ARNOLD & PORTER LLP

CLIENT ADVISORY

The *De Beers* Case: Art. 82 EC Commitments for the First Time Reviewed and Overturned by the Court of First Instance

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Brussels
+32 (0)2 517 6600

London
+44 (0)20 7786 6100

Washington, DC
+1 202.942.5000

New York
+1 212.715.1000

Los Angeles
+1 213.243.4000

San Francisco
+1 415.356.3000

Northern Virginia
+1 703.720.7000

Denver
+1 303.863.1000

INTRODUCTION

Pursuant to Art. 9 of Regulation n°1/2003 ("Regulation n°1"), the European Commission ("Commission") can avoid the burden of adopting a formal decision prohibiting conduct that is incompatible with Art. 81 or 82 EC if the infringing companies offer commitments that address its competition concerns. Industry has welcomed this novel provision, and the Commission has made frequent use of it since Regulation n°1 entered into force in May 2004. So far, the Commission has adopted six commitment decisions.[1] Others are in the pipeline.[2]

Yet, in the very first case where such a commitment decision has come up for judicial review, the Court of First Instance ("CFI") has overturned it.[3] As will be explained in more detail below, the case concerns a supply agreement between De Beers and Alrosa, the world's two leading diamond producers. The Commission had accepted De Beers' commitment to phase out this agreement by 2009, but De Beers' contracting partner Alrosa challenged the Commission's decision ("Decision") and on 11 July 2007, the CFI annulled it.

The main "take away" from this judgment is that the CFI will review commitment decisions on their compliance with the proportionality principle in exactly the same way as it would review remedies contained in prohibition decisions. The question is whether this judicial review standard will dampen the enthusiasm with which the Commission has used Art. 9 of Regulation n°1 so far.

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1 See Case COMP/37.214, *Joint selling of the media rights to the Deutsche Bundesliga*, Commission decision of 19 January 2005, OJ L134/46, 27.05.2005; Case COMP/39.116, *Coca-Cola*, Commission decision of 22 June 2005, OJ L253/21, 29.09.2005; Case COMP/38.381, *De Beers*, Commission decision of 22 February 2006, not yet reported; Case COMP/38.173, *Joint selling of the media rights to the FA Premier League*, Commission decision of 22 March 2006, not yet reported; Case COMP/38.348, *Repsol*, Commission decision of 12 April 2006, not yet reported; Case COMP/38.681, *Cannes Agreement*, Commission decision of 4 October 2006, not yet reported.

2 See e.g. Case COMP/38.698, CISAC, OJ C128/12, 9.06.2007 and Case COMP/37.966, *Distrigaz*, OJ C77/48, 5.04.2007;.

3 Case T-170/06, *Alrosa v. Commission*, judgment of 11 July 2007, not yet reported. For the Commission's commitment decision, see footnote 1.

1. LEGAL BACKGROUND: ART. 9 OF REGULATION N°1

Since the entering into force of Regulation n°1, the Commission can do one of two things when it reaches the preliminary conclusion that companies have infringed Art. 81 or 82 EC.

Pursuant to Art. 7 of Regulation n°1 ("Art. 7"), the Commission can adopt a formal prohibition decision establishing the existence of an infringement and requiring the companies to bring the infringement to an end. If it follows that route, the Commission may impose on these companies "any behavioral or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end".

Alternatively, the Commission can accept voluntary commitments from the companies, provided these meet the competition concerns set out in its so-called preliminary assessment. Pursuant to Art. 9 of Regulation n°1 ("Art. 9"), the Commission will then "make those commitments binding" upon the companies and close the case, stating that there are no longer any grounds for action. In contrast with Art. 7, Art. 9 does not explicitly require that the commitments be "proportionate" and "necessary".

In their initial stages, the Art. 7 and Art. 9 procedures are usually identical: the Commission will set out its competition concerns in a formal statement of objections ("SO") and give the companies an opportunity to express their views in writing and orally. The bifurcation of the two procedures will occur when the companies decide to offer commitments. In an Art. 7 procedure, the Commission will head straight for the adoption of a prohibition decision. In contrast, when it reaches the preliminary view that the commitments offered by the parties pursuant to Art. 9 meet its concerns, it will—pursuant to Art. 27-4 of Regulation n°1 ("Art. 27-4")—publish a "concise summary of the case and the main contents of the commitments" inviting interested parties to "submit their observations within a time limit (…) which may not be less than one month". Commitments may be amended or even withdrawn following this consultation stage. However, if and when the Commission is satisfied that the commitments are indeed adequate, it will adopt and publish a decision making these binding upon the companies and close the case without more. The commitments will be published as an attachment to the commitment decision.[4]

2. FACTUAL BACKGROUND

In January 2003, the Commission raised antitrust concerns over a supply agreement whereby De Beers, the world's number one diamond producer with a market share above 40%, purchased rough diamonds worth US$800 million each year from 2002 until the end of 2006 from Alrosa, its closest competitor with a market share above 20%. The purchases covered roughly 50% of Alrosa's production and 100% of its exports out of the Commonwealth of Independent States ("CIS", formerly the Soviet Union). The renewable five-year agreement was based on a longstanding commercial relationship between the two companies that went back to 1959.

The Commission addressed an SO to both De Beers and Alrosa for violation of Art. 81 EC (which prohibits anti-competitive agreements) and a separate SO to De Beers for violation of Art. 82 EC (which prohibits abuses of dominance). The Commission's main objection was that the agreement eliminated an alternative source of supply for customers outside the CIS in what was a highly concentrated market dominated by De Beers.

In March 2003, De Beers and Alrosa produced a joint reply to the Art. 81 EC SO, and De Beers replied separately to the Art. 82 EC SO. An oral hearing took place in July 2003.

On 12 September 2003, Alrosa offered to phase out its supply arrangement with De Beers from 2007 onwards and to terminate it all together in 2013 ("first commitment proposal"). However, Alrosa withdrew that offer as—upon reflection—not viable.

[4] For an early—pre-Regulation n°1—example of a case that was closed after the parties offered commitments, see Case n° IV/36.120, *La Poste/SWIFT + GUF,* OJ C 335/3, 6.11.1997.

On 14 December 2004, De Beers and Alrosa jointly offered to reduce the annual quantities of diamonds covered by the supply arrangement between 2005 and 2010 and to cap the quantity thereafter at US $275 million—roughly 35% of Alrosa's production ("second commitment proposal"). This proposal led the Commission to publish its Art. 27-4 notice in June 2005. Numerous third parties (mostly customers) submitted comments. While sharing the Commission's concerns, they argued that the proposed commitments did not sufficiently address these concerns. They referred in particular to the risk of a market-sharing cartel between De Beers and Alrosa.[5] In October 2005, the Commission orally informed De Beers and Alrosa of the gist of the third-party comments and invited them to offer new joint commitments.

On 26 January 2006, De Beers offered unilaterally to phase out the supply arrangement with Alrosa from 2006 onwards and to terminate it all together in 2009 ("third commitment proposal"). Immediately thereafter, the Commission provided Alrosa with a copy of De Beers' commitments and of a non-confidential version of the third-party observations on the previous joint commitment proposal, inviting it to submit comments. Alrosa rejected the third commitment proposal and continued instead to defend the proposal it had submitted jointly with De Beers. However, it added that it was prepared to sell the capped quantity of diamonds (US $275 million) at auction to parties other than De Beers after 2010.

Just a few days later, the Commission nevertheless consulted the Advisory Committee of National Competition Authorities on the third commitment proposal and on 22 February 2006, it adopted the Decision accepting this proposal and making it binding upon De Beers. The Decision was solely based on Art. 82 EC. The Commission restated its initial concerns about the anti-competitive effects of the supply agreement. In its view, the agreement granted De Beers *de facto* distribution exclusivity and hindered Alrosa from competing fully with it. Thus, De Beers unlawfully enhanced its dominant position.[6] The Commission also stressed that the supply agreement had to be placed in the context of a "long-lasting trade relationship" between De Beers and Alrosa which had allowed De Beers to act as a real "market maker".

3. THE CFI'S JUDGMENT

It should be borne in mind that the CFI's observations in annulment cases are always to be interpreted in light of the merits of the case at hand.

However, in *De Beers*, the CFI has reviewed for the first time a commitment decision, and, quite naturally, it makes a couple of points that are bound to have an impact on future commitment decisions.

In addition, some of these points may well have an impact on future Art. 82 EC prohibition decisions based on Art. 7. This client advisory will focus on five such points.

a) Proportionality

While Art. 9—in contrast with Art. 7—does not explicitly refer to the proportionality principle, the CFI observes that this principle also applies where companies voluntarily offer commitments and that the Commission therefore cannot use the Art. 9 route to make binding commitments that are not "necessary to re-establish the situation which existed prior to the infringement".[7] In other words, it is not enough that the commitments are sufficient to address the competition concerns. They must also "satisfy the criterion of necessity".[8] It is irrelevant that the market analysis and the identification of the infringement under the Art. 9 procedure are "less definitive than those which are required for the application of Art. 7 (…)".[9] Nor does it matter that the companies have offered their Art. 9 commitments on a voluntary basis because, in the end, these have to be made binding by the Commission's decision.[10] It follows

5 See point 196 of the judgment.

6 See §§ 31 and 46 of the Decision.

7 Points 92-93 and 103 of the judgment.

8 Id., point 121.

9 Id., point 100.

10 Id., point 105.

that "the Commission cannot lawfully propose to the parties that they should offer it commitments which go further than a decision which it could have adopted under Art. 7 (…)".[11]

The interesting point here is not so much that the CFI confirms that the principle of proportionality also applies in Art. 9 procedures (a conclusion shared by the Commission), but rather that this principle applies in exactly the same fashion as in Art. 7 procedures.

This means that the Commission cannot use the Art. 9 procedure to cash in on "overbroad" voluntary commitments, i.e. commitments that provide an extra tonic to competition without there being an identifiable competition concern in the first place.

In other words, a certain degree of pragmatism may be fine in the context of Art. 9, but it should not lead to "overkill".

b) Judicial review

The CFI points out that judicial review of Art. 81 or Art. 82 EC decisions, including commitment decisions, is limited to verifying whether the Commission has committed any manifest errors only if these decisions contain "a complex economic assessment". In merger cases, judicial review is always so limited since the Commission's assessment is, by its very nature, prospective and hence complex.[12]

If the Commission accepts a commitment proposal without examining alternative solutions on the ground that this "would have required a complex economic assessment which Art. 9 (…) is intended to avoid", judicial review is not limited to verifying the existence of manifest errors, and the CFI can proceed with a full review of the adequacy of the commitments.[13]

In the past, the CFI has always left a margin of discretion to the Commission in Art. 81 and 82 EC cases without suggesting that its enforcement actions were any less complex than in merger cases. However, let us not read too much into the CFI's suggestion that there is a different standard of judicial review in merger cases, given the fact that merger analysis is prospective whereas Art. 81 or 82 analysis focuses on existing practices and is therefore retrospective. It seems indeed likely that the CFI only intended to warn the Commission not to use the Art. 9 procedure for the purpose of creating more competition than there was competition to be restored as a result of the anti-competitive conduct identified in its preliminary assessment. The Commission's own candor about the need for some degree of pragmatism in Art. 9 cases seems to have triggered that warning.[14]

c) The notion of abuse

Referring to the fact that under the second commitment proposal, De Beers would reserve 35% of Alrosa's diamond production for resale, the CFI observes that, "even if it were accepted that [these purchases] could have allowed [it] to maintain or strengthen its dominant position, an infringement of the competition rules would not necessarily be established".[15] The Commission cannot require a dominant company to refrain from such purchases, if that company "does not, in so doing, resort to methods which are incompatible with the competition rules". Indeed, "while special responsibilities are incumbent on [a dominant company], they cannot amount to a requirement that the very existence of the dominant position be called into question".[16] The CFI even criticizes the Commission for having accepted the third commitment proposal (which implies the termination of all supplies in 2009) "with the clear intention of weakening De Beer's role as market-maker".

To our knowledge, this is the first time that the CFI uses the (in)famous *Michelin I* quote concerning a dominant company's "special responsibility" in the dominant company's favor, and not as a prelude to an explanation why that company's conduct is abusive.[17] The CFI takes

11 Id., point 140.

12 Id., points 108-110.

13 Id., points 124-125.

14 See point 124, cit. above.

15 Point 146 of the judgment.

16 Id.

17 Case 322/81, *Michelin v. Commission*, judgment of 9 November 1983, [1983] ECR 3461, point 57.

the refreshing view that the (partial) exclusive dealing agreement which enables De Beers to maintain or even strengthen its market position is not *per se* unlawful. The CFI thus advocates an effects-based approach. Remarkably, it adopts this approach in a case where the commercial relationship between the parties to the exclusive dealing agreement is not just a vertical one. Alrosa and De Beers are each other's closest competitors, and the agreement enabled De Beers to strengthen its dominant position. [18]

d) The impact of commitments on the dominant company's trading partners

In the CFI's view, the Decision "exceeds the powers of the Commission under Art. 82 EC", because it "*de facto* obliges Alrosa, which is not subject to the procedure initiated under Art. 82 EC, to make significant changes to its structure and activity in order to compete with De Beers outside the CIS, and to do so within a period of three years", "thus forcing [it] to work towards a change in the structure of the market for the production and supply of rough diamonds".[19] According to the CFI, the complete and indefinite prohibition of any supply arrangements between Alrosa and De Beers could only have been justified in "exceptional circumstances", possibly in a situation where both trading partners would have been found to hold "a collective dominant position".[20]

In Art. 82 cases, prohibition as well as commitment decisions will always have an impact on a dominant company's trading partners. Customers risk losing attractive rebates, convenient tying arrangements, etc. In that sense, they too will have to "work towards a change in the structure of the market".

However, in purely vertical sale/purchase situations, the CFI is—in our view—unlikely to consider such consequences as a sign of *ultra vires* enforcement action on the Commission's behalf.

The present case is different. Alrosa is not just De Beers' supplier but also—and above all—its closest competitor, and the Decision was meant to enable Alrosa to fly on its own wings by 2009. In Commissioner Kroes' words: "(…) there is an opportunity for genuine competition. De Beer's long-running primacy can now effectively be challenged by its biggest competitor Alrosa".[21]

Therefore, the CFI rather seems to hold against the Commission that, in the absence of compelling evidence of a cartel between De Beers and Alrosa, it did not check whether Alrosa would have been capable to challenge De Beers' position by 2009 by selling its entire production outside the CIS to customers through its own distribution network. In other words, the CFI annulled the commitment Decision because the Commission had not adequately assessed the effectiveness of the commitments that it had accepted.

e) Alrosa's right to be heard

The CFI concludes that until the very end of the Art. 9 procedure, the Commission should have accorded Alrosa the rights given to an "undertaking concerned". This is because of its unique status as De Beers' contracting partner in the contentious supply arrangement, its status as "undertaking concerned" in the parallel Art. 81 EC case in which it submitted a joint reply to the SO with De Beers and, last but not least, its involvement in the first and second commitment proposals.[22]

The Commission adopted its Decision only a few weeks after it had invited Alrosa to comment on the non-confidential third-party observations concerning the second (joint) commitment proposal and on the De Beers' third commitment proposal. This deprived it of the opportunity to exercise its right to be heard fully, "even though the extent to which such an irregularity might have affected the Commission's decision cannot be precisely determined in the present case".[23]

18 Bearing in mind Alrosa's market share (above 20%) and the volume of the purchased diamonds under the second commitment proposal (35% of Alrosa's production), one could argue that the supply agreement produced a foreclosure effect of a little more than 7%.

19 Points 147-149 of the judgment.

20 Id., point 141.

21 See IP/06/204, 22 February 2006.

22 Points 175-187 of the judgment.

23 Id., point 203.

Clearly, the Commission could have avoided trouble, had it tested the third commitment proposal more fully with Alrosa instead of rushing for a final Decision. After all, the effectiveness of the commitment depended on Alrosa's capacity to compete more aggressively with De Beers from 2009 onwards.

Alternatively, the Commission should have examined from the outset whether the two companies held a collective dominant position and were abusing it. The reference to "exceptional circumstances" suggests that the CFI would have found it appropriate for the Commission to accept the third commitment proposal without further analysis in such a situation. An interesting question—and one that is bound to remain unanswered—is whether this implies that the CFI would have annulled—as disproportionate—a decision based on Art 7 prohibiting the supply agreement and containing an immediate cease and desist order.

We hope that you find this brief summary helpful. If you would like more information, or assistance in addressing or commenting on the issues raised in this client advisory, please feel free to contact:

Luc Gyselen
+32 2 517 6331
Luc.Gyselen@aporter.com

Audrey Mikolajczak
+ 32 2 517 6313
Audrey.Mikolajczak@aporter.com

Alexandra Maingard
+ 32 2 517 6330
Alexandra.Maingard@aporter.com