection: in committing to laws abstracted from specifics and unwavering in their application, the political benefits of rigidity are argued to outweigh the detriments of inflexibility to

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<sup>84</sup> See: Rosenfeld [2001] 61-62. This is comparable to the constitutional economics literature discussed in Section IV, eg Brennan and Buchanan [1985] 10.

<sup>85</sup> Rosenfeld [2001] 60-61 ('a future oriented act of law-making grounded in the very process of adjudicating a present dispute concerning past acts').

<sup>86</sup> Hayek's response was that judicial discretion was limited by general principles known by individuals: [1960] 183, 186; [1973] 63, 83, 95-96, 110-114. See: Rosenfeld [2001] 61; Tamanaha [2004] 69-70; Mestmäcker [2008] 27-28.

<sup>87</sup> Similarly: Fuller [1969] chapter 2 (on strict liability).

<sup>88</sup> Tamanaha [2004] 122.

circumstances.<sup>89</sup> Having noted the critique offered by Marxist writers and adopted by many Critical Legal scholars, it is important to recognise that such imperfection is not lightly undertaken by liberals.<sup>90</sup> There is plenty of scope to differ in calculating this trade-off. It is not inherently more “just” to treat all instances the same, rather than recognising particularities of circumstance.<sup>91</sup> Indeed, as discussed in Section II, the primary criticism of the formal rule of law is that its commitment to generality and formal equality prevent steps towards distributive equality and substantive fairness that are necessarily purposive, responsive, and circumstance-dependent.<sup>92</sup> The restraint of the formal rule of law can thus been considered a bulwark to majoritarian and socialist ambitions.<sup>93</sup> But it also formally hinders many other ends, commonly leading administrative authorities to avoid its restraining rigidity, as will be considered in Part II.

But for many *liberal* theorists, that is exactly the point. The desirable restraint of the formal rule of law ideal is less frequently lauded than limited competence conferral, constitutional rights, or the separation of powers.<sup>94</sup> Still, that coercion limited to generalised norms of equal application constitutes a politically-valuable extra bulwark against the state, as opposed to *ad hoc*, subject-specific determinations, is a recurrent motif of liberal political philosophy and scholarship on the formal ideal: Locke's advocacy of 'a standing Rule to live by, common to every one of that Society' as opposed to the 'inconstant, uncertain, unknown, arbitrary Will of another Man'<sup>95</sup> or 'Extemporary Decrees';<sup>96</sup> Dicey's championing of the English rule of law as the supremacy of the ordinary law of the land and its equal application to all, not 'of arbitrary power',

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<sup>89</sup> Hayek [1976] 194; Schauer [1991] 31-33; Epstein [1995] 38-39 (on the diminishing returns of aspiring to perfection), 53; Schauer and Zeckhauser [2007]. cf Kaplow [1992] 586-596 (rules can also be complex).

<sup>90</sup> Hayek [1973] 59 ('The preservation of a free system is so difficult precisely because it requires a constant rejection of measures which appear to be required to secure particular results, on no stronger grounds than that they conflict with a general rule').

<sup>91</sup> Schauer [1991] 136-137.

<sup>92</sup> Raz [1977] 228-229 ('Sacrificing too many social goals on the altar of the rule of law may make the law barren and empty.); Unger [1977] 192-193, 198-199, 204-205. cf Tamanaha [2004] 120-121 (distributive goals can also be achieved through general and equally-applicable norms). For some proponents of the rule of law, this was the point: Hayek [1973] 134; [1976] 244-248. For similar concerns about rigidity norms, see the exceptional treatment of pardoning by: Locke [1690] 81-82 [S159]-[s160]; Montesquieu [1748] 208. Perhaps case-by-case exceptionalism is accepted as it benefits the defendant: Tamanaha [2004] 120-121.

<sup>93</sup> Hutchinson and Monahan [1987] 99-100 (a bulwark to the 'flourishing of a rigorous democracy.').

<sup>94</sup> See text accompanying fn 54-56. cf Hayek [1979] 436 (unusually affording the restraint of the formal rule of law the same credit as the other devices).

<sup>95</sup> Locke [1690] 13 [S22].

<sup>96</sup> ibid 65 [S131]. See also: 48 [S94] (on absolute legal equality), 68-69 [S136]-[S137] ('Extemporary Arbitrary Decrees', 'Absolute Arbitrary Power'), 72 [S142] ('establish'd Laws, not to be varied in particular Cases').

prerogative, or wide discretionary authority on the part of the government’;<sup>97</sup> Fuller on managerial direction as a ‘set of instructions for accomplishing specific objectives’ versus the ‘general declarations’ furnishing ‘a baseline for self-directed action’;<sup>98</sup> Raz contrasting the restraint of the formal rule of law with the ‘arbitrary power’ to issue ‘particular legal orders’ at will;<sup>99</sup> Unger distinguishing the commands of bureaucratic law from the ‘generality in lawmaking and uniformity in application’ of the rule of law ideal;<sup>100</sup> or in Rawls’ reformulation of the rule of law as promoting the justice of ‘regularity’ in one’s dealings through the restrained enforcement of impartial norms by the administration and courts.<sup>101</sup> What unites these varied distinctions is their contrast between the *form* of state action by general and equally-applicable norms as opposed to more discriminating normative acts. This is most clear in Hayek’s distinctions between the ‘Rule of Law’ and ‘*ad hoc* action’,<sup>102</sup> ‘abstract rules’ and ‘particular commands’,<sup>103</sup> or, in his later work, ‘*nomos*’ and ‘*thesis*’.<sup>104</sup> The former ideals meet the rule of law principle that norms ought to be general in scope and equally applicable,<sup>105</sup> whilst the latter represent arbitrariness: “rule-less” or determined by particular will rather than according to recognized rules.’<sup>106</sup>

The virtue common to all of these divisions goes to the core of the freedom/centralised coercion tension, and connects this principle of the formal rule of law to the previous: individual liberty and the ability to rationally plan is amplified by formally restraining the state from determining legality through *ad hoc*, subject-specific evaluations. Legal subjects are free to do as they wish, to pursue their own purposes and ends, without incomprehensible bouts of interference.<sup>107</sup> The process of generalisation was seen in the

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<sup>97</sup> Dicey [1915] 120-121. See also: 110 (‘the rule of law is contrasted with every system of government based on the exercise by persons in authority of wide, arbitrary, or discretionary powers of constraint’), 114-115 (‘universal subjugation of all classes to one law’).

<sup>98</sup> Fuller [1969] 209-210.

<sup>99</sup> Raz [1977] 219.

<sup>100</sup> Unger [1977] 53-54.

<sup>101</sup> Rawls [1999] 206-209.

<sup>102</sup> Hayek [1944] 75-76.

<sup>103</sup> Hayek [1960] 131.

<sup>104</sup> Hayek [1973] chapters 5 and 6.

<sup>105</sup> On generality: Hayek [1944] 78 (‘typical situations into which anyone may get’); [1960] 133-134, 182 (‘referring to yet unknown cases and containing no references to particular persons, places or objects’); [1973] 47-48, 82, 116 (‘applicable to an unknown number of future instances’). On equal application: Hayek [1960] 75, 183; [1973] 116.

<sup>106</sup> Hayek [1979] 438.

<sup>107</sup> Locke [1690] 13 [S22] (preventing arbitrary coercion affords ‘Liberty to follow my own Will in all things where the Rules prescribes not’), 29 [S57], 70 [S137] (freedom is threatened if subjected to ‘the exorbitant and unlimited decrees of their sudden Thoughts, or unrestrain’d, and till that moment unknown Wills, without having any measyres set down which may guide and justify their Action... that both the People may

previous chapter to be at the core of Kant's *Doctrine of Right*; coercion by the state was rightful in the execution of laws capable of universal acceptance, thereby coexisting with the mutual freedom of all.<sup>108</sup> Habermas similarly links the very concept of law to that of generalised norms guaranteeing equal spheres of individual autonomy.<sup>109</sup> Such abstraction generates end-independent obligations that otherwise afforded the tangible freedom to do as one wishes.<sup>110</sup> This political virtue of general norms for freedom was brought into sharper focus with Hayek's discussion of *nomos* as 'purpose-independent rules'.<sup>111</sup> Through the process of abstraction beyond specifics,<sup>112</sup> norms become merely reliable 'data on which the individual can base his own plans'.<sup>113</sup> Autonomy shifts from the legal decision-maker to the individual subjected to general and equally applicable norms that restrain and rigidify determinations of legality.<sup>114</sup> For Hayek, ignorance of the formal rule of law's desirability for permitting individuals to pursue their own ends was a result of legal positivism's willingness to label any old normative order "law".<sup>115</sup> Of course, there is still room for *ad hoc*, subject-specific commands in the legal system, though Hayek argued that they are the device of *public law*: 'instructions issued by the state to its servants concerning the manner in which they are to direct the apparatus of government and the means which are at their disposal'.<sup>116</sup> The problem was in applying the same conceptualisation to legal norms structuring relations between individuals and/or the individual's relation to the state; even if a governmental agent is tasked with the means to achieve a particular purpose (eg "competition"), 'in a free society, these means do not include the private citizen'.<sup>117</sup>

Although a desirable resultant legal order for subjects wishing to exercise their individual autonomy with normative comprehensibility, this freedom is intimately connected to formally restricting and rigidifying the power of the state to prohibit or

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know their Duty, and be safe and secure within the limits of the Law; and the Rulers too kept within their due Bound'); Dicey [1915] 110 (freedom is insecure under discretion); Unger [1977] 69-70.

<sup>108</sup> See Chapter III, text accompanying fn 203-204.

<sup>109</sup> Habermas [1996] 82-83.

<sup>110</sup> Kant [1793] 291; Gregor [1963] 28, 37-38, 46.

<sup>111</sup> Hayek [1973] 82. See also: 107 (like language, general rules are 'not a means to any purpose, but merely a condition for the successful pursuit of most purposes.').

<sup>112</sup> Hayek [1976] 205. For explicit recognition that he was building upon Kant: 321.

<sup>113</sup> Hayek [1960] 20. See also: [1944] 61-62 ('follow their own values and preferences rather than somebody else's'), 76; [1960] 132 ('merely additional information to be taken into account in the decision of the actor.');

<sup>114</sup> ibid 131-132 (moving from commands to generalised norms, initiative 'shifts progressively from the issuer of the command or law to the acting person.'), 134-135.

<sup>115</sup> ibid 207-209; [1973] 87-88; [1976] 214, 217 (on legal positivism as the handmaiden of absolute authority).

<sup>116</sup> Hayek [1960] 182; [1973] 126-127. Similarly: Unger [1977] 54.

<sup>117</sup> Hayek [1973] 126-127.

permit conduct as it deems necessary. For this reason, Hayek thought it unlikely that the lawgiver would voluntarily forgo the means of *ad hoc* normative acts in ‘the needs of the moment’.<sup>118</sup> Conceptualising determinations of legality on the basis of generalised norms of equal application formally prevents what Locke referred to as the ‘Tyranny’ of the ‘arbitrary and irregular commands’ that may ‘impoverish, harass, or subdue’ individuals based on the ‘Ambition, Revenge, Covetousness, or any other irregular Passion’ of those with normative authority.<sup>119</sup> It is a formal bulwark against a discriminatory ‘reign of status’,<sup>120</sup> the ‘*ad hoc* application of state power against individuals or groups singled out for special treatment’.<sup>121</sup> The prohibition of particularistic normative decision-making specifically forestalls attempts to reduce liberty as it must be applied generally to all, across the board, thus increasing the ‘cost of oppression’<sup>122</sup> by holding friends ‘hostage’ with enemies.<sup>123</sup> It also prevents positive privileges as a result of lobbying, addressed further below.<sup>124</sup>

But even putting to one side such nefarious ends, the commitment to imperfectly generalised norms and a lack of flexibility to accurately categorise the “good” as legal and the “bad” as illegal in individual instances, thereby affording normative comprehensibility to legal subjects, is a formal hindrance to any number of laudable policy goals.<sup>125</sup> As will be discussed in Chapter VI, one such imperfectly realised end is competition enforcement aiming to maximise market efficiency.

Nevertheless, so valuable to freedom was the quality of generally-applicable and equally-enforced norms that both Locke<sup>126</sup> and Hayek<sup>127</sup> argued that this was not simply

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<sup>118</sup> *ibid* 83-84 (Such restraint ‘would require a degree of self-denial not to be expected... Abstract rules are not likely to be invented by somebody concerned with obtaining particular results.’).

<sup>119</sup> Locke [1690] 99-100 [S199]-[S201]. See also: Dicey [1915] 111 (‘ruled by law and not by caprice’); Raz [1977] 219 (restricting the ‘arbitrary use of power for personal gain, out of vengeance or favouritism’); Unger [1977] 70 (inhibits law ‘as a weapon of personal oppression’), 177 (preventing individualised punishment or favour); Epstein [1982a] 1720 (if wishing to target certain groups, ‘the clandestine use of formally neutral principles is a poor second choice’ to subject-specific normative acts); Rawls [1999] 209 (against bills of attainder).

<sup>120</sup> Hayek [1960] 135.

<sup>121</sup> Epstein [2011] 20.

<sup>122</sup> Posner [2007] 266.

<sup>123</sup> Epstein [2011] 67. See also: Hayek [1960] 135-136, 184 (equal application makes it improbable ‘that any oppressive rules will be adopted.’); Schmidtchen [1984] 67; Summers [1993] 139; Tamanaha [2004] 71; Epstein [2011] 25-26 (‘much harder to go after one’s political enemies if it is necessary to also go after one’s friends.’).

<sup>124</sup> See Section IV.

<sup>125</sup> See the many commendable goals pursued through the European Commission’s discretion in Chapter V.

<sup>126</sup> Locke [1690] 65 [S131] (the legal sovereign ‘is bound to govern by establish’d standing Laws, promulgated and known to the People, and not by Extemporany Decrees’), 68 [S136]. For recognition: Hayek [1979] 363.

a desirable ideal to be realised, but a *binding formal requirement* for state action.<sup>128</sup> Of course, there are practical limits to the restraint that this principle of the rule of law imposes. The general scope of norms often falls short of universality, resulting in many different categories of legal subject - landlord, employer, dominant undertaking.<sup>129</sup> Nevertheless, so long as the categories are not sham placeholders for individuals or small groups, and norms are still applied equally to all in the category, the worst excesses of discriminatory, subject-specific determinations are avoided, and this political benefit of the formal rule of law may be generally realised.<sup>130</sup>

C) Principle III: The Instrumental Virtue of Robust Review

The formal characteristics of the rule of law that have hitherto been explored as valuable desiderata in liberal political theory - comprehensibility, generality of scope and equal application - are aspirational ideals. And aspirational ideals they will probably remain without a third principle: an independent institutional mechanism by which the subjects of normative acts are able to have them closely reviewed, usually entrusted to courts.

Unlike the first and second principles of the rule of law which have clearly been foreshadowed and appreciated in previous chapters, the crucial role of the courts for realising this ideal has not been a prominent feature of either Chicagoan or Ordoliberal scholarship. For the former, the judiciary were primarily the source of the law's economic failings, and actively *undermined* the rule of law through perpetuating determinations of illegality through *ad hoc*, subject-specific evaluations (eg discretion, the unstructured rule of reason standard).<sup>131</sup> As will be argued in Part II, such failures to prospectively approximate the formal rule of law ideal may also, at times, be attributed

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<sup>127</sup> Hayek [1979] 445 (a constitutional requirement for laws consisting of 'universal rules intended to be applied in an unknown number of future instances and over the application of which to particular cases it had no further power.') See: Tamanaha [2004] 71.

<sup>128</sup> cf Kant [1793] 296-297 (the legislator *should* create norms in a self-disciplined manner that *could be* universally accepted by citizens).

<sup>129</sup> Leoni [1961] 68-69 (a distortion of equality before the law); Waldron [1989] 81-82; Tamanaha [2004] 94.

<sup>130</sup> Similarly: Hayek [1960] 183-184.

<sup>131</sup> See Chapter II, Section III. Though note the discussion below of how courts can render standards more generalised and comprehensible.

to the EU Courts. For the Ordoliberalists, courts were almost completely overlooked,<sup>132</sup> though have come into sharper focus for contemporary descendants of their thinking.<sup>133</sup>

Nevertheless, entirely denigrating or omitting the role of courts from discussion of the concept of the rule of law is a mistake. It will be demonstrated that this third *institutional* aspiration is of key instrumental value to the realisation of the two politically-desirable *formal* principles: i) not only does the rule of law mean little if there is no independent method to ensure congruence between legal norms and lived experience, but ii) the institutional possibility for review makes the generality and comprehensibility of norms more likely to materialise in the face of *ad hoc* decision-making, inescapable uncertainty, and the natural administrative desire to expand discretion. Essentially, robust review by the courts renders the rule of law ideal of normative restraint and rationality-respecting rigidity more achievable.

i) *Congruence between Norms and Reality: Nulla Poena Sine Lege and Judicial Independence*

The politically desirable principles of the rule of law advanced so far represent *additional* formal aspirations for constitutionally valid norms of law.<sup>134</sup> Nevertheless, it would be naïve to exclude from even the most formal of conceptualisations any mechanism for independently checking that all normative determinations undertaken actually *are* legal and that there continues to be ‘congruence between official action and declared rule’.<sup>135</sup>

This is connected to two mutually-reinforcing ideals of liberal political philosophy: the independence of the judiciary and no crime without law (*nulla poena sine lege*), the latter of which Tamanaha has summarised as basic ‘legal liberty’.<sup>136</sup> Locke stressed that the certainty of property was insecure in despotic societies as there was no independent judge ‘who may fairly and indifferently, and with authority decide, and from whence relief and redress may be expected of any injury or inconvenience’.<sup>137</sup> Montesquieu

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<sup>132</sup> For a rare discussion: Röpke [1950a] 193 (praising US antitrust judges).

<sup>133</sup> eg Schweitzer [2008] 569-577 ('Ensuring that the Commission remains closely tied to the substance of the competition rules, and ensuring effective judicial review, are essential prerequisites for protecting the balance of powers and the rule of law.');

<sup>134</sup> See text accompanying fn 5.

<sup>135</sup> Fuller [1969] 81. Nevertheless, Fuller gave less consideration than other scholars to the role of the courts for the rule of law ideal: Loughlin [2010] 335.

<sup>136</sup> Tamanaha [2004] 34-35.

<sup>137</sup> Locke [1690] 45-46 [S91]. See also: 63 [S124]-[S126] (distinguishing between legislative, executive and judicial functions), though note the peculiarity of his conceptualisation: fn 55.

most famously developed the separation of powers,<sup>138</sup> but also advanced the *nulla poena* principle.<sup>139</sup> However it was Dicey that included the latter as a fundamental requirement of the rule of law. It stood for the virtuous proposition that ‘no man can be made to suffer punishment or to pay damages for any conduct not definitely forbidden by law.’<sup>140</sup> Of course, the requirement that there be some independent mechanism for checking that normative acts have *some* legal basis is a very austere requirement of rule *by* law; this was the criticism levied at the more positivist interpretation of the *Rechtsstaat*, which guaranteed no coercion without law but shed more expansive substantive limitations to state coercion.<sup>141</sup> But, as Hayek recognised,<sup>142</sup> rule *by* law is a necessary precondition for the additional formal desiderata of the rule *of* law. He therefore claimed that strong judicial review of the legality of administrative decision-making was one of the key developments from Germanic theorising on the *Rechtsstaat*.<sup>143</sup>

To this end, a number of theorists include oversight of legal validity by the courts amongst the ‘basic institutional conditions that bolster the formal qualities of rule-based order, converting it into an operative regime’.<sup>144</sup> Jeremy Waldron has stressed not only that the institutional mechanism of judicial review of basic legality by the courts is a necessary element of the rule of law,<sup>145</sup> but also that it should be considered essential to the very concepts of law and of a legal system.<sup>146</sup> But in justifying the presence of courts for the rule of law on this very basic ground, a more significant, residual dynamic can be set in motion: progress *towards* the impossible aspiration.

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<sup>138</sup> Montesquieu [1748] 198-199. See also: Kant [1797] 456-460 (the ‘irreproachable’ legislator, an ‘irresistible’ executive, and an ‘irreversible’ judicial authority); Epstein [2011] 27 (on the connection between the separation of powers and the rule of law).

<sup>139</sup> ibid 197 (‘no man shall be compelled to do things to which the law does not oblige him, nor forced to abstain from things which the law permits.’).

<sup>140</sup> Dicey [1915] Iv. See also 110-111.

<sup>141</sup> See Chapter III, text accompanying fn 208-213.

<sup>142</sup> Hayek [1960] 173-174, 181 (‘the most important consequence’ of the rule of law).

<sup>143</sup> ibid (‘all exercise of administrative power... should be made subject to judicial review’), 185 (‘The rule of law requires that the executive in its coercive action be bound by rules’ which can only be ensured through judicial review). See also: Böckenförde [1991] 54-55.

<sup>144</sup> Loughlin [2010] 335. For support: Hayek [1960] 174, 185; Raz [1977] 216-218 (principles 4 to 8 concern ‘supervising conformity to the rule of law’); Unger [1977] 177; Nonet and Selznick [1978] 54; Summers [1993] 129-130, 133; [1999] 1694-1695; Habermas [1996] 173; Rawls [1999] 209-210.

<sup>145</sup> Waldron [2008] 7-8.

<sup>146</sup> ibid 20, 55-57. Similarly: Habermas [1996] 134 (enforcement and adjudication ‘are not just functionally necessary supplements to the system of rights but implications already contained in rights’).

### ii) *Facilitating the Formal Rule of Law: A More Achievable Ideal*

The conceptualisation of the rule of law advanced in this chapter is an impossible ideal. This is not just because abstract 'law' can never rule alone;<sup>147</sup> nor as the two formal principles may pull in opposite directions if taken to extremes.<sup>148</sup> Rather, it reflects the fact that the two desirable formal requirements justified and celebrated in liberal political theory simply cannot be perfected in real legal systems.<sup>149</sup>

With regards to the principle that norms be comprehensible, even if it is conceded that this may be met through seeking legal assistance rather than reading law textbooks,<sup>150</sup> a degree of normative ambiguity is unavoidable: there will always be questions regarding the application of norms at their periphery owing to factually novel scenarios, technological development, and the inevitable, open-textured vagueness of language.<sup>151</sup> Comprehensive codes perfectly delineating norms without an iota of ambiguity are a fantasy.

So too with the second principle: even if real legislation were not scattered with group-specific rights and obligations,<sup>152</sup> inequality in the application of norms (or 'enforcement discretion') is a necessary corollary of limited time and finite budgets, rendering the choice prosecution of notorious targets all the more appealing. Neither can such decision-makers be expected to always think like administrative Immanuel Kants, transforming particulars into norms of universal application; legally, it is merely sufficient for the specific factual case concluded to meet the goal conferring their power to coerce. *Ad hoc* determinations of rights and obligations by the administration are an inescapable reality of contemporary governance.<sup>153</sup>

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<sup>147</sup> It will always require human involvement: Raz [1977] 212; Loughlin [2010] 312-313.

<sup>148</sup> Waldron [1989] 82 ('predictability and capacity to plan... have nothing to do with universality'). Subject-specific determinations can be clear: Fuller [1969] 207-208; Epstein [2011] 7. Excessively abstracted obligations can be incomprehensible: Nonet and Selznick [1978] 83. Similarly in Marxist critique: Picciotto [1979] 174.

<sup>149</sup> Hayek [1960] 181 ('ideals which we can hope to approach very closely but can never fully realize'); Raz [1977] 222 ('Conformity to the rule of law is a matter of degree. Complete conformity is impossible').

<sup>150</sup> See: Waldron [1989] 91; Kaplow [1992] 571-577; Epstein [1998] 67 (normative ignorance is rational as more information can be acquired later); Tamanaha [2004] 122.

<sup>151</sup> Hayek [1960] 183 ('complete certainty of the law' should be the aspiration but cannot be perfectly attained); [1976] 191 ('No system of rules of conduct is complete in the sense that it gives an unambiguous answer to all moral questions.); Raz [1977] 222 ('some vagueness is inescapable'); Radin [1989] (analysing the certainty of law through linguistic philosophy); Schauer [1991] 35-36; Sunstein [1995] 984-985; Endicott [1999] 6-7 (on unavoidable vagueness in law); Yalnazov [2018] 13-14. cf Epstein [2011] 14-15 (accepting linguistic ambiguity but cautioning against abject scepticism).

<sup>152</sup> See text accompanying fn 129.

<sup>153</sup> As even accepted by a noted libertarian/classical liberal: Epstein [2011] 6-7.

But rather than a reason to despair, the impossibility of the ideal recommends closer attention to the instrumental value of institutional oversight (principle (iii)) to gradually realise the important formal characteristics of norms (principles (i) and (ii)).<sup>154</sup> If the formal desiderata for laws are seen not as sacred *prerequisites* for every normative act but a *systemic aspiration*, the courts can be considered an indispensable institution for making the formal rule of law more achievable. Rather than a binary quality, aspiring to realise the formal rule of law is instead to move along a sliding scale towards normative generality and comprehensibility.

This can be explained through a basic hypothetical scenario. A country passes a constitutionally-valid law with only two provisions:<sup>155</sup> Article 1 stipulates that citizens are prohibited from actions that hinder a vague and contestable societal “good” (eg “competition”); Article 2 entrusts investigation and enforcement of Article 1 to an administrative authority. Three possible options can be envisaged for how its decisional practice could develop:

- (i) The authority immediately translates the vague goal into a comprehensive code of generalised normative obligations covering every possible eventuality, so that subjects can perfectly comprehend acts that are legal and illegal. The subsequent decisions finding individual violations perfectly match the code, and are equally applied without exception.
- (ii) The authority undertakes individual, *ad hoc*, subject-specific determinations of legality and illegality, giving negative decisions whenever it believes that particular acts breach the vague goal of the law. It is not immediately clear to subjects where the boundary between legality and illegality lies. However, over time, general patterns emerge from its decisional practice: individual instances crystallise into broader norms frequently enforced when breached, and normative obligations become clearer. Eventually, the constellation of cases is as general and comprehensible as the code of option (i).

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<sup>154</sup> Similarly: Rawls [1999] 207.

<sup>155</sup> This law (and Article 3 to follow) is a stylised reimagining of the broad framework constructed by the EU Treaties: 1) Articles 101 ('prevention, restriction or distortion of competition') and 102 TFEU ('abuse' of dominance); 2) Article 105 TFEU (enforcement by the European Commission); 3) Article 19 TEU (jurisdiction of CJEU to interpret Treaties) and Articles 263 TFEU (judicial review of legality of Commission decisions).

- (iii) The authority takes *ad hoc* negative decisions, prohibiting whatever specific actions it believes breach the vague goal of the law. No general or comprehensible norms emerge from the pattern of cases: each bears no relation to previous decisions or future enforcement.

Options (i) and (ii) are different institutional paths to realising the formal requirements of the rule of law: in the first, generally-applicable and comprehensible norms are *rationally constructed ex ante*; in the second, the same outcome is reached by a *gradual, evolutionary process of ex post rationalisation*.<sup>156</sup> The benefits of the formal rule of law for legal subjects are realised quicker in the former, but the latter is arguably a more accurate reflection of how administrative agencies operate. Of course, the ideal is never realised in option (iii).

Now imagine an addition to the hypothetical law: Article 3 grants courts the power to review decisions by the authority pursuant to Article 2 for compliance with the societal good of Article 1, alongside sole jurisdiction to interpret the legal meaning of that end. The court takes its role seriously: it affords the authority no deference as to the legal interpretation of Article 1, nor as to whether specific decisions are in furtherance of that societal goal (ie the legal characterisation of facts). How does this institutional development change the results?

In all three options, the court will independently check that the decisions taken - with or without comprehensive code/decisional pattern - prohibit actions that it deems to be contrary to its own interpretation of the societal good, and permits conduct it considers to be compliant. Sometimes it will agree with new, novel decisions, and at other times not.<sup>157</sup> Essentially, it actively reviews the legality of administrative decision-making.

However judicial review of administrative decision-making in option (iii) may itself transform subject-specific decisions based on unclear normative obligations *towards* the formal rule of law ideal.<sup>158</sup> In interpreting the societal good of Article 1 in the context of individual decisions, instances of judicial review can *generalise* norms from specifics and *elaborate upon* legal obligations, permitting wider societal understanding of conduct

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<sup>156</sup> Corresponding to Hayek's discussion of constructivism versus evolution. See fn 191.

<sup>157</sup> To mitigate the unforeseeable prohibition it may neutralise the punishment in this individual instance. See discussion of the common law at text accompanying fn 84-87.

<sup>158</sup> Or accelerate the organic administrative development of option (ii).

that is prohibited by the law. This normative comprehensibility is facilitated as the generalised norms restrict and rigidify administrative decision-making in the future. Much like the authority's organic pattern of option (ii), the court's precedents can crystallise into a body of general and comprehensible norms, and thus approximate the rule of law ideal. Indeed, it has been claimed that US antitrust law has developed in exactly this spontaneous manner from ambiguously-worded origins in the Sherman Act to a more 'precise, principled content' for legal subjects as a result of the 'judicial craft'.<sup>159</sup>

Principles (i) and (ii) of the formal rule of law should be considered an aspirational *outcome*, an *unachievable end-state* towards which a legal order should attempt to progress over time. Whether it is the legislature formulating precise codes, the administration translating vague statutory powers into normative guides, or the judiciary meeting the possible absence of both in individual cases and responding with generalised precedents that restrain future normative determinations, the actual site of agency for realising the formal rule of law in practice is largely immaterial; the means to the formal end justified by liberal political theory is institutionally ambiguous.<sup>160</sup> Comparisons can be drawn with Martin Shapiro's early writing on administrative decision-making and judicial review by courts as complementary opportunities for incremental norm-formulation, both capable of gradually furnishing vague statutory goals with more comprehensible obligations.<sup>161</sup>

Nevertheless, the residual presence of incisive and independent judicial review by courts should be considered a necessary failsafe. As the economic analysis of judicial review highlights, decisions by the courts are Janus-faced:<sup>162</sup> individual incidents of *reactive error correction* regarding the law, fact, or legal characterisation of facts by administrative decisions; but simultaneously a source of *prospective norm formulation and elaboration*, transforming particular decisions into generalised and more comprehensible norms going forward by structuring administrative decision-making. Courts as curators of the formal quality of legal obligations relates to Hayek's view of

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<sup>159</sup> Scalia [1989] 1183.

<sup>160</sup> cf the discussion of judicial norm-creation as a better guarantor of the rule of law in Section III.A.

<sup>161</sup> M Shapiro [1968] 44-45 (both courts and administrative decision-makers fill 'general statutes' with 'sufficient supplementary and explanatory rules to make them adequate guides'), 91-93 (dual 'supplementary law-makers').

<sup>162</sup> eg Shavell [1995]; Geradin and Petit [2011] 5-6. One-time or infrequent defendants are obviously more driven by the former role: Galanter [1974] 100.

judges as an institution in a spontaneous order that ‘serves, or tries to maintain and improve, a going order’.<sup>163</sup> Wherever authorities decide in an *ad hoc*, particularistic manner,<sup>164</sup> or there is normative ambiguity,<sup>165</sup> judicial review provides the route to ‘gradual perfection’ by improving the ‘existing system by laying down new rules’ that rigidify future determinations of legality.<sup>166</sup> In the words of Habermas, normative certainty can be approximated through ‘a jurisprudence that works through the legal corpus in a rigorous fashion, making it the subject of doctrinal refinement and systematization.’<sup>167</sup> Recognising this role of the courts for making the formal rule of law a more achievable ideal avoids the unfortunate implication that there has to be absolute generality and certainty at all times.

The role of judicial review also relates to the age-old debate between determining legality through rules or standards.<sup>168</sup> As seen in Chapter II, Posner and Easterbrook were displeased with the *ad hoc* determination of legality through the unstructured rule of reason standard for its unpredictable and unforeseeable application. More generally, the formal rule of law has frequently been characterised as the rule of rules,<sup>169</sup> an ideal challenged by the rise of broad standards (eg “reasonable”, “fairness”) for separating legal and illegal conduct.<sup>170</sup> There are good reasons for doubting whether the idealised distinction between “certain” rules and “flexible” standards is theoretically watertight.<sup>171</sup> But putting that abstract question to one side, it is not logically impossible for the use of standards to *gradually* meet the formal rule of law ideal, despite their individually *ad hoc* and unforeseeable application. The courts may formulate a system of general and comprehensible norms that structures the legal analysis undertaken through routinely reviewing the legality of specific administrative decisions taken pursuant to the standard.<sup>172</sup> Or alternatively they may not, perpetuating

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<sup>163</sup> Hayek [1973] 113.

<sup>164</sup> Hayek [1960] 187 (neutralised by independent judicial review); [1973] 82, 90 (the common law transforms individual decisions into generalised norms).

<sup>165</sup> Hayek [1973] 95, 113. See also: Endicott [1999] 13-15.

<sup>166</sup> *ibid* 96. See also: 113 (‘piecemeal tinkering, or “immanent criticism”, to make the whole more consistent’); [1976] 191 (through constantly answering questions where the ‘established system of rules gives no definite answer... the whole system evolves and gradually becomes more determinate’).

<sup>167</sup> Habermas [1996] 144.

<sup>168</sup> For overviews of the typical “pros” and “cons” raised in the rules/standards debate: Ehrlich and Posner [1974]; Schlag [1985] 384-389; Kaplow [1992]; Sunstein [1995] 959-996; Korobkin [2000] 25-43; Raban [2010].

<sup>169</sup> Tamanaha [2004] 96-97; Epstein [2011] 20.

<sup>170</sup> Unger [1977] 193-194, 196-197, 204; Nonet and Selznick [1978] 82-83; Radin [1989] 795-796.

<sup>171</sup> See generally: Schlag [1985].

<sup>172</sup> On transformations from standards to rules and vice versa: Schlag [1985] 428-429. Similarly: Kaplow [1992] 611 (the predictability of standards will be enhanced by precedents transforming them into rules).

incomprehensible and particularistic decision-making under vague standards, and perhaps actively generating even more unstructured ‘totality of circumstances’ tests.<sup>173</sup> The failure of the US rule of reason to eventually meet the formal rule of law ideal was not, therefore, an inevitably. Instead, it highlights a major caveat of the important role that the courts serve in moving towards the formal rule of law: it requires not just the basic potential for judicial review, but meaningful, incisive deployment of such oversight powers.<sup>174</sup>

In summary, any conceptualisation of the rule of law that does not include independent judicial review as a necessary element overlooks the tangible difference that this residual normative “caretaking” role can make to otherwise subject-specific, incomprehensible normative determinations by the administration. Instead, it is to naively entrust realisation of the formal rule of law to the generosity and self-discipline of administrative decision-makers who may, understandably, have incentives to avoid its rigidity and restraint to more effectively pursue their ends.

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The virtue of the rule of law ideal is a common motif of centuries of liberal political theory, going to the core of the tension between individual freedom and state limitation. The formal principle mandating an endeavour towards normative comprehensibility respects the freedom and rationality of legal subjects, permitting them to plan their affairs accordingly and attributing responsibility for knowable lawbreaking. The aspiration towards general and equally-applicable norms is an additional bulwark to state coercion beyond constitutionalism, formally preventing *ad hoc*, subject-specific normative acts that unforeseeably disrupt individual plans and permit discrimination between legal subjects. And the institutional mechanism for independent review provided by the courts allows for disgruntled recipients of administrative decisions to check their legal validity and gradually move the normative framework towards these impossible formal ideals, restraining and rigidifying future

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<sup>173</sup> Scalia [1989] 1180-1182. For a comparable discussion of courts perpetuating standards and normative uncertainty in eminent domain and tort law: Epstein [1982b] 354-356. See also Easterbrook’s general criticism of ‘laundry lists’: Chapter II, text accompanying fn 199-204.

<sup>174</sup> For an attack on judicial deference to questions of law: Epstein [2011] 7, 153-160. This raises the spectre of judicial discretion: see fn 86 for Hayek’s response; Unger [1977] 180-181 (doubting the possibility of ‘a truly impartial method of judging’).

determinations of legality through formulating generalised, comprehensible norms. The rule of law is therefore justified as an aspiration of considerable political virtue.

But the purpose of the first part of this thesis is to consider the legitimate form for determining legality in *competition policy - market interventions* in pursuit of *economic goals*. Metaphysical concerns for freedom in liberal political theory might be considered *prima facie* off the mark.<sup>175</sup> It is therefore fortunate that economics has also reached similar conclusions on the desirability of the formal rule of law.

#### **IV. Convergence: The Formal Rule of Law in New Institutional Economics**

The value of neo-classical microeconomics for exploring the concepts underpinning competition policy derives from its abstraction, isolating a few moving parts to understand how market forces may produce societally-beneficial results.<sup>176</sup> Without diminishing the value of this endeavour, it is clear that real-world markets operate within a framework of institutions - laws, customs, rights, money - that exogenously impact the working of that economic order. Questions of how these framing institutions and their variability affect markets are the focus of New Institutional Economics ("NIE").

This body of scholarship is notable for providing a parallel set of justifications for aspiring towards determining legality through the equal application of generalised norms that afford comprehensible obligations and are subject to robust judicial review. Albeit by diverging disciplinary routes, liberal political theory and New Institutional Economics essentially converge on the value of the formal rule of law ideal. Given its economic underpinnings, this is especially significant when considering the appropriate form of market interventions in furtherance of competition policy.

##### **A) New Institutional Economics: An Overview**

Economics has always had an institutionalist strand that has challenged the abstraction of microeconomic theory. Chapter I argued that contemporary competition microeconomics consists of an uneasy dialectic between the generality of neo-classical

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<sup>175</sup> Article 2 TEU itself cautions against this rash conclusion: 'The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights'.

<sup>176</sup> See Chapter I, text accompanying fn 45-48.

price theory and the specificity of industrial organisation scholarship.<sup>177</sup> NIE is a sub-discipline of the latter with a long intellectual lineage. Adam Smith recognised the importance of institutional context for markets,<sup>178</sup> suggesting that disparate economic performance between countries may be related to ‘the nature of its laws and institutions’,<sup>179</sup> and warning against private efforts to secure governmental privileges that artificially distort the interplay between supply and demand.<sup>180</sup> The same conclusion can be reached on aspects of Karl Menger’s writing, one of the major contributors to neo-classical microeconomics.<sup>181</sup> An extreme example of the ‘old’ institutional school was encountered in the previous chapter: the German Historical School.<sup>182</sup> But despite the criticisms levied by Eucken, Ordoliberalism itself arguably represented an ‘embryonic neo-institutionalist doctrine *avant la lettre*’.<sup>183</sup> This is clear from their focus upon the interdependence of the legal and economic order, Böhm’s writing on the complementarity of free markets with the private law society,<sup>184</sup> and Eucken’s advocacy of ‘policy to *shape* the economic system’.<sup>185</sup>

Although the genealogy of NIE involves multiple strands of economic scholarship,<sup>186</sup> two elements are of particular note.

The first was Hayek’s later writing on the relationship between organic market forces and the normative framework within which they occurred.<sup>187</sup> The free economic order – “*catalaxy*” –<sup>188</sup> operated spontaneously through a decentralised process of mutual adjustment in response to price signals by market actors with little individual

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<sup>177</sup> See Chapter I, Section III.C.

<sup>178</sup> On Smith as an institutionalist: Hayek [1973] 65; Brennan and Buchanan [1985] 1, 13; Kasper and Streit [1998] 34; Mestmäcker [2008] 15-16.

<sup>179</sup> Smith [1776a] 197-198 (on Chinese contract law hindering productivity).

<sup>180</sup> *ibid* 228 (entry-limiting regulations), 231-232 (import tariffs), 358-359 (cautious about privately-motivated business regulations).

<sup>181</sup> Schotter [1981] 3-5; Vanberg [1994] 145.

<sup>182</sup> Chapter III, text accompanying fn 31. See also: Hutchison [1984] 21-22.

<sup>183</sup> Ptak [2009] 126. See also: Hutchison [1984] 22; Mestmäcker [2008] 18, 38; Kasper and Streit [1998] 36. See Chapter III, text accompanying fn 48-52.

<sup>184</sup> Chapter III, Section II.B.i, iii, and IV.B.iii.

<sup>185</sup> See Chapter III, text accompanying fn 85.

<sup>186</sup> Other important sub-disciplines include property rights economics, public choice theory, and constitutional economics: Mantzavinos [2001] 163.

<sup>187</sup> An indebtedness recognised by: Vanberg [1994] 4; Kasper and Streit [1998] X. This is especially the case for those critical of orthodox neo-classical microeconomic theory and/or focusing upon the spontaneous development of institutions.

<sup>188</sup> Hayek [1976] 269.

knowledge.<sup>189</sup> Rather than an equilibrium end-state to be replicated with guaranteed beneficial consequences, competition was conceptualised by Hayek as an experimental discovery procedure of knowledge acquisition and promulgation that could be more or less intense.<sup>190</sup> This reflected his abject epistemological distaste for constructivist rationalism,<sup>191</sup> which he believed downplayed the ‘necessary and irremediable ignorance on everyone’s part’ of the knowledge distributed between individuals that cannot be located in a single place.<sup>192</sup> It was most unavoidable in the economic system,<sup>193</sup> and justified faith in the decentralised market order for coordinating disparate pieces of information, thus overcoming the permanent barrier to constructivist central direction.<sup>194</sup> But as a spontaneous, reactive, organic system, the norms enshrouding market transactions were of critical importance for influencing its operation. Markets could scarcely be conceptualised absent the state, necessitating its role as curator of the normative framework within which economic forces operated:<sup>195</sup>

*‘This particular function of government is somewhat like that of a maintenance squad of a factory, its object being not to produce any particular services or products to be consumed by citizens, but rather to see that the mechanism which regulates the production of those goods and services is kept in working order.’*

The second formative impetus for the broader NIE movement since the 1960s was the sub-discipline of transaction cost economics.<sup>196</sup> This has largely resulted from the pioneering work of Oliver Williamson,<sup>197</sup> refining the writing of Ronald Coase on the importance of costs for economic decision-making.<sup>198</sup> Williamson investigated how bounded rationality, few players, opportunism, and market uncertainty shaped the nature of contractual governance mechanisms between businesses and the ultimate

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<sup>189</sup> Hayek [1973] 14-15; [1976] 275-277. See also: [1944] 52 (enabling ‘entrepreneurs, by watching the movement of comparatively few prices, as an engineer watches the hands of a few dials, to adjust their activities to those of their fellows.’).

<sup>190</sup> Hayek [1979] 407.

<sup>191</sup> For Hayek’s discussion of centralised, constructivist rationalism and preference for decentralised, spontaneous, evolutionary order: [1960] 22, 50-54 (on the English evolutionary and French rationalist traditions) [1973] 5, 10-11, 28, 35-37 (on *cosmos* and *taxis*).

<sup>192</sup> Hayek [1973] 13-14.

<sup>193</sup> Hayek [1979] 496-497 (‘We have never designed our economic system. We were not intelligent enough for that.’).

<sup>194</sup> Hayek [1973] 37. See also: [1944] 51-52 (‘decentralisation has become necessary because nobody can consciously balance all the considerations bearing on the decisions of so many individuals’).

<sup>195</sup> Hayek [1973] 45-46. See also: [1944] 37 (‘carefully thought-out framework’, ‘conditions under which the knowledge and initiative of individuals is given the best scope so that they can plan most successfully’), 39-41; [1960] 62; [1976] 274 (‘to increase equally the chances for any unknown member of society of pursuing with success his equally unknown purposes.’).

<sup>196</sup> Schotter [1981] 147.

<sup>197</sup> For representative articles: Williamson [1973]; [1974]; [2000].

<sup>198</sup> Coase [1937]; [1960]. For his influence on the Chicagoans: Chapter II, text accompanying fn 89.

decision of whether to internalise.<sup>199</sup> From here it was only a short distance to the general reflection that the efficient operation of market forces is dependent upon the institutional context within which business decision-making takes place;<sup>200</sup> it cannot simply be assumed that the law beneficially influences these everyday choices.<sup>201</sup>

Despite inevitable factionalism,<sup>202</sup> the multifaceted “New” Institutional Economics movement can be reduced into a series of general tenets that offer an interesting perspective on the relationship between markets and law.<sup>203</sup> The starting position is that neo-classical microeconomic price theory abstracts away from the limits of human rationality in the face of uncertainty and how institutions develop in response to these cognitive defects.<sup>204</sup> The efficient operation of the price mechanism is constantly beset by limits to perfectly rational decision-making and the lack of complete information, on future conditions and the behaviour of others.<sup>205</sup> Institutions are norms that develop to provide predictable regularity in the face of continual market uncertainty;<sup>206</sup> “rules of the game” within which economic processes take place.<sup>207</sup> They may emerge through spontaneous experience (eg conventions) or deliberate construction (eg statute law).<sup>208</sup> Their purpose is to facilitate stability by constituting norms that limit the range of permissible options open to market actors - prohibiting certain actions, delineating rights<sup>209</sup> and obligations - thus rendering individual decision-making simpler and the conduct of others more foreseeable.<sup>210</sup> Business decisions do not need to consider every

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<sup>199</sup> Williamson [1974] 1442-1447.

<sup>200</sup> Williamson [1973] 316 (economic research should consider “institutional failures” (of internal organizational, political, and judicial types)').

<sup>201</sup> Williamson [1983c] 520.

<sup>202</sup> The main rift (Kasper and Streit [1998] 37) relates to whether institutions can be grafted onto neo-classical microeconomic theory, or whether bounded rationality and uncertainty are incompatible. The latter camp tends to be influenced more by Hayek's heterodox, evolutionary perspective. For a more conciliatory approach: Williamson [1974] 1494-1495.

<sup>203</sup> This account is largely based upon: Schotter [1981]; North [1990]; Kasper and Streit [1998] Mantzavinos [2001].

<sup>204</sup> Schotter [1981] 149-150; Hutchison [1984] 26-27; North [1990] 11; Vanberg [1994] 77; Kasper and Streit [1998] X, 3; Korobkin [2000] 44 (law shapes ‘the context in which preferences are formed.’); Mantzavinos [2001] 166.

<sup>205</sup> Langlois [1986] 5; North [1990] 25; Kasper and Streit [1998] 44-45 (ignorance is the fundamental obstacle to efficient resource allocation); Mantzavinos [2001] 86.

<sup>206</sup> Schotter [1981] 11 (institutions as a ‘regularity in social behavior’); North [1990] 3; Kasper and Streit [1998] 28 (norms restricting ‘arbitrary and opportunistic behaviour’ to ‘channel human actions in reasonably predictable paths, creating a degree of order.’).

<sup>207</sup> Schotter [1981] 6; North [1990] 4; Mantzavinos [2001] 167-168.

<sup>208</sup> Schotter [1981] 1, 28-29; North [1990] 4; Kasper and Streit [1998] 100, 116-117.

<sup>209</sup> The most frequently discussed are property rights: Samuels [1971] 440; Kasper and Streit [1998] 173-176; Mantzavinos [2001] 240-241.

<sup>210</sup> Schotter [1981] 109, 118 (supplementing price information and assisting decentralisation); North [1990] 3, 25 (norms simplify, structure, and limit market actions), 67; Kasper and Streit [1998] 1-3, 95, 118; Mantzavinos [2001] 89; Mestmäcker [2008] 37.

possible eventuality.<sup>211</sup> Institutions thus may make markets more efficient in two ways:<sup>212</sup> by *systemically* reducing normative uncertainty to permit actors to more effectively respond to the price mechanism;<sup>213</sup> or by *specifically* facilitating efficient exchange through reducing transaction costs.<sup>214</sup> And as these institutions are constantly evolving,<sup>215</sup> it is possible to contrast the economic desirability of rival institutional frameworks within which market forces operate.<sup>216</sup>

*B) NIE and the Rule of Law*

The rule of law is rarely well-theorised in NIE literature, often little more than shorthand for broad “good-governance” considerations of secure property rights, contractual enforceability, and recourse to the courts to guarantee both.<sup>217</sup> These criteria are frequently linked to higher economic growth,<sup>218</sup> fostering a plethora of reductionist rule of law “metrics” foisted upon stagnant economies.<sup>219</sup>

Nevertheless, it is possible to note two particular instances where NIE and the conceptualisation of the rule of law proposed in this chapter meet, justifying the ideal as of significant economic merit: i) comprehensible and generalised norms are more effective institutions, stabilising rights and obligations to facilitate optimal economic ordering; and, more specifically, ii) formally preventing *ad hoc* normative determinations inhibits privately-desired market distortions. Both arguments are pre-empted - and perhaps better articulated - in Hayek’s scholarship on the rule of law and free markets.

Although not recapitulated in this section, the instrumental virtue of independent review by the courts for gradually approximating these formal ideals is just as important as above, with reactive adjudication and prospective norm-formulation a key institution within the decentralised market system. This economic connection is made explicit in Hayek’s discussion of courts as institutions within a spontaneous order noted

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<sup>211</sup> Schotter [1981] 139; North [1990] 83; Vanberg [1994] 18; [2009] 23; Kasper and Streit [1998] 95-96; Mantzavinos [2001] 87.

<sup>212</sup> North [1990] 6, 83-83.

<sup>213</sup> Schotter [1981] 109; Schmidtchen [1984] 67 (stabilising expectations facilitates efficient exchange as value can be ‘more exactly specified’); Mantzavinos [2001] 214-215.

<sup>214</sup> North [1990] 62-63; Kasper and Streit [1998] 126-127, 222-223; Cross [2002] 1769.

<sup>215</sup> See particularly: North [1990].

<sup>216</sup> Schotter [1981] 6; Brennan and Buchanan [1985] 1; Vanberg [1994] 77.

<sup>217</sup> eg Cross [2002] 1768-1769; Haggard, MacIntyre, and Tiede [2008] 207, 210-213.

<sup>218</sup> North [1990] 69, 138; Olson [1996]; Kasper and Streit [1998] 1-2, 13-21; Mantzavinos [2001] 246-248; Cross [2002] 1740-1741; Knack [2002] 1-2; Haggard, MacIntyre, and Tiede [2008]. Similarly: Leoni [1961] 22-23, 90-91.

<sup>219</sup> See: Cross [2002] 1768-1769; Knack [2002] 4-20.

previously,<sup>220</sup> and Röpke's inclusion of the judiciary within the mechanisms 'creating the necessary framework of laws and institutions' for the free economic order, supervising compliance 'with relentless but just severity.'<sup>221</sup>

i) *Effective Institutions as Reliable Expectations*

According to NIE, institutions are informational "crutches" upon which market actors can rely to facilitate their spontaneous ordering through the price mechanism, of which the framework of legal norms constitutes one of the most important elements. But if particular laws are to be effective institutions - economising on information, delineating rights, obligations, and prohibitions - so that coordination through the price mechanism can operate as efficiently as possible, norms ought to be *comprehensible* to market actors (clear, public, prospective, etc).<sup>222</sup> NIE is premised upon the limits of human rationality and investigates how norms arise to counteract such uncertainty: this is not just a question of simply *having* institutions that shape economic behaviour, but of how they can be amplified as market-enshrouding norms through considering their formal characteristics.<sup>223</sup> The ideal of the rule of law, where businesses can comprehend their legal obligations, is functionally equivalent to what Kasper and Streit label the successful 'normative impact' of institutions.<sup>224</sup> Given that laws are informational signals facilitating the efficient operation of a free market economy, they suggest that the desiderata of the formal rule of law 'relate directly to the fundamentals of institutional economics and are essential to the proper functioning of the capitalist system.'<sup>225</sup> This argument is the economic counterpart to the political argument in favour of the comprehensibility of norms fostering 'good fences',<sup>226</sup> though substitutes "efficient market activity" for "meaningful exercises of freedom".

The desirability of comprehensible obligations for stabilising normative expectations, thereby facilitating the optimal operation of economic forces, is comparable to the writing of Böhm on the private law society, reiterated by his student Mestmäcker's

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<sup>220</sup> See: text accompanying fn 163-166.

<sup>221</sup> Röpke [1950a] 228.

<sup>222</sup> Kasper and Streit [1998] 96 (simplicity, certainty, stability), 122-123 127, 137 (if institutions cannot be comprehended, they are 'ineffectual in norming individual behaviour'), 165-168 (listing rule of law criteria); Tamanaha [2004] 119, 121.

<sup>223</sup> Kasper and Streit [1998] 96 (given cognitive limitations, 'institutions, to be effective, have to be easily knowable.').

<sup>224</sup> *ibid* 122.

<sup>225</sup> *ibid* 168.

<sup>226</sup> See Section III.A.

praise for ‘expectations that people can rely on’.<sup>227</sup> The same can be deduced from Hayek’s reflections on the state’s role in maintaining the framework within which markets operate. He argued that the ideal conceptualisation of legal norms ought to be in accordance with *nomos*, the formal rule of law, owing to facilitation of normative comprehensibility: the efficiency of mutual adjustment to the price mechanism was better realised where ‘there is a known delimitation of the sphere of control of each individual’.<sup>228</sup> Legal certainty is of economic virtue for stabilising the institutional framework surrounding spontaneous economic order, allowing reciprocal coordination in response to the price mechanism and collaboration of actors in confidence:<sup>229</sup>

*‘Where the elements of such an order are intelligent human beings whom we wish to use their individual capacities as successfully as possible in the pursuit of their own ends, the chief requirement for its establishment is that each know which of the circumstances in his environment he can count on.’*

Indeed, like contemporary attempts to link the ideal to economic growth, Hayek asserted that there was ‘probably no single factor which has contributed more to the prosperity of the West than the relative certainty of the law’.<sup>230</sup> In this way, Hayek channelled Max Weber’s argument that capitalist enterprise required ‘an unambiguous and clear legal system’ that ‘functions in a calculable way’.<sup>231</sup>

But it should also be noted that Hayek’s pre-emptive discussion of effective institutions fused principles (i) and (ii) of the rule of law as conceptualised in this chapter: he considered *generality* of legal norms itself to be a necessary requirement for the stability of expectations that promoted positive economic outcomes. Whether the legal norms framing markets were institutions generated through gradual common law evolution or more deliberate normative corrections,<sup>232</sup> the economically-desirable stability of market conditions was dependent upon them taking the form of generalised norms; ‘isolated and subsidiary’ commands by the state, such as *ad hoc*, subject-specific determinations of legality, disrupted the organic coordination of market actors using their dispersed knowledge for their own purposes.<sup>233</sup> Even if the “corrections” were well-intentioned, this particularistic form was incompatible with a decentralised market order.<sup>234</sup> It failed

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<sup>227</sup> See Chapter III Section IV.C and Mestmäcker [2008] 40.

<sup>228</sup> Hayek [1960] 140 (emphasis added).

<sup>229</sup> *ibid* 140-141.

<sup>230</sup> *ibid* 183.

<sup>231</sup> Weber quoted in: Raban [2010] 177-178. See also: Olson [1982] 4 (uncertainty reduces investment).

<sup>232</sup> Hayek [1973] 84-85.

<sup>233</sup> *ibid* 49. See also: [1944] 79; [1976] 287-288.

<sup>234</sup> Hayek [1976] 300.

to provide scope for ‘individual adaptation and explorative search’ that is the essence of competition as a dynamic discovery procedure.<sup>235</sup> The administrative restraint of formally requiring intervention via general norms engrained much-needed economic modesty,<sup>236</sup> solely permitting background improvements to the overall framework within which market ordering took place.<sup>237</sup> This would forestall unpredictable and sporadic ‘interfering with – and to that extent impeding – the forces producing the spontaneous order,’<sup>238</sup> in much the same way as Röpke and Rüstow were seen to articulate *formally* incompatible interventions in the previous chapter.<sup>239</sup> Promulgating generalised norms was merely oiling the market clock, as opposed to *ad hoc* interventions that shifted the hands; according to Hayek such modesty did not deserve the pejorative connotations of the term ‘interference’.<sup>240</sup> Therefore in aspiring to comprehensible and generalised norms as effective institutions, Hayek argued that the formal rule of law was ‘necessary’ for the optimal operation of the free economy.<sup>241</sup>

Returning to the more specific suggestion that norms as effective institutions are comprehensible (clear, prospective, public, and so on), it is here that articulating the virtues of the formal rule of law shades from NIE and its predecessors into “law & economics” literature, as well as a classic debate in Anglo-American jurisprudence. What connects these disparate discussions is an instrumental rationale: law is better able to achieve its goal if norms are cognisable to legal subjects. Chapter II detailed Posner’s influential economic analysis of the rule of law ideal:<sup>242</sup> law is a means to alter the incentives of individuals to guide them away from conduct deemed harmful, and comprehensible norms for legal subjects thus better realise the underlying societal goals. Like Posner, Böhm similarly suggested that as law was a signalling system delineating permissible and impermissible conduct on the market, clear rights and obligations represented law at its most ‘extremely effective’ as a means of social control.<sup>243</sup> Posner’s claim that the formal characteristics of the rule of law are entirely

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<sup>235</sup> Vanberg [2009] 8.

<sup>236</sup> Hayek [1973] 31, 40, 286; [1979] 464. This is primarily related to his distaste for constructivist thinking: see fn 191.

<sup>237</sup> Hayek [1973] 49. See also: [1973] 40; [1976] 274, 284-285, 288-290; Vanberg [2009] 23.

<sup>238</sup> *ibid* 40.

<sup>239</sup> See Chapter III, Section IV.B.ii.

<sup>240</sup> Hayek [1976] 287. See also: [1960] 194 (classical liberals did not see the ‘regular enforcement of the general law’ as interference; the important criterion was not the aim but ‘the method employed’, namely ‘specific orders and prohibitions.’).

<sup>241</sup> Hayek [1960] 195. But not sufficient: 200 (eg, property security, enforcement of contracts).

<sup>242</sup> See Chapter II, text accompanying fn 245-254, and Easterbrook at fn 255.

<sup>243</sup> See Chapter III, text accompanying fn 309-311.

deducible from economic analysis of effective legal norms has become a motif of “law & economics” scholarship.<sup>244</sup> To take but one example, Hadfield and Weingast’s economic analysis of decentralised enforcement finds that this would most effectively deter harmful conduct where norms are comprehensible. Their model thereby reaffirms ‘the relationship between the attributes of law and the capacity of an individual to be guided by rules’ common to “law & economics” literature.<sup>245</sup> But both NIE on effective institutions and “law & economics” on optimal incentive recalibration are more market-focused variants of the well-known critique by Raz and Hart of Fuller’s *Morality of Law*. In response to his novel challenge to legal positivism that the formal rule of law represented an internal “morality” to law, recognising the rational agency of the legal subjects,<sup>246</sup> they denied such a metaphysical connection with a widely-accepted counterargument:<sup>247</sup> in acknowledging human rationality, the formal rule of law rendered norms more effective for realising their underlying purposes.<sup>248</sup> The ideal was akin to the quality of sharpness to a knife; whether innocently chopping or maliciously stabbing, a sharper knife more effectively achieves its intended goal.<sup>249</sup> Despite a trenchant - and perhaps justified -<sup>250</sup> defence, Fuller’s work itself routinely accepted that normative comprehensibility was ‘essential for the practical efficacy of law’.<sup>251</sup> As a result, he and his detractors are often bundled together as *instrumental* advocates of the formal rule of law as affording effective ‘incentives to structure behaviour’.<sup>252</sup>

To summarise the justification from NIE for the formal rule of law ideal, the aspiration towards comprehensibility and the rigidity of normative generalisations is economically desirable for producing laws that are effective institutions, a cognisable and stable legal framework that more precisely communicates information to businesses to facilitate the smooth operation of market processes.

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<sup>244</sup> Korobkin [2000] 37-38 (summarising the common “law & economics” claim that imprecise norms lead subjects ‘to commit socially undesirable acts or forbear from taking socially desirable actions.’).

<sup>245</sup> Hadfield and Weingast [2012] 473-474.

<sup>246</sup> Fuller [1969] 39-40; Rundle [2014] 101.

<sup>247</sup> Tamanaha [2004] 96 (‘Uncertain or unclear rules have limited efficacy in guiding behaviour.’)

<sup>248</sup> Raz [1977] 214, 224-226; Hart [1965] 1286.

<sup>249</sup> Raz [1977] 225-226. Hart’s analogy was poisoning: Hart [1965] 1286.

<sup>250</sup> Fuller argued that *ad hoc*, subject-specific normative determinations could be more effective than the restraint of the rule of law, the general stance adopted in this thesis: [1969] 202-204, 212-213.

<sup>251</sup> Fuller [1969] 155-156 (likening the rule of law to the skill of a carpenter who can more effectively build an orphanage or a den for thieves.). See also: 150-151 (‘demands that must be met (sometimes with considerable inconvenience) if [law’s] objectives are to be attained.’).

<sup>252</sup> Radin [1989] 784-787; Loughlin [2010] 334 (‘functional or prudential criteria’ making law more effective).

ii) *Generalised Norms: Resilience against Private Interests*

The central tenet of New Institutional Economics is that the framework of norms surrounding and structuring market practices have an impact upon the efficiency and performance of spontaneous economic ordering. But in recognising the state's formative role in the economy, this claim makes institutions particularly valuable assets for private actors who may wish to influence their content and secure specific outcomes.<sup>253</sup> Two sub-disciplines of NIE have attempted to explore and remedy this potential hindrance to the optimal operation of markets. Once again, NIE reaches comparable conclusions to liberal political theory on the considerable desirability of the formal rule of law ideal for preventing *ad hoc*, subject-specific normative acts; an effective means to forestall private direction of public institutions is to formally mandate market intervention through generalised and equally-applicable norms.

Hayek's final volume of *Law, Legislation and Liberty* is an extended assault upon 'para-government', the assemblage of interests that encircle centralised decisions and intend to divert 'the stream of governmental favour to their members.'<sup>254</sup> Much like the Ordoliberals before, Hayek's characterisation of how political representatives come to be influenced by organised interests is highly charged.<sup>255</sup> Even genuine and well-intentioned *ad hoc* intervention would set a dangerous precedent for more malevolent economic forces.<sup>256</sup> The endeavours of these organised groups are manifold: limiting entry or regulating *certain* trades to restrict their output;<sup>257</sup> fixing prices or wages for *specific* industries;<sup>258</sup> raising import tariffs on *particular* products to shield domestic businesses;<sup>259</sup> designating *individual* cartels or monopolies for legal protection;<sup>260</sup> *discretely* disadvantaging successful businesses to shield less efficient rivals;<sup>261</sup> and so on. All such subject-specific interventions distort the spontaneous order, intending to 'bring about a particular result which is different from that which would have been

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<sup>253</sup> Samuels [1971] 442.

<sup>254</sup> Hayek [1979] 356.

<sup>255</sup> *ibid* 347, 352-355 ('the sharing out of funds extorted from a minority', 'no limit to the blackmail to which government will be subject', 'becomes their slave'), 435-436, 439 ('legalized corruption').

<sup>256</sup> Hayek [1976] 300.

<sup>257</sup> Hayek [1960] 199; [1976] 175; [1979] 426.

<sup>258</sup> Hayek [1976] 300.

<sup>259</sup> Hayek [1979] 353.

<sup>260</sup> Hayek [1944] 48; [1979] 413, 423.

<sup>261</sup> Hayek [1979] 417.

produced if the mechanism had been allowed unaided to follow its inherent principles.<sup>262</sup>

Hayek's criticisms are closely related to public choice theory, a strand of NIE that has primarily developed since the 1960s. The concern of public choice theory is the principal-agent problem between citizens and state actors: that those entrusted with centralised decision-making powers may act opportunistically or against the common good owing to the costliness of monitoring.<sup>263</sup> As a result, organised private interests may come to direct state powers to their own ends.<sup>264</sup> Profitable privileges can be accrued by successfully bargaining with public actors to lessen competitive forces through market interventions (closing market entry, restricting imports, protectively regulating).<sup>265</sup> This risk is particularly acute where private interests represent a small number of focused market actors as the spoils are shared between fewer beneficiaries.<sup>266</sup> But maintaining the competitiveness of the free market economy is not simply about forestalling privately-desired regulation. As the Ordoliberals forewarned,<sup>267</sup> decision-making in furtherance of an active competition policy may be a particularly prominent focus for lobbying.<sup>268</sup> As a consequence, there is a need to guarantee the optimal operation of the free market, preventing anticompetitive regulations and defending a robust programme of intervention, by erecting 'institutional constraints on competition for political favours'.<sup>269</sup>

If public choice theory describes the phenomenon of private steering of state powers over the economy, constitutional economics, an interrelated sub-discipline of NIE, aims to provide a solution. Frequently citing David Hume's connection of constitutional checks and balances to the claim that 'every man ought to be supposed a knave, and to have no other end, in all his actions, than private interest',<sup>270</sup> contemporary

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<sup>262</sup> Hayek [1976] 287.

<sup>263</sup> Kasper and Streit [1998] 65. See also: Olson [1982] 17-19 (as broad groups, citizens and consumers are unlikely to react as the pay-off is individually small).

<sup>264</sup> Stigler [1971] 3 (The state 'is a potential resource or threat to every industry in society', selectively helping or hurting businesses and granting privately-beneficial regulation).

<sup>265</sup> Samuels [1971] 443-444; Green and Nader [1973] 871, 879; Stigler [1971] 4; Posner [1975b] 818-819; Olson [1982] 43-47, 59-60, 62-65; Shughart [1995] 7-10, 20-21; Epstein [1995] 127; [1997] 124-125 (the state as the 'covert agent of monopoly power'); [2003] 51; Kasper and Streit [1998] 247-248, 285, 324-326; Vanberg [2014] 217.

<sup>266</sup> Olson [1982] 29-31.

<sup>267</sup> See Chapter III text accompanying fn 105.

<sup>268</sup> See generally McChesney and Shughart [1995] (public choice and US antitrust); Epstein [1995] 126 (antitrust succumbing to the 'hurly-burly pressures of a political environment').

<sup>269</sup> Kasper and Streit [1998] 249, 326-333 (constitutions, separation of powers, federalism, elections, etc).

<sup>270</sup> Hume [1777] 42-43. This quote has been taken out of context; Hume *disagreed* with it: Marciano [2005].

constitutional economics evaluates binding norms (discrete competences, fundamental rights) as pre-commitment mechanisms.<sup>271</sup> For example, although we may be perfectly content with how a benevolent dictator exercises their omnipotence, it is possible to envisage that their successor might be tempted to use such unbounded power for oppression. Or a decision-maker is aware that long-term policy success is based upon doing X (eg prohibiting cartels), but they also know that possible emergencies could lead them to abandon X and do Y (accepting a crisis cartel to manage job losses). In both instances, constraints are formulated *today* to prevent choosing undesirable options in the unpredictable *future*.

Taken together, public choice theory and constitutional economics advocate tying the hands of public actors for ‘when, in the heat of the battle, they are tempted to abandon principles’ on an as-needed basis.<sup>272</sup> Although various norms could be contemplated to limit market-distorting regulation and impressionable competition enforcement, the simplest preventative measure is to *formally* restrain the state from discriminatory actions in the market by determining legality through applying generalised norms:<sup>273</sup>

*‘Both a legislature confined to laying down general rules and a governmental agency which can use coercion only to enforce general rules which it cannot change can resist such pressure; an omnipotent assembly cannot.’*

The principle that norms ought to be abstract in scope and equally-applicable restrains the state from granting *ad hoc* privileges to powerful private interests, thus shielding the continuing operation of the free market order.<sup>274</sup> Hayek applied this logic to cartel law, cautioning against ‘discretionary surveillance to prevent abuse’ and favouring a general prohibition without any exception.<sup>275</sup> Of course, this formal restraint against certain means of market intervention can be deeply divisive: subject-specific interventions into markets may prove to be very popular,<sup>276</sup> or, as the Marxist critique suggested, necessary for meaningful equality. But it should also be noted that, despite the ideological stance of many of the scholars cited above, similar concerns about private

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<sup>271</sup> See: Brennan and Buchanan [1985] 74-79; Vanberg [1994]; Mantzavinos [2001] 243-244.

<sup>272</sup> Kasper and Streit [1998] 335.

<sup>273</sup> Hayek [1979] 439. See also: [1979] 359 (to limit private influence requires the limitation of governmental powers), 463; Brennan and Buchanan [1985] 29.

<sup>274</sup> As argued by: Kasper and Streit [1998] 195, (universal property rights prevent discriminatory treatment), 316 (citing Ordoliberal support for decision-makers ‘blind to the specific outcomes of rule-guided behaviour.’); Mantzavinos [2001] 244-245 (‘formal rules provide a credible limit to the exertion of political power by governmental authorities in favour of’ private interests); Vanberg [2014] 211, 218 (on Ordoliberalism seeing this as the solution to discriminatory privileges).

<sup>275</sup> Hayek [1979] 423-424 (though without penalties, preferring invalidity and legal unenforceability).

<sup>276</sup> Hayek [1973] 134; Kasper and Streit [1998] 223, 316.

steering of public powers has occupied less politically-charged economists,<sup>277</sup> and also those from the opposite end of the spectrum: indeed, famed US consumer rights advocate Ralph Nader was just as perturbed by private interests ‘dominating agency decisions’ and compromising ‘independent regulatory judgment’ by securing ‘policies which often frustrate, rather than promote, economic competition.’<sup>278</sup> That public decision-makers will not act in the common good but will respond to exogenous influence is a perennial, apolitical worry.

Whatever angle one approaches the capacity for private interests to steer the state towards institutions that hinder the optimal operation of markets, whether through protective regulation or targeted antitrust, the rule of law ideal can be considered of crucial economic benefit: mandating market intervention through generalised norms of equal application formally prevents *ad hoc* determinations of legality favouring some over others.

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Both liberal political theory and New Institutional Economics reach the same conclusion: the rule of law is an ideal of considerable virtue. Similar themes cut across centuries of political and economic scholarship: comprehensible rights and obligations permit the meaningful exercise of individual freedom and stabilise markets to facilitate more efficient reactions to the price mechanism; generalised norms of equal applicability rigidify determinations of legality to foster normative certainty, prevent tyrannical discrimination against individuals, and forestall market-distorting privileges at the behest of private interests; and the courts provide an institutional fall-back for gradually approximating these aspirational ideals in the day-to-day existence of the legal order. The formal rule of law is therefore not a legalistic, philosophical construct that can be dismissed as inappropriate for market interventions in pursuit of economic goals. Competition enforcement thus has ample political and economic justifications for aspiring to realise the formal rule of law ideal.

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<sup>277</sup> eg Olson [1982].

<sup>278</sup> Green and Nader [1973] 876. For an historical overview of convergence in the 1960s on regulatory capture: Posner [1997] 955-956.

## **V. Conclusion to Part I: From Justification to Realisation**

Competition law is a fundamentally economic endeavour.<sup>279</sup> Its goal is to ensure that markets operate “better”, however defined (efficiency maximisation, market freedom?). It can best be comprehended with basic concepts derived from neo-classical price theory and applied with various techniques of industrial organisation economics. Schools of competition thought popularly stand or fall on whether their substantive economic orientation is deemed sophisticated or illiterate, as the contemporary perception of Ordoliberalism suggests. So too do existing competition law norms, as the Chicagoan revolution vividly demonstrated.

But substantive merits aside, Part I of this thesis has sought to answer an important foundational question: to which *form* should competition policy aspire for determining the legality of business conduct on the market in furtherance of, at root, economic goals? The preceding chapters have offered a justification for attempting to realise the formal rule of law ideal, determining lawfulness via generalised, equally-applicable norms, which are comprehensible to businesses (public, prospective, clear, etc) and subject to robust judicial oversight. Chapters II and III analysed in detail the *formal* dimensions of Chicagoan and Ordoliberal competition scholarship, often obscured by debates as to the merit or demerit of their substantive orientation. It was argued that both “rival” schools place a premium upon market intervention through abstracted norms that can be internalised by businesses, rather than *ad hoc*, unstructured, subject-specific appraisals. This chapter has synthesised and situated their fledgling justifications for the formal rule of law within centuries of liberal political and economic scholarship, whilst also highlighting the crucial role of close judicial review. The rationality-respecting rigidity and centralised restraint of the formal rule of law, facilitated by rigorous judicial oversight, has been shown to be an ideal of considerable virtue. The Chicago School knew it, the Ordoliberals implied it, and generations of political and economic writing have thoroughly theorised it. Rather than an abstract ideal, inappropriate in the context of market interventions pursuing economic goods, the arguments justifying movements towards the formal rule of law ideal, and thus dissuading subject-specific determinations of legality that are incomprehensible to businesses, are therefore of overwhelming significance for competition policy. In short, the *form of market intervention matters*.

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<sup>279</sup> Following the discussion of NIE, it might be more broadly argued that *all law* is an economic endeavour.

Justifying the Rule of Law: Rationality, Restraint, Robust Review		
I: Norms Capable of Comprehension	II: Norms General in Scope and Equally Applied	III: Institution for Reviewing Compliance (Courts)
<p><u>Political Virtue:</u> meaningful exercise of individual freedom, ability to plan, fair attribution of responsibility for violations</p> <p><u>Economic Virtue:</u> effective institutions facilitate market processes, overcome information limits, reduce transaction costs</p>	<p><u>Political Virtue:</u> additional limitation upon state coercion of individuals, freedom to pursue own ends, limits discrimination</p> <p><u>Economic Virtue:</u> limited disruption to market forces, hinders rent-seeking that distorts markets and influences competition policy</p>	<p><u>Instrumental Virtue:</u> ensures congruence between legal norms and reality (<i>nulla poena sine lege</i>)</p> <p>residual institutional mechanism for shaping particularistic and incomprehensible normative acts into generalised and comprehensible norms</p>

Part II of this thesis shifts from the theoretical *justification* for aspiring towards the formal rule of law ideal in competition policy, to the second research question concerning its practical *realisation* in EU competition law. Is European enforcement a picture of respect for rationality and coercive restraint, facilitated by robust review? Or is it awash with incomprehensible obligations upon businesses and *ad hoc*, discretionary decision-making, all facilitated by lax judicial oversight? Furthermore, how is this means to be reconciled with contemporary advocacy of efficiency-focused enforcement, seemingly requiring highly context-, market- and fact-specific analysis to accurately determine legality? Having justified the formal rule of law ideal as a politically and economically desirable aspiration for competition policy in the abstract, will it be the case that in the struggle for effective and “more economic” enforcement, this is shown to be ‘correct in theory, but is of no use in practice’?<sup>280</sup>

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<sup>280</sup> Kant [1793].

## **Part II**

# **EU Competition Policy and the Rule of Law: Realisation?**

# Chapter V: Effective Ends and Discretionary Means: Disregarding the Formal Rule of Law in EU Competition Policy

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## I. Introduction: Effective Realisation of Immaterial Ends

Whether the maximisation of economic efficiency,<sup>1</sup> creating a single European market,<sup>2</sup> securing equitable market structures,<sup>3</sup> or pursuing any of the other values scattered throughout the EU Treaties,<sup>4</sup> from the perspective of the formal rule of law it is largely immaterial which goal underpins EU competition policy. The ideal imposes no limits to the *ends* animating specific decisions by the European Commission and EU Courts pursuant to Articles 101 and 102 TFEU. Instead, it offers an aspirational form for the *means* by which power is exercised to deliver such outcomes. Any of these aims could be realised whilst also taking steps towards enforcement in accordance with the ideal of generalised, equally-applied, comprehensible norms.

The problem with regard to approximating the formal rule of law in EU enforcement is not necessarily one of impossibility, but likelihood. It was noted in the previous chapter that those entrusted with promoting societal goods would probably not voluntarily succumb to this form of market intervention. It may *seem* to an authority more effective

<sup>1</sup> *Guidelines on Vertical Restraints [2000]* [7] (competition ‘enhances consumer welfare and creates an efficient allocation of resources’); *Guidelines on the Application of Article [101(3) [2004]* OJ C101/97 (“*Guidelines on 101(3) [2004]*”) [13]; *Guidance on the Commission’s Enforcement Priorities in Applying Article [102] of the EC Treaty to Abusive Conduct by Dominant Undertakings [2009]* C45/02 (“*Article 102 Guidance [2009]*”) [5] (ensuring ‘consumers benefit from the efficiency and productivity’), [19] (preventing foreclosure ‘having an adverse impact on consumer welfare’).

<sup>2</sup> eg C-56 and 58/64 *Etablissements Consten SA & Grundig-Verkaufs-GmbH v Commission* [1966] ECLI:EU:C:1966:41 (absolute territorial partitioning); *The Distillers Company Ltd* (IV/28.282) [1978] OJ L50/16 (differential pricing for exports). For overviews: Monti [2002]; Ibáñez Colomo [2016].

<sup>3</sup> As alleged by, eg: James [1976] 251-252; Korah [1978a] 797; [1993] 158; Venit [1987] 20-21; Gyselen [1989] 613-615; Turnbull [1996] 96; Kallaugher and Sher [2004] 277; Pera and Auricchio [2005] 160; Lovdahl Gormsen [2006] 8; [2007] 329; Auricchio [2007] 374; Pera [2008] 149-150. cf *Article 102 Guidance [2009]* [5]-[6] (‘not simply protecting competitors’, less-efficient firms may ‘leave the market’ owing to the superior efficiency of a dominant firm, but note [24] on the importance of a ‘less efficient competitor’); C-209/10 *Post Danmark A/S v Konkurrencerådet* [2012] ECLI:EU:2012:172 (“*Post Danmark I [2012]*”) [21]-[22]; C-413/14P *Intel v Commission* [2017] ECLI:EU:C:2017:632 [133]-[134].

<sup>4</sup> eg Articles 9 (high level of employment), 11 (environmental protection), 12 (consumer protection) TFEU. See generally: Monti [2002]; Jones and Sufrin [2016] 242-247.

to realise its ends through subject-specific normative determinations, particularly *discretion*, as opposed to the restraint and rationality-respecting rigidity of applying generalised, comprehensible legal norms. The historic and contemporary enforcement of EU competition policy is, at times, a demonstration of such formal reluctance. The variety of conceivable ends animating decisions are capable of exerting a significant pull for the Commission, in particular, to see them realised as *effectively* as possible and by whatever means necessary.<sup>5</sup> If their maximal delivery is the sole criterion for evaluating the legitimacy of market interventions, and discretionary normative determinations of the individually “bad” and “good” are thought to offer the most effective means, it is understandable why competition decision-makers would come to neglect alternative, more restrained, forms for deciding legality and illegality.

This chapter will demonstrate that both the Commission and Courts have sometimes contributed towards a prevalent focus upon the policy effectiveness of EU competition enforcement - the variable *ends* of intervention - and a disregard for realising the formal rule of law - the desirable *means* of intervention. The first part of this thesis argued that aspiring to enforcement in the form of generalised, equally-applicable norms that are comprehensible to businesses and subject to rigorous judicial oversight was an ideal of considerable political and economic virtue. But this means comes with a cost: it rejects discretionary normative acts on a subject-specific basis which may be an effective and flexible tool for achieving policy ends. EU competition enforcement has at times failed to address this relationship between ends and means, favouring the potency of policy delivery through discretionary, incomprehensible market interventions. This chapter explores a variety of examples of the legality of business conduct being determined in a manner antithetical to the formal rule of law ideal.

Sections II and III consider the Commission’s pre-modernisation decisional record, particularly focusing upon the treatment of joint venture agreements and rebate schemes under Articles 101 and 102 respectively. In both instances the Commission secured for itself a powerful position of discretionary oversight to effectively realise its policy goals. It could rewrite agreements to guarantee their pro-competitive implementation and established its ability to scrutinise the competitive merits of a wide variety of discounts by dominant firms. But in each example, this was achieved through undertaking *ad hoc*, subject-specific determinations of legality and distorting the law -

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<sup>5</sup> Discussing the policy effectiveness justification in commitment decisions: Dunne [2014] 434; [2015] 88-89.

gaming the Article 101(1)/(3) relationship, ignoring case law that restrained market intervention – with the result of fostering substantial normative uncertainty for firms.

In both instances the EU Courts failed to meet their key residual role envisaged by the formal rule of law of rigorously checking administrative discretion, and attempting to approximate the rule of law through formulating generalised norms to restrain and rigidify legal analysis. With regard to Article 102, the CJEU accommodated and legitimated the Commission's discretion-building decisional record, even where it sought to marginalise the case law. In the context of Article 101, there is a live debate about whether the EU Courts offer too much deference to the Commission's legal appraisals of factual scenarios. But even where the CJEU took a more proactive role to curbing the Commission's discretion by insisting upon rigorous effects-based analysis, there is a risk that this may also fail to foster legal certainty, itself falling short of the formal rule of law ideal, if it remains an *unstructured* inquiry. In essence, the Court might have simply substituted one *ad hoc*, subject-specific means for determining the legality of business conduct that failed to offer normative comprehensibility for another.

Section IV is a detailed analysis of the most egregious post-modernisation example of the Commission prioritising the effective realisation of policy ends through discretionary enforcement over considerations of the means of market intervention: commitment decisions. Without a doubt, this procedure represents the most powerful weapon in the Commission's competition policy arsenal as it can probe *any* business conduct and beneficially restructure entire markets through negotiating ambitious remedial packages. Such a means of *ad hoc*, subject-specific decisions beyond or below the scope of pre-existing normative obligations is a form of market intervention that has facilitated extensive legal uncertainty. The EU Courts have also failed to structure the Commission's manifest discretion, thereby being implicated in this systemic degradation in the formal rule of law. They have actively missed the opportunity to exercise judicial control over the scale and type of remedies offered as conditions for on-going legality. But somewhat more sympathetically, given that neither investigated firms nor third parties are likely to bring commitment decisions before the Courts in the first place, it is not immediately obvious how their deployment as a tool of contemporary competition enforcement can be restrained. In short, the use of commitment decisions is arguably the greatest divergence from realising the formal rule of law in EU competition policy.

## II. Enforcement of Article 101 TFEU

### A) Pre-Modernisation Commission Decisions: Exercising Discretion via Exemption Decisions

Paragraph 1 of Article 101 TFEU governs collusive acts between independent undertakings that prevent, restrict or distort competition by object or effect. Any form of coordination which falls foul of this prohibition may in principle benefit from exemption if it satisfies the four cumulative requirements of paragraph (3).<sup>6</sup> Prior to the procedural modernisation of Regulation 1/2003,<sup>7</sup> an agreement could only enjoy legality pursuant to Article 101(3) if it had been notified in advance, and solely the Commission had the discretion under Regulation 17/62 to grant individual exemptions.<sup>8</sup> Given the context within which this highly centralised regime for the oversight of agreements was born, the structure of Regulation 17/62 made a great deal of sense. The vast majority of Member States had little experience with competition law, and the potential for comparable agreements to be treated differently by national authorities and courts could have been a recipe for normative anarchy.<sup>9</sup>

From the perspective of the *effectiveness* of EU competition policy, the Commission's discretion to grant individual exemptions allowed for the close scrutiny of possibly problematic business agreements. The flexibility of Article 101(3) also permitted it to secure substantial changes to proposed contracts that were intended to ensure that competition would not be distorted. This was clearly a potent tool for the Commission to realise its ends.

Nevertheless, this *means* of competition enforcement through discretionary, subject-specific normative determinations resulted in widespread uncertainty for businesses. Owing to exploitation of the mechanics of Article 101, the legality of every agreement was subject to the Commission's discretion to exempt, and it was not clear what remedial changes had to be made to secure its blessing. The end of maximal control

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<sup>6</sup> (i) improve production/distribution or promote technical/economic progress; (ii) allow consumers a fair share of this benefit; (iii) only impose restrictions indispensable to attaining such benefits; (iv) do not eliminate a substantial degree of competition. See: *Guidelines on 101(3) [2004]* [38]-[114]. Restrictions by object or effect may in principle receive exemption: *T-17/93 Matra Hachette SA v Commission* [1994] ECLI:EU:T:1994:89 [85].

<sup>7</sup> Council Regulation 1/2003 on the Implementation of the Rules on Competition laid down in Articles [101] and [102] of the Treaty [2003] ("Regulation 1/2003") OJ L1/1.

<sup>8</sup> Council Regulation 17/62 Implementing Articles [101] and [102] of the Treaty [1962] OJ Spec Ed 87 ("Regulation 17/62"), Article 4(1) (compulsory notification), Article 9(1) (Commission power to exempt).

<sup>9</sup> Forrester and Norall [1984] 12-13; Wils [1999] 154.

over business agreements was secured through a means antithetical to the formal rule of law ideal. This is demonstrated by considering the Commission's pre-modernisation treatment of joint venture agreements.

i) *The Effective Ends of Discretion*

Joint venture ("JV") agreements concern competitors temporarily cooperating on research and development, production, marketing, etc. Their competitive consequences are unavoidably complex. While they can promote innovation and investment, open markets, and generate new products, JV agreements may also facilitate anticompetitive collusion through market-sharing, price-fixing, and production quotas.<sup>10</sup>

Given their unpredictable impact on markets, defying any 'simple, universally applicable standard',<sup>11</sup> the Commission's approach was to determine their legality pursuant to Article 101 through incisive scrutiny of the 'the economic circumstances of the individual case'.<sup>12</sup> This was achieved through the Commission's discretion to grant Article 101(3) exemption decisions, where it could consider the subject-specific competitive merits of each JV agreement in question to decide its legality or illegality. Often its decision-making record revealed substantial economic nuance. Many *prima facie* restrictive clauses in such agreements were accepted as necessary for the pro-competitive consequences of the JV to be realised at all. For example in *Vacuum Interrupters* [1977],<sup>13</sup> the Commission exempted a JV for the creation of a new product where the parents had agreed not to individually develop competing interrupters, as this restriction was 'indispensable' *ex ante* for them to cooperate at all and guarantee its commercial success.<sup>14</sup> As a result, the vast majority of joint venture agreements were ultimately found to be lawful through the Commission's exercise of its discretion to grant an Article 101(3) individual exemption.<sup>15</sup> In recognising their substantial pro-competitive efficiencies in the longer term, despite necessary short-term restraints between competitors, this was arguably market intervention that successfully sought to improve consumer welfare.

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<sup>10</sup> Caspari [1985] 452-453; Faull [1984] 360.

<sup>11</sup> Caspari [1985] 453.

<sup>12</sup> Vestryng [1984] 688.

<sup>13</sup> *Vacuum Interrupters Ltd* (IV/27.442) [1977] OJ L48/32 [23].

<sup>14</sup> On the *ex post* bias against *ex ante* necessary restrictions: Korah [1983] 747; [1986a] 93-95; [1992a] 253; [1994a] 212, 274; Horspool and Korah [1992] 385; Van den Bergh [1996] 77. For Commission recognition: *Guidelines on Vertical Restraints* [2000] [100]-[118]; *Guidelines on 101(3)* [2004] [17]-[19]; *Guidelines on Vertical Restraints* [2010] C130/01 [100]-[109]. For comparable Chicagoan claims on vertical restraints: Chapter II, text accompanying fn 91-95.

<sup>15</sup> M Waelbroeck [1987] 716-718.

The Commission's discretion to grant an Article 101(3) exemption decision was also an effective tool for competition enforcement as there was scope for determinations of legality that considered various non-efficiency goals.<sup>16</sup> For example in the early *Transocean Marine Paint* [1967] exemption, intense cross-border collaboration to formulate a new paint was clearly influenced by the desire to foster trans-European product development to compete worldwide.<sup>17</sup> Similarly, the lawfulness of the joint venture in *Ford/Volkswagen* [1993] was swayed by the potential for a new, innovative factory to aid regeneration of a disadvantaged area.<sup>18</sup> Outside of JV agreements, the Commission even exempted a crisis cartel to reduce industrial overcapacity in an orderly fashion in *Synthetic Fibres* [1984],<sup>19</sup> and in CECED [2000], permitted the agreement between 95 per cent of washing machine manufacturers to abandon production of cheaper, more polluting products, thereby promoting more energy-efficient - and expensive - machines.<sup>20</sup> In this way, the pre-modernisation discretion of Article 101(3) exemptions afforded the Commission an opportunity to consider a variety of noble ends in determining legality.

But the effectiveness of the Commission's oversight was not simply reactive, auditing the potential efficiency gains or other benefits of joint ventures; it often aimed to *ensure* that anticompetitive consequences would not materialise through proactively renegotiating their terms with coordinating companies. The Commission's discretion to find business collaboration legal through an Article 101(3) exemption decision was frequently conditional upon contractual changes, where it essentially rewrote a number of proposed JV agreements.<sup>21</sup> Examples include the negotiations with the Commission in its *De Laval-Stork* [1977],<sup>22</sup> *Optical Fibres*,<sup>23</sup> and *UIP* [1989] decisions.<sup>24</sup> Perhaps the most prominent example of the policy effectiveness of the Commission's discretion to conditionally legalise joint ventures were the various Article 101(3) exemptions intended

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<sup>16</sup> See generally: Monti [2002]; Jones and Sufrin [2016] 242-247.

<sup>17</sup> *Transocean Marine Paint Association* (IV/223) [1967] JO L163/10. See: Schwarz and Wellman [1972] 204, 207; Deringer [1974] 104-105.

<sup>18</sup> *Ford/Volkswagen* (IV/33.814) [1993] OJ L20/14. See: Jones and Sufrin [2016] 245-246 ('difficult to justify on pure efficiency grounds').

<sup>19</sup> *Synthetic Fibres* (IV/30.810) [1984] OJ L207/17. See: Bodoff [1984] 52; Hornsby [1987] 89-92; Jones and Sufrin [2016] 246.

<sup>20</sup> *CECED* (IV/36.718) [2000] OJ L187/47.

<sup>21</sup> Korah [1983] 713-714; [1992a] 270; Van Bael [1986] 62.

<sup>22</sup> *De Laval-Stork* (IV/27.093) [1977] OJ L215/11 (exempted after securing stringent conditions to ensure the independent operation of the parties after its expiry). See: Korah [1992a] 269-270.

<sup>23</sup> *Optical Fibres* (IV/30.320) [1986] OJ L236/30 (exempted after changes to management, the powers of the parents, licensing conditions). See: Korah [1992a] 278-279.

<sup>24</sup> *UIP* (IV/30.566) [1989] OJ L226/25 (exclusive joint selling venture that the Commission redesigned through swapping exclusivity for first refusal, redrawing the organisational structure).

to liberalise the telecommunications industry before regulatory changes at the end of the 1990s, pre-emptively combatting domestic failures to control incumbents.<sup>25</sup> When national telecoms companies notified their differing international agreements for strategic alliances prior to liberalisation,<sup>26</sup> the Commission's exemptions were conditional upon commitments by the parent firms to prevent future abuses as infrastructure owners.<sup>27</sup> This hands-on approach to guaranteeing that competitive concerns would not materialise in JV agreements was reflected in its engagement with other types of coordination, from the deletion of problematic clauses in selective distribution agreements,<sup>28</sup> through to more demanding and creative conditions in complex commercialisation agreements.<sup>29</sup> And as the annual *Reports on Competition Policy* revealed,<sup>30</sup> even where the Commission informally closed the notification without a formal Article 101(3) exemption decision, it leveraged its discretion to potentially reopen formal proceedings to secure changes to business agreements.<sup>31</sup>

The pre-modernisation treatment of JV agreements demonstrates how the Commission's power to grant legality to individual agreements through Article 101(3) exemption decisions permitted the realisation of its intended competition policy *ends* with utmost effectiveness. It enjoyed a tight grip over JVs to ensure that their various clauses would deliver on their purported pro-competitive efficiencies. Decisions like *Vacuum Interrupters* evidence the Commission's economically-sophisticated understanding of the need for certain restrictive clauses to ultimately secure outcomes beneficial to consumers, but it could also factor non-efficiency values into its legal determinations. Furthermore, if agreements were found to pose serious competitive risks, the Commission could negotiate sweeping changes to their operation to guarantee efficiency, or, as the telecoms exemptions demonstrate, any other goals it had in the

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<sup>25</sup> Larouche [2000] 312-313; Cave and Crowther [2005] 489.

<sup>26</sup> *Infonet* (IV/33.361) [1992] OJ C7/3; *Atlas* (IV/35.337) [1996] L239/23; *Phoenix/Global One* (IV/35.617) [1996] L239/57; *Unisource* (IV/35.830) [1997] L318/1; *British Interactive Broadcasting/Open* (IV/ 36.539) [1999] 312/1. See: Larouche [2000].

<sup>27</sup> eg non-discriminatory network access, information disclosure, no bundling or cross-subsidisation. See: Larouche [2000] 187, 239, 262; Cave and Crowther [2005] 486-487.

<sup>28</sup> eg *Yves Saint Laurent Parfum* (IV/33.242) [1992] OJ L12/24 (deletion of cross-supply and quantitative location restrictions).

<sup>29</sup> eg *Joint selling of the Commercial Rights of the UEFA Champions League* (COMP/C.2-37.398) [2003] OJ 291/25 ("Champions League [2003]").

<sup>30</sup> eg *Twenty-First Report on Competition Policy 1991* [1992]: 67-68 (*Campina*, articles of association concerning members leaving were rewritten), 73-74 (*Amadeus/Sabre*, 'detailed undertakings' securing non-discriminatory use of computer reservation systems), 76 (*Compagnie des Cristalleries Baccarat*, removing location and cross-supply restrictions in selective distribution agreements).

<sup>31</sup> Korah [1981] 16; Van Bael [1986] 61-62; D Waelbroeck [1986] 269.

field. In short, the Commission's discretion to permit or prohibit individual agreements was a valuable tool for pursuing its competition policy ends.

*ii) The Problematic Means of Discretion*

The Commission's discretion was an effective means to achieve its ends, but in rejecting determinations of legality through applying generalised norms, the obligations incumbent upon businesses contemplating JV agreements were incomprehensible and unstructured. This uncertainty was exacerbated by the Commission exploiting the relationship between Article 101(1) and (3) to subject almost *every* agreement to its discretionary oversight.

The lawfulness of coordination between firms pursuant to Article 101 was dependent upon the Commission's contract-specific assessment of its merits. As Chapter IV argued, where principle (ii) of the formal rule of law - determining legality through generalised norms - is not met, the consequence is often injurious to principle (i) - normative comprehensibility for legal subjects. In the context of JV agreements, there were *no* generalised norms structuring and restraining the Commission's 'virtually unfettered discretion whether to grant an exemption';<sup>32</sup> there was no indication, for instance, that certain common clauses were deemed legally innocuous. The Commission's exercise of its discretion to grant an Article 101(3) exemption for a joint venture involved 'a complicated, open-ended and somewhat unpredictable process of weighing relative economic gains and losses',<sup>33</sup> making it 'impossible for those who advise firms whose business is affected by it'.<sup>34</sup> Even the basic question of for how long from the decision the exemption would be in force was unforeseeable, seemingly a random number selected by the Commission; would it be around fifteen, nine, seven years, or just under 16 months?<sup>35</sup> As the resulting decisions were so subject-specific in their findings of legality, it was difficult for businesses to generalise from them to inform their own proposals for collaboration.<sup>36</sup> This was not impossible: for example, through a number of decisions it became clear that the granting of individual exclusive licences *tended* to be

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<sup>32</sup> Korah [1994a] 272.

<sup>33</sup> Bodoff [1984] 67.

<sup>34</sup> Korah [1994a] 272.

<sup>35</sup> *Optical Fibres* [1986] (15), *De Laval-Stork* [1977] (9), *Vacuum Interrupters* [1977] (7), *Synthetic Fibres* [1984] (16 months, but a crisis cartel).

<sup>36</sup> Hawk [1972] 256-257 ('difficult to extrapolate general rules [as] decisions are dependent upon the facts of each case').

exempted.<sup>37</sup> But this was a pattern, not a guarantee. Until restrained by an authoritative norm,<sup>38</sup> the Commission retained the discretion to be as consistent or inconsistent as it wished, and businesses had no security that such terms would be found legal in their own particular instance.

Furthermore, this normative uncertainty was amplified by the Commission's discretion to include a wide variety of public interest factors in its determinations of legality. For example, exempting coordination between firms in *Synthetic Fibres* [1984] to gradually reduce oversupply and manage industrial decline was informed by the noble policy end of making it 'easier to cushion the social effects' of plant closures.<sup>39</sup> But from a pure efficiency perspective, this was a *crisis cartel*, diluting the clarity of reductions in output as hard-core restrictions of competition. The same interpretation can be given to the *CECED* [2000] exemption decision, concerning the agreement between firms to stop producing cheaper consumer washing machines to promote less pollution but more expensive models.<sup>40</sup> Admittedly, in both decisions the Commission's discretion was used to *absolve* companies through incorporating public interest considerations. And as reiterated at the outset, the formal rule of law does not limit the ends of exercises of centralised power; all goals can be realised in accordance with the ideal, or not. But as Bork recognised in his advocacy of consumer welfare as a singular benchmark to restrain judges from concluding unlawfulness on the basis of many individually commendable ends,<sup>41</sup> the rule of law is better approximated by selecting a *singular goal* consistently underpinning market interventions, whatever it may be. As the Commission's decisional practice through Article 101(3) demonstrates, the flexibility to determine legality based on any number of inconsistent values in a discretionary, *ad hoc* manner that is not foreseeable in advance intensifies normative uncertainty for market actors.

This legal insecurity was exacerbated by the Commission's seeking of contract-specific changes to secure its discretionary blessing under Article 101(3). Of course, this potential for conditional exemption made for effective competition enforcement, how much would companies have to offer to secure validity for their proposed agreement?

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<sup>37</sup> eg *Davidson Rubber Co* (IV/17.545, 6.964, 26.858, 26.890, 18.673, 17.448) [1972] JO L143/31.

<sup>38</sup> As eventually occurred: Commission Regulation 2349/84 on the Application of Article [101](3) of the Treaty to Certain Categories of Patent Licensing Agreements, Article 1.

<sup>39</sup> *Synthetic Fibres* [1984] [37].

<sup>40</sup> *CECED* [2000].

<sup>41</sup> See Chapter II, Section III.A.

Would it require relatively modest tweaks to agreements, perhaps removing a couple of terms the Commission disliked?<sup>42</sup> Or more substantial changes to key features of the anticipated coordination between businesses?<sup>43</sup> Or, as with the far-reaching telecoms exemption decisions,<sup>44</sup> significant commitments on future conduct that seemingly have no connection to the notified agreement?<sup>45</sup> When there is such a degree of uncertainty as to what will be required to gain the Commission's discretionary seal of approval, it is understandable why pro-competitive coordination comes to be chilled to the ultimate detriment of consumers. It simply might not be clear that the benefits of creating a joint venture with another firm would be worth the conditions necessary to secure its lawfulness from the Commission pursuant to Article 101.

Discretionary determinations of legality by the Commission that resulted in normative uncertainty for businesses could have been a formally problematic but nevertheless marginal element of Article 101 enforcement in the pre-modernisation era. The requirement for a paragraph (3) exemption decision only came into play if there was a finding of a restriction of competition pursuant to paragraph (1). However the Commission deliberately amplified the extent of this departure from the restraint of applying generalised and comprehensible norms envisaged by the rule of law, thereby expanding its discretionary control over agreements. Essentially, it found *everything* presumptively illegal under paragraph (1) unless it chose to grant a paragraph (3) exemption decision in the individual instance.<sup>46</sup>

Returning to the example of joint venture agreements, Article 101(1) was applied in an overbroad manner through recurrent findings of restrictions by object and laconic effects analysis, basically applying the *prima facie* prohibition to any arrangements that constrained the parties' "economic freedom".<sup>47</sup> But all joint ventures - or indeed *any* contractual relations - are inherently intended to restrict freedom through accepting mutual obligations.<sup>48</sup> Therefore regardless of efficiency or clear consumer benefits, the

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<sup>42</sup> eg *Yves Saint Laurent Parfum* at fn 28.

<sup>43</sup> eg *Optical Fibres* at fn 23 or *Champions League* at fn 29.

<sup>44</sup> See fn 26-27.

<sup>45</sup> On the conditions being more related to Article 102 than the initial Article 101 notification: Larouche [2000] 280; Ibáñez Colomo [2010] 277.

<sup>46</sup> Korah [1983] 712-713; [1990] 1033; [1994a] 272; Forrester and Norall [1984] 12, 22; Venit [1987] 33; Hawk [1992] 324-325; [1995] 974, 983; Bright [1996] 536.

<sup>47</sup> Deringer [1965] 604-605; Van Houtte [1982] 498-500; Hawk [1992] 333.

<sup>48</sup> Joliet [1967] 9; Van Houtte [1982] 500; Hawk [1995] 978; Bright [1996] 535.

Article 101(1) prohibition applied automatically to ‘any joint venture agreement’.<sup>49</sup> This resulted in embarrassingly ‘schizophrenic’ decisions.<sup>50</sup> The common illustration of this dynamic repeatedly criticised by Korah was the (non-JV) exemption decision in *Davidson Rubber* [1972].<sup>51</sup> The Commission’s economically-nuanced understanding of the need for exclusivity in patent licensing was evident in its Article 101(3) analysis, noting that ‘no manufacturer would have been prepared to undertake the necessary investment without the protection’ of an exclusive licence.<sup>52</sup> But to push the decision into the scope of its Article 101(3) discretion to closely scrutinise agreements, consider public interest ends, and impose conditions, a few pages earlier pursuant to paragraph (1) analysis, committing to exclusivity in the *Davidson Rubber* licence was considered a restriction of competition by object for limiting the commercial freedom to grant the patent to others. For joint venture agreements in particular, the blunt deployment of the paragraph (1) presumptive prohibition was not only contrary to claims by officials that it would be ‘flexible and applied in the light of all prevailing economic circumstances’,<sup>53</sup> momentarily supported by the negative clearance in *Odin* [1990]<sup>54</sup> but reconfirmed in decisions such as *European Night Services* [1994].<sup>55</sup> It also often violated the clear case law of the CJEU on the need for rigorous effects-based analysis of the restrictive consequences of certain types of agreements for finding them in breach of Article 101(1).<sup>56</sup> So further to the normative uncertainty generated by its entirely discretionary granting of Article 101(3) exemptions, as expanded by a deliberately overbroad interpretation of the Article 101(1) prohibition, the Commission was *also* ignoring and undermining the legal restraints imposed by the CJEU on the requirement for effects-based analysis. This disjuncture between the Commission’s decisional practice and the authoritative case law on the interpretation of paragraph (1) was therefore another source of legal uncertainty for business agreements subject to Article 101.

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<sup>49</sup> M Waelbroeck [1987] 718 (emphasis added).

<sup>50</sup> Venit [1987] 33-34; [1991] 9. See also: Korah [1975] 183; [1983] 710-711; [1986a] 94; [1990] 1027; [1992a] 251-252; [1994a] 269; Claydon [1986] 159; M Waelbroeck [1987] 716-718; Hawk [1988] 70; Venit [1991] 9; Wesseling [2000] 25-26, 89.

<sup>51</sup> Korah [1975] 183, 255; [1976] 187; [1983] 710-711; [1986a] 95.

<sup>52</sup> *Davidson Rubber Co* [1972].

<sup>53</sup> Faull [1984] 360. See also: *Thirteenth Report on Competition Policy 1983* [1984] (outcomes ‘determined in each case on the basis of the economic reality of the situation’); Caspari [1985] 454-461.

<sup>54</sup> *Elopak/Metal Box-Odin* (IV/ 32.009) [1990] OJ L209/15 (cooperation between can and carton-filling producers to create a hybrid would not occur individually, so they could not be considered potential competitors and the Article 101(1) prohibition did not apply). See: Venit [1991] 6, 26-27; Horspool and Korah [1992] 357-358, 360.

<sup>55</sup> *European Night Services* (IV/34.600) [1994] OJ L259/20. For disappointment: Korah [1994a] 257, 268; Bright [1996] 538.

<sup>56</sup> See fn 101.

As if this departure from the formal rule of law was not substantial enough, even the sole certainty that the legality of proposed agreements was entirely at the Commission's discretion provided little solace. As it was constantly overwhelmed by the thousands of notified agreements seeking exemption - a predicament entirely of the Commission's making in its broad-brush approach to Article 101(1) - it was forced to respond primarily through informal reassurances that it would not investigate further ("comfort letters").<sup>57</sup> Given the uncertain legal status of these letters before national courts,<sup>58</sup> businesses frequently self-applied the paragraph (3) exemption to develop a justification should the Commission decide to intervene, or simply ignored EU competition law altogether.<sup>59</sup> This was undoubtedly a counterproductive consequence of the Commission's desire to enjoy maximal control of business coordination.

In sum, the discretion of Article 101(3) exemption decisions afforded the Commission an undeniably effective means to realise its policy goals. It had close oversight of notified agreements and could determine their legality on an individual, contract-specific basis, often demonstrating a nuanced economic understanding of the *ex ante* necessity of restrictive terms and considering wider public interest goals. Furthermore, it frequently secured far-reaching commitments to assuage long-term competitive concerns. But the Commission's pre-modernisation approach to Article 101 was solely driven by a desire to pursue its competition policy *ends* with utmost efficacy, giving no consideration to the detrimental consequences of this *means* of market intervention. Its absolute discretion to grant exemption decisions, constituting subject-specific determinations of legality, failed to produce generalised, comprehensible norms to inform business decision-making. Lawfulness was often conditional, but there was no indication of what would actually be required in any instance. And this systemic uncertainty was exacerbated by the Commission's exploitation of the decisional mechanics of Article 101, reluctance to heed the requirements of the case law, and reliance upon unenforceable informalities to remedy an administrative burden of its own making. The ends may have been effective, but the means evidence a failure to realise the restrained, rationality-respecting ideal of the formal rule of law.

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<sup>57</sup> For dissatisfaction: Korah [1981]; Kon [1982] 544; Forrester and Norall [1984] 17; Van Bael [1986] 61 (estimating that 96 per cent of cases closed without a formal decision); Hawk [1992] 324 [1995] 984; Wils [1999] 154, 156.

<sup>58</sup> Korah [1981] 22-24, 39; Van Bael [1986] 77.

<sup>59</sup> Forrester and Norall [1984] 16-17, 31-37.

## *B) Judicial Review of Article 101 Decisions*

The conceptualisation of the formal rule of law developed in Chapter IV stressed the importance of effective judicial review. This institutional requirement is both reactive and prospective. On the one hand, it provides a necessary mechanism for checking that administrative decisions are within the legal restrictions upon their authority to act (eg compliance with pre-existing law, meeting legal thresholds for characterising factual scenarios as prohibited, using powers for their intended purpose).<sup>60</sup> On the other hand, judicial review also provides the opportunity for the courts to engage in the prospective formulation of legal norms. Whether crystallising a series of individualised decisions by the authority or of its own creation, courts can generate more generalised and comprehensible norms for determining legality, that thereby restrain the decision-maker's discretion and provide legal certainty.<sup>61</sup> In this regard, courts are a key institutional actor in the approximation of the formal rule of law ideal.

It is questionable whether the response of the EU Courts to the Commission's pre-modernisation enforcement of Article 101 effectively met either aspect of this dual role.

### *i) Pre-Modernisation Article 101(3) Discretion and Wider Issues of Deferential Review*

With regard to the reactive judicial role of ensuring the legality of decisions and reviewing administrative appraisals, the extent to which the Commission's discretion to grant Article 101(3) exemption decisions has been circumscribed by the EU Courts is debateable. Since the 1960s the CJEU had seemingly assumed a relaxed standard of review as to its legal characterisation of instant facts (ie that the Commission's reasoning met the requirements of the Treaty).<sup>62</sup> In the foundational case of *Consten* [1966] it ruled that Article 101(3) 'necessarily implies complex evaluations on economic matters' and therefore its oversight would be confined to an examination of the relevance of facts and the legal consequences deduced from them.<sup>63</sup> This judicial reluctance to intervene in the Commission's determining of exemptions has been regularly reasserted,<sup>64</sup> with the CJEU in *Metro I* [1977] directly acknowledging the

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<sup>60</sup> See Chapter IV, Section II.C.i.

<sup>61</sup> See Chapter IV, Section II.C.ii.

<sup>62</sup> Forrester [2009]; Jaeger [2011] 297-298; Kalintiri [2016] 1287-1289.

<sup>63</sup> *Consten* [1966].

<sup>64</sup> eg T-7/93 *Langnese Iglo GmbH v Commission* [1995] ECLI:EU:T:1995:98 [178].

Commission's 'discretionary power in this sphere'.<sup>65</sup> The classic formulation (or 'mantra')<sup>66</sup> of this deferential stance was given by the CJEU in *Remia* [1985] for when:<sup>67</sup>

*"the Commission has to appraise complex economic matters. The Court must therefore limit its review of such an appraisal to verifying whether the relevant procedural rules have been complied with, whether the statement of the reasons for the decision is adequate, whether the facts have been accurately stated and whether there has been any manifest error of appraisal or a misuse of powers"*

*Consten* was an example where an Article 101(3) exemption was not granted by the Commission. So long as it takes seriously a firm's evidence of counterbalancing benefits resulting from the restrictive agreement,<sup>68</sup> the Courts have often been happy to accept such refusals.<sup>69</sup> In contrast, *Matra Hachette* [1994] involved proceedings brought against the Commission's decision in *Ford/Volkswagen* [1993] to grant exemption to a joint venture for a car factory in Portugal. As noted above, the Commission decision was influenced, at least, by consequential job creation and investment in a deprived region.<sup>70</sup> The General Court upheld the exemption decision in its entirety, having acknowledged that as 'complex economic facts are involved, judicial review of the legal characterisation of the facts is limited to the possibility of the Commission having committed a manifest error of assessment'.<sup>71</sup> There are contrasting instances where review by the EU Courts of the Commission's discretion to grant an Article 101(3) exemption has been more searching, leading to their overturning.<sup>72</sup> Nevertheless, the combination of hands-off judicial statements as to the standard of review and the few examples of overturned decisions further contributed to the uncertain boundaries of the Commission's discretion to grant exemptions. Given that this procedure was at times viewed as a forum for EU competition decision-making by the Commission to internalise public interest considerations, judicial abstinence was at least understandable. And deciding upon the appropriate standard of review vis-à-vis the legal characterisation of facts by an expert, administrative decision-maker is never a simple task.<sup>73</sup> But still,

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<sup>65</sup> C-26/76 *Metro-SB-Grossmärkte GmbH v Commission* [1977] ECLI:EU:C:1977:167 ("Metro I [1977]") [50].

<sup>66</sup> Forrester [2009].

<sup>67</sup> C-42/84 *Remia and Nutricia v Commission* [1985] ECLI:EU:C:1985:327 [34].

<sup>68</sup> T-168/01 *GlaxoSmithKline Services Unlimited v Commission* [2006] ECLI:EU:T:2006:265 [236].

<sup>69</sup> T-111/08 *MasterCard v Commission* [2012] ECLI:EU:T:2012:260 [194]-[237].

<sup>70</sup> *Ford/Volkswagen* [1993] [36]. See text accompanying fn 18.

<sup>71</sup> *Matra Hachette* [1994] [104].

<sup>72</sup> eg T-374, T-375, T-384, and T-388/94 *European Night Services* [1998] ECLI:EU:T:1998:198; T-185/00, T-216/00, T-299/00 and T-300/00 *Métropole Télévision SA (M6) v Commission* [2002] ECLI:EU:T:2002:242.

<sup>73</sup> Especially as it is difficult to separate law, facts, and their legal characterisation: *Vesterdorf* [2005] 11; *Van Cleynenbreugel* [2012] 528-529; *Laguna de Paz* [2014] 206.

recourse to the EU Courts was an unreliable mechanism for structuring the Commission's *ad hoc* determinations of legality pursuant to Article 101.

More problematic has been the consequent spread of judicial deference. Given the uncertain scope of what constitutes a "complex" assessment, the breadth of light-touch scrutiny by the EU Courts may have come to shield potentially vast swathes of Commission decision-making.<sup>74</sup> From its origins in *Consten* [1966] and the specific context of granting individual exemptions pursuant to Article 101(3), perhaps reflecting the multiplicity of values informing determinations of legality, deference has also been extended to cover many facets of Commission analyses concerning both Articles 101(1) and 102. For example, the classic statement in *Remia* [1985] of the relaxed standard of review related to the CJEU evaluating the Commission's finding in the context of Article 101(1) that a non-compete obligation for ten years was excessive, but a period of four years was not.<sup>75</sup> In *Microsoft* [2007], not only did the General Court offer a margin of appreciation to the Commission's economic assessments substantiating the claim of abusive conduct prohibited by Article 102,<sup>76</sup> but it further extended lighter judicial scrutiny to 'complex technical appraisals'.<sup>77</sup> These are matters that go to the core of the Commission's decision-making as to the legality of business practices, leading a number of commentators to urge an intensification in the review exercised by the EU Courts.<sup>78</sup>

This is not a universally accepted interpretation. Several justifications for judicial deference have been offered based upon the robustness of Commission decision-making,<sup>79</sup> comparative economic expertise,<sup>80</sup> or the separation of powers.<sup>81</sup> Others have simply refuted the allegation that scrutiny by the EU Courts is not strong enough already,<sup>82</sup> preferring to judge its deeds rather than words.<sup>83</sup> Cases can be highlighted

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<sup>74</sup> Cengiz [2011] 141-142; Gerardin and Petit [2011] 23; Jaeger [2011] 309; Kalintiri [2016] 1290-1302.

<sup>75</sup> *Remia* [1985].

<sup>76</sup> T-201/04 *Microsoft v Commission* [2007] ECLI:EU:T:2007:289 [87], eg [379] (on whether the interoperability information was "indispensable").

<sup>77</sup> *ibid* [88].

<sup>78</sup> eg Siragusa [2009] 4; Forrester [2009]; [2011] 191-197 (on fining review); Slater, Thomas, and Waelbroeck [2009] 140; Temple Lang [2010] 238; Gerard [2010]; [2011]; Killick and Berghe [2011] 277; Bronckers and Vallery [2012] 294; Nikolic [2012] 586-587; Nazzini [2015b] 506.

<sup>79</sup> Castillo de la Torre [2009] 568-569; Sanchez Graells [2014] 260-263.

<sup>80</sup> Fritzsche [2010] 395, 397. See also: Caffarra and Walker [2010] 159. cf Forrester [2009]; Rose [2009] 8; Jaeger [2011] 309-311.

<sup>81</sup> Laguna de Paz [2014].

<sup>82</sup> eg Castillo de la Torre [2009] 565; Pais Antunes [2009] 3; Wils [2010] 28; [2011] 367-368; [2014] 19; Jaeger [2011] 300, 313; CMLRev Editorial [2011] 1411; Lenaerts [2013]; Loozen [2014] 106-107; Sanchez Graells [2014] 267; Laguna de Paz [2014] 204-206; Prek and Lefèvre [2016] 68.

<sup>83</sup> eg Castillo de la Torre [2009] 566; Wils [2010] 28; [2014] 16; Jaeger [2011] 300; Fritzsche [2010] 380; Sanchez Graells [2014] 267; Laguna de Paz [2014] 216; Kalintiri [2016] 1315. For judicial support: C-272/09P

that suggest close review of the Commission's characterisation of the facts as meeting legal thresholds for prohibition under Article 101,<sup>84</sup> 102,<sup>85</sup> and merger control.<sup>86</sup> More adversarial statements by the EU Courts of searching oversight can also be found,<sup>87</sup> often following recitation of the deferential mantra, and perhaps suggesting that there is no clear, consistent logic at all as to the intensity of review.<sup>88</sup> According to the CJEU at least, there is no cause for concern.<sup>89</sup>

Regardless of which of the two accounts is accurate, it is clear that with regard to the Commission's discretion to grant an Article 101(3) exemption, as well as many other aspects of competition decisions, there is uncertainty as to how exacting scrutiny will be by the EU Courts as to its legal characterisations of factual scenarios. When compared with the restraining role envisaged as part of the formal rule of law ideal, there has been legitimate cause for concern that the judiciary have not set limits to the Commission's subject-specific determinations of legality, thereby perhaps doing little to ameliorate the occasional absence of normative certainty for firms.

### *ii) The Scope of Article 101(1): From Frying-Pan to Fire*

While there is debate as to whether the EU Courts restrained the Commission's Article 101(3) discretion through demanding review of its direct exercise, the CJEU did however prospectively formulate norms for determining legality under Article 101(1) to indirectly limit its scope. Most commonly,<sup>90</sup> this was by insisting that certain types of agreements ought to be evaluated through robust analysis of their potential anticompetitive effects.<sup>91</sup> Although these cases set clear boundaries to the extent of the Commission's discretion under Article 101(1), such a method for determining legality also risks failing

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*KME Germany AG v Commission* [2011] ECLI:EU:C:2011:810 [109] (the General Court *said* it would afford deference to discretion, but carried out a 'full and unrestricted review'). For criticism: Nazzini [2012] 995-997; [2015b] 449; Nagy [2016] 238.

<sup>84</sup> C-89, 104, 114, 116-117, and 125-129/85 *Ahlström Osakeyhtiö v Commission* [1993] ECLI:EU:C:1993:120.

<sup>85</sup> *Microsoft* [2007]. See: Wils [2010] 28; [2014] 16; Jaeger [2011] 302.

<sup>86</sup> T-342/99 *Airtours v Commission* [2002] ECLI:EU:T:2002:146; T-310/01 *Schneider Electric v Commission* [2002] ECLI:EU:T:2002:254; T-5/02 *Tetra Laval v Commission* [2002] ECLI:EU:T:2002:264. See: Pais Antunes [2009]; Cengiz [2011] 142; Geradin and Petit [2011] 24-25; Gerard [2011] 472; Jaeger [2011] 599, 601; Ibáñez Colomo [2013] 404-405, 420-422; Laguna de Paz [2014] 217; Kalintiri [2016] 1300-1302, 1308; Prek and Lefèvre [2016] 72-74.

<sup>87</sup> eg C-12/03P *Tetra Laval BV v Commission* [2005] ECLI:EU:C:2005:87 [39]; *Microsoft* [88]-[89]; *KME* [2011] [102] (the margin of discretion doesn't prevent 'an in-depth review of the law and of the facts.').

<sup>88</sup> Forrester [2009]; Fritzsch [2010] 380; Bronckers and Vallery [2012] 294; Van Cleynenbreugel [2012] 532-533; [2014] 39-40; Nazzini [2015b] 492; Kalintiri [2016] 1286, 1289.

<sup>89</sup> *KME* [2011]. See: Sibony [2012] 1993; Bronckers and Vallery [2012] 292; Nazzini [2012] 995-996; [2015b] 500-505; Van Cleynenbreugel [2014] 41, 44; Nagy [2016] 236.

<sup>90</sup> See the discussion of presumptions of legality in the next chapter.

<sup>91</sup> For praise: M Waelbroeck [1987] 697; Hawk [1988] 70; [1995] 982; Gerber [1994] 117-118, 127-128; Bright [1996] 551; Wesseling [1999] 422; [2000] 28, 30, 91, 93; Pera and Auricchio [2005] 177.

to approximate the formal rule of law ideal if it is left *unstructured*. Essentially, the CJEU may have substituted one means of market intervention without generalised, comprehensible normative obligations for legal subjects under Article 101(3), for another pursuant to Article 101(1).

In the foundational case of *Société Technique Minière* [1966] the CJEU was asked to rule on the legality of exclusive distribution agreements divided along national lines.<sup>92</sup> The agreement in question prevented distributors deliberately selling into each other's allotted territories (active sales) but did not prevent them from responding to requests from customers outside of their territory (passive sales). The CJEU reasoned that such partial territorial insulation could be 'necessary for the penetration of a new area' to guarantee the distributor a return on a novel product.<sup>93</sup> As a result, exclusive distribution agreements would only breach Article 101(1) and be subject to the Commission's discretion to grant a paragraph (3) exemption if restrictive of competition by effect. This required analysis of the specific agreement 'within the actual context', where the Commission would have to consider, amongst other things, the alternative counterfactual level of competition, the particular nature and quantity of products covered, the 'position and importance' of the specific parties, the severity of the exclusivity clauses, whether it was an 'isolated' or 'series' of agreements, and so on.<sup>94</sup> It was thus legally prevented from simply assuming a restriction and then exercising its discretion to grant a paragraph (3) exception.

The same narrowing of Article 101(1) was achieved by the CJEU with regard to single branding agreements, where distributors agree to stock only the products of a particular manufacturer. Although exclusivity may potentially foreclose upstream rivals, it can also increase inter-brand competition by focusing distributor attention upon one brand without free-riding by others, and is usually in exchange for manufacturer support, especially financial.<sup>95</sup> In *Brasserie de Haecht* [1967] the CJEU essentially reiterated its approach to exclusive distribution agreements in *STM*; the prohibition of single branding under Article 101(1) was dependent upon an analysis of the agreement's 'effects in the context in which they occur', including the 'cumulative effect' of similar contracts on the

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<sup>92</sup> C-56/65 *Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECLI:EU:C:1966:38 ("STM [1966]").

<sup>93</sup> *ibid.* Praising its economic sophistication: Chard [1980] 407-408; Korah [1994a] 168-169, 269-270. Further restricting passive sales is presumed illegal by object: *Consten* [1966].

<sup>94</sup> *ibid.*

<sup>95</sup> Chard [1980] 418-419; *Guidelines on Vertical Restraints* [2010] [130], [144].

market.<sup>96</sup> This means for determining legality was affirmed and elaborated upon in *Delimitis* [1991].<sup>97</sup> Recognising the potential pro-competitive efficiency of their restrictions for both brewers and retailers, the CJEU found presumptions of anticompetitive harm by object inappropriate,<sup>98</sup> instead recommending a two-stage effects-based analysis to apply the Article 101(1) prohibition: first, evaluating whether the totality of agreements had the ‘cumulative effect of denying market access’ to new entrants;<sup>99</sup> and second, if so, whether the agreements of the producer in question contributed to that effect.<sup>100</sup>

Through requiring close consideration of their restrictive effects for the application of Article 101(1) to certain categories of agreement, the CJEU in *STM, Brasserie de Haecht*, and *Delimitis* disrupted the Commission’s reliance upon Article 101(3) exemptions to engage in discretionary determinations of legality. The ultimate substantive outcome might frequently have been the same, regardless of whether the conclusion of lawfulness was reached through finding a lack of restrictive effects under paragraph (1) or a more nuanced analysis of its pro-competitive efficiencies under (3). But these cases limited the potential for searching, contract-specific, often conditional conclusions through Article 101(3) exemption decisions, thereby hindering the effectiveness with which the Commission could pursue its own ends in competition policy. It is therefore unsurprising that it resisted, often simply ignoring these precedents and engaging in laconic effects analysis to find the paragraph (1) prohibition met anyway.<sup>101</sup> At least for single-branding agreements, the Courts eventually required the Commission to comply, thereby guaranteeing congruence between the legal requirement of effects analysis and its actual application in competition decision-making.<sup>102</sup>

But just because the CJEU’s effects-based case law limited the scope of the Commission’s Article 101(3) discretion, it did not automatically mean that EU competition policy approximated the formal rule of law ideal. The legality of agreements was still determined by a means far from aspirations of applying generalised norms that

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<sup>96</sup> C-23/67 *Brasserie de Haecht SA v Wilkin (No 1)* [1967] ECLI:EU:C:1967:54.

<sup>97</sup> C-234/89 *Delimitis v Henninger Bräu* [1991] ECLI:EU:C:1991:91.

<sup>98</sup> *ibid* [10]-[12].

<sup>99</sup> *ibid* [23].

<sup>100</sup> *ibid* [24].

<sup>101</sup> Korah [1981] 35; [1984] 53; [1994b] 171; Veltrop [1994] 563-567, 573; Hawk [1995] 982.

<sup>102</sup> *Langese-Iglo GmbH* (IV/34.072) [1993] OJ L183/19; *Schöller Lebensmittel GmbH & Co KG* (IV/31.533 and IV/34.072) [1993] OJ 183/1. Reaffirming the requirement for rigorous effects analysis: *Langnese* [1995]; C-279/95P *Langnese Iglo GmbH v Commission* [1998] ECLI:EU:C:1998:447.

were comprehensible to businesses. The source of comparable legal uncertainty and contract-specific normative acts had simply changed.

*Prima facie*, purely effects-based tests for determining legality appear the picture of simplicity, as the two-step *Delimitis* approach for evaluating single branding agreements would suggest. But when compared with the formal rule of law ideal, such standards mask the sheer complexity of the factual analysis required for deciding lawfulness, which businesses cannot simply be expected to prospectively emulate to comprehend their legal obligations and formulate their future commercial plans. According to the CJEU in *Delimitis*, whether single branding agreements come within Article 101(1) and require individual exemption depends upon, for instance, the number of distributors and quantity of products affected, duration, possibility of new entry through acquisition of another established brewer, opening their own distributors, the rules governing company acquisition, the minimum distribution necessary for profit, market saturation, customer loyalty, and other factors.<sup>103</sup> Essentially, everything is relevant but nothing is especially important. Just as with the Commission's Article 101(3) discretion it replaced, unstructured, purely effects-based analysis is a problematic means for determining the legality of individual agreements from the perspective of the formal rule of law.<sup>104</sup> In its commendable ambition to legally categorise anti-competitive and pro-competitive acts with absolute economic accuracy, the *Delimitis* "test" fails itself to provide any generalised norms - or even to list a series of decision-making factors - to structure and rigidify legal analysis, which would permit businesses to prospectively comprehend their obligations under Article 101. It is the European cousin of the US rule of reason standard, heavily criticised by the Chicago School for its unpredictability and administrability.<sup>105</sup> Purely effects-based evaluations of lawfulness require the Commission to determine legality through a factually complex, *ad hoc* analysis that takes a team of economists with information, resources, and expertise months to conduct. Undoubtedly, the richest companies could amass a rival team, scrutinising the potential competitive consequences of every proposed commercial decision, but what of the costs, delay, and likelihood of reasonable disagreement between experts? Furthermore, what about companies that are not able to buy a degree of legal certainty for their

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<sup>103</sup> Paraphrasing: Lasok [1991] 195. See also: M Waelbroeck [1991] 114.

<sup>104</sup> On this as a necessary sacrifice: Holley [1992] 693.

<sup>105</sup> The primary difference is that no pro-competitive efficiencies are to be considered under Article 101(1), but addressed under paragraph (3): T-112/99 *Métropole Télévision (M6), Suez-Lyonnaise des eaux, France Télécom and Télévision française 1 SA (TF1) v Commission* [2001] ECLI:EU:T:2001:215 [72]-[77].

envisioned commercial strategy? How are they to know whether their single branding agreements are prohibited by Article 101(1), aside from waiting for the Commission to tell them so? Additionally, all of these problems assume that the Commission is indeed able to reach the economically “correct” outcome. As Easterbrook warned in the 1980s,<sup>106</sup> it would be naïve to overlook the potential for decision-making errors when effects-based analysis is entirely unstructured, given the complexity of the analysis and potential for a lack of economic consensus. And noting the aforementioned uncertainty over the EU Courts’ standard of review, successful error correction cannot be guaranteed, especially by bodies with relatively less economic expertise.

When considered from the perspective of the formal rule of law, the CJEU’s precedents in *STM* and *Delimitis* indeed took the lawfulness of exclusive distribution and single branding agreements out of the frying pan: subject-specific determinations of their legality without generalised, comprehensible norms via the Commission’s *Article 101(3) discretion*. But they still risked entering the equally undesirable fire: subject-specific determinations of their legality without generalised, comprehensible norms via *Article 101(1) effects-based analysis lacking any decision-making structure*. To be clear, discretion and effects-based analysis are distinct concepts: the Commission has no discretion if it can only prohibit conduct where anticompetitive effects arise; or if the Commission has discretion, it can actively choose to prohibit actions based on their effect. Yet when deciding the lawfulness of conduct is exclusively a question of its specific effects, facts, and circumstances, this is as unstructured, particularistic, unpredictable a form of market intervention as discretion, both far from approximating the formal rule of law.

Of course, factually-complex determinations are present in many fields of law,<sup>107</sup> raising comparable issues of certainty, administrability, and errors. But small concessions to the value of normative generalisations can mitigate the worst excesses of purely unstructured decision-making without compromising too heavily in terms of economic accuracy. As realisation of the formal rule of law is relative, moving along a sliding scale, even modest attempts to concretise effects-based standards through more generalised factors indicative of competitive concerns improves legal certainty for businesses. The issue with these CJEU cases is the *prima facie* purity of the effects analysis based on the

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<sup>106</sup> Chapter II Section III.C.

<sup>107</sup> Forrester [2009] (on factual complexity throughout law).

totality of circumstances. As will be discussed in the next chapter, the Commission has published a number of documents highlighting important indicators which elaborate upon the nature and content of this analysis. Such efforts towards *structured* effects-based determinations of legality should be praised; in comparison to the form of market intervention seen in *STM* and *Delimitis*, they represent an attempt to reconcile the need for economically-accurate enforcement with approximating the formal rule of law ideal.

### III. Enforcement of Article 102 TFEU

#### A) Commission Decisions: Building Discretion

Article 102 TFEU does not outlaw the holding of a dominant position on the market.<sup>108</sup> Instead, it simply prohibits an ‘abuse’ of such pre-eminence, conceptualised since the 1970s as ‘recourse to methods different from those which condition normal competition’,<sup>109</sup> or, as commonly referred to in English, not competition “on the merits”.<sup>110</sup> This distinction can be traced to the Ordoliberal divide between “performance” competition, where firms successfully gain market share through better products and lower prices than their competitors, and “impediment” competition, abusing their dominance to the detriment of rivals.<sup>111</sup> Like the Article 101(3) exemption, the EU Courts have ruled that it is possible to justify *prima facie* abuses by demonstrating their objective justification or efficiency,<sup>112</sup> though this has so far never been successful.

As the standard for determinations of illegality under Article 102, “competition on the merits” does not have a deducible essence revealing in itself that certain types of conduct undertaken by dominant firms are abusive.<sup>113</sup> In the absence of a clear legal boundary to the concept, the Commission has assumed the discretion to intervene against and prohibit *any* conduct by a dominant firm it deems for whatever reason to be abusive, to not be competition “on the merits”. To this end, a variety of business practices have been condemned by the Commission since the early 1970s: the combined

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<sup>108</sup> C-322/81 *Nederlandsche Banden-Industrie Michelin v Commission* [1983] ECLI:EU:C:1983:313 (“*Michelin I* [1983]”) [57].

<sup>109</sup> C-85/76 *Hoffmann-La Roche & Co AG v Commission* [1979] ECLI:EU:C:1979:3 (“*Hoffmann* [1979]”) [91]. See also: *Michelin I* [1983] [70] (‘recourse to methods different from those governing normal competition in products or services based on traders’ performance.’).

<sup>110</sup> For judicial use: C-280/08P *Deutsche Telekom AG v Commission* [2010] ECLI:EU:C:2010:603 [177].

<sup>111</sup> Gerber [1998] 53. See Chapter III, text accompanying fn 115-116.

<sup>112</sup> *Article 102 Guidance* [2009] [29]-[30]; *Intel* [2017] [140].

<sup>113</sup> Gerber [1987] 102; Korah [1993] 156.

sale of two products;<sup>114</sup> refusals to continue supplying inputs<sup>115</sup> or begin to licence;<sup>116</sup> squeezing the margin of downstream rivals;<sup>117</sup> misleading patent offices;<sup>118</sup> bringing injunctions against a willing licensee of a standard-essential patent;<sup>119</sup> and the favourable display of the dominant firm's related businesses on a general search engine,<sup>120</sup> to name but a few.

Without doubt, the Commission's discretion to find that any practice is not competition "on the merits" has permitted it to effectively pursue its competition policy ends, however constituted. But once again, the Commission's attempt to secure for itself the broadest possible flexibility to find conduct abusive under Article 102 as and when it sees fit has been at the expense of realising the formal rule of law. As the example of its pre-modernisation decisional record on rebates illustrates, there were seemingly no limits to the Commission's discretion to intervene on an *ad hoc* basis. The consequence of this means for determining the legality of market conduct was considerable normative uncertainty for dominant firms. But what makes the policing of rebates a particularly egregious example of the Commission prioritising effective enforcement at all costs is how it actively sought to marginalise the restraining influence of generalised legal norms formulated by the CJEU upon its discretion to intervene. In essence, the Commission deliberately tried to avoid the rigidity of determining legality in the manner envisaged by the formal rule of law.

*i) The Effective Ends of Discretion*

From the perspective of the formal rule of law, the Commission's commonly alleged bias against efficient and fierce competition by big businesses, as supposedly manifest in its approach to rebates,<sup>121</sup> is irrelevant. Whatever the ends of its enforcement activity, it is clear that the Commission was able to effectively realise them. From its first engagement in the mid-1970s to controversial decisions at the dawn of its substantive modernisation of Article 102, the Commission has secured for itself the discretion to

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<sup>114</sup> *Eurofix-Bauco v Hilti* (IV/30.787 and 31.488) [1988] OJ L65/19; *Microsoft* (COMP/C-3/37.792) [2004].

<sup>115</sup> *ZOJA/CSC - ICI* (IV/26.911) [1972] JO L299/51; *Microsoft* [2004].

<sup>116</sup> *Magill TV Guide/ITP, BBC and RTE* (IV/31.581) [1989] L78/43.

<sup>117</sup> *Deutsche Telekom AG* (COMP/C-1/37.451, 37.578, and 37.579) [2003] OJ L263/9.

<sup>118</sup> *Generics/Astra Zeneca* (COMP/A. 37.507/F3) [2005].

<sup>119</sup> *Motorola - Enforcement of GPRS Standard Essential Patents* (AT.39985) [2014].

<sup>120</sup> *Google Search (Shopping)* (AT.39740) [2017].

<sup>121</sup> eg *Korah* [1994a] 106; *Turnbull* [1996] 100; *Lang and O'Donoghue* [2002] 86; *O'Donoghue* [2003] 392; *Kallaugher and Sher* [2004] 263, 271; *Sher* [2004] 243; *Pera and Auricchio* [2005] 160; *Pera* [2008] 155; *Eilmansberger* [2009] 167.

scrutinise and ultimately find illegal almost any rebate schemes, however specifically constituted.

The Commission's initial focus was discounts conditional upon exclusivity or near-exclusivity in *Hoffmann* [1976].<sup>122</sup> If any of the manifold schemes operated by dominant firms are to raise competitive concerns, these *loyalty* or *fidelity* rebates are arguably it. Granting discounts for satisfying all or most of a company's individual product demand, regardless of the actual volume purchased, can be a strong incentive to deal exclusively with a supplier to the possible exclusion of other firms.<sup>123</sup> For the first time in *Hoffmann* the Commission deemed such rebates for near-exclusivity by the vitamin producer to be violations of Article 102. Indeed, this form of discounting was found automatically abusive as 'by its nature [it] hampers the freedom of choice' of purchasers.<sup>124</sup>

The Commission soon expanded the scope of its Article 102 oversight of rebates to also potentially outlaw discounts offered by a dominant firm for satisfying *individually-set targets*. In *Michelin I* [1981] and *BA* [2000], it prohibited pre-agreed rebates on all purchases granted to repairers and travel agents respectively for meeting annual sales thresholds.<sup>125</sup> Although frequently depicted by economists as a manifestation of legitimate and 'natural competitive rivalry',<sup>126</sup> a presumption of competitive harm was prioritised by the Commission over consideration of their actual market consequences.<sup>127</sup> This was despite the fact that in the latter decision, BA's rivals had actually *increased* their market share.<sup>128</sup> In finding it legally acceptable to ground presumptions of illegality upon a practice's mere *capability* of anticompetitive

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<sup>122</sup> *Vitamins* (IV/29.020) [1976] OJ L233/27 ("*Hoffmann* [1976]").

<sup>123</sup> Lang and O'Donoghue [2002] 91; Ridyard [2002] 294. Even these are defensible in industries with high fixed costs that may only be recoverable through sacrificing margins to secure customer support: Ridyard [2002] 294; Martinez Lage and Allendesalazar [2003] 343-344.

<sup>124</sup> *Hoffmann* [1976] [22]-[23]. For criticism of this presumption: Fox [1986c] 1010-1011; Ridyard [2002] 294; Lovdahl Gormsen [2006] 340.

<sup>125</sup> *Bandengroothandel Frieschebrug BV/NV Nederlandsche Banden-Industrie Michelin* (IV/29.491) [1981] OJ L353/33 ("*Michelin I* [1981]"); *Virgin/British Airways* (IV/34.780) [2000] OJ L30/1 ("*BA* [2000]").

<sup>126</sup> Ridyard [2002] 293; O'Donoghue [2003] 372.

<sup>127</sup> *Michelin I* [1981] [38] ('clearly aimed' at exclusion and preventing entry). Confirmed: *Michelin I* [1983] [84]-[86]; *BA* [2000] [101] ('necessarily' encouraging exclusivity). For criticism: Korah [1982]; Ridyard [2002] 298-299.

<sup>128</sup> *BA* [2000] [107] (asserting rivals would have done better without the rebates.).

consequences,<sup>129</sup> the EU Courts endorsed a low threshold for the Commission to reverse the burden of proof onto defendant companies to substantiate a justification.<sup>130</sup>

The final panel in the triptych establishing the Commission's discretion to outlaw a wide range of rebate schemes was *Michelin II* [2002], where Article 102 was applied to discounts for meeting *standardised targets*.<sup>131</sup> These provided discounts equally applied to buyers of all sizes for annual volume purchases, where passing each threshold secured a discount on every product acquired. In this instance, the Commission found such rebates abusive.<sup>132</sup>

Through this series of decisions over a 25 year period, the Commission gradually expanded its discretion to condemn a variety of rebate schemes as abusive under Article 102, from exclusivity, through individualised targets, to standardised volume discounts. This broad legal control of almost all forms of rebates was undoubtedly effective for the Commission to achieve its ends. If its goal was to protect the existence of smaller companies and the maintenance of a more equitable market structure, the ability to readily find many discounts illegal under Article 102 was clearly of utmost efficacy. But even if a more efficiency-focused approach were to be pursued instead, the Commission's decisional record was of great utility. Economic theory does not entirely rule-out that the various rebate systems investigated cannot be harmful to consumer welfare, but instead reaches differing conclusions as to the *likelihood* of anticompetitive outcomes in each case. This is what has motivated calls for an end to imperfect presumptions<sup>133</sup> and for legality to be determined through effects-based analysis.<sup>134</sup> Having established that many types of rebate scheme may come within the scope of the Article 102 prohibition, the Commission's discretion to find individual instances illegal, however specifically constituted, *could be* deployed to effectively pursue the end of only prohibiting the exclusion of as-efficient rivals.

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<sup>129</sup> T-219/99 *British Airways v Commission* [2003] ECLI:EU:T:2003:343 [293]; C-95/04P *British Airways v Commission* [2007] ECLI:EU:C:2007:166 ("BA [2007]") [68], [70]-[77].

<sup>130</sup> Pfeiffer [2007] 598-599.

<sup>131</sup> *Michelin* (COMP/E-2/36.041/PO) [2002] OJ L143/1 ("Michelin II [2002]") [209]. For a damning critique: Sher [2002].

<sup>132</sup> Similarly: *Portuguese Airports* (IV/35.703) [1999] OJ L69/31.

<sup>133</sup> Lang and O'Donoghue [2002] 111; O'Donoghue [2003] 395; Ridyard [2002] 296, 302; Martinez Lage and Allendesalazar [2003] 346.

<sup>134</sup> Ridyard [2002] 297, 302 (an 'economically rational policy' requires 'more regard to their economic effects in the markets concerned.); O'Donoghue [2003] 396; Martinez Lage and Allendesalazar [2003] 344 (rebates 'should be assessed on an individual basis... a case-by-case basis avoiding definitions involving automatic imposition of the prohibition.); Kallaugher and Sher [2004] 281.

### ii) The Problematic Means of Discretion

The efficacy of the Commission's oversight of a variety of rebate schemes pursuant to Article 102 was constructed through a means of market intervention that was detrimental to normative certainty for businesses. More specifically, this broad-ranging discretion resulted from the Commission conquering and expanding the gap left by the CJEU's ruling in *Hoffmann* [1979].

In the landmark *Hoffmann* judgment, the Court accepted the Commission's conclusion that fidelity rebates – 'discounts conditional on the customer's obtaining all or most of its requirements' from a dominant undertaking – were not competition "on the merits" and amounted to an abuse. It was content to endorse the Commission's finding of legality in this instance as it found that exclusivity discounts were 'designed' to restrict the free choice of purchasers, denying other producers access to the market, and applying 'dissimilar conditions to equivalent transactions'.<sup>135</sup> Putting aside the economic sophistication of this presumption, the CJEU formulated a general, comprehensible legal obligation: fidelity rebates for near-exclusive purchasing are illegal. In contrast, it also established a norm of presumptive legality for 'quantity rebates exclusively linked with the volume of purchases' offered equally to all buyers.<sup>136</sup>

As a means for determining the lawfulness of discounts, from the perspective of the formal rule of law the two norms established by the CJEU have a great deal to commend them; they are general, relatively clear obligations applicable to all dominant firms that are capable of informing business decision-making. But it is the same formal characteristics that make these problematic from the view of a competition authority wishing to realise its ends as effectively as possible: they restrain and rigidify the Commission's discretion in individual instances to decide that quantity rebates *are* illegal, or (more unlikely) that exclusivity rebates *are* permissible under Article 102. They also said nothing as to the space left between, upon which the CJEU presumably reached no conclusion as to their permissibility.

To guarantee the effective realisation of its competition ends under Article 102, the Commission responded by systematically distorting both generalised, comprehensible norms in its pre-modernisation decisions on rebates. It was thereby able to cement its

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<sup>135</sup> *Hoffmann* [1979] [89]-[91].

<sup>136</sup> *ibid* [89]-[90].

far-reaching discretion to determine legality on an *ad hoc* basis against potentially *any* form of discount by a dominant firm.

This was principally achieved by unpredictably expanding the CJEU's condemnation of exclusivity rebates through analogising and the (economically-sound) insistence that all discounts *could have* anticompetitive consequences. Essentially, the Commission's decisions aimed to colonise the gap between exclusivity and quantity discounts through finding that everything could be "loyalty-inducing", a discretionary conclusion based on a holistic, unstructured analysis of all the circumstances, rather than applying clear, generalised norms for determining legality. For instance, it jumped from the *Hoffmann* prohibition of near-exclusivity loyalty rebates to individually-determined target rebates in *Michelin I* by asserting that 'the bonuses must be regarded as a *variant* of loyalty rebates' on the facts.<sup>137</sup> Although this was not at all obvious on the basis of the *Hoffmann* precedent, the Commission concluded with little substantiation that such discounts were not competition "on the merits" and were abusive.<sup>138</sup> Individualised target schemes therefore came within the scope of its enforcement of Article 102.

The same can be said of the finding in *Michelin II* that standardised volume rebates granted annually to all buyers on the same terms were prohibited. Here the Commission's decision diverged from the plain reading of the CJEU's precedents suggesting that such discounts were legal: *Hoffmann* had explicitly indicated this, and *Michelin I* stressed that the *individualised* nature of targets was what could be loyalty-inducing.<sup>139</sup> Prior to *Michelin II*, businesses may legitimately believe that standardised volume rebates fell outside of the Article 102 prohibition. Yet the Commission evaded the restraint of the law and broke the expectations of businesses by nevertheless finding them abusive, through what can only be considered conclusory logic rather than legal reasoning: *Hoffmann* conceptualised abuses as competition not "on the merits",<sup>140</sup> which meant that dominant companies could not strengthen or abuse their position,<sup>141</sup>

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<sup>137</sup> *Michelin I* [1981] [44] (emphasis added). Reaffirmed: *BA* [2001] [102] ('clearly related to loyalty'). For criticism: Lang and O'Donoghue [2002] 109.

<sup>138</sup> *ibid* [49].

<sup>139</sup> Martinez Lage and Allendesalazar [2003] 350.

<sup>140</sup> *Michelin II* [2002] [209].

<sup>141</sup> *ibid* [211].

and ‘this is exactly what has occurred in the case in point’ as Michelin’s action ‘was not based on the methods which condition normal competition.’<sup>142</sup>

As for the clear *Hoffmann* presumption of legality for quantity rebates itself, aside from breaching it in *Michelin II*, the Commission maximised its discretion by conceptualising it as a very narrow exception to legal condemnation that is difficult to prove. First, it secured its broad discretion through finding quantity rebates the *only* variety classifiable as competition “on the merits”: ‘no discount should be granted *unless* directly linked to a genuine reduction in the manufacturer’s costs.’<sup>143</sup> And second, it made quantity rebates a *defence* that is almost impossible to meet. As decisions such as *Michelin II* and *Portuguese Airports* demonstrate, the Commission found volume discounts loyalty-inducing and *then* shifted the burden of proof onto defendants to demonstrate that they were actually pure quantity rebates, with a very difficult evidential threshold to establish legality: that the rebate amount reflected a ‘fair marginal or linear return on the additional purchase’, thus allowing the firm to realise savings through economies of scale.<sup>144</sup> This is particularly challenging for the provision of services: Portugal could not show cost-based savings to justify purely quantitative discounts for greater frequencies of airport landings a month, so the Commission found them abusive.<sup>145</sup> In this way, the presumption of legality for quantity rebates established by the CJEU was narrowed to the point of extinction.

The Commission’s pre-modernisation policing of rebates pursuant to Article 102 was undoubtedly rigorous. Whether its end was to protect small competitors or only prohibit the exclusion of as-efficient rivals, the expansion of the Commission’s discretion to scrutinise *any* discount system through 25 years of decisional practice did, for better or worse, allow its policy goals to be realised with utmost effectiveness. But these potent ends were achieved through freeing itself from the restraint and rationality of generalised, comprehensible norms approximating the rule of law ideal. In building its unstructured discretion to find various schemes illegal, businesses evidently had little indication of what could be found illegal. The initial prohibition of loyalty rebates was expanded to cover everything as they could have “loyalty-inducing” effects on the basis of holistic, conduct-specific analysis. Even where it looked as if there was a safe harbour

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<sup>142</sup> *ibid* [212].

<sup>143</sup> *Michelin I* [1981] [54] (emphasis added). See also: *BA* [2001] [101]-[102] (Asserting the rebates ‘are clearly related to loyalty rather than efficiencies’). Affirmed: *BA* [2007] [84].

<sup>144</sup> *Michelin II* [2002] [216]. See also: *Sher* [2002] 486-487.

<sup>145</sup> *Portuguese Airports* [1999] [27].

for quantity rebates, the Commission broke this expectation and the *Hoffmann* precedent anyway. With *Michelin II* completing the Commission's discretion-building decisions, at the dawn of the substantive modernisation of Article 102 it could find pretty much any rebates abusive.

From the perspective of dominant firms, there were no generalised, comprehensible norms meaningfully restraining the Commission's legal oversight of this common business practice.<sup>146</sup> The illegality of "loyalty-inducing" rebates was an unforeseeable discretionary determination by the Commission that could prohibit any discount system as it saw fit,<sup>147</sup> and the legality of quantity rebates was almost impossible for businesses to prove.<sup>148</sup> The only certainty that businesses enjoyed was knowing that exclusivity rebates were illegal, which offered little solace. The best advice to dominant firms wishing to avoid Commission condemnation pursuant to Article 102 was simply not to offer any discounts for purchasers.<sup>149</sup> Given that rebates are an ordinary part of fierce competition, and dominant firms will often compete with non-dominant firms not subject to the law of Article 102, normative uncertainty recommending abstinence from often efficient conduct is not a satisfactory outcome for competition enforcement.

#### *B) Judicial Review: Who Interprets the Law of Article 102?*

It was argued with regard to judicial oversight of Article 101 that the CJEU was, at times, a hindrance to the Commission's discretion to grant Article 101(3) exemption decisions. Although the form of market intervention substituted risked falling far from the formal rule of law ideal – *ad hoc*, contract-specific determinations of legality without any generalised, comprehensible norms to inform businesses - the CJEU's insistence upon (albeit unstructured) effects-based analysis set legal boundaries to the automatic imposition of the Article 101(1) prohibition, ultimately restraining the Commission's discretionary oversight for certain categories of agreement. Despite a perhaps deferential standard of judicial review afforded to the Commission's Article 101(3) decisions, the CJEU's prospective formulation of the law on Article 101(1) generated a degree of institutional antagonism in the pre-modernisation era. The Court was at least *attempting* to constrain the Commission's discretion.

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<sup>146</sup> Martinez Lage and Allendesalazar [2003] 328-329.

<sup>147</sup> Sher [2002] 483.

<sup>148</sup> *ibid* 484 ('the black and white world of efficiency and loyalty ties').

<sup>149</sup> Turnbull [1996] 100.

The same cannot (always)<sup>150</sup> be said of the EU Court's scrutiny of Commission decisions pursuant to Article 102. The subject of rebates provides an illustrative example of the Courts failing to prospectively formulate and defend general norms for determining legality, which would have restrained the Commission's discretion and offered certainty to dominant firms. Ultimately, the EU Courts did not meet their role envisaged as part of the formal rule of law, of structuring *ad hoc* decisions, clarifying legal obligations deduced from Article 102, and setting boundaries to the Commission's individual findings of illegality.

Following the leadership of the CJEU in *Hoffmann* where it formulated two general, clear norms of legality and illegality, the subsequent relationship between the Commission and Courts on rebates was relatively more deferential. Rather than defending the *Hoffmann* presumptions and rigidifying the Commission's means of finding everything possibly "loyalty-inducing" through conduct-specific analysis, the Courts legally legitimised its discretion to deem any rebates abusive on an *ad hoc* basis. In contrast to judicial deference on the decision-maker's legal characterisation of instant facts as meeting thresholds for prohibition, the CJEU may have afforded deference to the Commission's *interpretation of the law* itself.

In *Michelin I* [1983] the CJEU was asked to rule upon the Commission's stretching of abusive exclusivity rebates in *Hoffmann* to individualised target schemes. It accepted that these discounts fell between the stools of illegal loyalty and legal quantity rebates.<sup>151</sup> But it was nevertheless content to endorse the Commission's finding of them as abusive under Article 102 in this *specific* instance,<sup>152</sup> given the annual reference period, high market shares, a lack of transparency, and so on.<sup>153</sup> But in simply recounting the many factors that had gone into the Commission's holistic justification for a finding of illegality in this instance, the CJEU neglected to offer generalised norms for determining the legality of individualised target regimes that could inform businesses and limit the Commission's ability to intervene. Essentially, the Court endorsed the Commission's unstructured discretion to deem individualised target schemes illegal as and when it saw fit.

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<sup>150</sup> A notable exception is predatory pricing: Chapter IV, Section III.C.i.

<sup>151</sup> *Michelin I* [1983] [72].

<sup>152</sup> *ibid* [84].

<sup>153</sup> *ibid* [81]-[86].

The same can be said of the General Court in *Michelin II* [2003], where it once again accepted the Commission's drive to maximise its discretionary oversight of discounts.<sup>154</sup> It endorsed the notion that 'any loyalty-inducing rebate system' of a dominant firm was illegal.<sup>155</sup> This does not amount to a general and comprehensible threshold for determining the legality of rebates. It is a *conclusion* reached on an *ad hoc* basis through 'consider[ing] *all* the circumstances' specific to the individual discount scheme.<sup>156</sup> Given the particularities of the standardised target scheme in question, the Court was happy to accept that the Commission had demonstrated loyalty-inducing characteristics in this instance.<sup>157</sup> Again, the General Court failed to approximate the formal rule of law by providing no limits or structure to the Commission's discretion to find any rebate scheme illegal. It once more legitimated the determination of legality through *ad hoc*, subject-specific market interventions.

But *Michelin II* was also a particularly egregious instance of judicial deference as to the law because the General Court did not defend the only apparent restraint to the Commission's discretionary enforcement: that quantity rebates were legal. The sole normative certainty that dominant firms had in this field was removed by the Court accepting that standardised volume rebates could nevertheless be "loyalty-inducing" in individual instances, when the entirety of circumstances were evaluated.<sup>158</sup> Furthermore, it endorsed the Commission's marginalisation of the legality of quantity rebates by accepting the difficult evidential burden to rebut the presumption of an abuse. Repeating that their permissibility was related to considerations of lower costs on bulk-dealing,<sup>159</sup> the General Court agreed with the need for businesses to demonstrate the passing-on of 'actual cost savings'; mere references to economies of scale were 'too general' and 'insufficient'.<sup>160</sup> This was a reaffirmation of the CJEU's problematic claims in *Portugal v Commission* [2001] on standardised volume rebates at airports.<sup>161</sup> As it ruled that notionally volume-based quantity rebates could also amount to abusive discrimination if the higher bands with large savings were routinely met by

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<sup>154</sup> T-203/01 *Manufacture Française Des Pneumatiques Michelin v Commission* [2003] ECLI:EU:T:2003:250 ("*Michelin II* [2003]") (though rejecting the Commission's claim that reference periods over 3 months were automatically abusive).

<sup>155</sup> *ibid* [65] (emphasis added).

<sup>156</sup> *ibid* [62] (emphasis added).

<sup>157</sup> *ibid* [95] (significant variation between lower and higher steps, annual reference period, discount fixed on total turnover achieved).

<sup>158</sup> See fn 155.

<sup>159</sup> *Michelin II* [2003] [58]-[59].

<sup>160</sup> *ibid* [108]-[109]. For criticism: D Waelbroeck [2005] 171.

<sup>161</sup> C-163/99 *Portugal v Commission* [2001] ECLI:EU:C:2001:189 [49], [55].

only a few firms,<sup>162</sup> it accepted the shifting of the burden of proof onto defendants; the Commission could presume that even quantity rebates were abusive, unless firms met the nigh-on impossible threshold for demonstrating their status as pure quantity discounts.

Judicial review of the Commission's decisional practice on rebates accepted its discretion building, shifting the nature of market intervention away from the formal rule of law. Every extension of the Commission's *ad hoc* ability to find various discounts illegal was met with approval, even if it distorted the CJEU's own case law that businesses had relied upon. On individualised and standardised target rebates, the Courts failed to structure the Commission's holistic determinations of illegality for "loyalty-inducing" discounts with any generalised norms for firms to comprehend the lawfulness of their own rebates. *Post-Hoffmann*, the Courts declined opportunities to approximate the restraint and rationality-respecting rigidity of the formal rule of law ideal in this area of EU competition enforcement.

This example of a reserved reaction by the EU Courts to the development of the means for determining the legality of conduct pursuant to Article 102 raises a wider question: which institution actually deduces the normative obligations of EU competition law from the Treaty? According to the Article 19(3) TEU this is solely a task for the EU judiciary. The Courts are to ensure that the Commission's decisions are in accordance with the law, without providing for deference as to what "the law" means.<sup>163</sup> It would be unrealistic to suggest that Commission decision-making at the enforcement coalface should *never* attempt to expand the boundaries to capture new types of business conduct that could legitimately be considered abusive under Article 102; there is clearly a welcome degree of dialogue between administrative action and judicial interpretation of the law deduced from the Treaties. As noted above, the varieties of conduct that have been categorised as abusive by the Commission and accepted by the EU Courts has grown exponentially since the 1970s. In terms of the ends of enforcing Article 102, whether efficiency- or equity-based, the maximal jurisdiction to intervene allows for their effective pursuit as and when required.

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<sup>162</sup> *ibid* [52]-[53].

<sup>163</sup> *Vesterdorf* [2005] 12.

But as the EU Courts have routinely rubber-stamped new abuses as falling within the dominant undertaking's "special responsibility", can it *really* be maintained that judges alone deduce the requirements of the law; authoritatively deciding what is permitted and prohibited, and the means for determining their legality?<sup>164</sup> There are no limits to the types of conduct that can be found contrary to "normal" competition "on the merits".<sup>165</sup> This phenomenon of adding new types of conduct to the "special responsibility" of dominant firms continues in earnest in the post-modernisation era of Article 102, both directly<sup>166</sup> and indirectly,<sup>167</sup> and will perhaps be reaffirmed in the forthcoming review of the *Google Search* prohibition decision.<sup>168</sup> Of course, it may well be the case that the EU Courts have been correct to accept every extension of the scope of Article 102, albeit fostering legal uncertainty for businesses. But as discussed in the previous chapter, there is a tension between normative comprehensibility and individual responsibility on the one hand, central to the formal rule of law, and incremental, organic norm-formulation on the other.<sup>169</sup> At the very least, unforeseeable violations of the law should be met with no punishment (*nulla poena sine lege*). Rather than the EU Courts upholding this tenet of the rule of law, it has, in fact, been the Commission commendably exercising punitive self-restraint for novel determinations of an abuse.<sup>170</sup> Yet this has not been wholesale, as illustrated by the imposition of a €2 billion fine in *Google Search* for an entirely unprecedented violation of Article 102.<sup>171</sup>

What is more problematic is where there has *seemed* to be a generalised, comprehensible norm limiting the Commission's ability to find illegality which the Courts have subsequently declined to uphold. One example of such deference to formulating the legal obligations deducible from Article 102 was discussed above: *Michelin II* on standardised volume rebates contradicting *Hoffmann* on quantity rebates. Another instance was *Tetra Pak II* [1994] where the clear wording of the Treaty itself was diluted, freeing the Commission from its apparent restraint. Article 102(d) explicitly lists as an

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<sup>164</sup> Art and Ibáñez Colomo [2010]; Gerard [2011] 470-471; Ibáñez Colomo [2013] 411-412. cf Wils [2011] 364-384.

<sup>165</sup> C-6/72 *Europemballage Corporation and Continental Can Company Inc v Commission* [1973] ECLI:EU:C:1973:22 ("Continental Can [1973]") [26].

<sup>166</sup> eg C-457/10P *AstraZeneca AB and AstraZeneca plc v Commission* [2012] ECLI:EU:C:2012:770 (misuse of regulatory procedures).

<sup>167</sup> eg C-170/13 *Huawei Technologies Co Ltd v ZTE Corp and ZTE Deutschland GmbH* [2015] ECLI:EU:C:2015:477 (injunctions against standard-essential patents).

<sup>168</sup> T-612/17 *Google and Alphabet v Commission* [pending]. See: [2017] OJ C369/37.

<sup>169</sup> See Chapter IV, text accompanying fn 76-87.

<sup>170</sup> *Motorola* [2014] (owing to the novelty of finding injunctions for standard-essential patents abusive). For praise: Whish [2014] 604.

<sup>171</sup> *Google Search* [2017].

exemplary abuse the concluding of contracts with ‘supplementary obligations’ which have ‘no connection’ according to ‘commercial usage’. One would presume that if it *did* reflect ordinary ‘commercial usage’, it would not amount to an abuse. Yet when Tetra Pak argued as much in response to the Commission condemning its tied sale of carton-filling machines and cartons, the CJEU found that this generalised limit to market intervention didn’t actually matter: Article 102 was ‘not exhaustive’ and therefore even where tying did accord with ordinary business practice, ‘such sales may still constitute an abuse’.<sup>172</sup>

But restraining the Commission’s unpredictable discretion to find conduct abusive does not just concern the Courts merely scrutinising *what* can be deemed illegal. Judicial leadership in formulating the norms of EU competition law also goes to *how* determinations of illegality pursuant to Article 102 are made; whether the Commission’s decision-making is structured by generalised rules, presumptions, or multi-stage tests that are comprehensible to businesses, or is simply an *ad hoc*, context-specific discretionary appraisal. The rebates cases discussed above, where the Courts endorsed individualised findings of “loyalty-inducing” discounts on the particular facts of the case, represent the unstructured latter. The Courts’ record in this regard is mixed, coming down to the type of abuse in question. Sometimes it has formulated generalised presumptions of illegality that tightly constrain and rigidify the Commission’s discretion to condemn conduct as abusive, thus affording dominant companies a reasonable degree of certainty as to their legal obligations.<sup>173</sup> In other instances, EU Courts have assisted the Commission in loosening the normative restraint of demanding structured tests for finding conduct illegal, thereby expanding its discretion to intervene unpredictably against conduct as it sees necessary.<sup>174</sup>

Overall, the EU Court’s adherence to the role envisaged as part of the formal rule of law ideal is debateable under Article 102. It has set no boundaries to the Commission finding new abuses of a dominant position and has, at times, neglected to promulgate norms that would structure its discretion. Although the next chapter will discuss more decisive instances of leadership by the CJEU to shape EU competition law into generalised and comprehensible norms, it is nevertheless clear at this stage that judicial endeavours to

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<sup>172</sup> C-333/94P *Tetra Pak International SA v Commission* [1995] ECLI:EU:C:1996:436 [37].

<sup>173</sup> See Chapter VI, Sections III.C.i, and D.ii.

<sup>174</sup> See the discussion of *Microsoft* [2007] in Chapter VI, Section III.D.ii.

restrain Commission decision-making and foster legal certainty for businesses have sometimes been lacking.

#### **IV. Commitment Decisions in the Post-Modernisation Era: More Effective Ends, Same Problematic Means.**

By the end of the 1990s, the Commission had realised that its gaming of the procedural idiosyncrasies of Regulation 17/62 had become counterproductive. As Section II demonstrated, it had deliberately adopted an unnecessarily broad approach to interpreting Article 101(1), thereby ensuring maximal oversight to effectively realise its policy ends through the discretionary granting of paragraph (3) exemption decisions. The eventual problem was one of *too much* oversight; the quantity of agreements notified had become unmanageable for the Commission to meaningfully scrutinise. As a result, the compulsory notification and centralised exemption regime for Article 101 eventually came to an end with Article 5 of Regulation 1/2003, permitting national courts and enforcement bodies to apply Article 101(1) *and* (3) together for the first time.

But the procedural modernisation was both an instance of change *and* continuity.<sup>175</sup> Despite the decentralisation of Article 101(3), Regulation 1/2003 affords the Commission the discretion to pursue its competition policy ends as it sees fit in individual instances through negotiating directly with businesses. But this post-modernisation discretion to intervene in markets is *even more* effective: it can also be used for Article 102 investigations;<sup>176</sup> as there is no formal finding of illegality, rudimentary analysis<sup>177</sup> and fewer defence rights<sup>178</sup> are permissible; the remedial packages can be ratcheted-up via invariably negative responses to their compulsory

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<sup>175</sup> Some imply that commitment decisions are an innovation: Georgiev [2007] 973; Botteman and Patsa [2013] 349. For more accurate accounts: Van Bael [1986]; D Waelbroeck [1986]; Bourgeois [1993]; Furse [2004] 5; Sousa Ferro [2005] 459; Cook [2006] 210; Wils [2006] 347-348; [2015] 10-12; Marquis [2008] xxii-xxii; Schweitzer [2008] 548; Martinez Lage and Allendesalazar [2008] 583-584; Forrester [2008] 639-630; Jenny [2015] 703-705. See Section II.A.i on conditional exemption decisions and comfort letters.

<sup>176</sup> Although without a legal basis, companies regularly agreed an “undertaking” to suspend the Commission’s Article 102 investigation, eg: IBM, ‘Averting the Danger of an Abuse of Dominant Position: The IBM Case’ [1984] 17(7/8) *Bulletin of the European Communities* 7 (see: Hughes [1985] 189-195; Van Bael [1986] 70-75); *Twenty-Seventh Report on Competition Policy* 1997 (Brussels 1998) mentions *La Poste/SWIFT* (26), *IRI/Nielsen* (144-148), and *Digital* (26-27); *Marathon*, Commission press releases IP/01/1641, IP/03/547, IP/03/1129, and IP/04/573 (see: Temple Lang [2003] 356; Cave and Crowther [2005] 487).

<sup>177</sup> ‘Report on the Functioning of Regulation 1/2003’ [2009] Commission Staff Working Paper SEC(2009) 574 (“Staff Working Paper [2009]”) 33.

<sup>178</sup> ‘To Commit or not to Commit?: Deciding Between Prohibition and Commitments’ [2014] Competition Policy Brief (“*To Commit?* [2014]”). The procedural safeguards conceded are not addressed in this thesis.

market testing;<sup>179</sup> enforcement of non-compliance is more robust than before;<sup>180</sup> and all of this without the cumbersome notification regime of old. Such is the absolute discretion afforded to the Commission by the Article 9 commitment decision procedure.<sup>181</sup>

In comparison to the conclusion of formal Article 7 prohibition decisions,<sup>182</sup> since their introduction in 2004 commitment decisions have become the Commission's main enforcement tool for investigating non-cartel cases.<sup>183</sup> There are clearly substantial incentives (or pressures) for businesses to prefer this procedure: time, publicity, consensual remedial solutions, ever-increasing fines, general risk aversion, and many other factors.<sup>184</sup> As for the Commission, it has sometimes attributed its frequent recourse to Article 9 to the concession of defence rights, allowing it to swiftly secure competitive conditions upon the investigated market and to quickly bring potentially problematic conduct to an end.<sup>185</sup> This is particularly appealing and appropriate, it has claimed, in technology markets.<sup>186</sup> At other times the Commission has suggested that the relative mildness of the conduct investigated through commitments, as expected by Regulation 1/2003,<sup>187</sup> justifies their use and simultaneously conserves resources to pursue the most heinous behaviour - especially cartels - via Article 7 prohibition.<sup>188</sup>

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<sup>179</sup> Regulation 1/2003, Article 27(4). On the risk of the Commission using negative responses to leverage greater remedies: Forrester [2008] 65; Rab, Monnoyeur, and Sukhtankar [2010] 176; Wagner-Von Papp [2012] 948; Botteman and Patsa [2013] 361; Gerard [2013] 13-15; Watheler [2015] 553-554.

<sup>180</sup> Regulation 1/2003, Article 23(2)(c). See: *Microsoft (Tying)* (AT.39530) [2013]. Criticising fines without finding illegality: Aleixo [2013] 479; Dunne [2014] 418. Previously exemption decisions could be revoked, but breaching comfort letters and Article 102 undertakings required the initiation of formal proceedings.

<sup>181</sup> Regulation 1/2003, Article 9.

<sup>182</sup> *ibid* Article 7.

<sup>183</sup> For statistics: Wils [2015] 3-4; Ibáñez Colomo and Kalintiri [2018] 53. For Commission acknowledgement: 'Ten Years of Antitrust Enforcement under Regulation 1/2003: Achievements and Future Perspectives' [2014] Commission Staff Working Document SWD(2014) 230/2 ("Staff Working Document [2014]" 55-56.

<sup>184</sup> On incentives: Cook [2006] 219-221; Wils [2006] 350-352; Cooke [2008] 267; Ratliff [2008] 306-307; Schweitzer [2008] 559, 571; [2012b] 3; Forrester [2008] 645-646; Rab, Monnoyeur, and Sukhtankar [2010] 182; Piergiovanni [2010] 8; Cengiz [2011] 136; Talus [2011] 1588; Lugard and Möllmann [2013]; Marsden [2013]; Gerard [2013] 6,8; Moullet [2013] 91; Botteman and Patsa [2013] 362; Dunne [2014] 437; Lianos [2014] 24; Jenny [2015] 760.

<sup>185</sup> 'Report on the Functioning of Regulation 1/2003' [2009] COM(2009) 206 ("Commission Report [2009]" 5; 'Ten Years of Antitrust Enforcement under Regulation 1/2003: Achievements and Future Perspectives' [2014] COM(2014) 453 ("Commission Report [2014]" 7; *To Commit?* [2014]; Almunia [1/10/2013] (Commitments 'solve competition concerns more quickly and concretely, with an immediate impact on the market'); [27/10/2013] ('main advantage' is speed and immediate impact).

<sup>186</sup> eg Almunia [21/5/2012]; [27/10/2013]; Commission Report [2014] 7.

<sup>187</sup> Regulation 1/2003, recital 13 ('Commitment decisions are not appropriate in cases where the Commission intends to impose a fine').

<sup>188</sup> Staff Working Paper [2009] 33.

Despite these claims, their use in practice casts doubt on explaining the rise of commitment decisions by their speed,<sup>189</sup> high-tech focus,<sup>190</sup> or legal innocuousness.<sup>191</sup>

The alternative justification offered for the prominence of Article 9 commitment decisions is that they are perhaps the most powerful tool conceivable for the European Commission to realise its competition policy goals with absolute effectiveness. They constitute the unrestrained, unpredictable enforcement of competition policy through sheer discretion. It will be demonstrated that through commitment decisions it is possible to A) secure changes to *any* conduct, even if beyond or below the pre-existing scope of EU competition law, and B) negotiate *any* remedial package with businesses, regardless of its connection to the initial competitive concern. Essentially, the Commission can successfully sanction conduct and redraw markets according to its idealised vision for their perfect operation with maximum efficacy. Once again however, C) such effective policy realisation through *ad hoc* discretionary enforcement is achieved at the expense of approximating the formal rule of law ideal. Commitment decisions substantially diminish normative comprehensibility for businesses. In sidestepping the restraint and rigidity of the Court's case law, the certainty afforded by every authoritative norm of EU competition law is systemically depleted. Like the conditional exemptions of old, legality is also dependent upon unforeseeably offering whatever remedial package is necessary to please the Commission. And, D) again, the EU Courts are implicated, though their culpability is less clear. Essentially, the Commission's absolute discretion in commitment decisions prioritises the short-term gains of enforcing competition policy with efficacy in individual instances at the expense of long-term movements towards realising the formal rule of law ideal.

#### A) Effective Ends I: Competition Enforcement without Competition Law

As the above discussions of judicial review implied, there are several distinct ingredients that go into making a competition decision. The first is the law, the normative

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<sup>189</sup> Various calculations suggest that on average commitment decisions have *not* been significantly faster: Lugard and Möllmann [2013]; Mariniello [2014] 4. For acknowledgement: Staff Working Paper [2009] 34.

<sup>190</sup> Lugard and Möllmann [2013]; Mariniello [2014] 5 (only 24% of commitments since 2004, compared with 61% of prohibition decisions); Jenny [2015] 732-733.

<sup>191</sup> Schweitzer [2008] 549; [2012b] 6; Lugard and Möllmann [2013]; Jenny [2015] 724-725, 736-737. eg *Coca-Cola* (COMP/A.39.116/B2) [2005] (concerning rebates ordinarily treated severely in prohibition decisions); *E-Books* (AT.39847) [2012/2013] (investigating conduct akin to a hub-and-spoke cartel); *Container Shipping* (AT.39850) [2016] (comparable to information exchanges on future prices commonly considered a restriction of Article 101 by object). cf *Telekomunikacja Polska* (COMP/39.525) [2011] (Commission explicitly ruled-out a commitment decision owing to the severity of the case).

obligations determining the legality of conduct by firms, as authoritatively deduced by the CJEU from Articles 101 and 102. The second input is the articulation of facts, the matrix of events established by the Commission to have taken place. The third bridges the gap between the first and second: the legal characterisation of the factual circumstances as satisfying the norms determining legality or illegality. For example, the reasons leading to a conclusion that certain statements *do* amount to an illegal plan to exclude a rival through pricing below average total cost, or that a particular selective distribution agreement can be considered legal as its requirements *are* qualitative.<sup>192</sup>

The effectiveness with which commitment decisions permit the Commission to successfully pursue its policy objectives primarily concerns the first and third ingredients. Article 9 affords the Commission a discretion to investigate conduct and secure changes without being subject to the restraint of EU competition law as deduced by the CJEU. It can enforce competition policy i) *beyond* the law, through pursuing novel theories of harm, and (ii) *below* the law, without necessarily meeting high judicially-determined thresholds for finding certain forms of conduct illegal. Commitment decisions facilitate market interventions on an *ad hoc* basis against specific companies as and when the Commission deems necessary, regardless of the legal originality or strength of its concerns. This is undoubtedly an effective means to achieve its aims, unshackled from the rigidity and restraint of replicating pre-existing violations of the law or having to rigorously justify that high hurdles for illegality have been met in instant cases. To this end, the Commission's discretion in commitment decisions has achieved a great deal of good. Nevertheless, it represents a form of competition enforcement without competition law.

i) *Market Interventions **Beyond** the Law*

Through commitment decisions the Commission has the discretion to target *any* business conduct, regardless of whether it has been previously found illegal pursuant to Articles 101 or 102.<sup>193</sup> With Article 9, it can secure effective changes to subject-specific behaviour as and when it sees fit. Numerous examples could be given of enforcement activity beyond the scope of the pre-existing law deduced by the CJEU.

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<sup>192</sup> These examples are discussed in the next chapter

<sup>193</sup> Schweitzer [2008] 559; Cengiz [2011] 137; Hjelmeng [2013] 1012; Gerard [2013] 20; Svetiev [2014] 470.

One such instance is *patent ambush*. In *Rambus* [2009] the Commission suggested that dishonesty in standard-setting procedures could be an abuse contrary to Article 102.<sup>194</sup> The patent holder was argued to have ‘engaged in intentional deceptive conduct’ in keeping secret the inclusion of its intellectual property within the internationally-agreed standard for DRAM chips,<sup>195</sup> aiming to charge considerable royalties to locked-in producers. The goal pursued by the Commission through its intervention in *Rambus* of ensuring confidence in international standard-setting processes is commendable.<sup>196</sup> It nevertheless bears no relation to pre-existing EU competition law.<sup>197</sup>

Although there has yet to be an authoritative ruling on their legality, the Commission has also been able to secure remedies in response to the contractual use of *most favoured nation* (“MFN”) clauses through the Article 9 process. In *E-Books* [2012/2013] it raised concerns about five publishers separately negotiating agency contracts with Apple that all included various MFNs.<sup>198</sup> The specific breach of Article 101 alleged was that the publishers had jointly converted the sale of e-books from a wholesale model to an agency model through introducing similar MFN clauses. The Commission suspected that their intention was to raise retail prices above those hitherto offered by Amazon, which had used its wholesale relationship to offer substantial discounts on e-books, thereby undercutting physical sales directly by the publishers. The facts of *E-Books* were shuffled around in the more recent Article 102 commitment decision of *Amazon* [2017] concerning its own imposition of MFNs on publishers.<sup>199</sup> In both instances, the Commission’s investigations into MFNs were motivated by a desire to combat the artificial raising of prices to the detriment of consumers, a bread-and-butter concern of competition enforcement. Indeed, *Amazon* is one of the most robustly articulated commitment decisions to date, with the possible anticompetitive effects of various MFNs covered in great detail. The Commission’s effective realisation of consumer welfare in these instances through Article 9 was in no way prejudiced by the lack of clear, analogous precedents.

Although ultimately ending in failure, the Commission’s initial recourse to Article 9 for investigating potentially abusive *preferential treatment of related services* in *Google*

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<sup>194</sup> *Rambus* (COMP/38.636) [2009].

<sup>195</sup> *ibid* [27].

<sup>196</sup> *Mouillet* [2013] 87 (good faith standard-setting was the Commission’s concern).

<sup>197</sup> *Lianos* [2014] 24; *Dunne* [2015] 110.

<sup>198</sup> *E-Books* [2012/2013].

<sup>199</sup> *E-book MFNS and Related Matters* (AT.40153) [2017] (“*Amazon* [2017]”).

*Search* nevertheless demonstrates the potential effectiveness of discretionary market intervention through commitments. The theory of harm proposed by the Commission from the very beginning - displaying related vertical search results (eg shopping, restaurants) more favourably than those of competitors in response to generic website searches <sup>200</sup> was always clearly driven by a desire to forestall potential market foreclosure consequences in the specific instance. So too were the increasingly demanding remedial packages negotiated over numerous years on the ground of 'preferential' or 'favourable treatment of Google's own services'.<sup>201</sup> At no point did the Commission feel the need to indicate how the investigated practice related to the legal norms deduced by the EU Courts from Article 102;<sup>202</sup> intervention was apparently to be legitimised by the resultant positive outcome of more competitive online search markets. This ends-driven approach to enforcement has been replicated in the feast of economic analysis and famine of legal precedent that is the formal *Google Search* prohibition decision itself.<sup>203</sup> That the same outcome was *almost* achieved through an Article 9 commitment decision - novel theory of harm, ambitious remedies, and all - is a testament to the effectiveness with which this procedure can be utilised by the Commission to alter business conduct and pursue its ends as considered desirable, even if 'significantly stretch[ing] the boundaries' of the law.<sup>204</sup>

As a final example of the efficacy of enforcement through commitment decisions to improve competition beyond pre-existing legal obligations, the Commission has frequently targeted *capacity hoarding* and *strategic underinvestment* in the energy sector.<sup>205</sup> These investigations focus upon owners of infrastructure bottlenecks such as transmission networks, pipes, or terminals for import. The allegation of capacity hoarding concerns a vertically-integrated bottleneck owner reserving for its upstream/downstream business a substantial portion of the infrastructure's transmission volume for a long period.<sup>206</sup> The Commission's interventions range from hoarding via explicit contracts, to vagueness as to the capacity available,<sup>207</sup> poor

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<sup>200</sup> eg 'Commission probes allegations of antitrust violations by Google' [30/11/2010] IP/10/1624.

<sup>201</sup> eg Almunia [21/5/2012].

<sup>202</sup> Nazzini [2015a] 307-308; Akman [2017].

<sup>203</sup> *Google Search* [2017].

<sup>204</sup> Nazzini [2015a] 314.

<sup>205</sup> Terminology adopted in: Staff Working Document [2014] 32.

<sup>206</sup> eg *RWE Gas Foreclosure* (COMP/39.402) [2009]; *Gaz de France* (COMP/39.316) [2009]; *ENI* (COMP/39.315) [2010]; *E.ON Gas* (COMP/39.317) [2010]; *CEZ, a.s.* (AT/39727) [2013] (though with a clearer intent to prevent market entry). cf Scholz and Purps [2010] 73-74 (long-term entry booking is normal behaviour on energy markets and promotes security of supply).

<sup>207</sup> eg *RWE* [2009] [26]; *ENI* [2010].

congestion management,<sup>208</sup> or simply failures to make it easier for third parties to gain access.<sup>209</sup> Sometimes the more subtle forms of hoarding have blended into suspicions of strategic underinvestment, where the bottleneck operator neglects to expand capacity to hinder upstream/downstream market entry. *Gaz de France* [2009], for example, concerned two import capacity terminals. For one, the Commission criticised GdF for never taking seriously external offers to co-finance expansion; for the other, it censured a failure to invest in additional capacity that the Commission deemed ‘sufficiently profitable’.<sup>210</sup> These commitment decisions have permitted the Commission to effectively address its belief that vertically-integrated infrastructures necessarily have distorted incentives against capacity expansion to protect their upstream or downstream profits. Via Article 9 it has been possible to secure ‘investment obligations’ with the aim of fostering more competition through increased market entry.<sup>211</sup> It is possible to disagree with the end pursued by the Commission through these interventions, especially given the highly unpredictable impact upon business incentives to invest and innovate.<sup>212</sup> Yet it is undeniable that the discretion afforded by Article 9 commitment decisions has facilitated the highly effective realisation of its competition goals in this sector, despite the specific conduct investigated bearing little relation to pre-existing legal obligations.<sup>213</sup>

In short, commitment decisions have proven to be a powerful tool of competition enforcement for whenever the Commission has reason to believe that harm is being caused to markets, but where there has been no previous finding of illegality for the alleged theory of harm. Freed from the scope of the pre-existing law of Article 101 and 102, its discretionary market interventions can be directed towards realising its policy views on improving specific markets, however conceptualised, and addressing conduct by particular firms as and when it deems necessary.

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<sup>208</sup> *RWE* [2009] [27].

<sup>209</sup> *ibid.*

<sup>210</sup> *Gaz de France* [2009] [39]. Similarly: *ENI* [2010] (ENI knew many requests went unmet and failed to consider expansion or canvass opinions on co-financing it).

<sup>211</sup> Scholz and Purps [2010] 48.

<sup>212</sup> It may cement dominant bottlenecks by disincentivising users from finding competing distribution methods (Scholz and Purps [2010] 48) or could inhibit infrastructure creation (Merlino and Faella [2013] 536).

<sup>213</sup> Scholz and Purps [2010] 47-48, 65; Talus [2011] 1592; Hjelmeng [2013] 1012; Merlino and Faella [2013] 516-519 (saturated capacity was previously viewed by the Commission as an *objective justification* for refusing access); Dunne [2014] 421; Lianos [2014] 24.

### ii) Market Interventions **Below** the Law

The effectiveness of the commitment decision procedure for realising competition policy ends with utmost efficacy does not stop at permitting Commission enforcement beyond the pre-existing scope of the law. Article 9 only requires the identification of a ‘possible’ infringement of EU competition law, rather than the demonstration of an ‘actual’ violation.<sup>214</sup> The Commission therefore has discretion not just as to the statement of facts,<sup>215</sup> but also as to its *legal characterisation that the instant facts meet criteria for prohibition*. As a result, it can intervene against conduct possibly *below* authoritative thresholds deduced by the EU Courts for a formal finding of illegality. Although the Commission is (unsurprisingly) adamant that it does not use this discretion to close weak cases,<sup>216</sup> its reasons for investigating conduct caught by pre-existing legal precedents are often less substantial than in a formal prohibition decision.<sup>217</sup> Albeit a blunt metric, comparing the average number of paragraphs signals the possibility of a more sparse justificatory logic.<sup>218</sup> In terms of more qualitative analysis, a number of commitment decisions can be interpreted as evidencing the Commission’s discretion to secure changes to business conduct without necessarily passing exacting legal thresholds. As with Article 9 enforcement *beyond* the law, these examples of enforcement possibly *below* the law reinforce the effectiveness of commitment decisions for the Commission to realise its various goals in competition enforcement, often securing admirable ends.

The first concerns establishing a position of *collective dominance* for the purposes of Article 102. The substantive test for prohibition under the original EU Merger Regulation did not textually afford the possibility to prohibit a concentration on the basis of concerns for non-collusive oligopoly consequences. Although this seems to have motivated the Commission’s prohibition in *Airtours*,<sup>219</sup> the legislative gap led it to conclude that the merger would create a sustainable position of collective dominance.<sup>220</sup> In a period of major embarrassment for the Commission,<sup>221</sup> the General

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<sup>214</sup> *To Commit?* [2014] (emphasis in original).

<sup>215</sup> See fn 177.

<sup>216</sup> *To Commit?* [2014]; ‘Commitments decisions – frequently asked questions’ [8/3/2013] MEMO/13/189.

<sup>217</sup> Sadowska [2011] 451 (‘far more perfunctory’, ‘weak’ allegations); Cengiz [2011] 137; Sadowska and Willems [2013] 142; Mariniello [2014] 7; Jenny [2015] 734; Witt [2016] 3, 149-150.

<sup>218</sup> Ibáñez Colomo and Kalintiri [2018] 38-39 (From 2005 to 2017, 93 paragraphs for commitment decisions and 502 for prohibition decisions).

<sup>219</sup> *Airtours/First Choice* (IV/M.1524) [2000] OJ L93/1, especially [54]. This interpretation is offered by: Whish and Bailey [2018] 883.

<sup>220</sup> *ibid* [158]

<sup>221</sup> Witt [2016] 27-32.

Court re-instated the demanding test for establishing collective dominance,<sup>222</sup> and found that that its legal characterisation of the proposed merger fell short.<sup>223</sup> The high hurdles to substantiating collective dominance for the purposes of Article 102 and merger control restrained the Commission's ability to effectively intervene in oligopoly markets. The utility of the discretion afforded by commitment decisions in this regard was demonstrated by *German Electricity Wholesale Market* [2008].<sup>224</sup> E.ON was alleged to have engaged in the serious practice of capacity withdrawal, but the requirement of dominance under Article 102 was dubious given its low market share. Instead, the Commission claimed that this could amount to an individual abuse<sup>225</sup> of collective dominance with other energy companies. The flexibility of the commitment decision procedure is revealed in how easily the Commission was able to justify this characterisation in a few hundred words without actual reference to the stringent norms of EU competition law. This was plainly an effective means to remedy a gravely anticompetitive action in the individual instance for the good of consumers, without being held back by robustly substantiating the difficult *Airtours* criteria.

*Excessive pricing* investigations are another example of commitment decisions providing discretion as to the legal characterisation of facts. The early *United Brands* [1978] case established the test for high pricing as abusive under Article 102 in bearing 'no reasonable relation to the economic value of the product supplied', either in comparison to competitive price benchmarks or in itself.<sup>226</sup> This threshold for formal prohibition is rather hazy and has hampered successful condemnation of excessive pricing by the Commission for decades.<sup>227</sup> However such difficulties forestalling market intervention have been evaded through the evaluative latitude of commitment decisions. For example in *Standard and Poor's* [2011] the Commission felt confident in tersely concluding that prices 'significantly exceed the costs incurred' so as to potentially amount to an abuse of dominance, despite the usual legal vulnerability of such claims.<sup>228</sup>

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<sup>222</sup> *Airtours* [2002] [62].

<sup>223</sup> ibid [294] (instead of 'cogent evidence' it 'is vitiated by a series of errors of assessment', thus failing to meet 'the requisite legal standard').

<sup>224</sup> *German Electricity Wholesale Market* (COMP/39.388) and *German Electricity Balancing Market* (COMP/39.389) [2008] ("German Electricity [2008]") [13].

<sup>225</sup> See: T-228/97 *Irish Sugar plc v Commission* [1999] ECLI:EU:T:1999:246.

<sup>226</sup> C-27/76 *United Brands and United Brands Continental v Commission* [1978] ECLI:EU:C:1978:22 [250].

<sup>227</sup> Dunne [2014] 422.

<sup>228</sup> *Standard and Poor's* (COMP/39.592) [2011] [37]. See: Dunne [2014] 424 ('patently neglects' to attempt meeting the legal test).

Following the recent reengagement of the CJEU with the law on excessive pricing,<sup>229</sup> the commitment decision in *Gazprom* [2018] is slightly more rigorous, adopting competitive price benchmarks for gas in Germany and the Netherlands as a gauge for alleged abuses in Central and Eastern Europe, and noting average differences of 22-44 per cent (reduced to 9-24 per cent on another metric).<sup>230</sup> Still, the conclusion that these variations meet that the *United Brands* definition of excessive pricing is reached in fewer than two pages.<sup>231</sup> Very high prices are an exercise of market power of clear consumer detriment, and the Commission's determination to effectively prevent customer exploitation is therefore an understandable end of competition policy.<sup>232</sup> Article 9 affords the discretion to do so as it thinks necessary, with greater ease than at any time before Regulation 1/2003.

A third and final example of the Commission's latitude as to the legal characterisation of facts in commitment decisions, thereby effectively pursuing its policy goals, concerns the law on refusals to deal with companies requiring access to physical property. As will be discussed in the next chapter, it is not easy to meet the legal test for characterising such refusals as abusive. In *Bronner* [1998] the CJEU found that illegality required a demonstration that the facility in question was *indispensable* to operate on the market, lacking actual or potential substitutes; 'less advantageous' alternatives would not suffice.<sup>233</sup> While explicit and constructive refusals have been found illegal through formal Article 7 prohibition decisions since *Bronner*, they invariably involve long and detailed appraisals that the legal test (as reformulated by the Commission)<sup>234</sup> is met.<sup>235</sup> This blockage to effective market intervention has been minimalised by recourse to the discretion of commitment decisions, where the Commission admits to regularly finding constructive refusals to grant access to energy infrastructure.<sup>236</sup> Notwithstanding academic scepticism that such facilities *are* actually indispensable or objectively necessary to operate,<sup>237</sup> it has nevertheless characterised infrastructure as potentially

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<sup>229</sup> C-177/16 *Autortiesību un Komunīcēšanās Konsultāciju Aģentūra/Latvijas Autoru Apvienība v Konkurences Padome* [2017] ECLI:EU:C:2017:689.

<sup>230</sup> *Upstream Gas Supplies in Central and Eastern Europe* (AT.39816) [2018] ("*Gazprom* [2018]").

<sup>231</sup> *ibid* [69]-[79].

<sup>232</sup> Vestager [21/11/2016]; 'Commission opens formal investigation into Aspen Pharma's pricing practices for cancer medicines' [15/5/2017] IP/17/1323.

<sup>233</sup> C-7/97 *Oscar Bronner GmbH & Co KG v Mediaprint* [1998] ECLI:EU:C:1998:569 ("*Bronner* [1998]") [41]-[43].

<sup>234</sup> *Article 102 Guidance* [2009] [81]-[90].

<sup>235</sup> eg *Telekomunikacija Polska* [2011] [695]-[884]; *Slovak Telekom* (AT.39523) [2014] [355]-[821]; *ARA Foreclosure* (AT.39759) [2016] [74]-[115] (though more truncated as a voluntary settlement).

<sup>236</sup> Staff Working Document [2014] 31-32.

<sup>237</sup> Scholz and Purps [2010] 74-75; Talus [2011] 1588-1590; Merlino and Faella [2013] 531.

meeting the high justificatory threshold for Article 102 intervention with comparably scant reasoning, at times bordering on assertion.<sup>238</sup> Along with the novel theories of harm in the previous section and remedies in the next, the Commission's discretion to readily justify market intervention without rigorous legal appraisal of the instant facts in commitment decisions have permitted it to effectively pursue its goals for competitive energy markets.

In summary, Article 9 has proven to be a powerful tool for the Commission to realise its varied policy ends with utmost efficacy. In facilitating market interventions beyond the scope of the law or, where demanding legal thresholds exist, below judicially-determined strictures, it has the discretion to target a wide variety of market conduct that may be much more difficult through the formal prohibition decision procedure. This is competition enforcement without competition law, and it is undoubtedly very effective for realising the Commission's often commendable ends.

*B) Effective Ends II: The Remedial Potential of Commitment Decisions*

The ability to persuade companies to merely *cease* market conduct where the Commission has competitive concerns, even if beyond or below pre-existing legal prohibition, would in itself be a useful enforcement tool. But the effectiveness with which the Commission can reach its competition ends through Article 9 goes far beyond such remedial restraint. It has the discretion to finalise a commitment decision as a result of companies offering all manner of business changes. Article 9 has been a site of extensive experimentation in competition remedies,<sup>239</sup> leading some to suggest that the outcome-based potency of this procedure has been the key impetus for its prevalence.<sup>240</sup> The appeal to an administrative authority is not surprising. Through commitment decisions the Commission essentially has the discretion to effectively redraw targeted markets according to its idealised vision,<sup>241</sup> whether informed by efficiency, equity, European integration, or anything else.

Although free to impose behavioural or structural solutions in prohibition decisions, the text of Article 7 only permits remedies that are 'proportionate to the infringement

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<sup>238</sup> Ibáñez Colomo [2010] 298; Merlino and Faella [2013] 533-534, 539; Dunne [2014] 424.

<sup>239</sup> As predicted by: Temple Lang [2003] 354-356.

<sup>240</sup> eg Gerard [2013] 5 (they are 'entirely driven by the nature and scope of remedies').

<sup>241</sup> See generally: Devlin [2012]; Dunne [2014] 429.

committed' and necessary to bring it 'effectively to an end'.<sup>242</sup> Fines are the 'baseline' remedy beyond cease-and-desist,<sup>243</sup> even when recidivism is a key concern.<sup>244</sup> The Commission has *never* imposed a structural remedy through Article 7.<sup>245</sup> Such restraint has therefore rarely led to judicial engagement with the subject.<sup>246</sup> The exception was the General Court's annulment of the monitoring trustee remedy in *Microsoft* [2007] owing to illegal delegation and disproportionality,<sup>247</sup> where it stressed that the Commission 'does not have unlimited discretion when formulating remedies' under the predecessor procedure to Article 7.<sup>248</sup>

In contrast, the actual text of Article 9 states that the Commission has the discretion to accept any remedies that 'meet the concerns' it has expressed, thereby rendering divestiture more likely.<sup>249</sup> Early remedial extensions beyond the strictures of Article 7 were relatively modest. Although the *Coca-Cola* [2005] commitment decision expressed competitive worries under Article 102 about contractual practices with distributors in only four countries, the remedial package covered all EU member states where it was dominant.<sup>250</sup> Similarly in comparing *Premier League* [2006] with the almost identical Article 7 decision in *Champions League* [2003] on joint-selling of football broadcasting rights, the commitment decision included a bonus remedial obligation to prevent a single buyer from acquiring all of the packages.<sup>251</sup>

Yet it has since become clear that the potential outcomes of Article 9 are a very effective tool for the Commission to pursue its policy ends through creative remedies. For instance, an apparent desire to assist smaller competitors vis-à-vis tech giants through pro-active commitments can be seen in *Microsoft (Tying)* [2009]. The theory of harm from its infamous investigation into the pre-installation bundling of Windows Media Player with the Windows operating system was replicated in a commitment decision on

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<sup>242</sup> Regulation 1/2003, Article 7. See also: Recital 12 (structural remedies are only available where there is no equally effective behavioural change or where they would be less of a burden).

<sup>243</sup> Staff Working Document [2014] 56. See also: Lianos [2011] 21; Hjelmeng [2013] 1014; Ritter [2016] 588.

<sup>244</sup> Ritter [2016] 589.

<sup>245</sup> For Commission acceptance: Staff Working Paper [2009] 30-31; Staff Working Document [2014] 56-57. It tried in *Continental Can* [1973] though the decision was overturned on unrelated matters. In *ARA Foreclosure* [2016] the undertaking voluntarily offered divestiture: Wollmann [2017].

<sup>246</sup> See generally: Ritter [2016].

<sup>247</sup> *Microsoft* [2007] [1251]-[1279].

<sup>248</sup> *ibid* [1276].

<sup>249</sup> On Article 9 energy divestitures not being permitted under Article 7: Rab and Sukhtankar [2008] 200-201; Johnston [2009] 286; Ibáñez Colomo [2010] 300; Scholz and Purps [2010] 51; Wagner-Von Papp [2012] 960. cf Von Rosenberg [2009] 242.

<sup>250</sup> *Coca-Cola* [2005]. See: Schweitzer [2008] 570.

<sup>251</sup> *Joint Selling of Media Rights to the FA Premier League* (COMP/C-2/38.173) [2006]. cf *Champions League* [2003]. See: Ibáñez Colomo [2010] 289-290.

Internet Explorer.<sup>252</sup> Rather than simply requiring the two products to be de-coupled, the Commission secured from Microsoft a pledge to offer a consumer ballot screen presenting a selection of browsers from which to choose, thereby giving rivals an unprecedented visibility on the market.<sup>253</sup> The same promising of extensive remedies to assist smaller rivals was sought in the abandoned *Google Search* commitment negotiations. Over four years the Commission and Google's rivals attempted to redraw how the search engine displayed the related shopping suggestions of itself and other services, scrutinising package after package to get the 'icing on the cake' and finally the 'cherry on top'.<sup>254</sup> Commissioner Almunia himself considered the final set to be 'far-reaching' concessions to 'restore a level playing-field' in online search.<sup>255</sup> Although ultimately failing to convince his successor, the extent of the radical remedies to which Google was willing to commit still demonstrates the effectiveness with which the Commission can pursue its competition goals through the flexible outcomes permissible via Article 9.

Without a doubt, the most vivid examples of the Commission's discretion as to the remedies accepted to finalise commitment decisions concern the energy sector. This has been an area of activity where the Commission has a very particular vision it wishes to replicate as effectively as possible. Since the 1990s, it has spearheaded various EU legislative packages endeavouring to liberalise domestic markets, foster entry to challenge vertically-integrated former-incumbents, and introduce a single, borderless European energy market.<sup>256</sup> Its 2007 sector report still found a number of inadequacies,<sup>257</sup> though its insistence that the appropriate solution was regulation rather than competition enforcement was short-lived.<sup>258</sup> Commitment decisions have given the Commission ample remedial discretion to effectively restructure energy markets in creative and radical ways. The potential examples of the remedial latitude

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<sup>252</sup> *Microsoft (Tying)* [2009].

<sup>253</sup> For commentary: Ibáñez Colomo [2010] 294; Rab, Monnoyeur, and Sukhtankar [2010] 180; Lianos [2011] 24; Aleixo [2013] 474-475. On the risk that commitment remedies may represent an inefficient bias against concentration: Ibáñez Colomo [2010] 281-282, 302; Hjelmeng [2013] 1018-1019. eg Almunia [8/4/2011] (on 'leav[ing] the door wide open for new competitive companies' to enter and challenge existing firms).

<sup>254</sup> Leyden and Dolmans [2014] 253, 255.

<sup>255</sup> Almunia [5/2/2014].

<sup>256</sup> For overviews: Cameron [2005]; Rab and Sukhtankar [2008] 199.

<sup>257</sup> 'Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors [10/1/2007] COM(2006) 851 final (eg high concentration, vertical integration, barriers to entry, lack of price transparency).

<sup>258</sup> *ibid* 9.

afforded by Article 9 are too numerous to all be considered in detail, so priority is given to the most dramatic.

In *Swedish Interconnectors* [2010] the electricity transmission system operator had managed internal bottlenecks at peak times by restricting export to Denmark, thus discriminatorily raising prices for Danish customers.<sup>259</sup> Plainly animated by the goal of market integration,<sup>260</sup> the Commission fundamentally reorganised the Swedish electricity system through the remedial package negotiated.<sup>261</sup> Despite the existence of less drastic solutions,<sup>262</sup> and regulatory ambivalence as to the chosen option for congestion management,<sup>263</sup> the Commission had the discretion to realise its ideal outcome. It similarly reconstructed the Bulgarian energy market in *BEH Electricity* [2015].<sup>264</sup> Article 9 was utilised to negotiate the offering of electricity on a newly created power exchange for five years before its transfer to the Bulgarian Ministry of Finance, amongst other things, to thereby realise its commendable ends of anonymous sales, greater liquidity, improved transparency, and cross-border integration with utmost efficacy.

The effectiveness of Article 9 and the breadth of the Commission's remedial discretion is also evidenced by decisions where the outcomes bear little relation to the conduct initially considered problematic.<sup>265</sup> In *German Electricity Wholesale Market* [2008], allegations of production withdrawal to raise prices for downstream providers were closed with the unrelated divestiture of generation capacity to a potential buyer, clearly intended to force new market entry.<sup>266</sup> In *CEZ* [2013] the Commission was concerned with long-term capacity booking into the transmission network by the former electricity monopolist potentially reducing entry and expansion by rivals.<sup>267</sup> But despite this specific impetus, and contrary to remedies in earlier analogous investigations,<sup>268</sup> CEZ also agreed to divest generation capacity. And in the recent *Gazprom* [2018] decision,

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<sup>259</sup> *Swedish Interconnectors* (COMP/39.351) [2010].

<sup>260</sup> Sadowska and Willems [2013] 137, 143-144.

<sup>261</sup> Splitting Sweden into two bidding zones with their own electricity prices, deliberately leading to higher tariffs for some southern customers but hopefully signalling the need for investment.

<sup>262</sup> Sadowska and Willems [2013] 153-154 (discussing counter-trading, the preference of the Swedish TSO).

<sup>263</sup> *ibid* 161-162, 170 (including cross-border restrictions)

<sup>264</sup> *BEH Electricity* (AT.39767) [2015].

<sup>265</sup> Lianos [2011] 28. These go beyond the occasional 'collateral conditions' in prohibition decisions: Ratliff [2008] 311-312.

<sup>266</sup> *German Electricity* [2008]. For doubt about the suitability of the remedy: Scholz and Purps [2010] 51.

<sup>267</sup> *CEZ* [2013].

<sup>268</sup> *Gaz de France* [2009]; *E.ON Gas* [2010]. Both concerning long-term capacity booking into gas transmission networks, with the sale of some contracted capacity to rivals and limits to the overall percentage reserved agreed as remedies.

allegations of excessive pricing offered the opportunity for the wholesale reconceptualisation of Central and Eastern European energy flows through remedial negotiations.<sup>269</sup>

So powerful are commitment decisions as a tool for competition enforcement that the Commission even has the discretion to secure remedial ends that have been explicitly *rejected* as mandatory in regulation, essentially side-stepping obstructive intermediates to its ends - Member States in the legislative process.<sup>270</sup> In *German Electricity Balancing Market* [2008],<sup>271</sup> *RWE Gas* [2009],<sup>272</sup> and *ENI* [2010],<sup>273</sup> various bottleneck infrastructures (transmission networks, import pipelines) were divested by vertically-integrated energy companies who might have used this control to the advantage of their related upstream or downstream businesses. These outcomes reflected the Commission's belief that the *only* suitable remedy to address the risk of 'distorted incentives'<sup>274</sup> was ownership unbundling; operation by an independent firm driven by a singular commercial incentive to manage the bottleneck efficiently, invest in capacity expansion, and invite market entry,<sup>275</sup> without any 'inherent conflict of interest'.<sup>276</sup> In comparison to merger control where divestiture is relatively common, this represents an unusually far-reaching outcome.<sup>277</sup> The remedial discretion of commitment decisions is particularly highlighted by the fact that the Commission's stated preference for compulsory ownership unbundling through regulation<sup>278</sup> was *not* accepted by Member States in the Third Energy Package, which left open a variety of options.<sup>279</sup> Through competition enforcement via Article 9, it nevertheless achieved the same result via one-to-one negotiation with owners.<sup>280</sup> Utilisation of commitment decisions to evade regulatory decisions clearly raises concerns for the legitimacy of EU legislative

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<sup>269</sup> *Gazprom* [2018].

<sup>270</sup> Hancher and de Hauteclercque [2010] 323, 329-330; Sadowska and Willems [2013] 142; Dunne [2014] 435.

<sup>271</sup> *German Electricity* [2008].

<sup>272</sup> *RWE* [2009].

<sup>273</sup> *ENI* [2010].

<sup>274</sup> *German Electricity* [2008].

<sup>275</sup> Von Rosenberg [2009] 241-242. For support: Pollitt [2006]; Moselle and Black [2011] 85-87, 89-90; Johnston and Block [2012] 66-67.

<sup>276</sup> *RWE* [2009]. The same phrase is also used in: *ENI* [2010].

<sup>277</sup> Ibáñez Colomo [2010] 300-301 (commitment to operate on FRAND terms often suffices).

<sup>278</sup> eg Kroes [28/9/2006]; [23/3/2007]; [27/9/2007]; [27/3/2008].

<sup>279</sup> Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas [2009] OJ L211/94; Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity [2009] L211/55. For an overview of the options: Piergiovanni [2009] 4; Johnston and Block [2012] 37-39. For similar Commission cherry-picking of multiple regulatory options, see text accompanying fn 263.

<sup>280</sup> Piergiovanni [2010] 8; Johnston and Block [2012] 71-72; Dunne [2014] 430.

procedures and the separation of powers.<sup>281</sup> Still, these qualms further highlight the power of commitment decisions for the Commission to realise its policy goals with extreme effectiveness.

In sum, given the remedial discretion of commitment decisions, the attraction of Article 9 for conducting and concluding competition investigations is surely irresistible to an administrative decision-maker. Critics are correct to equate this manner of enforcement with regulation;<sup>282</sup> the Commission can, in theory, reach *any* outcome, including those that lead to divestiture, redraw Member State markets, force entry, aid competitors, and so on, even where they appear unrelated to the initial competitive concern.<sup>283</sup> When combined with the discretion to investigate market conduct beyond and beneath the law, useful even if simply resulting in cessation, the Commission arguably has the most powerful tool conceivable for pursuing its various policy ends with utmost efficacy. The competitive outcomes have in many instances, done a great deal of good for European consumers. The question is whether the unbridled realisation of these ends justifies a means antithetical to the formal rule of law ideal.

### *C) Problematic Means: Systemic Detriment to the Rule of Law*

The Commission's continual recourse to the discretion of Article 9 commitment decisions represents the maximal prioritisation of delivering its ends in an individual investigation above the broader detrimental consequences of this means of market intervention, which eschews administrative restraint and rationally-comprehensible norms. It is beyond doubt that commitment decisions are potent tools for achieving competitive "goods", however defined, through the ability to intervene against *any* conduct as and when necessary, and to secure *any* remedy that is thought desirable for the market to work optimally. But this effectiveness for realising competition goals comes with a disregard for realising the formal rule of law.<sup>284</sup>

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<sup>281</sup> Forrester [2008] 655; Cengiz [2011] 136.

<sup>282</sup> eg Forrester [2008] 659; Schweitzer [2008] 559; [2012b] 3; Moullet [2013] 86; Sadowska and Willems [2013] 142; Dunne [2014] 430; Jenny [2015] 702.

<sup>283</sup> This disjuncture challenges the common claim that enforcement beyond the law directly leads to far-reaching remedies, eg: Sadowska [2011] 451, 453 (expansive competition concerns to negotiate greater remedies); Gerard [2013] 13-14; Lianos [2014] 10-11 (flexibility on the theory of harm facilitates remedial discretion) 24. But as *any* conduct and *any* remedy can result from a commitment decision, there is no need for the Commission to connect the two halves at all.

<sup>284</sup> Similarly: Dunne [2014] 401 (on effective enforcement and undermining the rule of law as a 'double-edged sword'). For broader recognition of this trade-off: Hancher and de Hauteclercque [2010] 328-329; Ibáñez Colomo [2010] 277; Gerard [2013] 22-24; Hjelmeng [2013] 1030; Mariniello [2014] 4.

The Commission's unbounded discretion to intervene against and secure changes to *any* business conduct systematically undermines the normative comprehensibility of EU competition policy for firms. As it is able to mount a serious investigation beyond the pre-existing scope of the law with novel theories of harm, or below high thresholds for findings of illegality through superficial legal characterisation of the facts, businesses have no reasonably guaranteed zone of legality. In both instances, the authoritative legal norms deduced by the EU Courts from Articles 101 and 102 fail to prospectively demarcate the boundary between permission and prohibition as they have no restraining influence upon the Commission's discretion to pursue an Article 9 commitment decision. This is not simply an issue of concentric normative circles, with the scope of conduct caught by the Commission's commitment decisions being somewhat broader at the edge than the Courts' jurisprudence. *All* business behaviour beyond or below the pre-existing ambit of EU competition law can potentially be questioned and lead to remedial change. With market intervention through unbounded discretionary enforcement, official recommendations that companies will be fine if they simply 'stay on the right side of the law at all times' ring hollow.<sup>285</sup> Firms can act within the confines of authoritative competition law and still be the subject of informal enforcement. The Commission's calculation of the benefits of adopting *individual* commitment decisions - pursuit of its ends with utmost effectiveness as it deems necessary - fails to take into account the costs of market interventions that undermine systemic aspirations towards normative comprehensibility for *all* other firms.<sup>286</sup>

Perhaps this picture of normative anarchy from the perspective of the formal rule of law is too stark. Although with a largely negative intent, a number of commentators have speculated that commitment decisions might over time come to themselves gradually provide guidance, crystallising into a rival 'shadow jurisprudence'.<sup>287</sup> Cognition of what is prohibited and permissible, might still be enjoyed by market actors but they just have to look at how the Commission has exercised its discretion through commitment decisions, rather than the law.<sup>288</sup> This was indeed a possible institutional route towards realising the rule of law considered in Chapter IV, where the decisional practice of an administrative authority incrementally approximated the desirable form of generalised,

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<sup>285</sup> Almunia [8/3/2013].

<sup>286</sup> Schweitzer [2008] 577; Wagner-Von Papp [2012] 964; Botteman and Patsa [2013] 363; Watheler [2015] 554.

<sup>287</sup> Marquis [2008] lxxiv. See also: Forrester [2008] 638; Georgiev [2007] 1035; Wagner-Von Papp [2012] 931; Gerard [2013] 24; Marsden [2013]; Jenny [2015] 723.

<sup>288</sup> Martinez Lage and Allendesalazar [2008] 583; Wagner-Von Papp [2012] 931; [2013]; Gerard [2013] 22.

comprehensible norms of legality.<sup>289</sup> This more optimistic interpretation of commitment decisions seems to be the Commission's reading of its record under Article 9. For example, its 2009 Staff Working Paper praised the ability for commitments to 'serve as a model for addressing similar situations', highlighting its investigations into long term energy contracts and joint-selling of broadcasting rights as providing 'sufficient orientation to operators' to adapt their business practices.<sup>290</sup>

Nevertheless, there are two reasons to be sceptical that commitment decisions could gradually crystallise into a series of comprehensible competition norms for firms, further demonstrating the extent to which the discretion characterising the Article 9 decisional procedure leaves EU competition policy far from approximating the formal rule of law.

The first cause for caution relates to the nature of the EU legal order as laid out in the Treaties. No matter how many commitment decisions the Commission concludes, or how consistently it treats like investigations alike in the future, the unavoidable truth of the EU's legal architecture is that they can *never* be treated as authoritative determinations of the norms of competition law. Although the Commission has specific competence to investigate suspected violations of Articles 101 and 102 TFEU,<sup>291</sup> it is the sole preserve of the CJEU to authoritatively interpret those provisions and deduce the obligations incumbent upon businesses.<sup>292</sup> Despite their frequency and substantial remedial packages, without the CJEU's seal of approval normative determinations within commitment decisions are necessarily more precarious points of reference against which to orientate business decision-making. The Commission's discretion to intervene in markets as and when it sees fit against potentially anticompetitive behaviour may temporarily settle the individual investigation, but simply cannot guide other businesses as to the legality of the practice overall.<sup>293</sup>

When it comes to enforcement *beyond* the law, inconsistency between the silence of the determinative law and discretionary enforcement against unprecedented practices means that the latter exist within a normative void, their legality never authoritatively

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<sup>289</sup> See Chapter IV, text accompanying fn 155-156.

<sup>290</sup> Staff Working Paper [2009] 35. For support: de Hauteclercque [2009]. cf routine admissions that only prohibition decisions provide the appropriate basis for precedential certainty for all firms and deterrence: Staff Working Paper [2009] 29; *To Commit?* [2014]; Staff Working Document [2014] 55.

<sup>291</sup> Article 105 TFEU.

<sup>292</sup> Article 19(3) TEU.

<sup>293</sup> Hancher and de Hauteclercque [2010] 330; Mariniello [2014] 2.

settled.<sup>294</sup> At the same time the jurisprudence of the Courts, the only valid statements of the obligations upon market actors, becomes stale and outmoded, failing to evolve alongside constantly innovating business practices.<sup>295</sup> If, for instance, “patent ambush” is a live competitive concern as the formulation of international standards containing IP rights becomes more important to industry,<sup>296</sup> the authoritative norms of EU competition law contain a gap that *matters* to markets, yet cannot be decisively addressed by Article 9 decisions. Even if the Commission prefers to advance novel theories of harm through its unbounded discretion in commitment decisions rather than a formal prohibition, the issue may still come before the EU Courts via an Article 267 preliminary reference from national disputes.<sup>297</sup> However such referrals arise in a necessarily sporadic and unforeseeable manner that fails to guarantee a steady stream of opportunities for judicial engagement with legal questions perhaps most in need of clarification.<sup>298</sup>

With regard to commitment decisions investigating conduct *below* the law, the Commission’s discretion is *de facto* undermining the normative assurance of deliberately high *de jure* thresholds for intervention. It may have used particular legal doctrines in Article 9 decisions where it would struggle to successfully characterise instant cases as meeting their tests through formal prohibition.<sup>299</sup> But that difficulty was arguably the Courts’ intention: high legal boundaries were set to restrain the Commission’s ability to reach certain conclusions, thereby reflecting the controversy of, for instance, bringing individually non-dominant firms within the ambit of the Article 102 “special responsibility” via findings of collective dominance,<sup>300</sup> or threatening investment incentives through readily granting compulsory access in refusal to deal cases.<sup>301</sup> Although not ruling-out findings of illegality, businesses could previously take solace in their limitation to truly exceptional circumstances. EU competition law provided certainty in setting limits to the Commission’s decision-making. Yet the unbounded discretion afforded by commitment decisions has allowed the Commission to sidestep these restraints, thereby undermining their reassuring normative clarity by transforming

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<sup>294</sup> Wagner-Von Papp [2012] 961-962 (summarising US literature on the same issue).

<sup>295</sup> Marquis [2008] lxxiv.

<sup>296</sup> Rambus [2009].

<sup>297</sup> eg *Huawei* [2015] (injunctions for standard-essential patents).

<sup>298</sup> cf *Wathelet* [2015] 554 (uses *Huawei* to argue that references can still generate precedents when commitments are the norm).

<sup>299</sup> Gerard [2013] 20; *Dunne* [2015] 126.

<sup>300</sup> *Dunne* [2014] 423; *Lianos* [2014] 24.

<sup>301</sup> *Dunne* [2015] 110.

once rare legal findings to now rather routine elements of informal competition policy enforcement.

In this way, the parallel yet inconsistent existence of authoritative, judicially-determined norms and unauthoritative commitment decisions, permitting discretion to intervene beyond and below the law, has degraded the restrained normative comprehensibility afforded by the former, without providing any additional clarity to the demarcation of illegality through the latter.

The second reason for scepticism that the Commission's use of commitments could eventually form an enlightening body of guiding decisions goes to the connection between the first and second formal principles of the rule of law articulated in Chapter IV.<sup>302</sup> The comprehensibility of the obligations upon subjects often results from determinations of legality in accordance with norms of *generalised-scope and equal-application*. If there are no prospective, general norms but discretionary findings of competitive concerns through *ad hoc*, narrow, subject-specific decisions that need not be consistently applied, others have little capacity to comprehend the obligations upon them. Article 9 commitment decisions represent the latter means for enforcing EU competition policy.

Considering the examples of enforcement *beyond* the law, it often appears that the Commission uses the discretion of commitment decisions to create exceptional findings of possible illegality at the firm- or industry-specific level. Not only does this raise questions of equal treatment before the law. Such normative pointillism also renders the extrapolation of generalised obligations to guide other market actors difficult.<sup>303</sup> What, for example, are other businesses to read into the Commission's distaste for: patent holders acting deceptively in standardisation processes to then ambush producers for excessive royalties;<sup>304</sup> competitors all including MFN clauses in their agency agreements with the intent of forcing a wholesaler to switch model and thus not undercut prices for products not subject to the agreement;<sup>305</sup> owners of infrastructure bottlenecks reserving substantial access and protecting their upstream/downstream business by failing to invest in capacity expansion or accepting offers/inviting responses

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<sup>302</sup> cf the possibility that the two taken to extremes may be contradictory: Chapter IV, fn 148.

<sup>303</sup> For similar arguments: Forrester [2008] 649-650; Wathelet [2015] 554 (as they 'tend to target particular sectors' this may affect their 'precedential value.').

<sup>304</sup> Rambus [2009].

<sup>305</sup> E-Books [2012/2013].

from competitors to co-finance such;<sup>306</sup> or of non-indispensable but still very important services directing users to their own related search services more favourably than those of competitors?<sup>307</sup> Compare these decisions to the generalised presumptions of illegality for resale price maintenance and pricing below average variable cost,<sup>308</sup> or the slightly more complex though nonetheless comprehensible requirements for abusive refusal to grant access to physical property.<sup>309</sup> The normative clarity of the latter derives from their restraining and structuring of Commission decision-making to reasonably generalised norms for determining legality, applicable to all. How much greater would the uncertainty of EU competition policy have been without such universal norms for when the law would be violated?<sup>310</sup> But the difficulty of generalising context-dependent theories of harm in many commitment decisions may well be the intention, a further element of their effectiveness: as universal application of some of the novel findings of possible illegality could be inefficient and highly burdensome (“strategic underinvestment”?),<sup>311</sup> the potential for unequal, subject- or industry-specific normative acts through the unbound discretion of commitment decisions amplifies their appeal for the Commission to realise its ends. Nevertheless, market intervention through subject-specific appraisals of legality is a means deleterious to realising the normative clarity envisaged by the formal rule of law ideal.

The same *ad hoc*, discretionary form of intervention through Article 9 forestalls the comprehensibility of those commitment decisions enforcing competition policy *below* the law. Where generalised norms of legality and illegality already exist, the Commission uses the discretion of Article 9 to create individual exemptions falling short of the authoritative thresholds for intervention. This has been particularly noticeable in the energy sector, where it was demonstrated that the Commission has systematically undermined high thresholds for market intervention in specific instances. For example with the doctrine of collective dominance, it can avoid the restraining influence of the stringent and *generalised* normative hurdles established in *Airtours*, thus reaching the same conclusion regardless in the *individual* case of *German Electricity* through a series of assertions and banal reflections on the structural characteristics of the *particular*

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<sup>306</sup> See text accompanying fn 205-213.

<sup>307</sup> *Google Search*, see text accompanying fn 200-204; Lamadrid de Pablo [2013] 483.

<sup>308</sup> See Chapter VI, Section III.C.ii (on RPM), Section IV.C.i (on predatory pricing).

<sup>309</sup> *Bronner* [1998].

<sup>310</sup> Similarly: Forrester [2008] 647-648.

<sup>311</sup> Cook [2006] 227-228; Botteman and Patsa [2013] 363; Hjelmeng [2013] 1029; Dunne [2014] 439.

market.<sup>312</sup> The Commission has been more open about using its Article 9 discretion to create individual exemptions to the generalised, reasonably comprehensible *Bronner* test for abusive refusals of access that restricts its enforcement activity in formal decisions. Rather than novel theories of harm, it has characterised capacity hoarding and strategic underinvestment as ‘sector specific’ manifestations of constructive refusals to supply,<sup>313</sup> though without having to rigorously meet the high thresholds of the legal test. Are these dilutions of *Bronner* only applicable in the energy sector? Other industries with bottlenecks? Or, as seems a simpler assumption, as and when the Commission sees fit in an Article 9 decision? Its own justification itself stresses that Article 9 is a vehicle for avoiding the restraint of generalised, exacting tests for reaching certain legal conclusions, thereby undermining the normative clarity of the law. In short, the Commission has the discretion to engage in exceptional, subject- or industry-specific enforcement activity via commitment decisions that is deliberately discriminatory.

The lack of clarity as to the divide between legality and illegality that results from the Commission’s absolute discretion in commitment decisions is also related to the radical remedies negotiated. The conceptualisation of the rule of law offered in the previous chapter did not mention the outcome of normative determinations of illegality, focusing instead upon whether this was through applying generalised norms or *ad hoc*, subject-specific decisions, and their resultant consequences for normative comprehensibility. The concern was for the predictability of a finding of illegality, not the foreseeability of the resultant punishment. But as with the conditional granting of Article 101(3) exemption decisions considered above, commitment decisions blur the neat conceptual divide between legality and punishment; unlike the punitive fines attached to a formal Article 7 prohibition decisions, the remedial packages negotiated in Article 9 commitment decisions are better considered *conditions of legality*. And as has been seen, the Commission has the discretion to require all manner of far-reaching changes for it to close the investigation. Unsurprisingly, it has always maintained that these remedial packages are offered by businesses of their own volition.<sup>314</sup> There are good reasons to question this self-portrayal of the Commission neutrally encouraging commitments from

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<sup>312</sup> See text accompanying fn 219-225.

<sup>313</sup> Staff Working Document [2014] 32.

<sup>314</sup> ‘Commitments decisions – frequently asked questions’ [8/3/2013] MEMO/13/189; Almunia [8/3/2013] (the ‘cooperative attitude’ makes them a ‘favourite option among companies’); Staff Working Paper [2009] 33. It has particularly stressed that it does not negotiate or bargain remedies, but considers those independently offered: *To Commit?* [2014].

companies, eschewing messy negotiations and not applying pressure to settle.<sup>315</sup> But regardless of which side of the investigation is suggesting the remedies, it remains the case that there is no way of knowing in advance what changes will satiate the Commission's concerns.

To secure no further investigations under EU competition policy going forward, companies have agreed to conditions that are not just severe (eg divestiture), but also against the wishes of their national government (eg ownership unbundling of German energy networks) or tenuously connected to the competitive concerns the Commission initially raised.<sup>316</sup> But sometimes the Commission's use of its Article 9 remedial discretion has been rather restrained, for instance in *E-Books* and *Amazon* merely requiring the deletion of the MFN terms it thought problematic.<sup>317</sup> As an exercise of unbounded discretion, it is unclear whether the Commission expects such moderate changes or something more radical. As *CEZ* [2013] also demonstrates, even where commitment decisions on similar grounds have resulted in one form of outcome (the sale of reserved capacity),<sup>318</sup> the Commission still has the discretion to inconsistently acquire something else to close its investigation (generation divestiture).<sup>319</sup>

The unpredictability of what will have to be offered is further amplified by the *ad hoc*, subject- or industry-specific nature of commitment decision negotiations. If the Commission opens proceedings against a company that is *not* the owner of the world's largest computer operating system for the suspected bundling of software, what can it learn from Microsoft pleasing the Commission with a creative consumer ballot screen?<sup>320</sup> What normative clarity can be derived from geographical discrimination being remedied by splitting the Swedish electricity market into two bidding zones for any business that is *not* a national transmission system operator?<sup>321</sup> Very little. Yet these have been the conditions for the Commission to accept that on-going market practices are legal from the perspective of EU competition policy enforcement. Such uncertainty

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<sup>315</sup> The extent of Commission creativity is difficult to gauge given the confidentiality of discussions. However the General Court implied in *Alrosa* that the Commission *told* firms what it expected them to offer: Cengiz [2011] 150; Jenny [2015] 760. See also: Aleixo [2013] 476 (the choice screen in *Microsoft (Tying)* was proposed by the Commission after rejecting Microsoft's remedy of decoupling).

<sup>316</sup> See text accompanying fn 265-269.

<sup>317</sup> *E-Books* [2012/2013]; *Amazon* [2017].

<sup>318</sup> *Gaz de France* [2009]; *E.ON Gas* [2010].

<sup>319</sup> *CEZ* [2013].

<sup>320</sup> *Microsoft (Tying)* [2009].

<sup>321</sup> *Swedish Interconnectors* [2010].

as to what must be done by firms for their behaviour to be deemed lawful represents a manner of enforcement far from the formal rule of law ideal.

When viewed in this light, the hope or fear of commitment decisions crystallising into a “shadow jurisprudence”, guiding businesses to a greater extent than the authoritative law deduced from Articles 101 and 102 by the CJEU, is not likely. The Commission’s discretion is not structured by any generalised norms for comprehending when it will intervene or what concessions will be necessary for it to close the investigation. The *ad hoc*, subject-specific, inconsistent collection of commitment decisions constitutes a rag-bag of legal novelties, shallow characterisations falling short of the requirements of the law, and particularistic remedial packages that are unable to meaningfully inform market decision-making.

The Commission’s discretion to investigate *any* conduct and secure *any* remedy has permitted the enforcement of its policy ends with maximum efficacy, often with substantial benefits for European consumers. But as a means of market intervention, this is highly problematic. In freeing competition policy from the restraining influence of the authoritative, generalised norms of law for determining the permission and prohibition of business conduct, there is little normative certainty. As an exercise of pure administrative discretion, commitment decisions represent a form of EU competition enforcement seriously failing to approximate the principles and resultant virtues of the formal rule of law ideal.

#### *D) Judicial Review: A Missed Opportunity?*

It is thoroughly unsurprising that an administrative authority would endeavour to realise as effectively as possible the various policies it believes to be in the general interest. The same is true of the Commission’s discretion to intervene in markets as and when it pleases through the Article 9 commitment decision procedure. Mere suggestions that it ought to exercise such power with ‘impeccable judgment’<sup>322</sup> are unrealistic. This explains the importance of judicial review for gradually approximating the formal rule of law ideal. It can be an institutional fail-safe, a residual mechanism for reactively ensuring that administrative decision-making stays within the confines of the law, and for

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<sup>322</sup> Marquis [2008] lxxiv. See also: Wils [2008] 348 ('strict and effective internal procedures and controls ensuring that weak cases are not opened'); Wagner-Von Papp [2012] 931.

prospectively formulating norms for determining legality that structure discretion, thus affording normative certainty to legal subjects.

Judicial review of commitment decisions has not satisfied this role, but it may not be an oversight entirely of the Courts' making. Although the CJEU missed an opportunity to provide some boundaries to the use of commitment decisions, it is unlikely that they will appear before the Courts in any event.

Whenever judicial review is raised in the context of commitment decisions, the *Alrosa* saga invariably comes to mind, culminating in what has been labelled the 'Worst Decision of the EU Court of Justice' ever.<sup>324</sup> The Courts were essentially called upon to either terminate or legitimate the extreme remedial discretion seen in Article 9 commitment decisions, by answering whether they should be held to the same proportionality requirement of Article 7 prohibition decisions.<sup>325</sup> The concept of proportionality – that suitable penalties and remedies ought to be the least onerous possible – is a general principle of EU law.<sup>326</sup> The alleged disproportionality of remedies has often been the perspective from which the compliance of commitment decisions with the rule of law has been questioned.<sup>327</sup> As noted above, in *Microsoft* [2007] the General Court annulled the establishment of a monitoring trustee partly on this ground,<sup>328</sup> and stressed that the Commission 'does not have unlimited discretion when formulating remedies' under the predecessor procedure to Article 7.<sup>329</sup>

When asked in *Alrosa* to rule on whether the same limitation applied for Article 9 commitment decisions, the General Court answered in the affirmative, finding that the Commission could only secure the least onerous outcome that met its competitive concerns.<sup>330</sup> Celebrations that the Commission was forced to 'respect the rule of law' and that 'quasi-regulatory solutions' via commitment decisions had been brought to an end were short-lived.<sup>331</sup> The CJEU overturned the ruling on appeal and rubber-stamped

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<sup>324</sup> Jenny [2015].

<sup>325</sup> For overviews: Kellerbauer [2011]; Messina and Ho [2011]; Jenny [2015] 737-761.

<sup>326</sup> C-331/88 *ex parte Fedesa* [1990] ECLI:EU:C:1990:391 [13]. See also: Article 5(4) and Protocol 2 TEU.

<sup>327</sup> eg Wils [2006] 351-352; Cook [2006] 212-213; Schweitzer [2008] 559; Cengiz [2011] 135; Schweitzer [2012b] 3; Hjelmeng [2013] 1009, 1012; Moullet [2013] 86, 89.

<sup>328</sup> *Microsoft* [2007] [1251]-[1279].

<sup>329</sup> *ibid* [1276].

<sup>330</sup> T-170/06 *Alrosa v Commission* [2007] ECLI:EU:T:2007:220 [92]-[111].

<sup>331</sup> Siragusa and Guerri [2008] 202. See also: Schweitzer [2008] 568-569; Forrester [2008] 651. cf Cengiz [2011] 149-150.

the Commission's discretion pursuant to Article 9 to secure *any* outcome,<sup>332</sup> so long as it only accepted the least onerous of the proposed remedial packages that it considered to be satisfactory.<sup>333</sup> The Commission's analysis of the proportionality of remedies in commitment decisions immediately became noticeably more scant.<sup>334</sup>

As a striking example of judicial deference, *Alrosa* has understandably been the subject of widespread condemnation.<sup>335</sup> The CJEU declined the opportunity to set at least *some* boundaries to the Commission's discretion manifest in commitment decisions. The sheer breadth of remedies that may be required for the Commission to deem market conduct immune from further scrutiny makes it difficult to know what is necessary. By using the concept of proportionality to narrow the scope of the possible and the Commission's remedial discretion, the CJEU could have provided a greater degree of certainty for companies considering which remedies to offer. Furthermore, by actually establishing a direct link between the potential infringement investigated and the outcomes of commitment decisions, the CJEU could have prevented those instances where the Commission's discretion has permitted it to secure remedies seemingly disconnected from its competitive concerns. Such examples are *so* disproportionate as to perhaps even raise the spectre of a possible challenge on the ground of misuse of powers. Instead, the CJEU chose not to take the only opportunity it has hitherto had to shift the use of commitment decisions towards the formal rule of law ideal.

But having noted the failure in *Alrosa* to set boundaries to the discretion of Article 9 decisions, it is worth questioning whether adopting the General Court's more searching oversight would *really* have made much of a difference. As the last section argued, the problems with commitment decisions go beyond the unpredictability with which the Commission exercises its remedial discretion. That legality is conditional upon unknowable concessions is only one element in a phenomenon with complex implications for normative comprehensibility; remedial proportionality would not have touched upon the undesirable consequences of enforcement against business conduct beyond and below the scope of the pre-existing norms of EU competition law. Put

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<sup>332</sup> C-441/07P *Commission v Alrosa* [2010] ECLI:EU:C:2010:377.

<sup>333</sup> The rational course of action for investigated firms is to adopt 'salami tactics' to cover the 'entire spectrum of adequate remedies': Wagner-Von Papp [2012] 937-938. Similarly: Messina and Ho [2011] 747.

<sup>334</sup> Wagner-Von Papp [2012] 942-943.

<sup>335</sup> Cengiz [2011] 129, 150-151; Wagner-Von Papp [2012] 937, 967-968; Botteman and Patsa [2013] 369; Jenny [2015] 702. cf Messina and Ho [2011] 750. Supporting a system of compulsory judicial authorisation: Ratliff [2008] 314; Wagner-Von Papp [2012] 967; Massarotto [2015] 499.

differently, commitment decisions predicated upon novel theories of harm but where the Commission's remedial discretion is exercised in a more restrained fashion, such as *E-Books* or *Amazon*, still foster legal uncertainty but owing to issues unrelated to their outcomes.

But the main reason to be somewhat more forgiving of the CJEU failing to exert a restraining influence upon the Commission's discretionary use of commitment decisions is practical. The very nature of enforcement through Article 9 leaves any opportunity for review by courts highly unlikely. Regardless of the intensity of judicial scrutiny, it is not obvious how much control the EU Courts could actually apply, setting limits to the use of commitment decisions and affording greater clarity to businesses. Having made the strategic decision to agree a remedial package with the Commission, it makes little sense for the investigated undertaking to launch judicial review proceedings of it.<sup>336</sup> And given the Commission's enforcement beyond and below the law to effectively *sanction* firms, often with substantial remedies, it is also improbable that third parties would frequently launch a challenge to privately-negotiated commitments either. This is a very different scenario to pre-modernisation exemption decisions, where the suspicion of administrative *leniency* acted as a red rag to disgruntled competitors and trading partners to bring legal proceedings.<sup>337</sup> Although not impossible,<sup>338</sup> businesses close to a firm subjected to a commitment decision would probably feel overjoyed with their use by the Commission rather than litigious.

The unlikelihood of judicial review reinforces that the Commission's discretionary enforcement of EU competition policy through commitment decisions is absolute. The authoritative norms deduced by the Courts for determining legality exert no restraining influence upon their subject-matter. Following *Alrosa*, neither do the Courts rigorously scrutinise the proportionality of their remedies. And given the rarity of commitment decisions being subject to judicial review at all, it seems highly implausible that this problematic form of market intervention will change any time soon.

It is not obvious how such a major departure from the formal rule of law ideal can be solved. One possibility is for the Commission to not use commitment decisions for novel

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<sup>336</sup> Wagner-Von Papp [2012] 968.

<sup>337</sup> eg *Metro I* [1977].

<sup>338</sup> A third-party challenge was brought by Hynix against *Rambus* [2009] as to the royalty rate agreed, though withdrawn after signing a patent agreement: Botteman and Patsa [2013] 359-360.

theories of harm, or, as with standard-essential patents in *Motorola* and *Samsung* [2014], to bring concurrent Article 7 and 9 proceedings. There would be at least one fully-reasoned decision for businesses to internalise and which may eventually be authoritatively considered by the EU Courts through subsequent review of its legality.<sup>339</sup> But short of a legislative reformulation of Regulation 1/2003, there is no means to currently *compel* the Commission to do so.

Another possibility would be for the EU Courts to intensify the review of Article 7 prohibition decisions. It has commonly been noted that the discretion in commitment decisions is most effectively restrained not by Courts but by investigated firms, who can always question its enforcement activity by forcing it into a formal prohibition decision.<sup>340</sup> Why this does not happen more frequently, and whether multinational business empires *really* succumb to the worst excesses of the Commission's discretion - novel abuses, superficial substantiation, extreme outcomes - to enjoy a quieter life and save a few Euros, is open to debate.<sup>341</sup> The perception, at least, that the EU Courts afford deference to the Commission's complex appraisals in prohibition decisions, and perhaps the legal norms themselves, has already been noted. Maybe even the most powerful firms prefer the 'known sacrifice' of Article 9 to the perceived difficulty of overturning the inevitable Article 7 prohibition decision before the Courts.<sup>342</sup> Admittedly, substantiating such an explanation for the prevalence of commitment decisions would require a great deal of deeper research. But it is at least conceivable as a possibility that the perception of lax judicial review by the EU Courts of formal infringement decisions has failed to provide businesses with a meaningful alternative to humouring the Commission in commitment decisions.<sup>343</sup> Putting to one side the *Alrosa* saga, the EU Courts can be forgiven for a practical lack of opportunities to restrain this discretion through *direct* review of commitments. Still, they may be *indirectly* implicated in this systemic degradation of normative comprehensibility in EU competition policy through failures elsewhere to meet the role envisaged by the formal rule of law ideal.

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<sup>339</sup> Whish [2014].

<sup>340</sup> Sousa Ferro [2005] 459; Cook [2006] 222; Wils [2006] 352; Svetiev [2014] 484; Wathelet [2015] 553. cf Ratliff [2008] 311; Dunne [2014] 437 (the substantial incentives might sway commitments on borderline or even legal conduct).

<sup>341</sup> Similarly: Wagner-Von Papp [2012] 944-948.

<sup>342</sup> Forrester [2008] 647; Ibáñez Colomo [2013] 406; Jenny [2015] 721-722 ('not offering such commitments is necessarily a losing strategy').

<sup>343</sup> Gerard [2011]; Jenny [2015] 722-723.

## **V. Conclusion**

The history and contemporary nature of competition enforcement demonstrates that the Commission has often been able to achieve its policy goals very effectively. Like many administrative decision-makers, it has frequently pushed the boundaries of the possible, securing for itself the widest discretion to scrutinise the competitive consequences of a broad array of market practices, while sometimes acquiring radical remedial outcomes. Regardless of whether one condones the various aims pursued from time to time through EU competition enforcement, it is difficult to seriously question the sincerity of the Commission's endeavours towards them; its close oversight of potentially problematic joint venture agreements, rebate schemes, and the variety of practices scrutinised through Article 9 commitment decisions, have all been genuinely motivated by a desire to make markets work "better" and to secure significant consumer "benefits".

Nevertheless, this chapter has argued that the efficacy with which these ends are realised in EU competition policy through the exercise of administrative discretion has been at the expense of normative comprehensibility for businesses. It represents a means of market intervention that disregards the political and economic desirability of the formal rule of law ideal. The Commission has at times aimed to avoid the restraint and rigidity of determining legality through the application of generalised norms that afford legal certainty to firms. It has skewed substantive legal concepts (eg restrictions under 101(1), loyalty and quantity rebates) and preferred particular decision-making procedures (eg Article 101(3) exemptions, commitment decisions) to expand the potential for discretionary market interventions in an *ad hoc*, subject-specific manner as and when it sees fit. Furthermore, the examples considered in this chapter cast doubt on whether the EU Courts have met their role envisaged by the formal rule of law ideal. Judicial review has not always produced rigorous scrutiny of Commission decisions. Nor are they guaranteed instances of the Courts prospectively formulating generalised norms for determining legality to restrain the Commission's discretion and afford some certainty to businesses. Indeed, the case law on rebates under Article 102 suggested a deferential approach to developing the law itself, instead affording legal legitimisation to the Commission's discretion-building decisional practice. But even in the example offered of the CJEU holding the Commission's method of market intervention to account - agreements necessitating effects-based analysis under Article 101(1) - the Court *still*

failed to approximate the formal rule of law, instead supplanting one unstructured means of determining legality through particularistic, incomprehensible analysis for another.

In short, EU competition enforcement has sometimes prioritised the effective, perfected pursuit of its policy ends through unstructured market interventions, while disregarding the negative consequences of this means of market intervention in terms of normative certainty. Put differently, approximating the formal rule of law ideal of generalised, comprehensible norms for determining legality would require a means of market intervention *less* effective at securing the ends of competition policy. The rule of law champions policy imperfection. Of course, an absolute, formally-unbridled authority *could* perfectly deliver society's ends (efficiency, equity, integration, etc), as the Commission's discretion in commitment decisions may well demonstrate. But given the political and economic detriments of *ad hoc* determinations and widespread legal uncertainty, the formal rule of law is an ideal content to settle for *prima facie* less, but ultimately more: the optimal combination of effective ends *and* desirable means in the inevitable trade-off between the two. This has not been the case for the enforcement activity considered in this chapter.

Nevertheless, there are examples of such a rival logic operating within EU competition policy. Whether deliberate or serendipitous, numerous aspects of EU market intervention *can be* interpreted as reasonable attempts to imperfectly synthesise effective, economically-sophisticated, and efficiency-focused ends, with a means aspiring towards the formal rule of law ideal of applying more generalised norms that are comprehensible to businesses.

# Chapter VI: *Ex Ante* Optimisation of Efficiency and the Rule of Law: Celebrating Imperfection in EU Competition Policy

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## I. Introduction

In merely recommending the desirable *means* of market intervention, the formal rule of law can come to be disregarded by *ad hoc*, subject-specific, incomprehensible normative determinations in the very effective pursuit of *any* conceivable end. The previous chapter demonstrated as much. Whether driven by economic freedom, market integration, environmental protection, energy policy, or any other outcome, the Commission has sometimes pursued noble ends through problematic means, circumventing the restraint that generalised, comprehensible norms for determining legality provide. This departure from the formal rule of law is compounded if courts fail to incisively review administrative decision-making or prospectively formulate norms that structure discretion.

The same is true of market interventions to maximise efficiency, where the basic goal is to permit practices that result in efficiency and prohibit conduct that results in inefficiency. This end of competition enforcement has a particularly tense relationship with the means of determining legality through applying generalised norms. *Perfectly* categorising the efficient as “legal” and the inefficient as “illegal” with absolute accuracy can *only* be achieved by *ad hoc*, conduct-specific analysis of the consequences of the instant business practice on the specific market. This is the core tenet of contemporary competition microeconomics: the particular context of conduct is critical to understanding its efficiency, so nothing can ever be deemed inherently pro- or anticompetitive.<sup>1</sup> As a result, determining legality with any degree of abstraction from the investigated case is to necessarily realise the end of efficiency maximisation imperfectly; the efficient will be prohibited and the inefficient will be permitted. And

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<sup>1</sup> See Chapter I, Section III.C.

that is exactly the means advocated by the formal rule of law to provide normative clarity to legal subjects.

The choice is stark: either market interventions attempt to *perfectly* maximise efficiency via a means formally indistinguishable from the exercise of absolute discretion; or they aspire to determinations of legality through the application of *imperfectly* generalised norms affording legal certainty to businesses.

Although commentators have commonly advocated the former, the purpose of this chapter is to demonstrate and celebrate instances where EU competition law has chosen the latter, the *imperfect* realisation of efficiency maximisation. The restraint of determining legality through generalisations of varying degrees (rules, presumptions, multi-stage tests) for certain types of conduct has afforded a greater deal of normative certainty for businesses than the fetishisation of pure, unstructured effects-based analysis. Such modesty is *not* to abandon the end of efficiency or engage in anti-economic “formalism”. It simply envisages a different relationship between law and economics in competition policy; one of *optimisation*, endeavouring towards the maximal combined reconciliation of economically accurate ends - permitting the efficient, prohibiting the inefficient - *and* a means that seeks to approximate the formal rule of law ideal. The absolute realisation of one will often be highly injurious to the other. But rather than a black or white, all or nothing view of this inevitable trade-off between means and ends, intermediate positions are available; economic learning can be incorporated *ex ante* into the design of generalised tests for determining legality that also afford normative comprehensibility to market actors. The characterisation of the individually efficient as legal and the inefficient as illegal will necessarily be imperfectly accurate, but the task is to minimise these errors without abandoning aspirations towards generalised and clear legal obligations. If the desiderata of efficiency-focused EU competition enforcement and the formal rule of law are to be pursued simultaneously, the best that can be hoped for is such imperfection.

Section II will briefly recount the history of “perfectionism” and “optimisation” in EU competition scholarship. Although the former has been dominant since the 1960s, often advocating the wholesale adoption of the CJEU’s unstructured effects-based method for determining legality, the logic of optimisation has come to prominence under the banner of a “Neo”-Chicago approach. Despite the prefix, this attempt to incorporate

economic wisdom into the *ex ante* design of generalised norms that are comprehensible to businesses, thereby approximating the formal rule of law ideal, is indistinguishable from the “old” Chicago School approach, and can also be extrapolated from Ordoliberalism, as was considered in Part I.

In contrast to the disregard for the desirability of the formal rule of law evidenced previously, the bulk of this chapter will analyse various aspects of EU competition policy that can be interpreted as commendable efforts to optimise efficiency-focused ends and legal certainty through positing norms of varying degrees of generality. Section III will consider: the diverse forms for determining legality proposed in the Commission’s soft law documents; the presumptions of legality formulated by the CJEU that restrain the Commission’s ability to intervene; presumptions of illegality pursuant to Article 101 and 102, focusing particularly upon the form-based institutional clash in *AKZO* and the CJEU’s important ruling in *Cartes Bancaire*; and finally more intermediary, discriminating means to determine lawfulness through cumulative stages of legal analysis, as represented by the “new” block exemption regulations and the varying tests for finding refusals to deal an abuse of dominant position.

Each aspect of EU competition policy considered in this chapter has been subjected to fierce critique. In eschewing *ad hoc*, subject-specific analysis in favour of normative generalisations of various degrees, they are unavoidably and inherently imperfect in categorising the efficient as legal and the inefficient as illegal. But such imperfection is what commends rather than condemns these elements of EU competition law. They grapple head-on with the ends/means trade-off, incorporating efficiency considerations into the *ex ante* design of generalised norms for determining legality that structure decision-making to thereby afford normative comprehensibility to market actors. Although not always constituting *the* optimal reconciliation between effective ends and clear means, in contrast to the unstructured, unpredictable forms of market intervention detailed in the previous chapter, they represent a more compromising relationship between efficiency-focused enforcement and the formal rule of law in EU competition policy.

## II. Efficiency “Perfectionism” and “Optimisation” in EU Competition Scholarship

Although the desirability of a “more economic” approach has been a recurrent motif of criticism directed at EU competition law for decades, it is not obvious what this actually entails. While there seems to be a general consensus that efficiency ought to be the exclusive goal of market interventions, there are multiple ways in which such an end can be incorporated into determining the legality of market conduct. Rather than *a singular* “more economic” approach, it is more accurate to speak of a variety of “more economic” *approaches*.<sup>2</sup> The result of such an oversight in EU competition scholarship has been advocacy of one particular conceptualisation fundamentally incompatible with the formal rule of law ideal: *efficiency perfectionism*. But abandoning aspirations towards the desiderata of determining legality via generalised norms that are comprehensible to businesses need not necessarily result from advocating a “more economic” form of EU competition enforcement. The logic of *optimisation* recommends itself as an admirable attempt to imperfectly reconcile legitimate means and effective ends. Although a minority perspective in the history of EU competition commentary, its more recent resurgence belies deeper conceptual roots.

### A) Efficiency Perfectionism: Effective Ends and Problematic Means Redux

The logic of efficiency perfectionism is as follows: to prohibit inefficient and permit efficient market conduct with absolute accuracy on the basis of sophisticated economic research, it is necessary to determine legality through *ad hoc*, particularistic, conduct- and market-specific analysis of its efficiency consequences; the restraint and rigidity of market intervention via applying generalised normative obligations necessarily detracts from such perfect separation between competitively “good” and “bad”, and therefore should be sacrificed in the pursuit of the end of efficiency maximisation on markets with maximum efficacy.

As discussed in the Introduction,<sup>3</sup> it is possible to interpret the writing of a number of scholars as advancing such an argument. René Joliet’s 1967 *The Rule of Reason in Antitrust Law* favoured EU adoption of the US rule of reason,<sup>4</sup> which he interpreted as legal prohibition on the basis of ‘factual analysis, on a case-by-case basis, in the light of

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<sup>2</sup> For rare recognition of this in the EU “modernisation” process: Witt [2016].

<sup>3</sup> See text accompanying fn 4-15.

<sup>4</sup> For discussion of the rule of reason: Chapter II, Section III.

economic investigation'.<sup>5</sup> Its virtue lay in the accuracy of the flexible standard, able to perfectly discriminate between efficient and inefficient business conduct in particular instances for deciding illegality.<sup>6</sup> In contrast, he denounced the Commission's preference for 'general and abstract rules' over 'economic investigation' and 'proceeding on a case-by-case basis',<sup>7</sup> attributable to a Germanic fascination with legal predictability.<sup>8</sup> Joliet considered such a 'lack of flexibility' and overreliance upon simple presumptions of harm to be the original 'major defect' of EU competition law.<sup>9</sup> And although he recognised the inescapable tension between perfectly prohibiting inefficient conduct and a means injurious to normative comprehensibility<sup>10</sup> - that *ad hoc* determinations of legality were a 'burdensome task' and businesses appreciated 'clear-cut rules of thumb' - Joliet deemed 'a certain amount of uncertainty' simply unavoidable in competition policy.<sup>11</sup> His preference was for a means of enforcement that constituted 'an economic investigation into each factual situation', thus deciding lawfulness through 'the collection of economic data' on the specific consequences of the act.<sup>12</sup>

This baton of admiration for *ad hoc*, particularistic determinations of legality that can accurately sift efficient from inefficient, and distaste for imperfectly generalised, simplistic norms in EU competition law, has been passed between many scholars since the 1960s: Korah's rallying against 'formalist reasoning' as opposed to close analysis of the particular effects of market conduct on competition;<sup>13</sup> Kon's critique of the 'rather mechanical and rigid' reliance on presumptive prohibitions, thereby overlooking the 'live economic significance of an agreement' specifically in question;<sup>14</sup> constant references to the ability of the US rule of reason standard to discern individual efficiency consequences and calls for its European transplantation;<sup>15</sup> and Hawk's influential condemnation of EU law on vertical restraints as categorisation and 'conclusory

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<sup>5</sup> Joliet [1967] 184.

<sup>6</sup> *ibid* 6-7, 63, 113-114 ('to ascertain when a restraint of trade has actually produced, or is intended to produce, an excessive anticompetitive effect on the market.').

<sup>7</sup> *ibid* 9, 66.

<sup>8</sup> *ibid* 76.

<sup>9</sup> *ibid* 10, 64-66 (limiting rigid and mechanical presumptions to price-fixing and boycotts).

<sup>10</sup> *ibid* 8.

<sup>11</sup> *ibid* 10. See also: 43, 63 (presumptions ease adjudication by making the law 'simpler and more certain').

<sup>12</sup> *ibid* 170-171. See also: Salzman [1979] 54; Vestryng [1984] 680.

<sup>13</sup> Korah [1993] 148. See also: Horspool and Korah [1992] 385.

<sup>14</sup> Kon [1982] 554.

<sup>15</sup> Van Bael [1980] 45; [1983] 75; Schechter [1982] 13; W Collins [1983] 516-520; Hawk and Victor [1985] 626; Jeanrenaud [1986] 36; Hawk [1988] 53; Frazer [1990] 618.

reasoning', rather than determining legality through rigorous 'economic analysis of a *particular* agreement or practice, i.e. its competitive harms and benefits'.<sup>16</sup>

In their defence, many of these scholars were reacting to the Commission's overbroad reading of Article 101(1) to thereby maximise the scope for its discretionary granting of exemption decisions. Still, recourse to *ad hoc* normative determinations was not the only way in which to limit the scope of paragraph (1).<sup>17</sup> Furthermore, this perspective has continued to be popular during the period of procedural modernisation through Regulation 1/2003 decentralising the application of Article 101(3), and subsequent Commission endeavours to substantively modernise via soft law documents. With regard to Article 101, Siragusa argued in the discussions on the future of enforcement that the legality of competitive restrictions must be determined through a '*sui generis* "rule of reason approach"'.<sup>18</sup> Competition decision-makers should attribute liability only by considering the counterfactual and balancing positive/negative efficiency consequences.<sup>19</sup> Save for a single rule prohibiting naked cartels as restrictions by object,<sup>20</sup> all other generalised, simplistic presumptions - including those of legality -<sup>21</sup> were necessarily imperfect and inaccurate tools for distinguishing between instances with efficient and inefficient market consequences, and should therefore be scrapped.<sup>22</sup> During the Article 102 modernisation process, a group of economists essentially advocated the same *ad hoc*, subject-specific method for determining the legality of conduct by dominant firms: an 'economics-based approach will naturally lend itself to a "rule of reason" approach',<sup>23</sup> defined as 'a careful examination of how competition works in each *particular* market in order to evaluate how *specific* company strategies affect consumer welfare'.<sup>24</sup> Any concessions to normative certainty through accepting comprehensible, generalised presumptions of legality or illegality, running 'counter to the economics of the cases', were considered the imposition of 'an uncomfortable

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<sup>16</sup> Hawk [1995] 984-986 (emphasis added).

<sup>17</sup> See Section III.B on presumptions of legality.

<sup>18</sup> Siragusa [1997] 547-548.

<sup>19</sup> *ibid* 548-549.

<sup>20</sup> *ibid* 548.

<sup>21</sup> Presumptions of legality and block exemption regulations are discussed in Section III.B and D.i.

<sup>22</sup> Siragusa [1997] 550.

<sup>23</sup> EAGCP [2005] 3.

<sup>24</sup> *ibid* 1 (emphasis added).

“straight jacket”, hindering the perfect sifting between conduct permitted as efficient and prohibited as inefficient.<sup>25</sup>

Given this perspective, it is unsurprising that the CJEU’s rulings on finding restrictions by unstructured effects analysis in *STM* [1966], *Brasserie de Haecht* [1967], and *Delimitis* [1991]<sup>26</sup> are often championed by these commentators as the gold-standard for determining legality, not just pursuant to Article 101,<sup>27</sup> but also as the appropriate means for characterising conduct as abusive under Article 102.<sup>28</sup> The last chapter detailed how these cases ruled that the illegality of certain types of agreement was to be evaluated through a rigorous, thorough, and far-reaching consideration of their nature, actual market context, and envisaged competitive consequences.<sup>29</sup> Without doubt, market intervention via *ad hoc*, particularistic normative determinations concerning individual agreements represents the most effective means to realise the end of perfectly prohibiting the inefficient and permitting the efficient.<sup>30</sup> The “more economic” sophistication of the law is reflected *ex post* in its potential for accurate sifting between the competitively “good” and “bad” in each instance. If the legitimacy of competition enforcement is only appraised on the basis of the desired end of maximising consumer welfare, pure effects-based analysis clearly scores highly in terms of its effectiveness for realising this end.

But efficiency perfectionism’s preferred means to determine legality also represents a form of market intervention simply incapable of offering normative comprehensibility to businesses, falling far short of the rule of law ideal.<sup>31</sup> Admittedly, in these cases the CJEU forced the Commission to abandon its discretion to grant Article 101(3) exemptions. It has no active choice as to whether conduct is presumed legal or illegal pursuant to Article 101(1) if the deeper effects analysis reveals that there has or has not been a restriction of competition. Nevertheless, the two means of market intervention are formally indistinguishable: both discretionary enforcement and entirely unstructured

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<sup>25</sup> *ibid* 16. See also: CLFA82RG [2005] 182-183.

<sup>26</sup> C-56/65 *Société Technique Minière v Maschinenbau Ulm GmbH* [1966] ECLI:EU:C:1966:38 (“*STM* [1966]”); C-23/67 *Brasserie de Haecht SA v Wilkin (No 1)* [1967] ECLI:EU:C:1967:54; C-234/89 *Delimitis v Henninger Bräu* [1991] ECLI:EU:C:1991:91.

<sup>27</sup> eg *Joliet* [1967] 12, 166, 170-171, 186; M *Waelbroeck* [1991] 115; *Korah* [1994b] 171 (though see text accompanying fn 38-43).

<sup>28</sup> eg *Sher* [2004] 245; *Sinclair* [2004]; CLFA82RG [2005] 180-182; EAGCP [2005] 1-3; *Bishop and Marsden* [2006] 1-4.

<sup>29</sup> See Chapter V, text accompanying fn 92-100.

<sup>30</sup> If the potential for decision-making errors is overlooked.

<sup>31</sup> See Chapter V, text accompanying fn 103-105.

effects-based analysis represent *ad hoc*, subject- and context-specific forms for determining legality, which in circumventing the rigid restraint of generalised norms fail to offer legal certainty to businesses. As suggested in the previous chapter, the normative comprehensibility of EU competition enforcement thus jumps out of the frying pan and into the fire.

This situation is not a necessary corollary of a “more economic” approach to EU competition policy, driven solely by the end of maximising efficiency. A more satisfactory reconciliation with the desirable means of the formal rule of law is possible, albeit necessitating contentment with the imperfect realisation of this singular outcome animating market intervention.

#### *B) Efficiency Optimisation: Imperfect Ends and More Comprehensible Means*

An efficiency optimisation approach recognise head-on the inherent, unavoidable tension between the end of accurately condemning conduct resulting in inefficiency or permitting that occasioning efficiency, and the valuable means of aspiring to determine legality through generalised, equally-applicable norms that afford legal certainty to businesses. But rather than prioritising the perfection of the former and disregarding the latter, the logic is to seek the optimal reconciliation of imperfect ends with approximating the means of the formal rule of law. This is achieved through the *ex-ante* incorporation of economic sophistication into the design of generalised norms (rules, presumptions, structured multi-stage analyses) for determining legality.

To give a stylised illustration, the pursuit of efficiency perfectionism with absolute, 100 per cent enforcement accuracy through purely *ad hoc* determinations of legality for resale price maintenance (manufacturers fixing the retail price) in individual instances is to abandon the desideratum of legal certainty. Alternatively, a universal *per se* rule of illegality for resale price maintenance may only be accurate in prohibiting inefficient conduct in, say, half of the individual instances included within its scope, but scores very highly in terms of normative comprehensibility. This might be considered too much of a sacrifice of the end of efficiency-focused enforcement to the formal rule of law. As a result, the rule of *per se* illegality could be swapped for a presumption with distinct exceptions, or a more discerning three-stage test based upon the economic consensus as to factors rendering inefficiency more likely; normative generality and comprehensibility would be slightly diminished to secure a more accurate,

discriminating prohibition of inefficient conduct in 80 per cent of instances. The end of efficiency-maximising competition policy is still realised imperfectly, as is the formal rule of law ideal. But the logic of optimisation is to strive for the *greatest possible combination of means and ends* through using economic wisdom to propose more and less discerning forms - rules, presumptions, structured tests - for determining legality as effectively as possible whilst also approximating the ideal of norms comprehensible to businesses.

Efficiency optimisation has generally been a minority position in EU competition scholarship. Some commentators have explicitly addressed the trade-off between accurately realising the efficiency-maximising end of market intervention and the means characterised by the formal rule of law,<sup>32</sup> thus exploring intermediate tests founded upon economic research into the indicators of likely efficient and inefficient consequences.<sup>33</sup> Defending the desirability of imperfect intervention through applying generalised but comprehensible norms has, over the decades, crystallised into a series of recurrent themes: that businesses are 'irritated' by an unclear divide between legality and illegality, chilling efficient conduct beneficial to consumers;<sup>34</sup> that steps towards realising the formal rule of law ideal represent a welcome restraint upon a competition authority's discretion to intervene in an unpredictably *ad hoc* and particularistic fashion, while easing administrative burdens;<sup>35</sup> that the US Courts have struggled with the rule of reason standard and have developed simpler norms;<sup>36</sup> and that Member State courts may be ill-suited to hyper-factual analyses for determining legality.<sup>37</sup> Given her long-term advocacy of effects-based determinations of legality,<sup>38</sup> Valentine Korah's frosty response to the unstructured analysis posited by the CJEU in *Delimitis* is especially notable. The test was 'not an easy one for national courts to apply' and it was

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<sup>32</sup> Vestrynge [1984] 689-690; Venit [1987] 42; Faull [1997] 503; Jenny [1998] 193; Bishop [2000] 55-63; Boscheck [2000] 7-8; Hawk and Denaeijer [2000] 130, 136; Nicolaides [2000] 10-11; Bruzzone and Boccaccio [2009] 466-467.

<sup>33</sup> Fox [1982] 162 (on ATP); Claydon [1986] 192 (on joint ventures); Faull [1997] 506 (on experience-based presumptions of harm; Nicolaides [2000] 10-11, 23; [2005] 134-135, 142-144; Bruzzone and Boccaccio [2009] 467.

<sup>34</sup> Osterweil [1976] 77, 103; Caspari [1987] 356; Whish and Sufrin [1987] 37; Schaub [2000] 252-253; Nicolaides [2000] 9; Röller [2005] 21.

<sup>35</sup> Alexander [1973] 85; Osterweil [1976] 77; Hawk [1980] 41-42; [1995] 975; Whish and Sufrin [1987] 7-8; Black [1997] 149, 151-152.

<sup>36</sup> Gyselen [1984] 653; Schröter [1987] 655; Whish and Sufrin [1987] 7-8; Hawk [1988] 65-69, 73; [1995] 979; Hawk and Denaeijer [2000] 134-137; Van Gerven [2003] 416, 437-438.

<sup>37</sup> Steindorff [1984] 642-644; Whish and Sufrin [1987] 37; Bishop [2000] 55, 61-62; Nicolaides [2005] 144 (on Article 101(3) as a series of presumptive filters to unify national decision-making).

<sup>38</sup> cf Korah [1986a] 85 (acknowledging US courts' difficulty with rule of reason).

problematic that ‘everything seems to be relevant’ for determining legality.<sup>40</sup> Perhaps this was a return to earlier form. Her first EU competition law treatise in 1975 had also critiqued *Brasserie de Haecht*<sup>41</sup> as highly complex and difficult to administer,<sup>42</sup> while basing legality upon an evaluation of ‘the actual, probable, or intended effects of the agreement’ was of substantial detriment to normative comprehensibility for businesses.<sup>43</sup>

As referenced in the Introduction,<sup>44</sup> the logic of efficiency optimisation and endeavours towards ‘economics-based rules of law’<sup>45</sup> have become much more prominent in EU competition scholarship since the millennium. The approach was effectively summarised in a 2005 piece by John Vickers, then Director General of the UK OFT:<sup>46</sup>

*“To say that the law ... should develop a stronger economic foundation is not to say that rules of law should be replaced by discretionary decision making based on whatever is thought to be desirable in economic terms case by case. There must be rules of law in this area of competition policy, not least for reasons of predictability and accountability. So the issue is not rules versus discretion, but how well the rules are grounded in economics... To be effective, however, economics must contribute in a way that competition agencies, and ultimately the courts, find practicable in deciding cases.”*

In recent years efficiency optimisation has come to be styled as the “Neo”-Chicago approach.<sup>47</sup> David Evans, Jorge Padilla, and a rotating cast of co-authors have advocated incorporating economic consensus positions on likely efficiencies into legal norms that may also approximate the formal characteristics of the rule of law ideal. The “Neo”-Chicagoans attribute the rise of efficiency perfectionism and its determinations of legality through *ad hoc*, particularistic analysis to the evolution of competition microeconomics since the 1980s: the Post-Chicago School’s absorption of various methods and tools from an array of sub-disciplines (eg game theory, econometrics, behavioural economics) stressing the importance of context for determining whether actual business practices have a positive or negative market impact.<sup>48</sup> In highlighting the hypothetically possible over the reasonably likely to justify market intervention via

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<sup>40</sup> Korah [1992b] 171-173.

<sup>41</sup> *Brasserie de Haecht* [1967].

<sup>42</sup> Korah [1975] 232.

<sup>43</sup> *ibid* 255.

<sup>44</sup> See text accompanying fn 20.

<sup>45</sup> Motta [2009] 595.

<sup>46</sup> Vickers [2005] F260. Favourably cited by: Röller [2005] 21; Motta [2009] 596. Note that this thesis does not consider unstructured effects-based analysis to be an exercise in administrative discretion but agrees that the formal case-by-case means for determining legality are nevertheless indistinguishable.

<sup>47</sup> Evans and Padilla [2005] 74-75.

<sup>48</sup> See Chapter I, Section III.C, and Chapter II, text accompanying fn 158-164.

individualised decision-making that could *theoretically* achieve absolute economic accuracy, the *practical* reality of perfectionism is often one of substantial decisional error by agencies and courts,<sup>49</sup> as well as normative uncertainty for legal subjects.<sup>50</sup> Their preferred approach is to bring the valuable insights of economics into EU competition law *ex ante* at the stage of normative design,<sup>51</sup> indicating the appropriate prior beliefs – on the likelihood of efficiencies, inefficiencies, administrative and error costs in implementation – to find the optimal generalised form (eg *per se* rules, presumptions, structured tests)<sup>52</sup> for market intervention against particular business practices, each approximating the end of accurate efficiency-maximisation and normative certainty to a varying degree.<sup>53</sup> The result is a system of more and less ‘differentiated’ norms for determining legality.<sup>54</sup>

Although a prominent contemporary example of the logic of efficiency optimisation in EU competition scholarship, there is nothing “neo” about “Neo”-Chicago; it represents a method of economically-informed market intervention indistinguishable from the original Chicago School itself.<sup>55</sup> This is why the frequent implication that the Chicagoans offer inspiration for *ad hoc*, particularistic determinations of legality in Europe, reminiscent of the rule of reason standard in US antitrust, are wide of the mark.<sup>56</sup> When closely analysing the writing of Bork, Posner, and Easterbrook, it was clear that their approach was to combine a foundational commitment to efficiency as the sole *end* of antitrust, but a *means* of intervention that aspired towards generalised and equally-applied norms where the boundaries between legality and illegality were comprehensible to businesses.<sup>57</sup> Easterbrook especially highlighted the trade-off

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<sup>49</sup> Evans and Padilla [2005] 74, 79-80. See also: Evans, Padilla, and Polo [2002] 511; Evans, Padilla, and Salinger [2003] 560, 567-568; Ahlborn, Evans, and Padilla [2004] 330, 337 (Although the best legal test ‘perfectly ferrets out anticompetitive ties from procompetitive ones’, decision-makers ‘are only human and make errors.’); Evans [2005] 95-96. Similarly: Maier-Rigaud [2006] 99-100 (economics ‘has focused on case-by-case analysis’ rather than principles informing ‘competition rules designed to be as general as possible’).

<sup>50</sup> Evans [2005] 93. On the importance of normative certainty: Evans and Grave [2005] 136; Evans and Padilla [2005] 74.

<sup>51</sup> Evans and Padilla [2005] 80 (on using economics to design administrable norms that minimise uncertainty and maximise efficiency); Evans and Grave [2005] 136.

<sup>52</sup> Referenced throughout their writing, eg: Ahlborn, Evans, and Padilla [2004] 337; Evans [2005] 94.

<sup>53</sup> Evans and Padilla [2005] 85; Evans [2005] 95-96. Similarly: Röller [2005] 11 (Not a question of “more” or “less” economics’ but how ‘economic analysis is used’); Christiansen and Kerber [2006]; Maier-Rigaud [2006] 99-100 (economics should investigate ‘what effects are likely to be produced under what circumstances’); Bruzzone and Boccaccio [2009] 484; Katsoulacos and Ulph [2009]; Motta [2009] 595-596 (using economics ‘to provide simple and easy-to-administer rules.’).

<sup>54</sup> Christiansen and Kerber [2006] 240-241.

<sup>55</sup> As also argued by: Kobayashi and Muris [2012] 147, 155; Wright [2012] 250-251.

<sup>56</sup> See citations in Chapter II, fn 10 and 105. cf recognition of their preference for clear and administrable presumptions: Hawk [1995] 979; Boscheck [2000] 28; Hawk and Denaeijer [2000] 134-137.

<sup>57</sup> See Chapter II, Section III.

between economically-perfect enforcement and the formal rule of law ideal, proposing intermediate positions that aimed to optimise both desirable characteristics of competition policy. The analysis of the “Neo”-Chicagoans is arguably more rigorous in articulating the method for reconciling means and ends. But their conceptualisation of the most appropriate relationship between law and economics in competition policy, and the idealised form of market intervention, is nevertheless almost identical.

But just as the prefix “Neo” is contestable, so too is the “Chicago” element. It was argued in Chapter III that the Ordoliberal approach to competition law has often been mischaracterised. Rather than anti-efficiency structuralists, driven by the pursuit of “economic freedom”, the substance of Ordoliberal policy was more ambiguous, frequently indicative of efficiency as the goal of competition, and more generally to be guided by current economic wisdom. At the same time, it was extrapolated from links between Ordoliberalism and the Kantian-*Rechtsstaat* tradition that they would expect market intervention by the independent monopoly office to entail the enforcement of general and comprehensible norms. In combining these two elements, it is reasonable to argue that Ordoliberal competition policy *also* advocated optimisation of means and ends: the incorporation of economic research into the *ex ante* design of generalised rules, presumptions, or structured tests that clearly and comprehensibly delineate legality and illegality.<sup>58</sup>

In short, the virtue of the optimisation approach to competition policy is that it grapples head-on with the tension between the end - the accurate categorisation of in/efficient conduct as il/legal - and means of enforcement - the formal rule of law ideal, where generality is connected to normative comprehensibility. Unlike the dominant perfectionist strand, it attempts to imperfectly realise both desiderata to the greatest possible extent through *ex ante* normative design, selecting the most appropriate level of generalisation (rule, presumption, structured test) to foster legal certainty without inflicting excessive harm to efficient business practices.

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<sup>58</sup> Argued by: Möschel [1989] 153-154; Herrera Anchustegui [2015] 164-165.

### III. Optimising Ends and Means in EU Competition Law

If the various forms for determining the legality of business practices were sorted from most to least “generalised” – or least to most “discriminating” – it might go as follows:<sup>59</sup>

- *Per Se* legality/illegality
- Presumptive legality/illegality with clear and specific exceptions
- Presumptive legality/illegality with the possibility of a generalised justification<sup>60</sup>
- Multi-stage test of legality/illegality with clear and specific stages
- Multi-stage test of legality/illegality with broader, more context-specific stages
- *Ad hoc*, context-specific evaluation of legality/illegality with indicative factors
- *Unstructured ad hoc*, context-specific evaluation of legality/illegality (eg *STM, Delimitis*)

Albeit highly stylised, this order captures the variable trade-off between the effective pursuit of ends and the restraining, rigidifying form of the rule of law. As one moves down the list, the means for determining legality becomes more flexible, better able to accurately categorise the efficiency consequences of *individual* instances of market conduct as warranting permission or prohibition. The last form of market intervention, unstructured, context-specific evaluation, is the only one capable of perfectly categorising the actually efficient/inefficient as legal/illegal; all other approaches are necessarily imperfect in constituting varying degrees of generalisation, representing divergent levels of rigidified decision-making. However as one moves towards the top, the means better approximate the formal rule of law ideal, as ever more imperfect economic accuracy that affords greater normative clarity to businesses. The optimisation approach is one that seeks to use the economic consensus to find the appropriate generalised form for determining legality that produces the greatest combination of accurate efficiency maximisation and approximation of normative comprehensibility.

The following sections will demonstrate that a number of aspects of EU competition law can be interpreted as reflecting this logic of optimisation, determining legality in a manner that overall reflects a sophisticated understanding of the efficiency consequences whilst also endeavouring as far as possible to constitute general,

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<sup>59</sup> Of course, this list represents a rather artificial separation of forms that frequently blend into each other in practice. For similar “Neo”-Chicagoan forms: text accompanying fn 52

<sup>60</sup> eg Article 101(3) or ‘objective justification’ under Article 102.

comprehensible norms. It can be argued A) that the Commission's soft law modernisation documents themselves suggest a commitment to blending a variety of forms for determining the legality of specific types of market conduct, ranging from more to less efficiency-differentiating, more to less compliant with the formal rule of law. On specific instances of optimisation in action, the subsequent discussion will essentially move down the list of forms from least to most discriminating, considering: B) the CJEU's case law establishing rules of *per se* legality outside the scope of Article 101(1); C) the use of presumptions of illegality in Article 101 and 102, and whether the recognition of more narrow, specific exemptions would better optimise efficiency-maximisation *and* legal predictability; and finally, D) more complex, discriminating multi-stage tests for legality, as evidenced by the block exemption regulation and the test for abusive refusals to deal. Whether each individual instance represents the optimal reconciliation of means and ends is open to discussion. Nevertheless, the examples analysed can be taken as at least reasonable attempts within EU competition policy to maximise market efficiency whilst approximating the desiderata of the formal rule of law.

#### A) *Mixing Forms of Market Intervention: The Commission's Soft Law Guidelines*

The previous chapter argued that the Commission's understandable desire to pursue its ends with utmost effectiveness, unbridled by the normative restraint and rigid predictability reflected in the formal rule of law ideal, continues into the post-modernisation era. Article 9 commitment decisions afford the Commission a discretion to flexibly and unforeseeably change *any* market conduct it dislikes. They represent an extreme example of a perfectionist approach to enforcement, regardless of which policy ends it ultimately chooses to realise through market interventions.

The logic of commitment decisions contrasts with the approach reflected in the Commission's attempts at substantive modernisation through the promulgation of soft law guidance and the "new" style of block exemption regulations.<sup>61</sup> Whether a deliberate rationalising exercise by the Commission, a mirror of the diverse case law of the EU Courts, or (more likely) a mixture of both, the documents distributed since 2000 can be interpreted as constituting a blend of more and less generalised forms for determining the legality of various types of business conduct.<sup>62</sup> Each proposed facet of

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<sup>61</sup> For discussion of block exemptions, see Section III.D.i.

<sup>62</sup> Similarly: Bruzzone and Boccaccio [2009] 484.

EU market intervention may be taken as an attempt to individually calibrate the optimal realisation of its underpinning ends with a means aspiring towards the normative comprehensibility of the formal rule of law ideal. Commissioner Kroes suggested as much in her characterisation of the substantive modernisation of Article 102 as an endeavour for ‘economically sound but also practically workable’ enforcement.<sup>63</sup> This would require implicating sophisticated economic research in the:<sup>64</sup>

*“search for sensible “rules” that would allow us to reach preliminary conclusions about when conduct may be exclusionary, and at the same time allow companies to know when they are on safe ground. Such an approach would have the advantage of being based on solid economic thinking while at the same time would give clear indications to companies and maintain workable enforcement rules.”*

This comes very close to the logic of optimisation, incorporating economic consensus positions *ex ante* into the design of generalised and thus clear norms for determining legality.

Certainly the soft law documents include various gestures that indicate a perfectionist agenda. The *Guidelines on Vertical Restraints* [2000] for Article 101 promised to decide the legality of agreements ‘based on the effects on the market’,<sup>65</sup> and the *Article 102 Guidance* [2009] similarly committed the Commission to analysing conduct by taking into ‘account the specific facts and circumstances of each case’.<sup>66</sup> The guidelines incorporate lengthy and individually indecisive lists of abstract factors that the Commission may consider in reaching *ad hoc*, context-specific decisions on lawfulness.<sup>67</sup> These statements were greeted by some as a positive sign that absolute accuracy in separating the efficient from inefficient was possible, as legality would be determined by ‘an individual and sound assessment of the (likely) effects’,<sup>68</sup> perhaps even amounting to a ‘full-blown rule of reason analysis’ in EU competition law.<sup>69</sup> Indeed, they do at times seem to mimic the method of unstructured effects-based analysis proposed by the CJEU in the likes of *STM* and *Delimitis*, where legal certainty is sacrificed to perfectly-realised ends.

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<sup>63</sup> Kroes [2005] 391.

<sup>64</sup> *ibid.*

<sup>65</sup> *Guidelines on Vertical Restraints* [2000] OJ C291/1 [7]. cf [2010] OJ C130/01 (omitting the reference to ‘an economic approach which is based on the effects on the market’).

<sup>66</sup> *Guidance on the Commission’s Enforcement Priorities in Applying Article [102] of the EC Treaty to Abusive Conduct by Dominant Undertakings* [2009] OJ C45/02 (“Article 102 Guidance [2009]”) [8].

<sup>67</sup> *Guidelines on Vertical Restraints* [2000] [111]-[127]; [2010] [96]-[127]; *Article 102 Guidance* [2009] [19]-[21].

<sup>68</sup> Bourgeois and Bocken [2005] 113.

<sup>69</sup> Van Gerven [2003] 436-437.

But it should be clear from even a cursory glance of the various soft law documents that this means of market intervention is *not* exclusively proposed by the Commission. On the contrary, they cover the entire spectrum of forms of normative generality and administrative restraint for determining the legality of various types of business conduct. In each instance the realisation of accurate efficiency maximisation is traded-off with the formal rule of law ideal to different degrees.

For example, the Commission continues to adopt certain presumptions of illegality. There are still restrictions of Article 101(1) by object, where it is unnecessary ‘to demonstrate any actual effects on the market’.<sup>70</sup> The same is true of presumptive abuses of Article 102,<sup>71</sup> justified as they can ‘only raise obstacles to competition’ and generate no efficiencies so that ‘anti-competitive effect may be inferred’.<sup>72</sup> Specific examples of presumptions include those against absolute territorial protection,<sup>73</sup> resale price maintenance,<sup>74</sup> and pricing below average variable cost.<sup>75</sup> The desirability of *prima facie* findings of illegality will be considered in greater detail below.<sup>76</sup> But with each presumption, the enforcement of EU competition policy is predictably restrained, for better or worse.

At the same time, more discriminating but less comprehensible thresholds for illegality are adopted for certain types of conduct, striking the balance between the accuracy of prohibiting anticompetitive conduct and the desiderata of the formal rule of law in a different way. For instance a refusal to supply will be prohibited as abusive where it relates to something objectively necessary to compete, is likely to lead to the elimination of effective competition, and will probably result in consumer harm.<sup>77</sup> This is an amalgamation of the various, multi-stage legal tests formulated by the CJEU for finding refusals to deal abusive under Article 102. As will be discussed below, the thresholds for determining illegality themselves reflect the economic hesitancy to

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<sup>70</sup> *Guidelines on the Application of Article [101](3) [2004]* OJ C101/97 (“*Guidelines on 101(3) [2004]*”) [21], [23]. See also: *Guidelines on Vertical Restraints [2000]* [7] (omitted in [2010]); *Guidelines on the Applicability of Article [101] of the EC Treaty to Horizontal Cooperation Agreements [2001]* OJ C3/02 [18]; [2011] OJ C11/1 [24]-[25].

<sup>71</sup> Pera [2008] 156 (‘a mixture of structural and efficiency analyses’); Akman [2009b] 78 (‘forms of conduct which justify intervention without an assessment of effects of conduct.’).

<sup>72</sup> *Article 102 Guidance [2009]* [22].

<sup>73</sup> *Guidelines on 101(3) [2004]* [23].

<sup>74</sup> *Guidelines on Vertical Restraints [2000]/[2010]* [223].

<sup>75</sup> *Article 102 Guidance [2009]* [44].

<sup>76</sup> See Section III.C.

<sup>77</sup> *Article 102 Guidance [2009]* [81].

readily compel free-riding on investments, reassuring businesses through a substantively high standard and a *formally* comprehensible, restrictive test.<sup>78</sup>

Finally, there are types of conduct where determinations of legality are closer to the *ad hoc* analysis advanced by the CJEU in its case law on Article 101(1) restrictions by effect, where context and individual efficiency consequences upon the market are key. These instances of possible market intervention place less emphasis upon realising the desirable characteristics of the formal rule of law. For example, the Commission's approach to rebates of various kinds in the *Article 102 Guidance* [2009] lists a substantial number of factors to be considered in the particular market.<sup>79</sup> The flexibility with which it can find individual schemes abusive mirrors its close oversight of "loyalty-inducing" discounts from the pre-modernisation era through holistic analysis of its elements (albeit with a clearer focus upon their efficiency consequences).<sup>80</sup> But in the *Guidance*, the Commission has still attempted to provide at least a degree of normative comprehensibility for businesses by indicating a number of informal, generalised presumptions that will structure its legal analysis in the individual instance: retroactive rebates tend to be more damaging than prospective;<sup>81</sup> discounts set at prices below average avoidable cost are 'as a general rule' abusive as they are capable of foreclosing as efficient competitors;<sup>82</sup> standardised volume thresholds are less problematic than individualised.<sup>83</sup> Of course, none of these are dispositive, guaranteeing that a conclusion of abuse will or will not be reached. Nevertheless, the commendable intention is to simplify and structure the Commission's analysis of their legality, for the benefit of businesses and its own resources. Even these small efforts to marginally approximate the formal rule of law ideal are a considerable improvement over the entirely unstructured effects-based analysis offered by the CJEU in *STM* and *Delimitis*.<sup>84</sup>

It is obvious why the Commission's substantive modernisation through such soft law documents was a disappointment to advocates of efficiency perfectionism in EU competition policy.<sup>85</sup> The guidelines do not wholeheartedly embrace *ad hoc*, particularistic, context- and conduct-specific analysis to determine legality, to perfectly

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<sup>78</sup> See Section III.D.ii.

<sup>79</sup> *Article 102 Guidance* [2009] [20], [37]-[46].

<sup>80</sup> See Chapter V, Section III.A.

<sup>81</sup> *Article 102 Guidance* [2009] [40].

<sup>82</sup> *ibid* [44].

<sup>83</sup> *ibid* [45].

<sup>84</sup> See Chapter V Section II.B.ii.

<sup>85</sup> eg Boscheck [2000] 40-41; Pera [2008] 156; Akman [2009b] 78; Ridyard [2009].

discriminate between individually inefficient and efficient market conduct. There are undoubtedly elements suggestive of such a form of market intervention. But pursuing the end of efficiency maximisation with perfect accuracy across the board is not the intention of these guidelines, which are replete with generalised and comprehensible (or, more negatively, rigid) rules, presumptions, structured multi-stage tests, and indicative factors for findings of illegality. These are necessarily imperfect means for sifting the “bad” from the “good”, and can therefore be interpreted as reflecting the logic of efficiency optimisation: incorporating economic research on the likelihood and indicators of pro- or anticompetitive consequences into the *ex ante* design of norms for determining legality, simultaneously aiming to realise the effective pursuit of efficiency maximisation with a means attempting to approximate the formal rule of law ideal.

It is possible to question whether the particular reconciliation of ends and means for each type of conduct *is* actually optimal, as will be considered in the following sections. But the effort to even give emphasis to the appropriate means for determining legality is significant. It is not just in sharp contrast with the contemporaneous nature of enforcement through the absolute discretion of Article 9 commitment decisions. It also marks a real break with the Commission’s pre-modernisation endeavours to avoid the restraint and rationality-respecting rigidity of the formal rule of law ideal at all costs.<sup>86</sup> The understandable preference for maximising the potential for flexible interventions as and when it deemed necessary, thereby pursuing its policy ends with utmost effectiveness, was detailed in the previous chapter. So what has changed for the approximation of the formal rule of law to seemingly feature so prominently in its documents aiming to modernise the substance of EU competition enforcement? One possible explanation could be *procedural* modernisation, the decentralisation of Article 101(3) as part of Regulation 1/2003. In the absence of compulsory notification, statements of the Commission’s decision-making logic and intentions are a useful complement to formal decisions for businesses wishing to understand the general contours of their normative obligations,<sup>87</sup> even if they do not constitute binding interpretations of the law.<sup>88</sup> Their promulgation may also be an attempt to at least *influence* national authorities and courts towards uniform decision-making. After

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<sup>86</sup> cf Section III.B, where the Commission was the initiator of presumed legality for certain selective distribution agreements.

<sup>87</sup> von der Groeben [1965] 920; Ferry [1979] 12, 14; Forrester and Norall [1984] 15; Hofmann [2006] 169.

<sup>88</sup> eg C-23/14 *Post Danmark A/S v Konkurrenserådet* [2015] ECLI:EU:C:2015:651 (“*Post Danmark II* [2015]”) [52]. On their “soft” or “hard” nature: Hofmann [2006] 162-165. On case law inconsistency (eg margin squeeze): Petit [2009] 500.

decades of avoiding the restraint and rigid regularity of determining legality through the application of generalised norms, as envisaged by the formal rule of law, it would be somewhat ironic if the Commission wished to achieve a comparable result vis-à-vis *other* decision-makers, by publishing a series of reasonably comprehensible enforcement norms to secure consistent and predictable enforcement of competition policy throughout the Union.

*B) Presumptions of Legality under Article 101*

Examples from the previous chapter did not depict the EU Courts in the most flattering light from the perspective of the formal rule of law. There is a live debate about whether judicial scrutiny of legal characterisations of facts is too superficial, and it could be argued that the Courts have occasionally failed to prospectively develop generalised norms for determining legality, setting boundaries to the Commission's power to intervene and affording legal certainty to businesses. Yet even when the Courts *did* take leadership over the substance of the law of Article 101(1) to restrain the Commission's discretion to exempt agreements, insisting upon robust, effects-based analysis, this itself neglected to approximate the rule of law ideal. Instead, cases such as *STM* and *Delimitis* substituted one instance of determining legality through unstructured, particularistic, unpredictable analysis for another.

But this was not the only method by which the CJEU recognised the positive efficiencies of particular agreements and clauses to limit the scope of Article 101(1). In an important line of cases from the late 1970s to the 1990s, the Courts incorporated sophisticated understandings of efficiency consequences on competitive restrictions *ex ante* into the design of generalised presumptions of legality that closely approximate the formal rule of law ideal. This method of market intervention reflects the logic of optimisation: economic literature suggests that particular *prima facie* restrictions – common contractual clauses or certain types of agreement - are necessary for generally pro-competitive outcomes, and therefore to promote normative comprehensibility they ought to be prospectively excluded from the scope of the Article 101(1) prohibition. The CJEU essentially married sophisticated first-principles on the high likelihood of efficient outcomes with simple but imperfect presumptions of legality. This represents a very different means for determining the legality of collusion from unstructured analysis of

its specific consequences on the market,<sup>89</sup> illustrating the logic and benefits of an optimisation approach to EU competition policy.

In *Metro I* [1977] the CJEU endorsed the Commission's uncharacteristic stance in the 1970s towards selective distribution agreements ("SDAs") based on qualitative admission criteria. Rather than over-expansive norms under Article 101(1) and *ad hoc*, subject-specific exemption pursuant to (3) that typically constituted pre-modernisation enforcement,<sup>90</sup> the Commission actually tended to find SDAs for luxury or technical products *outside* of Article 101(1) altogether.<sup>91</sup> It did so for an SDA permitting only specialist electronics dealers on stringent but 'general qualitative criteria' in *SABA* [1976].<sup>92</sup> As an excluded supermarket retailer, Metro challenged this relaxed stance.<sup>93</sup> The CJEU agreed with the Commission in finding that SDAs should not fall under Article 101(1) so long as the nature of the product necessitated selectivity, the criteria adopted were qualitative, objective, non-discriminatively applied, and were no more demanding than necessary for the product in question.<sup>94</sup> The Court's reasoning mimicked the largely positive tenor of economic literature on non-price inter-brand competition, using qualitative criteria to guarantee a level of sales support through restricting intra-brand competition, and to ensure that the brand's reputation is not undermined by discounters.<sup>95</sup>

*Nungesser* [1982] involved a French seed developer providing an exclusive licence to a German firm containing a commitment to not licence for any other firm in Germany, nor to itself export and compete there (an open exclusive licence).<sup>96</sup> Although the CJEU prohibited the prevention of all other parallel trade of the seed into Germany (a closed exclusive licence) as a restriction by object, contrary to the Commission it ruled that the bare grant of an open exclusive licence, should not be considered 'in itself incompatible with Article [101](1)', despite necessarily limiting the licensor's freedom.<sup>98</sup> Again, the CJEU's logic was sound from the perspective of efficiency-focused competition

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<sup>89</sup> Hawk [1988] 70 (not 'an inquiry into actual anti-competitive effects of a challenged agreement' but distinct '*per se* rule[s] of legality').

<sup>90</sup> See Chapter V, Section II.A.

<sup>91</sup> For analysis of the 1970s selective distribution cases: Forrester [1978] 19-20; Salzman [1979] 60-63.

<sup>92</sup> *SABA* (IV/847) [1976] OJ L28/19, [27]-[28]. Other clauses (eg supply targets, turnover and stock requirements) were Article 101(1) restrictions but exempted under Article 101(3).

<sup>93</sup> C-26/76 *Metro-SB-Grossmärkte GmbH v Commission* (No 1) [1977] ECLI:EU:C:1977:167 ("*Metro I* [1977]").

<sup>94</sup> *ibid* [20].

<sup>95</sup> *ibid* [21]. See: Chard [1980] 413-414; [1982] 91-95; Goebel [1987] 610.

<sup>96</sup> C-258/78 *Nungesser v Commission* [1982] ECLI:EU:C:1982:211.

<sup>98</sup> *ibid* [58].

enforcement: were a licensor legally prohibited from committing to not compete against the licensee or to grant it to anybody else in the territory, the licensee may be ‘deterred from accepting the risk of cultivating and marketing that product’, thus recognising the trade-off between intra- and inter-brand competition to promote the ‘dissemination of new technology’.<sup>99</sup>

It reached a comparable outcome four months later in *Coditel II* [1982] involving the exclusive right to exploitation, performance, and copyright along territorial lines.<sup>100</sup> Coditel (a collection of Belgian cable television broadcasters) argued that these agreements were void after they had violated the Belgian copyright of a film by relaying a German broadcast to their subscribers. The ability to sue under the licence for showing foreign broadcasts in Germany was akin to preventing passive sales.<sup>101</sup> But on reference to the CJEU, the Court ruled that absolute territorial protection in exclusive copyright licensing agreements was ‘not, as such, subject to the prohibitions contained in’ Article 101(1).<sup>102</sup>

Finally, the ruling in *Pronuptia* [1986] immunised common restrictions found in franchising agreements from the scope of Article 101(1) prohibition:<sup>103</sup> those protecting the communication of know-how from the risk of benefitting competitors;<sup>104</sup> and clauses necessary to protect the identity and reputation of the franchised network.<sup>105</sup> The economic pedigree of *Pronuptia* is clear from the CJEU’s discussion of the overwhelming benefits to consumers of such terms, thereby facilitating the rapid expansion of brands faster than vertical integration, and for franchisees to make a quick profit without substantial investment.<sup>106</sup>

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<sup>99</sup> *ibid* [57]. For praise: Schechter [1982] 17; Korah [1983] 754; [1994a] 214; M Waelbroeck [1987] 712-713.

<sup>100</sup> C-262/81 *Coditel SA and Others v Ciné Vog Films SA and Others (No 2)* [1982] ECLI:EU:C:1982:334 (“*Coditel II* [1982]”). See: Korah [1983] 753.

<sup>101</sup> See Section III.C.ii on absolute territorial protection as a restriction by object.

<sup>102</sup> *Coditel II* [1982] [20].

<sup>103</sup> C-161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECLI:EU:C:1986:41 [15]. See: Goebel [1986] 692; Venit [1986] 217; Korah [1988] 146; de Cockborne [1988] 13-3-13-5; Rosenthal [1990] 328).

<sup>104</sup> eg preventing the opening of a similar shop during or immediately after the agreement; not selling the shop without the franchisor’s consent if it will risk their know-how.

<sup>105</sup> eg requiring the use of the franchisor’s business methods and know-how; stipulating the location and decoration of the shop to guarantee uniformity; only selling the franchisor’s products or those it approves.

<sup>106</sup> *Pronuptia* [1986] [15]. For praise: Goebel [1986] 691, 693; Venit [1986] 216; Korah [1994a] 183-184. It drew the line at excluding territorial divisions and resale price maintenance, though left open their possible exemption: [23]-[24].

All four CJEU judgments reflect a sophisticated economic understanding of how certain restrictive clauses (*Metro I, Pronuptia*) or types of agreements (*Nungesser, Coditel II*) are indispensable for the pro-competitive outcomes to be realised. As a result, the Court ruled that they ought to be presumed beyond the Article 101(1) prohibition. Along with its judgments on the need to scrutinise certain categories of agreement by their effects, these cases demonstrate the Court's role in the pre-modernisation era as the primary guardian of an efficiency-driven approach, limiting the reach of Article 101(1) and therefore also the Commission's discretionary decision-making pursuant to Article 101(3).

But despite this similarity as to their substantive outcome, the *means* of market intervention in this line of cases is fundamentally different to the unstructured, *ad hoc* determinations of legality seen in the judicial authorities on restrictions by effect.<sup>107</sup> A number of commentators at the time did not notice this, mistakenly interpreting the above rulings as the advent of a European rule of reason.<sup>108</sup> Indeed, one response to *Nungesser* erroneously depicted the CJEU as undertaking a 'balancing approach' through weighing a host of 'factors which the Court took into consideration'.<sup>109</sup> But it did not, thus generating rather contradictory analyses praising the supposed adoption of contract-specific determinations of legality, but then criticising the CJEU's failure to actually engage in 'evaluating the competitive effects of an agreement'.<sup>110</sup> Instead, these cases can be interpreted as attempts to optimise an economically-sophisticated substance with the formal rule of law ideal; each case takes efficiency-focused first principles on the benefits and risks of certain types of agreement and common restrictions, before translating them into generalised, relatively comprehensible presumptions for determining legality.

Clearly these norms for limiting the reach of Article 101(1) are imperfect, both in legally categorising the *actual* efficiencies of individual agreements and approximating the formal rule of law ideal. For example, the *Coditel* conditions attached to the exclusion of copyright agreements absolutely partitioning territories from prohibition are rather

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<sup>107</sup> Recognised by: Whish and Sufrin [1987] 23-28. See also: Salzman [1979] 60; Van Houtte [1982] 502-503; Schechter [1982] 17; Korah [1986a] 101; [1986b] 103; M Waelbroeck [1987] 211, 219; de Cockborne [1988] 13-3-13-5.

<sup>108</sup> Siragusa [1982] 115, 119, 138-139; Goebel [1986] 691-692; [1987] 610-611; Jeanrenaud [1986] 37; Venit [1987] 217, 230; Holley [1992] 691.

<sup>109</sup> Siragusa [1982] 119. Similarly: Jeanrenaud [1986] 37; Venit [1987] 230.

<sup>110</sup> Jeanrenaud [1986] 37. Similarly: Goebel [1986] 693-694.

vague and could be formulated with greater clarity.<sup>111</sup> As for the *Metro* criteria concerning SDAs, there has been uncertainty over which products warrant selectivity,<sup>112</sup> and in deciding whether their requirements are actually objective, simple, and non-discriminatorily applied.<sup>113</sup> There is also the economically problematic distinction between qualitative and quantitative, the latter usually found to breach Article 101(1) and thus require exemption.<sup>114</sup> But these defects are a consequence of the impossibility of perfectly realising both the formal rule of law and complete economic accuracy in legally characterising inefficient and efficient practices. The normative certainty of the ancillary restraints cases is a direct result of restricting the Commission's ability to reach a contrary conclusion, even if individually warranted on efficiency grounds. If the tests developed by the CJEU do not optimise the two in their current form, other generalised means for determining legality ought to be devised, avoiding the tempting form of *ad hoc*, unpredictable decision-making.

For efficiency perfectionists, the concessions to rigid normative comprehensibility through the adoption of restraining, generalised presumptions of legality in this line of cases will always be problematic. Although their economically-sound and efficiency-focused first principles were welcomed, the *method* of carving-out exceptions from the Article 101(1) prohibition for categories of agreements and common restrictive clauses was frequently dismissed as swapping over- for under-expansive normative imperfection: enforcement characterised by 'anaemic economic analysis',<sup>115</sup> where specific consideration 'of both pro-competitive and anti-competitive effects have been seriously inadequate',<sup>116</sup> and representing 'an unfortunate example of lawyers' tendency to develop rules and sub-rules'.<sup>117</sup> It is true that the form of market intervention seen in *Metro*, *Nungesser*, *Coditel*, and *Pronuptia* is incapable of reflecting the actual efficiency consequences of specific agreements in their market context, and will necessarily be under or over-inclusive. But that's the point: this line of judgments by the CJEU is to be celebrated specifically *because* 'there is little economic analysis – just

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<sup>111</sup> *Coditel II* [1982] [19] (still prohibiting agreements creating 'artificial' barriers that are 'unjustifiable in terms of the needs of the cinematographic industry', including fees exceeding 'a fair return on investment', or of a 'disproportionate' duration). See: Korah [1990] 1024.

<sup>112</sup> Korah [1994a] 175 on C-243/83 *SA Binon & Cie v SA Agence et Messageries de la Presse* [1985] ECLI:EU:C:1985:284.

<sup>113</sup> Chard [1982] 85, 100.

<sup>114</sup> Salzman [1979] 62; Chard [1982] 96-97; Goebel [1987] 619-620; Korah [1988] 144; [1994a] 176; Pathak [1989] 268; Forrester [1994] 473-474.

<sup>115</sup> Hawk [1995] 975-976.

<sup>116</sup> Chard [1982] 89.

<sup>117</sup> Korah [1988] 146 (discussing selective distribution).

assertions of principle'.<sup>118</sup> As only a small collection of supporters have realised,<sup>119</sup> this means of enforcement involves the *ex ante* reconciliation of sophisticated understandings of the efficiencies resulting from various restrictive agreements with the formal desiderata of the rule of law. Both are realised imperfectly, but unlike the unstructured effects cases under Article 101(1), the CJEU's rulings resulted in generalised norms for determining legality to restrain the Commission's decision-making and thus offer a degree of normative certainty for market actors.

### C) Presumptions of Illegality

Shifting from one end of the legality spectrum to the other, both Article 101 and 102 utilise general presumptions of anticompetitive harm for specific types of business conduct, regardless of the *actual* efficiency consequences of individual instances falling within their scope. Article 101(1) has the category of restrictions by object presumed illegal 'by their very nature',<sup>120</sup> and Article 102 has been interpreted as allowing for comparable condemnation for conduct that '*must be* regarded as abusive'.<sup>121</sup>

Understandably, determinations of legality through the application of generalised norms have frequently been criticised by efficiency perfectionists as an anti-economic form of market intervention, ripe for reformulation towards *ad hoc* evaluation of the specific consequences of the investigated conduct.

But viewed from the perspective of optimisation, there is no reason to believe that rather blunt presumptions of anticompetitive harm cannot be reconciled with an efficiency-focused, "more economic" approach to EU competition law. Generalised presumptions *can* optimally synthesise efficiency considerations *and* continue to play a valuable role in affording normative comprehensibility to businesses as envisaged by the formal rule of law, but only so long as they condemn appropriate types of conduct, as informed by economics. It will be argued that i) the treatment of predatory pricing pursuant to Article 102 is a good example of the logic of optimisation recommending a presumption of anticompetitive harm, and ii) following the recent case law of the CJEU,

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<sup>118</sup> Korah [1994a] 267-268.

<sup>119</sup> eg Whish and Sufrin [1987] 23-29 ; González Díaz [1995] 330 (The absence of 'full-blown market analysis' offers business certainty).

<sup>120</sup> C-209/07 *Competition Authority v Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd* [2008] ECLI:EU:C:2008:643 ("BIDS [2008]") [17].

<sup>121</sup> C-62/86 *AKZO Chemie BV v Commission* [1991] ECLI:EU:C:1991:286 [71].

there is reason to believe that it intends to interpret restrictions by object under Article 101 in a comparable manner.

i) *Article 102: The Example of Predatory Pricing*

In substantiating a claim that a dominant undertaking has engaged in an abuse, Article 102 does not contain a *de jure* conceptual distinction between conduct presumptively illegal in and of itself, or as a result of more detailed analysis of its overall competitive consequences on the market. Nevertheless, a *de facto* distinction between the two forms of market intervention is discernible in practice, with different types of conduct categorised onto either side.<sup>122</sup> For example, while a margin squeeze requires a demonstration of the ‘anti-competitive effect on the market’ for prohibition,<sup>123</sup> exclusivity rebates were, until recently, considered ‘by their very nature capable of foreclosing competitors’ and thus abusive without examining ‘the circumstances of the case’.<sup>124</sup> As a result of this means for determining legality, the law deduced from Article 102 has been criticised by those seeking the perfect maximisation of efficiency for its deployment of overbroad presumptions of anticompetitive illegality for certain types of market conduct, regardless of their actual impact.<sup>125</sup> Such imperfect categorisation of inefficient and efficient conduct by dominant firms is often said to chill pro-competitive practices by dominant firms to the ultimate detriment of consumers.<sup>126</sup> It is therefore routinely argued that the legality of conduct by dominant firms ought instead to be determined through *ad hoc* analysis of the actual efficiency consequences of specific practices in their market context, akin to the unstructured effects analysis articulated by the Courts for Article 101(1).<sup>127</sup>

On the contrary, the logic of optimisation suggests that presumptions of abuse *can* be appropriate tools for prohibiting conduct as abusive pursuant to Article 102, effectively reconciling the goal of condemning inefficient conduct with the formal rule of law. The CJEU’s ruling in *AKZO* [1991] provides a good illustration. Much like the form-based distinction between *STM/Delimitis* and the presumptions of legality in the previous

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<sup>122</sup> Sinclair [2004]; Eilmansberger [2005].

<sup>123</sup> C-295/12P *Telefónica SA and Telefónica de España SAU v Commission* [2014] ECLI:EU:C:2014:2062 [124].

<sup>124</sup> T-286/09 *Intel v Commission* [2014] ECLI:EU:T:2014:574 [85]-[87]. cf C-413/14P *Intel v Commission* [2017] ECLI:EU:C:2017:632.

<sup>125</sup> Pathak [1989] 262 (‘Gross generalisations’ ignore efficiencies); Pera and Auricchio [2005] 177; Bishop and Marsden [2006] 2; Auricchio [2007] 374; Pera [2008] 150 (overlooking exclusionary effects ‘in the specific context’).

<sup>126</sup> CLFA82RG [2005] 182-183; EAGCP [2005] 2-3; Bishop and Marsden [2006] 1-2.

<sup>127</sup> Sinclair [2004]; CLFA82RG [2005] 180-181; EAGCP [2005] 1-3; Bishop and Marsden [2006] 1-4.

section, *AKZO* is an example from Article 102 of two diverging means of market intervention. But rather than a contrast between parallel lines of CJEU case law, *AKZO* was a direct clash between the *Commission* and the Court over the appropriate form for determining the legality of low prices.<sup>128</sup> Once again the CJEU's reasoning can be interpreted as evidencing the logic of optimisation in its approach to the promulgation of generalised norms, incorporating the economic consensus *ex ante* into a comprehensible and administrable presumption of illegality.

*AKZO* concerned a large peroxide manufacturer threatening and executing a policy of aggressively low prices to intimidate and exclude a smaller rival. The successful policing of predatory pricing includes pitfalls aplenty as low prices are, of course, a desired result of aggressive competition and can be difficult to distinguish from conduct meant to exclude competitors with shallower pockets.<sup>129</sup> Both the Commission and CJEU agreed that *AKZO* had engaged in abusive conduct contrary to Article 102, but their respective methods proposed for determining illegal predation varied.

On the one hand, the Commission continued its pre-modernisation endeavours to secure for itself maximal discretion to prohibit business conduct without generalised normative boundaries, as and when it saw fit. It suggested a broad and seemingly unrestrained threshold for finding a dominant firm's conduct abusive: it would intervene to prohibit '[a]ny unfair commercial practices... intended to eliminate, discipline or deter smaller competitors'.<sup>130</sup> Albeit unrelated to resultant efficiencies or effects-based analysis, such a means for determining legality constitutes a highly particularistic, *ad hoc* test, essentially coming down to the Commission's appraisal of a firm's perceived intentions in the individual instance.<sup>131</sup> It found this requirement met and concluded that *AKZO* had violated Article 102.

The CJEU also found that *AKZO* had engaged in predatory pricing on the basis of its clear intent, but proposed a different means for determining legality. Prices would be *presumed* to be abusive predation violating Article 102 either: where they fell below the average cost of producing an additional unit (average variable cost, "AVC") as 'each sale generates a loss', according to the Court explicable only as a means of excluding

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<sup>128</sup> *ECS/AKZO* (IV/30.698) [1985] OJ L374/1; *AKZO* [1991].

<sup>129</sup> Sharpe [1987] 54-55.

<sup>130</sup> *ECS/AKZO* [1985] [74].

<sup>131</sup> *ibid* [80], [87]. See: Sharpe [1987] 74-75.

rivals;<sup>132</sup> or where they fell below average total cost (“ATC”, AVC plus average fixed costs of production) and were part of ‘a plan for eliminating a competitor’.<sup>133</sup> The CJEU agreed with the Commission that AKZO met this second threshold for illegality.

Both the Commission and CJEU’s routes to a finding of abuse share difficulties. The common reliance upon intention focuses more upon the subjective perception of fairness rather than efficiency,<sup>134</sup> and it risks overlooking that a great deal of beneficial competition is driven by a desire to eliminate rival firms.<sup>135</sup> The cost-based thresholds for intervention could also be higher, requiring evidence of a risk of recoupment of losses after the targeted firm has been excluded. Following Chicagoan reasoning,<sup>136</sup> this would place greater faith in market self-correction as, in the absence of substantial barriers to entry, new firms might enter in response to the dominant firm raising prices to compensate earlier losses.<sup>137</sup>

But putting these issues to one side, the proposed methods of market intervention to determine illegality were of fundamentally different forms. The Commission’s decision preferred *ad hoc*, subject-specific analysis of intentions for finding abusive predation. Although the CJEU maintained a degree of culpability for anticompetitive intent, it conceptualised market intervention to police low pricing primarily through generalised cost-based presumptions of anticompetitive harm that are reasonably comprehensible to businesses. Indeed, it was the restraint and rigidifying clarity of the presumption for prices below AVC as abusive which led the Commission to explicitly *reject* cost-based tests for legality in its decision.<sup>138</sup> Its justification was, in essence, a desire to maintain the flexibility to determine illegality on a case-by-case basis: the ‘mechanical application’ of cost-based presumptions would restrict the Commission’s ability to ‘cover all cases of unfair conduct designed to exclude or damage a competitor’,<sup>139</sup> or, less charitably, to intervene against particular businesses as it deemed appropriate. It is this administrative

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<sup>132</sup> AKZO [1991] [71].

<sup>133</sup> *ibid* [72].

<sup>134</sup> Sharpe [1987] 74; Merkin [1987] 211-212.

<sup>135</sup> Merkin [1987] 211; M Waelbroeck [1991] 119; Levy [1992] 426; Mastromanolis [1998] 215, 222; O’Donoghue [2003] 414.

<sup>136</sup> See Chapter II, Section II.B.i.

<sup>137</sup> Gal [2007] 383. The CJEU declined this opportunity in: C-202/07P, *France Télécom SA v Commission* [2009] ECLI:EU:C:2009:214. On the US requirement of recoupment: Mastromanolis [1998] 216-221; Van den Bergh [2002] 45.

<sup>138</sup> ECS/AKZO [1985] [75].

<sup>139</sup> *ibid* [77]-[78].

restraint resulting from the application of generalised norms which affords normative clarity to businesses and thus approximates the rule of law ideal.

Of course, the CJEU's cost-based approach is imperfect, both as to the end of accurately maximising efficiency and the fostering of legal certainty. Cost-based tests are not necessarily easily ascertained, whether by businesses at the time of the allegedly anticompetitive behaviour or by the Commission *ex post*.<sup>140</sup> But in comparison to rival methodologies for determining predation, it may arguably be the most 'useable' of a defective bunch, and is 'something that European regulators and courts seem capable of applying, if not always with great sophistication'.<sup>141</sup> Once again, realising these characteristics of the formal rule of law is traded-off against the possibility of perfectly categorising efficient and inefficient low pricing. In certain circumstances, it is rational and efficient to price below AVC to promote a new product, clear stock, or to avoid expensive cessation of production during periods of downturn.<sup>142</sup>

But these limited exceptions ought not to lead to the conclusion that the CJEU's generalised presumption in *AKZO* [1991] is an 'exceedingly worrying' rule of thumb,<sup>143</sup> or to the perfectionist perspective that predation under Article 102 ought therefore to be determined through recourse to 'a close assessment of its effects on competition'.<sup>144</sup> The presumption of illegality for pricing below AVC represents a reasonable attempt at optimising ends and a means for determining legality that is generally clear for businesses. In terms of economic first-principles, the CJEU's generalised *presumption* of abuse reflects the consensus position that pricing below AVC accurately prohibits anticompetitive, efficiency-reducing behaviour in the *vast majority* of cases, albeit not *every* instance.<sup>145</sup> The automatic recourse to determining legality for low prices through particularistic analysis of the business, conduct, and market in question as a means to achieve a perfect legal categorisation between "good" and "bad" may simply not be worth the hassle. Catching the few pro-competitive instances that slip through the net

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<sup>140</sup> Sharpe [1987] 66-67; Guy [1987] 88-89; Merkin [1987] 214; Levy [1992] 427; Korah [1993] 177-178.

<sup>141</sup> O'Donoghue [2003] 410.

<sup>142</sup> Rapp [1986] 238; Horspool and Korah [1992] 367; Levy [1992] 425; Korah [1993] 176-177; Turnbull [1996] 99; Ridyard [2002] 296.

<sup>143</sup> Korah [1994a] 91.

<sup>144</sup> Ridyard [2002] 296.

<sup>145</sup> O'Donoghue [2003] 373, 410; Niels and Jenkins [2005] 607; Pera and Auricchio [2005] 160.

into illegality via this *ad hoc* form of competition enforcement might be outweighed by the dilution of normative comprehensibility for businesses.<sup>146</sup>

If, however, remedying the imperfect overreach of the presumption of illegality below AVC is still thought desirable, there are intermediate means. For example, a series of clear and narrow exceptions on stock clearance or short-term promotions could be formulated as distinct justifications to be recognised in the exculpatory analysis of the defendant offering an objective justification. Such a tweak to the form for determining legality or illegality of predatory pricing would arguably be closer to the optimal reconciliation of ends and means, improving both the accurate prohibition of market inefficiency *and* the normative comprehensibility of a relatively simple presumption of illegality with discrete exceptions.

In summary, the law on predatory pricing pursuant to Article 102 reflects the struggle between contrasting forms of market intervention to enforce EU competition policy: the Commission and some commentators advocating particularistic determinations of legality on the basis of intention or efficiency consequences; and the CJEU demonstrating the logic of attempting to optimise the end of accurately prohibiting conduct resulting in inefficiency, with a means that is comprehensible to legal subjects. This approach is necessarily imperfect, but unlike the recommendations of the former, it offers the restraint of a generalised presumption of illegality to thereby afford normative certainty to dominant undertakings.

### *ii) Article 101: Restrictions by Object and Hardcore Restrictions*

The use of generalised presumptions pursuant to Article 101(1) has been a contentious issue in EU competition enforcement ever since their first judicial articulation in 1966. In *STM* [1966] the CJEU ruled that the legality of a restriction on *active* sales by distributors into other national territories in an exclusive distribution agreement was to be determined by considering its particular restrictive effect within the market context. However three weeks later in *Consten* [1966], an exclusive distribution agreement also prohibited its members from *passive* sales requested by customers in other national territories.<sup>147</sup> This contractual guarantee of absolute territorial protection ("ATP", preventing active and passive sales) was categorised by the CJEU as a restriction by

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<sup>146</sup> Similarly: Sharpe [1987] 68.

<sup>147</sup> C-56 and 58/64 *Etablissements Consten SA & Grundig-Verkaufs-GmbH v Commission* [1966] ECLI:EU:C:1966:41.

object under Article 101(1), and therefore presumed illegal without the need to investigate ‘further considerations, whether of economic data’ or ‘possible favourable effects of the agreements in other respects’.

Rather than the unstructured, subject-, market- and context-specific decision-making constituting a finding of restriction by effect, restrictions by object determine the illegality of conduct through the application of generalised, simple presumptions against types of agreement that are deemed ‘by their very nature’ to harm competition.<sup>148</sup> Over the decades various categories of collusive acts have been added to the ‘object box’: <sup>149</sup> ‘obvious restrictions’ such as price-fixing or market-sharing;<sup>150</sup> exchanges of sensitive commercial information as to future market conduct;<sup>151</sup> paying rivals to delay the release of competing products,<sup>152</sup> resale price maintenance;<sup>153</sup> internet sales bans,<sup>154</sup> and many others. Functionally and formally equivalent are the hardcore, “black-listed” clauses found in block exemption regulations. For example, the Vertical Block Exemption Regulation cannot be used to find an agreement legal if it contains any of the hardcore restrictions noted in Article 4,<sup>155</sup> and the Commission’s view is that on individual analysis they are ‘presumed to fall within Article 101(1)’.<sup>156</sup> Although restrictions by object and hardcore restrictions pursuant to the block exemption *can* in principle be exempted via paragraph (3)<sup>157</sup> - and frequently *were* by the Commission in its pre-modernisation decisional practice -<sup>158</sup> the Commission recognises in its post-modernisation and post-decentralisation guidelines that this is ‘unlikely’.<sup>159</sup> Albeit not *de jure* the case, the reality is therefore more commonly than not one of *per se* condemnation.

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<sup>148</sup> *BIDS* [2008] [17].

<sup>149</sup> Whish and Bailey [2018] 131.

<sup>150</sup> T-374, T-375, T-384, and T-388/94 *European Night Services* [1998] ECLI:EU:T:1998:198 [136].

<sup>151</sup> C-8/08 *T-Mobile Netherlands BV* [2009] ECLI:EU:C:2009:343.

<sup>152</sup> T-472/13 *Lundbeck A/S v Commission* [2016] ECLI:EU:T:2016:449.

<sup>153</sup> *Pronuptia* [1986] [23].

<sup>154</sup> C-439/09 *Pierre Fabre Dermo-Cosmétique SAS v Président de l’Autorité de la Concurrence* [2011] ECLI:EU:C:2011:649 [47].

<sup>155</sup> Commission Regulation 330/2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices [2010] OJ L102/1 (“Vertical Block Exemption Regulation [2010]” or “VBER” [2010]) Article 4 (resale price maintenance, absolute territorial protection (save for a number of exceptions), restricting active or passive sales by approved members of a SDA, restricting SDA cross-supply, or preventing suppliers selling components as spare parts).

<sup>156</sup> *Guidelines on Vertical Restraints* [2010] [47].

<sup>157</sup> T-17/93 *Matra Hachette SA v Commission* [1994] ECLI:EU:T:1994:89 [85].

<sup>158</sup> See Chapter V, Section II.A.

<sup>159</sup> *Guidelines on 101(3)* [2004] [46].

Every single generalised presumption of illegality pursuant to Article 101(1) is necessarily and unavoidably imperfect as a means to realise the end of *only* prohibiting conduct resulting in inefficiency and permitting anything else.

For example, although the presumptive prohibition of ATP in *Consten* - or other means to the same end -<sup>160</sup> was clearly driven by the political end of preventing the partitioning of the EU market, it could be reinterpreted and defended on the basis of efficiency. Maintaining cross-border trade may stimulate greater price competition, market entry, and the realisation of productive economies of scale to the potential benefit of consumers.<sup>161</sup> However in certain circumstances, prohibiting ATP does not always maximise efficiency. As the CJEU noted in *STM*,<sup>162</sup> territorial exclusivity (restricting *intra*-brand competition) may *ex ante* incentivise distributors to undertake risky investments with a better chance of return, thereby promoting the introduction of new products (*inter*-brand competition) and avoiding the “free-rider” problem.<sup>163</sup> ATP in exclusive distribution contracts simply applies the same economic logic to an even higher level of territorial insulation.

The imperfect illegality of individually efficient market conduct is also a possibility with the categorisation of resale price maintenance (“RPM”, the fixing of minimum prices with retailers) as a hardcore restriction by object.<sup>164</sup> Generally, RPM can lead to losses in welfare through limiting price competition between distributors and possibly facilitating producer or retailer cartels, while its industry-wide adoption may allow for non-collusive price increases.<sup>165</sup> But as with ATP, RPM can also be another means to ensure that distributors provide additional services to customers and prevent free-riding on their investments by other sellers, thereby restricting intra-brand price competition to foster

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<sup>160</sup> eg differential pricing for exports: *The Distillers Company Ltd* (IV/28.282) [1978] OJ L50/16. See: Korah [1978b]; Chard [1980]; Baden-Fuller [1981]; Van Bael [1980]. C-501, 513, 515, and 519/06P *GlaxoSmithKline Services v Commission* [2009] ECLI:EU:C:2009:610.

<sup>161</sup> Korah [1978a] 768-769; *Guidelines on 101(3)* [2004] [13].

<sup>162</sup> *STM* [1966] (‘necessary for the penetration of a new area’).

<sup>163</sup> For discussion of the “free-rider” problem and the trade-off between intra-brand and inter-brand competition that may result from territorial partitioning: Deringer [1965] 608-610; Joliet [1967] 145; Chard [1980] 407-408; Van Bael [1980] 40-42; Gyselen [1984]; Korah [1988] 144; [1994a] 269-270; Lugard [1996] 170; Wesseling [2000] 82. On inappropriate *ex post* condemnation of restrictions necessary for *ex ante* investments: Korah [1983] 747; [1986a] 93-94; [1994a] 274; Horspool and Korah [1992] 347-348; Van den Bergh [1996] 77. For comparable claims by Chicagoans: Chapter II, text accompanying fn 91-95.

<sup>164</sup> eg *Metro I* [1977] [21]; *SA Binon* [1985] [44]; *Pronuptia* [1986] [25]; VBER [2010] Article 4(a); *Guidelines on Vertical Restraints* [2010] [48], [223]-[229]. For recent decisions: *Asus* (COMP/AT.40465) [2018]; *Denon & Marantz* (COMP/AT.40469) [2018]; *Philips* (COMP/AT.40181) [2018]; *Pioneer* (COMP/AT.40182) [2018].

<sup>165</sup> Kneepkens [2007] 664; Peeperkorn [2008] 206-208.

inter-brand, non-price competition that is beneficial to consumers.<sup>166</sup> On the basis of this potential for positive efficiencies, the US Supreme Court in *Leegin* [2007] overturned the *per se* prohibition of RPM set down in *Dr Miles* [1911] and now determines their legality through *ad hoc*, agreement-specific analysis of the restriction's competitive impact under the "rule of reason" standard.<sup>167</sup>

Efficiency perfectionists have understandably been highly critical of the overbroad scope of these generalised presumptions of illegality pursuant to Article 101(1).<sup>168</sup> In the 1960s Joliet condemned the absence of 'any sophisticated market analysis' in *Consten*,<sup>169</sup> and the preference for 'mechanical' generalisations that overlooked possible pro-competitive efficiencies resulting from specific agreements.<sup>170</sup> EU competition policy has been similarly accused of ignoring the 'powerful efficiency arguments' for permitting RPM to be found in economics.<sup>171</sup> The recommendation has invariably been to determine illegality through a thorough, *ad hoc* consideration of the likely context-specific efficiency consequences in each individual instance.

But from the perspective of optimisation, the category of hardcore restrictions by object can be a highly valuable means of market intervention, but *only* if the economic consensus on the conduct presumed unlawful indicates a high likelihood of inefficiency. It is clear that generalised, simple presumptions for determining legality closely approximate the formal rule of law. As Advocate General Kokkot noted in *T-Mobile*, the simplicity, rigidity, and restraint of a presumption fosters normative comprehensibility, as well as conserving administrative resources.<sup>172</sup> But in doing so, this desirable means is particularly at risk of diminishing the economic accuracy of competition policy, potentially condemning conduct that is, in the actual instance, efficient. Essentially, from an optimisation perspective, the appropriateness of considering particular clauses as presumptively illegal comes down to whether EU competition law actually sticks to its decades-long justification for their adoption: that the prohibited clauses *really can be* 'regarded, by their very nature, as being injurious to the proper functioning of normal

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<sup>166</sup> Van den Bergh [1996] 77; Kneepkens [2007] 664; Vickers [2007] 9, 11-12. cf Peeperkorn [2008] 205-212.

<sup>167</sup> *Dr Miles Medical Co v John D Park & Sons Co* 220 US 373 (1911); *Leegin Creative Leather Products Inc v PSKS Inc* 551 US 877 (2007).

<sup>168</sup> eg Korah [1990] 1020-1021; Hawk [1995] 975; Bright [1996] 538.

<sup>169</sup> Joliet [1967] 145. Similarly: Deringer [1965] 620 (a 'predetermined decision' without 'careful examination of the facts.').

<sup>170</sup> *ibid* 11, 150 (failing to consider 'market conditions to see whether competition has been affected').

<sup>171</sup> Van den Bergh [1996] 77. Similarly: Kneepkens [2007] 664; Vickers [2007] 11.

<sup>172</sup> *T-Mobile* [2009] (AG Kokkot) [44].

competition'.<sup>173</sup> This seems to be the logic espoused by the CJEU in *Cartes Bancaires* [2014].

As was discussed in the previous chapter, the pre-modernisation distinction between restrictions by object or effect was of little practical difference. The Commission almost always found some form of competitive restraint, whether through over-ready findings of anticompetitive object or by ignoring the rigor of effects analysis mandated by the CJEU.<sup>174</sup> However in the post-modernisation era where national decision-makers can apply the full range of Article 101, the scope of the object box is of live significance. In *T-Mobile* [2009] the CJEU's unclear formulation of restrictions by object as practices merely '*capable*' or having the '*potential*' to cause a negative competitive impact for a presumption of illegality afforded little guidance;<sup>175</sup> was this meant to suggest that possibly anything can be presumed illegal by object, or simply that the individual practices prohibited did not have to lead to inefficiency in every instance for the presumption to still stand?

The ruling in *Cartes Bancaires* [2014] is a welcome clarification that demonstrates an optimisation approach to presumptions of harm pursuant to Article 101(1). In brief, practices should only be categorised as hardcore restrictions by object - a generalised means of determining legality that is simple, administrable, and comprehensible - if there is considerable economic evidence that they are highly likely to lead to anticompetitive consequences in most instances. The CJEU stressed that this was a category of presumptions limited to those practices that 'reveal a sufficient degree of harm to competition', as otherwise it would afford the Commission a shortcut to finding breaches of Article 101.<sup>176</sup> The key criterion for categorisation as a restriction by object was that of economic '[e]xperience', demonstrating that the practice 'may be considered so likely to have negative effects' that it was 'redundant... to prove that they have actual effects on the market.'<sup>177</sup> It was on this basis that in the subsequent case of

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<sup>173</sup> *BIDS* [2008] [17].

<sup>174</sup> See Chapter V, Section II.A.

<sup>175</sup> *T-Mobile* [2009] [31].

<sup>176</sup> C-67/13P *Groupement des Cartes Bancaires* [2014] ECLI:EU:C:2014:2204 ("*Cartes Bancaires* [2014]") [58].

<sup>177</sup> *ibid* [51].

*Maxima Latvija* [2015], the CJEU refused to recognise another *generalised* presumption of illegality, despite accepting a negative competitive effect in the *instant* case.<sup>178</sup>

The example offered by the CJEU as an illustration of its proposed approach to presumptive breaches of Article 101(1) was naked price-fixing. This type of market conduct perfectly captures the logic of optimisation in action. The Court reasoned that the benefits of closely approximating the normative comprehensibility of the formal rule of law through a generalised presumption of illegality are justified because the economic evidence on the likelihood of negative efficiency consequences is so strong, counterbalancing the highly unlikely occurrence of individually pro-competitive outcomes from naked price-fixing.<sup>179</sup> This is essentially the same logic as Bork's defence of the *per se* rule in US antitrust. As discussed in Chapter II, although it cannot be claimed with absolute certainty that price-fixing will *never* be efficient, Bork argued that the overwhelming economic consensus on the vast majority of instances having no redeeming features heavily outweighed the costs of normative uncertainty, error, and administration brought about by more discriminating, case-specific scrutiny to save the (hypothetical) minority of pro-competitive instances from prohibition.<sup>180</sup>

This is a method for determining legality that incorporates efficiency considerations *ex ante* into the design of generalised norms, rigidifying competition decision-making to afford legal certainty to businesses. To be sure, it may well be the case that the treatment of certain types of conduct as restrictions by object - absolute territorial protection, resale price maintenance - does not represent an optimal reconciliation. But this should *not* automatically result in evaluating their legality according to Article 101(1) through individualised, unstructured efficiency analysis (effects-based evaluations, the rule of reason standard) that is thoroughly unpredictable.<sup>181</sup> If the particular instances of pro-competitive outcomes can be isolated into clear, narrow exceptions to the presumptive prohibition (eg the launch of a new product requiring distributor

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<sup>178</sup> C-345/14 SIA "Maxima Latvija" v Konkurences Padome [2015] ECLI:EU:C:2015:784 [20]-[23] (clauses in commercial leases allowing shopping centre tenants to veto other leases). cf a "new" presumption of illegality: C-179/16 Hoffmann-La Roche Ltd v Autorità Garante della Concorrenza e del Mercato [2018] ECLI:EU:C:2018:25.

<sup>179</sup> *Cartes Bancaires* [2014] [51].

<sup>180</sup> Chapter II, see text accompanying fn 138-141.

<sup>181</sup> Issues of uncertainty and administrability largely motivated the dissent of Justice Breyer in *Leegin* on the rule of reason standard for evaluating RPM: Jones [2009] 494-496. For "Neo"-Chicagoan support: Katsoulacos and Ulph [2009] 433.

investment to justify ATP or RPM),<sup>182</sup> the combination of accurately permitting efficient conduct *and* normative comprehensibility may be even closer to optimal.

In summary, the generalised presumptions of illegality pursuant to Article 101(1) are *capable* of reconciling a means approximating the formal rule of law and economically-sophisticated EU competition policy, so long as they only prohibit conduct that is highly likely to result in efficiency. The *Cartes Bancaires* ruling is a strong signal that the CJEU also views restrictions by object from this perspective of optimisation.

#### *D) More Discriminating Determinations of Legality: Multi-Stage Tests*

A great deal of routine business conduct falls between the extremes of positive or negative efficiency consequences in the vast majority of instances which would justify presumptions of legality or illegality. Understandably it is here that the temptation is strongest to abandon hopes of approximating the formal rule of law, and instead succumb to determining legality via *ad hoc*, case- and conduct-specific unstructured analyses of their individual efficiency consequences.

On the contrary, it is for these types of conduct that insights from economic research are most valuable in attempting to construct more discriminating multi-stage tests, which are nevertheless comprehensible to businesses and simple to administer. This section will consider two very different examples that share in common the form of determining the legality of market conduct via structured legal analysis constituting a number of cumulative steps: i) the legality of agreements pursuant to Article 101 which meet the stipulations of the Vertical Block Exemption Regulation; and ii) the EU Courts' requirements for concluding that a refusal to supply is an abuse of dominance in violation of Article 102. Once again, both of these multi-stage tests are imperfect means for categorising in/efficient agreements or refusals as il/legal with complete accuracy, as each step may include normative generalisation to differing degrees. But this imperfection is what recommends them over the uncritical recourse to unpredictable *ad hoc*, effects-based analysis; they represent reasonable attempts to incorporate economic consensus positions *ex ante* into determinations of legality that aspire to the characteristics of the formal rule of law, thereby aiming to optimise effective ends with

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<sup>182</sup> Peepercorn [2008] 211 (on RPM); *Guidelines on Vertical Restraints* [2010] [61] (accepting ATP for two years).

more comprehensible means. Essentially, they are formally comparable to Easterbrook's multi-stage filters for structuring the US rule of reason standard.<sup>183</sup>

i) *Article 101 Legality: "New" Block Exemption Regulations*

Since 1965 the Commission has been empowered to exempt categories of agreement *en masse* from the application of Article 101 via regulations, a tool frequently deployed to ease the administrative burden for both itself and businesses occasioned by the pre-modernisation regime of compulsory notification.<sup>184</sup>

Whether judged by their means or ends, the "old" block exemptions were highly problematic tools of EU competition enforcement. While firms appreciated the certainty afforded by regulations stipulating 'an area of absolute legal protection',<sup>185</sup> this came at a substantial cost to the overall maximisation of market efficiency. Their degree of prescriptiveness for securing legality often restricted the ability for firms to effectively innovate with contractual arrangements.<sup>186</sup> The long lists of prohibited ("black") and acceptable ("white") clauses had an air of regulatory dirigisme,<sup>187</sup> with the latter practically adopted as standard-form contractual templates by industry.<sup>188</sup> But even their approximation of the desiderata of generality, and thus normative comprehensibility, was deficient. Aside from routinely vague drafting and byzantine complexity rendering their scope of application contestable,<sup>189</sup> some were also unduly narrow<sup>190</sup> or inconsistent in their treatment of similar practices,<sup>191</sup> thus distorting

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<sup>183</sup> See Chapter II, Section III.C.

<sup>184</sup> Hawk [1972] 239; Snijders [1973] 82; Osterweil [1976] 103; Jeanrenaud [1986] 30; Faull [1992] 229; Kellaway [1997] 389.

<sup>185</sup> Vestrynge [1984] 683-684. See also: Hawk [1972] 239; Sutherland [1985] 669; Faull [1992] 226; Holley [1992] 687.

<sup>186</sup> Forrester and Norall [1984] 25; Jeanrenaud [1986] 23, 31, 34; Vogelaar [1986] 199; Venit [1987] 37; Holley [1992] 687; Horspool and Korah [1992] 357; Gerber [1994] 134; Korah [1994a] 64; Lugard [1996] 166, 173; Bishop [2000] 56.

<sup>187</sup> Van Bael [1983] 70; Korah [1984] 77; Forrester and Norall [1984] 15.

<sup>188</sup> Forrester and Norall [1984] 15; Venit [1987] 38; Korah [1990] 1033; [1994a] 64, 277-278; Horspool and Korah [1992] 357; Gerber [1994] 134; Forrester [2000] 76. On the Commission promoting the impression of automatic illegality outside the block exemption: Korah [1985] 296-300.

<sup>189</sup> Holley [1992] 687; Waller [1992] 64; Korah [1994a] 64, 279; Lugard [1996] 173-174. Criticisms particularly weighed at the first R&D block exemption regulation: Venit [1985] 172; [1987] 37; Jacquemin and Spinoit [1985] 511-512.

<sup>190</sup> Hawk [1972] 42 (on the specialisation exemption); [1995] 984; Venit [1987] 37; Holley [1992] 686-687 (on franchising and R&D exemptions); Horspool and Korah [1992] 356 (on exclusive distribution regulation not covering services, know-how regulation not including trademark licensing); Korah [1992a] 272-275 (on the R&D regulation); Waller [1992] 64-65 (lack of selective distribution exemption); [1994a] 279; [1998] 506; Whish [2000] 889.

<sup>191</sup> Korah [1994a] 277; Lugard [1996] 173; Van den Bergh [2002] 38.

business behaviour towards potentially inefficient methods.<sup>192</sup> Essentially, the old exemptions achieved the rare dual distinction of being both economically and legally deficient.

Despite the deluge of criticism levied at block exemptions over the decades, the Commission has maintained them as a means to determine the legality of agreements in the post-modernisation era. However a “new” approach to them was heralded with the introduction of the Vertical Block Exemption Regulation (“VBER”) in 1999.<sup>193</sup> At a general level, the adoption of an overall regulation for vertical contracts was meant to overcome the normative incomprehensibility of the old collection of narrow and inconsistent regulations.<sup>194</sup> Confusing jurisdictional questions have been marginalised<sup>195</sup> and certain agreements – particularly selective distribution – no longer fall between the cracks.<sup>196</sup> The economic logic underpinning the VBER also represents a ‘radical change’ from the past: ‘less formalistic, less prescriptive, more economics-based’.<sup>197</sup> In particular, this shift in approach is represented by the abandonment of long “white lists” of acceptable clauses to dispel their popular perception as compulsory codes for legality.<sup>198</sup>

Albeit more complex than the presumptions of legality or illegality considered above, the VBER can be interpreted as a more intermediate approach to reconciling the accurate permissibility of efficient agreements and the desiderata of determining legality through generalised and comprehensible norms. The legality bestowed by the VBER, as updated in 2010, now depends upon a four stage analysis of the agreement: first, the individual market shares of the parties involved must be below 30 per cent;<sup>199</sup> second, the agreement cannot include the hard-core restrictions listed in Article 4; third, the terms outlined in Article 5 must be severed;<sup>200</sup> and fourth, exemption may be withdrawn under Article 6 if the agreement contributes to a network of parallel

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<sup>192</sup> Korah [1994a] 278 (companies desiring control of retailers should use franchising, while territorial price discrimination was easier through exclusive distribution); Van den Bergh [2002] 38 (franchising became very popular in Europe due to the liberal block exemption).

<sup>193</sup> Commission Regulation 2790/1999 on the Application of Article [101](3) of the Treaty to Categories of Vertical Agreements and Concerted Practices [1999] OJ L336/21. Updated: Vertical Block Exemption Regulation [2010].

<sup>194</sup> Suggested by: Korah [1981] 39.

<sup>195</sup> Riley [1998] 483, 489.

<sup>196</sup> Riley [1998] 489; Hawk and Denaeijer [2000] 133

<sup>197</sup> Whish [2000] 887.

<sup>198</sup> Riley [1998] 489-490; Whish [2000] 891.

<sup>199</sup> Slightly changing the VBER [1999] which only required the buyer to have a market share under 30% if there were exclusive supply obligations.

<sup>200</sup> Non-compete obligations over 5 years, post-contractual non-compete obligations, restrictions on selective distributors selling brands of *particular* competitors.

relationships covering more than 50 per cent of the market. At every step, the discernible commitment to reconcile considerations of overall efficiency maximisation with approaching the formal rule of law has been critiqued by those desiring the perfect legal categorisation of individually “bad” and “good” agreements.

The market cap set at 30% is the most important innovation of the VBER, and was meant to be a sign of the Commission’s commitment to economically-sophisticated first-principles. Nevertheless, determining legality through this ‘rough instrument’<sup>201</sup> has been dismissed for not capturing with absolute accuracy the actual contestability of the market, or pressure faced by even the largest, most successful firms.<sup>202</sup> By bluntly accepting the legality of vertical agreements purely on this generalised basis, the VBER has routinely been trivialised as constituting a series of ‘mere screens’<sup>203</sup> or as a ‘glorified’ extension of the *de minimis* doctrine for vertical agreements.<sup>204</sup> The same allegations could be levied at the reverse presumption found in Article 6, where parallel networks of agreements covering over half of the market may be found by the Commission to fall outside the exemption regime.<sup>205</sup> But from the perspective of optimisation, this is exactly the reason to celebrate the use of market share presumptions: they constitute relatively clear thresholds based upon the logic that anticompetitive concerns with vertical agreements are highly unlikely for firms of such small market size,<sup>206</sup> or are more likely where a dense web of such relationships exist. Admittedly, the case could be made to raise the thresholds higher,<sup>207</sup> and despite the simplicity of their exposition, calculating actual market shares is no easy task, previously exacerbated by the EU’s imperfect methodology for defining relevant markets.<sup>208</sup> Nevertheless, there is really no other workable indicator of market power on offer<sup>209</sup> save for *ad hoc*, contract-specific effects analysis, which would defeat the point of a

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<sup>201</sup> Bortolotti [1999] 211. See also: Boscheck [2000] 25.

<sup>202</sup> ibid 209-210. See also: Boscheck [2000] 38 (‘a proxy of a proxy’); Griffiths [2000] 245-246 (‘crude’).

<sup>203</sup> Boscheck [2000] 38.

<sup>204</sup> Griffiths [2000] 247.

<sup>205</sup> Certainty could be improved by removing the Commission’s discretion (‘may by regulation declare’) in favour of a simple presumption that the exemption is inapplicable.

<sup>206</sup> Whish [2000] 907; Bruzzone and Boccaccio [2009] 469.

<sup>207</sup> Cowan and Nazerali [1999] 163 (advocating 40 per cent to ‘capture real market power’).

<sup>208</sup> Schroeder [1997] 431, 433; Korah [1998] 510; Riley [1998] 491; Bortolotti [1999] 208, 216-217; Cowan and Nazerali [1999] 160, 163; Nazerali and Cowan [2000] 53-56; Hawk and Denaeijer [2000] 133-134; Whish [2000] 907; Van den Bergh [2002] 47. On the clarity brought by the Commission’s documents on market definition and merger control experience: Korah [1998] 510; Griffiths [2000] 246; Whish [2000] 907-908; Van den Bergh [2002] 49-50. cf Schroeder [1997] 432; Cowan and Nazerali [1999] 163; Van den Bergh [2002] 47, 49-50.

<sup>209</sup> Korah [1998] 510.

simple and clear self-applied exemption regime. The use of necessarily imperfect market shares can therefore be interpreted as a reasonable economic and legal compromise.<sup>210</sup>

The same defence can be made of the Article 4 presumptions of illegality for hardcore restrictions. Again, as imperfect generalisations ‘every single entry... could be substantiated or challenged’ as pro-competitive in certain instances.<sup>211</sup> But as was argued above,<sup>212</sup> if determined in an economically nuanced manner, these almost automatic findings of illegality can optimally reconcile reasonably accurate condemnation of anticompetitive practices with a form for determining legality that affords normative certainty to businesses.

The recourse to four cumulative, presumption-laden steps in the VBER for finding that certain agreements are lawful will always represent a problematic means of market intervention for those seeking the perfect legal categorisation of practices into efficient and inefficient. Block exemptions clearly do not adopt the form of *ad hoc*, particularistic decision-making, relying instead upon the *ex ante* incorporation of economic thinking into necessarily imperfect indicators of a lack of competitive concerns. It is unsurprising that Joliet condemned the first block exemption for permitting agreements on generalised criteria ‘without examining specifically their market effect’<sup>213</sup> and for being ‘purely designed to avoid [the] case-by-case method.’<sup>214</sup> Korah similarly dismissed their avoidance of particularistic market intervention, preferring ‘rules of *general* application to a variety of situations, thereby necessarily preventing market analysis and ‘*special circumstances*’ in the individual case.’<sup>215</sup> Even their “new” style is said to reveal the Commission’s ‘stubborn unwillingness’ to embrace enforcement ‘consistent with economic theory’ and consider contract-specific efficiency consequences.<sup>216</sup>

But the VBER is more an instrument of efficiency optimisation than perfectionism, and is much the better for it. Claims that each of the four stages to a presumption of legality are ‘arbitrary’,<sup>217</sup> or constitute “simple” rules which seem easy to apply<sup>218</sup> are not a criticism, but a reflection of their commendable imperfection. The multi-stage legal

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<sup>210</sup> Bishop and Ridyard [2002] 35 (on Article 3).

<sup>211</sup> Boscheck [2000] 40. See also: Riley [1998] 491-492; Griffiths [2000] 241, 245.

<sup>212</sup> See Section III.C.ii.

<sup>213</sup> Joliet [1967] 151.

<sup>214</sup> *ibid* 176.

<sup>215</sup> Korah [1985] 298, (emphasis added).

<sup>216</sup> Van den Bergh [2002] 40.

<sup>217</sup> Griffiths [2000] 247.

<sup>218</sup> Van den Bergh [2002] 46.

analysis required for an agreement to be protected under the VBER adopts a ‘principled, economics-based approach’ that avoids recourse to an *ex post* “more realistic assessment” through incorporating economic theory into a sophisticated and reasonably comprehensible generalised normative framework for typically pro-competitive agreements.<sup>219</sup> Contracts in breach of the blacklisted clauses *might* be rational and efficient in particular instances. Firms with a market share above 30% *may* be subject to substantial competitive constraint and therefore lack market power. Alternatively, firms falling within the threshold *could* still produce agreements that lead to harmful inefficiency on the market. And a network of parallel contracts covering more than half the market *might* not prevent market entry. Each of the steps of the VBER for determining contractual legality is imperfect. But if the received economic consensus suggests these possibilities are rarer than the opposite presumption, they represent safe generalisations that attempt to reasonably optimise the accurate categorisation of efficient agreements as legal and normative certainty for businesses, much more so than the automatic assumption that *ad hoc*, particularistic market intervention must be the solution.<sup>220</sup>

Rather than ‘an outdated instrument’ in the post-modernisation era,<sup>221</sup> the deployment of “new” block exemption regulations can be considered an exercise in the logic of optimising the efficiency-maximising end of permitting largely innocuous agreements and a means aspiring towards the formal rule of law. To be sure, the VBER’s four-stage test for affording legality to vertical agreements is less comprehensible and more discriminating than a single presumption, and *vice versa* for the alternative of unstructured, individualised analysis of the specific agreement in question. But the chosen means for determining the legality of vertical agreements can be seen to result from the same method of optimisation. The VBER incorporates economic consensus positions on the likelihood - though not inevitability - of efficiency or inefficiency *ex ante* into a series of simple, generalised steps to thereby afford a degree of legal certainty to businesses.

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<sup>219</sup> Whish [2000] 924.

<sup>220</sup> At any rate, as a multi-stage test for legality, agreements not falling within the scope of the VBER are still subject to scrutiny pursuant to Article 101.

<sup>221</sup> cf Bruzzone and Boccaccio [2009] 470.

ii) Article 102 Illegality: Refusals to Deal

Like the four-stage analysis of the VBER under Article 101, the law on refusals to deal pursuant to Article 102 can also be interpreted as a more intermediate, discriminating means for determining illegality, lying below the simpler presumptions on the above list of forms. It nevertheless avoids the normative anarchy of absolute *ad hoc*, refusal-specific analysis through resorting to a series of comprehensible cumulative steps.

Attempting to reconcile the accurate legal categorisation of individually efficient and inefficient refusals with the formal desiderata of the rule of law for this particular type of market conduct is far from a simple task. Compelling business dealing has complex efficiency consequences. In the short term, legally mandating access may guarantee the existence of competition on the downstream market and facilitate further entry, or if concerning intellectual property (“IP”), compulsory licensing could allow for the development of a new product or other innovations. The problem is striking the appropriate balance with long-term business incentives. If the law is thought to frequently permit free-riding upon investments made by others, this could have a chilling-effect upon the impulse to invest in the first place. This mixed picture suggests that finding refusals to deal ought to be rare, but not necessarily impossible.

In the cases of *Magill* and *Bronner* the CJEU formulated multi-stage tests for determining the legality of refusals to deal. Both instances can be interpreted as reflecting the logic of optimisation, effectively incorporating *ex ante* their varied economic implications into the design of reasonably comprehensible cumulative steps to assuage business concerns about free-riding on their investments.<sup>222</sup>

In *Magill* the Commission and CJEU both found it abusive under Article 102 for Northern Irish TV broadcasters to refuse to licence their schedules to a publisher wishing to produce a single listings magazine. This elicited a resoundingly negative response from many commentators, for some representing a ‘significant diminution’ of IP protection to the detriment of innovation,<sup>223</sup> and a wholly disproportionate solution to the consumer inconvenience of buying three magazines.<sup>224</sup> On the contrary, both the substantive standard and form of intervention posited by the CJEU clearly demonstrated a

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<sup>222</sup> For “Neo”-Chicagoan support: Evans and Padilla [2005] 87-88; Evans [2005] 94.

<sup>223</sup> M Waelbroeck [1991] 136-137. Similarly: Myrick [1992] 303; Subiotto [1992] 237-238; Crowther [1995] 524-525.

<sup>224</sup> Myrick [1992] 303.

commitment to restraining the Commission to only compelling licensing ‘in exceptional circumstances.’<sup>225</sup> To reassure businesses that their intellectual property was generally safe, it formulated a four-stage test for concluding that there had been an abuse of dominance. A breach of Article 102 would only be found where: there is no substitute to the ‘indispensable’ IP held by the dominant firm;<sup>226</sup> such a refusal prevented the ‘appearance of a new product’;<sup>227</sup> it had the consequence of ‘excluding competition on that market’;<sup>228</sup> and it could not be objectively justified.<sup>229</sup> This represents a reasonable internalisation of the complex efficiency consequences of refusals to licences into a narrow, structured, comprehensible test for exceptionally finding illegality where inefficiency to the detriment of consumers is most likely to materialise; essentially, the blocking of a new product. It is *both* the substantively high standard for a finding of abuse under Article 102 *and* the formal restraint of the four-part test that suggests to businesses that their investment in innovation and development of IP will not unnecessarily be undermined by over-eager and unpredictable compulsory licensing under EU competition law.

The same desirable combination of economically-informed restraint and clarity on exceptional intervention can be seen with the means for determining legality as regards refusing access to physical property in *Bronner* [1998].<sup>230</sup> Protesting that postal delivery of a small newspaper was too burdensome, Bronner claimed that Mediaprint had abused its dominance by refusing to deliver their newspaper through its own sophisticated national system that could not feasibly be replicated. Advocate General Jacobs’ response closely considered the investment/competition trade-off and reflected the consensus of economic anxiety that frequent compulsion of access through Article 102 could severely undermine incentives to invest in the first place.<sup>231</sup> Like *Magill*, the CJEU laid out another four-part test for finding refusals to physical abusive where: it would eliminate all competition on the part of the requesting party; access was ‘indispensable to carrying on the person’s business’; there were no actual or potential

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<sup>225</sup> C-241-91P *RTE & ITP v Commission* [1995] ECLI:EU:C:1995:98 (“*Magill* [1995]”) [50]. See: Crowther [1995] 527; Forrester [2003] 509-510, 517, 519 (exceptionalism based on the unusual breadth of national copyright protection).

<sup>226</sup> *ibid* [53].

<sup>227</sup> *ibid* [54].

<sup>228</sup> *ibid* [56].

<sup>229</sup> *ibid* [55].

<sup>230</sup> C-7/97 *Oscar Bronner GmbH & Co KG v Mediaprint* [1998] ECLI:EU:C:1998:569 (“*Bronner* [1998]”).

<sup>231</sup> *ibid* (AG Jacobs [56]-[58]).

substitutes; and the refusal could not be objectively justified.<sup>232</sup> Again, this multi-stage test for abusive refusals to grant access can be interpreted as reflecting the logic of optimisation. The CJEU made a reasonable attempt to reconcile efficiency considerations recommending a high substantive threshold for exceptional intervention, with a means for determining legality through a series of comprehensible, relatively narrow generalised steps.<sup>233</sup> Of course, the stage of objective justification is a more fluid aspect of the legal analysis that is open to interpretation. In contrast, the generalised requirement of indispensability is a particularly satisfying optimisation of both the economic wariness on mandatory access and the desire for normative comprehensibility.

Given the strictures of the legal tests developed by the CJEU in *Magill* and *Bronner*, it is possible that refusals to deal falling short of a finding of abuse *do* cause detriment to consumers in individual circumstances. But the logic of optimisation is one of combining the economic consensus (ie compulsory dealing has long-term negative investment consequences) with a means for determining legality that involves a series of generalisations which render the scope of legal prohibition comprehensible to businesses. It does not automatically assume that *ad hoc* analysis of the efficiency consequences of a distinct refusal ought to be determinative of its legality pursuant to Article 102.

It is therefore regrettable that in *Microsoft* the Commission, supported by the General Court, expanded the narrow generalisations constituting the *Magill* test for compulsory licencing by diluting the clarity of each of the four stages of legal analysis to find an abuse in the instant case.<sup>234</sup> The exacting requirements initially posited by the CJEU were qualified and blurred to afford the Commission more opportunities to intervene against specific refusals, recalibrating the *Magill* trade-off away from more generalised and comprehensible steps, towards a more individually-discriminating and unpredictable form of analysis. For instance, rather than excluding competition on the market, the woollier requirement of eliminating ‘any *effective* competition’ was adopted, thereby permitting the Commission to still find an abuse where a number of

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<sup>232</sup> *ibid* [41].

<sup>233</sup> For praise: Capobianco [2001] 558-560; Mavroidis and Neven [2003] 362.

<sup>234</sup> *Microsoft* (COMP/C-3/37.792) [2004]; T-201/04 *Microsoft v Commission* [2007] ECLI:EU:T:2007:289 (‘*Microsoft* [2007]’). See: Pardolesi and Renda [2004] 529; Forrester [2004] 186-188; Killick [2004] 38; Howarth and McMahon [2008] 124; Andreangeli [2009] 585.

fringe operators continued.<sup>235</sup> The existence of these small competitors also raised questions as to whether the inter-operability information requested was strictly *indispensable*, as reverse-engineering was an available option, albeit difficult.<sup>236</sup> The step of preventing a new product from arising was also found to be satisfied where a refusal hindered follow-on ‘technical development’, essentially allowing the Commission to condemn businesses that limited any incremental additions short of simply replicating the initial product.<sup>237</sup> All of this led one commentator to mock the Commission’s initial decision as espousing the ‘doctrine of *convenient facilities*’.<sup>238</sup>

Although the four-stages of legal analysis for finding a breach of Article 102 remain intact from *Magill*, each element is slightly broader and less comprehensible than previously, permitting a greater degree of particularistic analysis by the Commission of the market consequences occasioned by the refusal in question. *Microsoft* could be considered a retrograde step in the treatment of refusals to licence under Article 102, shifting away from the previously admirable economic nuance and legal certainty of the *Magill* and *Oscar Bronner* tests to thereby secure more “effective” enforcement. But in terms of welfare consequences and the rule of law ideal, it constitutes a lose-lose outcome as investments are chilled, both by the greater likelihood of compulsory licensing than hitherto *and* by a shift towards a woollier, more unforeseeable scope for Commission intervention.

Be that as it may, the test for determining the legality of refusing to licence IP pursuant to Article 102 can still be interpreted as demonstrating the logic of optimisation. Although the combination of efficiency-focused ends and rule-of-law-compliant means may be further away from the optimum following *Microsoft*, especially given the dilution of the latter half of the sum, the test still occupies an intermediate position between absolute rules of legality/illegally and completely unstructured analysis of its specific competitive consequences. The result is a form of market intervention now closer to the second pole, broadening and blurring each stage of *Magill*, but the decision and ruling of the General Court continues to provide a series of cumulative, generalised criteria for evaluating the legality of refusals. When compared with the means of market

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<sup>235</sup> *Microsoft* [2007] [332], [563]. See: Killick [2004] 38-40; Pardolesi and Renda [2004] 530.

<sup>236</sup> The GC did not particularly engage with this element, though accepted the Commission’s finding that it was not a viable substitute. See: Killick [2004] 38, 41; Andreangeli [2008] 881-882.

<sup>237</sup> *Microsoft* [2007] [647], [653]. See: Geradin [2004] 1537-1538; Killick [2004] 38, 42-43; Andreangeli [2008] 884; Howarth and McMahon [2008] 123-124.

<sup>238</sup> Ridyard [2004] (emphasis added).

intervention advocated by efficiency perfectionists, the *Microsoft* test still offers *something* cognisable to IP owners, albeit to a lesser extent than previously. It also evidences how loosening the restraint imposed upon the Commission through generalised norms may facilitate more effective, efficiency-discriminating enforcement, but at the cost of normative comprehensibility for businesses.

#### IV. Conclusion: Less is More

The previous chapter was an exploration of how the realisation of ends in EU competition enforcement was often achieved by the Commission avoiding - and the EU Courts failing to formulate - generalised norms for determining legality that rigidified decision-making. Undoubtedly this means of market intervention was effective and led to outcomes ultimately beneficial to consumers. Nevertheless, determining the lawfulness of business conduct through *ad hoc*, subject-specific decisions, whether specifically dressed in the garb of Commission discretion or the indistinguishable form of completely unstructured effects-based analysis, is to abandon legal certainty for market actors. The examples considered in the previous chapter painted a bleak picture on the realisation of the formal rule of law in EU competition policy.

The argument of this chapter has been that less can be more in competition enforcement. A variety of areas of market intervention have been discussed, where the acceptance of *less effective* ends through a variety of generalised, less-discriminating tests for determining legality can foster *more certainty* for businesses. As concerns the specific goal of market interventions to promote efficiency, the logic of optimising the means and ends of competition policy has been explored and advocated: the *ex ante* incorporation of economic consensus positions on the likelihood of positive or negative efficiency consequences into the design of necessarily imperfect generalisations (rules, presumptions, multi-stage tests) that therefore aim to provide normative comprehensibility, thus approximating the formal rule of law ideal. Despite the contemporary “Neo” label, this is the same approach to reconciling law and economics in competition enforcement as proposed by the original Chicago School in Chapter II, and possibly the Ordoliberals too in Chapter III.

Many aspects of EU competition law can be reinterpreted as attempts at the optimisation of effective ends and generalised, comprehensible means in action. These

range from presumptions of legality developed by the CJEU for certain categories of *prima facie* restrictive agreements and clauses, through to presumptions of illegality under Article 101 (restrictions by object, the hardcore clauses of the VBER) and 102 (pricing below average variable cost), and intermediate, more discriminating multi-stage tests (block exemption regulations, findings of abusive refusals to deal). Unlike purely *ad hoc*, unstructured effects-based analysis, these aspects of EU competition law imperfectly distinguish between the individually efficient and inefficient. But it is such modesty as to the realisation of ends that permits steps towards approximating the formal rule of law ideal, sometimes to a substantial degree. This is not to suggest that the examples considered necessarily represent *the* optimum reconciliation; clearer exceptions to certain restrictions by object and the dilution of the straightforward *Magill* steps were considered. But rather than a reason to simply abandon aspirations towards realising both economic nuance and the rule of law, the challenge of formulating the optimal means for determining legality should be considered an on-going task for competition lawyers and economists alike.

When compared with the ends-focused nature of enforcement discussed in the previous chapter, or the common alternative proposal of perfect efficiency maximisation through *ad hoc*, conduct-specific, unstructured normative determinations, the examples considered in Section III are indicative of a very different approach to market intervention. There is a welcome rigidity and restraint to the generalised norms posited for analysing the legality of conduct. Attempts have been made by the Commission and Courts to render the ambit of legal prohibition relatively clear for businesses. And particularly when considering the Article 101 presumptions of legality and the *AKZO* dispute, this has often resulted from the CJEU directly rejecting conduct-specific means for deciding lawfulness, instead assuming leadership over the prospective development of the law towards norms that structure and restrain legal analysis. In settling for varying degrees of economic imperfection, these examples represent the closest approximations of the formal rule of law ideal to be found in EU competition policy.

# Conclusion

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This thesis began with two research questions.

The first was theoretical: *to which form for determining the legality of business conduct should the fundamentally economic endeavour of competition policy aspire?* It was derived from the shallow theoretical roots of scholarship exploring questions of appropriate form in EU competition law: where one group advocated unstructured, case-by-case analysis without any consideration of its formal implications or less absolute alternatives; and others defended “the rule of law”, “certainty”, or “judicial review” on the basis of an assumed relevance, with little justification of their meaning or place in this specific, economically-animated field.

The response to this question advanced in Part I was that aspiring to realise the formal rule of law ideal - of determining legality through the application of generalised, equally-applied, and comprehensible norms, overseen by courts – was of considerable virtue in competition enforcement. In eschewing *ad hoc*, unstructured, unpredictable determinations of legality in a case-by-case manner, this formal aspiration comes at a cost to the effectiveness with which the ends of market intervention are pursued. Nevertheless, by combining fledgling justifications found in the writing of the Chicago School and German Ordoliberalism with centuries of legal, political, and economic theory, it was shown that the positive implications of realising the formal rule of law cannot easily be discounted in competition enforcement. These include political desiderata, amongst them facilitating the meaningful exercise of freedom, the ability to plan one’s affairs, the legitimate attribution of responsibility, and an additional safeguard against discriminatory treatment. Perhaps more important, there are also *economic* goods from legal norms as effective institutions which facilitate market processes, overcoming informational limits and reducing transaction costs, whilst further formally restricting centralised decision-makers from overly disruptive interventions, especially at the behest of private rent-seeking. Additionally, as decision-makers may be tempted to prioritise the effective pursuit of ends over the desirability of merely applying restrained and regularised norms of legality and illegality, the opportunity for judicial review is a key mechanism for these valuable outcomes to be

approximated over time. Courts can reactively ensure congruence between law and enforcement, and prospectively structure future decision-making with more generalised legal norms, affording greater certainty to businesses.

Armed with a justification for aspiring towards this form of market intervention, the second research question turned to the reality of enforcement: *do the substantive norms, enforcement practices, and institutions of EU competition law realise the formal rule of law?* Part II offered a mixed response. Several illustrations were evaluated of the Commission attempting to avoid the rigidity and restraint of generalised, certain competition law norms to maximise the scope for discretionary determinations of legality, perhaps legitimated by deferential judicial oversight. Albeit a very effective means for pursuing its various policy goals, such flexible, unstructured discretion to engage in case-by-case analysis was achieved at the expense of certainty for businesses. But in contrast, many aspects of EU competition enforcement can be reinterpreted as attempts to reconcile economically-sophisticated ends with approximating the desirable means represented by the formal rule of law ideal. At times, the Commission and Courts have incorporated nuanced consensus positions on the likelihood and signals of in/efficiency *ex ante* into the design of norms that aspire towards generalisability and comprehensibility. In their abstraction from the actual market consequences of the individual practice, the resultant presumptions, structured tests, or indicative factors are necessarily imperfect for delivering the end of always accurately condemning the economically “bad” and permitting the “good”. But such imperfection in EU competition policy is to be *celebrated*. It is the modest restraint and foreseeable rigidity of determining legality through more structured means beyond *ad hoc*, conduct-specific evaluations of business practices, which allows for the political and economic virtues of the formal rule of law to be realised.

Having addressed both research questions, a number of recommendations can be briefly offered for EU competition law scholarship going forward.

First, the economic underpinnings of competition policy should not automatically render concerns about the appropriate legal form, and in particular the formal rule of law, irrelevant. The form of market intervention matters, not just for age-old reasons found in political liberalism, but as explored by certain institutionalist aspects of recent economic scholarship. Microeconomic price theory and the tools of industrial

organisation economics are legitimately the foundations of contemporary competition policy, but they are not exhaustive of thinking which can enlighten contentious aspects of European enforcement.

Second, incorporating theoretical considerations of the appropriate legal form into contemporary discussions would enrich an otherwise rather superficial debate. Advocates of the rule of law in competition scholarship cannot simply reference the concept and expect it to be heeded, but should make its political and economic value clearer. Conversely, critics of generalised norms and legal certainty ought to address head-on why this body of supportive literature is misguided. More crucially, those who indirectly and often unintentionally challenge the rule of law ideal through, for instance, proposing unstructured, conduct-specific determinations of legality, should more keenly consider the political and economic implications of their formal recommendations. The quality of scholarly analysis is lessened by assertions that concepts – eg the rule of law, subject-specific determinations - are necessarily “good” or “bad” in competition policy.

Third, dynamics between legal institutions have a crucial impact upon the resultant substance and form of law. This was emphasised in the role envisaged for courts in the conceptualisation of the rule of law offered in Part I, and evidenced at numerous points in Part II. Courts can prospectively structure discretion through presumptions or multi-stage tests, or defer when faced with attempts to stretch administrative boundaries. Enforcement authorities can utilise certain procedural tools (eg informal settlements) which essentially insulate their decision-making from effective judicial oversight and the restraint of pre-existing legal norms. They can also introduce certainty into their own decision-making when courts settle upon unstructured, case-by-case analysis (eg effects-based enquiries versus the Commission’s guidelines). These dynamics deserve closer conceptual and practical attention.

Fourth, the perennial debate on how to render EU competition law “more economic” must recognise that this is not an obvious, self-evident goal. There are numerous ways in which it can be conceptualised and realised. Wholesale adoption of unstructured, conduct-specific analysis of actual market consequences to determine legality is not the only form by which an exclusive focus upon the goal of efficiency can be introduced into the law. *Ex ante* incorporation of economic wisdom into the design of norms aspiring to

realise the formal rule of law ideal offers an alternative. The positive and negative implications of competing “more economic” approaches should be acknowledged.

Fifth and finally, an optimisation approach to formulating competition law, aspiring to realise accurate efficiency outcomes through generalised and comprehensible norms, still depends upon empirical economic research, but merely questions how its insights are utilised. Rather than stressing the importance of context, enquiries into economic generalisations – the likelihood of efficient and inefficient outcomes, specific instances of competitive concerns – should inform where particular business practices sit on the sliding scale between the forms of almost absolute rules and case-by-case analysis. Can economics provide, for instance, specific exceptions to presumptions of illegality based on their likely positive consequences (eg time-limited absolute territorial protection and pricing below AVC for new products)? As the Chicagoans explored, should effects-based analysis become a last resort, following a structured series of filters?

Discovering the optimal combination of economically-accurate ends and a means that aspires to realise the rule of law for determining the legality of each particular type of conduct will require the joint, interdisciplinary effort of both competition economists and lawyers. Considerations of legal form, normative design, and the rule of law have been shown to be of political and economic significance in the pursuit of competition policy. As stated at the beginning, academic intrigue in this societal endeavour derives from its location at the intersection between law *and* economics. There it should remain.

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