

CURRENT CHALLENGES TO COMPETITION LAW AND POLICY

*Slide-to-unlock competition in high-tech markets:
the need of rethinking IPRs in the digital revolution
era*

*European Banking Union: are the recent single
banking supervision and resolution truly European?
Lessons from the application of state aid rules on
financial institutions*

*The curious case of umbrella claims between
economic analysis and the arduous emergence of a
European private law*

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EXECUTIVE SUMMARY

This thesis presents three papers on three different competition law enforcement cases. These three cases have caught the author's attention because of the intrinsic novelty of the challenges they pose to predominant competition law and policy. In addition, their scrutiny inevitably allowed for a more general reflection on the evolving role of competition law in modern legal systems, especially in the European law framework. This chapter plays an introductory role in that it sets the tone for the following case studies, but beyond that, it functions as an executive summary of the entire thesis. Furthermore, it intends to give an account of the aforementioned more general reflections on the role of competition law in modern legal systems.

Competition laws are nowadays in place in all the developed countries and emerging economies. They have developed at country level in order to ensure a sound and fair competition in national markets. The particular names that these laws have taken on in the different nations usually reflect what is the country-specific bigger threat to a full-fledged competition in the respective national economies. For instance, the US antitrust law and the German Bundeskartellrecht reveal a common fear of collusion of firms that leads to concentrated market power, while the Chinese and the Russian "anti-monopoly" laws appear to be more concerned with single conducts of dominant players, traditionally ex-legal monopolists.

The historical origin of this law can be traced back to the English common law of restraint of trade that has inspired the US Sherman Act, adopted in 1890. At the end of World War II, the USA suggested the implementation of similar law also in the Europe under reconstruction. Therefore, the first European competition dispositions can be found in the European Coal and Steel Community agreement signed by France, Belgium, Italy, Germany, the Netherlands and Luxembourg. Only six years later, the same six states officially founded the European Economic Community with the ratification of the Treaty of Rome. The European competition law rules are part of the European law since its earlier existence and can be traced back to the 1957 Treaty. They are also the only norms of the Treaty that refer to subjects other than Member States, namely European businesses. Nowadays, the US antitrust law and the

European competition law represent the main systems of reference in the development of this type of legislation and its application.

While their statutory languages sounded incredibly similar, their policy goals and enforcement usually differed quite substantially. Historically, the US antitrust systems had to deal with the dismantlement of trusts that held the American economy hostage, while the European competition law got assigned the additional policy task of creating and protecting the European single market integration. Moreover, the US enforcement has always been more receptive to instances and arguments from sources other than the law (e.g. the economic analysis), thanks to the facilitating structure of the common law application. In contrast, the European enforcement has traditionally applied a more formalistic approach based on a rigorous interpretation of the wording of the law, as it is proper of the civil law tradition to which most of the European countries (especially the initial founders) belong. Different weights attached to the private or to the public interest in the two antitrust philosophies on both sides of the Atlantic also contributed to a divergent outcome in terms of preference for the private (in the case of the US) or the public enforcement (in Europe).

The economic globalization, made possible by the new ICT means, has deeply changed markets and their way of making business since the beginning of the new century. These changes impacted on the antitrust systems as well due to increased cooperation in international trade and yet despite the national scope of competition laws. First of all, they led to a convergence in the US and European competition policy and its enforcement. That convergence was due to the similarity of the challenges with which both markets had to deal, but also due to the need of not penalizing national firms on the global market by a too differently stringent law application. This trend is evident in the emergence of a shared US and EU preference for a more economic approach to antitrust issues that should minimize the still existing enforcement differences over time, reducing them to a divergence of minor policy sub-goals rather than totally opposite outcomes as happened in the past. The adoption of this policy approach is testified by the recent tendency to issue very similar policy statements on the same topics on both sides of the Atlantic.

Secondly, having a competition law became an essential asset for any country that would like to compete globally. Therefore, competition law surged from the status of

"special", market-dedicated, technical legislation between the public and private law spheres, up to acquire the status of essential law for any institutional actor that aspires to play a significant role in the global economy. Moreover, its now long-standing application made its clauses and standards familiar also to the traditionally more resistant civil law systems that, at the beginning, even tended to confuse it with the more established unfair competition rules, though with a recognized slight "economic regulation" flavour.

Lately, antitrust application has been unexpectedly assigned to tasks that resemble more closely those of the residual standards or general clauses of the legal systems rather than those of a specific law. It may sound like a provocative statement, but the three papers presented in this thesis are actually examples of this new tendency in the innovative resort to competition law to fulfil aims that traditionally fall beyond its scope.

The first case refers to the patent failure that represents a problem, especially for high-tech markets, on a global scale. The second case belongs to the Europe-specific context, dealing with the financial crisis and integration of the single market. Finally, the third is a European private enforcement case that deals with a matter that has not been clearly settled yet by the Supreme Court, therefore it might re-invigorate a comparative debate.

1. Competition law as a remedy for the anticompetitive (mis)use of other rules from different branches of law: the case of abusive patent litigation

The case of abusive patent litigation in high-tech markets is not new, but it recently degenerated furthermore. Therefore, the paper's primary aim is to investigate the current functioning of the patent system in those markets. In order to do so, it analyses the recent so-called patent bubble that animated the mobile Internet hi-tech industry. First, it correlates the contractual dimension of the bubble, i.e. the huge patent portfolio acquisitions that took place in 2011, to its judicial dimension, i.e. the following numerous patent lawsuits among industry's incumbents and new entrants. The paper more carefully analyses the lawsuits involving Samsung and Apple in ten jurisdictions around the world to argue for the emergence of a new litigation model according to which producing entities assert own patents in a troll-like manner.

Under this litigation model, the strategic use of IPRs can significantly distort the competition in the industry. Together with the losses typically associated to an anticompetitive exclusionary practice, the detriment of the social welfare is enhanced by the significant amount of resources wasted in unnecessary excessive litigation. The paper shows that recent IP law and policy attempts to reform the system have been too soft. It also argues that antitrust remedies for this problem cannot fix it once for all. Antitrust authorities cannot do more than issuing specific guidelines on the assessment of the abusive use of IPRs among competitors. This could help in antitrust case-by-case intervention but without a patent system reform the problem cannot be eradicated. Hence, the paper concludes with a desperate call for a patent law reform that could be able to remodel the IP system that was designed for the first industrial revolution and has unsuccessfully tried to fit into the new business world that the digital revolution is nowadays writing. More concrete proposals are those that argue for a switch from a property to a liability rule.

This case exemplifies the use of competition law to stem harms caused by the misuse, gap or lack of specific regulation that lead to business strategic misconducts. In the context of quickly evolving markets, these episodes are not rare and, both in the US and in Europe, this failure of the patent system has been temporarily fixed through sporadic antitrust interventions. This solution can work at the beginning, but it is not sustainable in longer-term perspective for the sake of high-tech markets, major drivers of growth and innovation in modern societies.

2. Competition law as a residual (emergency) law for sectors in which an effective harmonized law is missing: the case of state aid policy for the financial sector during the crisis.

The second paper deals with the European financial crisis management provided by the European Commission's state aid policy. Three main phases of such crisis-specific enforcement of competition rules can be distinguished, namely the rescue, restructuring and banking union eras. The analysis tries to isolate the main lessons from the recent state aid policy for the financial sector and comment on the new financial institutional architecture for the after-crisis Europe. On the basis of this comparison, the conclusive arguments recommend to design and enforce the single

supervisory mechanism and the single resolution mechanism in a way that would allow them to be joined by as many European Union countries as possible and not just by euro-area ones, for the final benefit of the integrity of the single market for financial services.

The EU Commission's state aid policy approach at issue has provided a uniform framework for the Member States to tackle the distress suffered by the European financial institution at the bursting of the crisis. In the absence of a harmonized regulation on the resolution of distressed institutions, an emergency, but uniform, use of state aid policy seemed to be the second best solution to adopt. Indeed, the Commission intervention provided a firm but flexible approach in a timely manner that contributed to prevent the collapse of the sector and, at the same time, preserved a level playing field in the internal market for financial services.

3. Competition law enforcement as a way to harmonize the European private law: the case of umbrella claims.

The *Kone* decision of the European Court of Justice established the possibility of awarding damages for harm stemming from umbrella pricing. Thereby, on the one hand, this interpretation raises the cost of cartelization and, on the other hand, it expands the scope of the European antitrust private enforcement. The curious case of umbrella claims is the last step in the arduous path towards the definition of European antitrust damages. The paper comments on the decision and reviews the economic and US antitrust law literatures in order to give a preliminary assessment of its quality. Furthermore, it intends to investigate the likely impact of an "indirect" rule on the compensation of "indirect" harm in the national enforcement systems, as well as the eventual effect on the interpretation of the principle of causation. The conclusions highlight the existence of a perpetual trade-off between national legal uncertainty and effectiveness of EU rules, which characterizes the application of EU law when both the lack of uniformity of national systems and the failure of the process of harmonization *de facto* delegate policy- and law-making to the ECJ. The harmonizing role of the ECJ interpretation of EU law has been already broadly assessed by many commentators. The ECJ preliminary ruling activity has the upside of being faster than the ordinary legislative process that often suffers from the

difficulty of reaching the necessary political consensus, even though this is a guarantee of a more democratic choice. In some very sensitive "national" or substantial matters, the harmonization method often fails or simply takes too long to be fully beneficial, taking into account the cost of its duration. This is for instance the case of the impossible mission of harmonizing the European private law, namely in the area of property, contract and liability.

The third case presented in this thesis assumes a greater importance under this perspective. If the *Kone* preliminary ruling would ever manage to inform a new interpretation of a dogma of the Romanistic laws as causation, for the sake of the effectiveness of the EU law and in a EU-uniform manner, it would represent a case for competition law enforcement to even become a driver of integration through enhanced European private law harmonization.

I acknowledge that the more general reflection presented in this summary might stretch the reasoning on the current role of competition law in the modern legal systems a bit too far. The intention was not just to portray the situation, but rather to extrapolate a pattern. The trend unequivocally signals how competition law nowadays plays a pivotal role in addressing market problems. Corporate and international trade law used to be the champions in this field and have now to share the podium with it and have to stop treating it as a younger stepsister.

The use of the antitrust as a primary filter to detect and to fix market malfunctioning due to non-traditional sources of threat to competition - because of their attitude of resulting also in anticompetitive practices - is a reality both in the US and in EU. Furthermore, in Europe, competition law is still fundamental in preserving the internal market level playing field, especially in those sectors where an effective harmonization still lacks, as it is the case of financial (and non-financial) services. Finally, the private enforcement of competition law may also foster European integration by indirect means, like eventual spillover effects in terms of harmonization of principles relevant to damages actions.

Moreover, I would like to highlight that what becomes a feature of the EU competition enforcement - because it successfully deals with a problem in the internal market - might become also a tool of the antitrust systems that are inspired by the EU model or by mixed EU-US models. Also, through the above-recalled tendency of convergence

among the EU and US systems, it might even lead to a new US approach. This is a further reason to look carefully at the actual aftermath of *Kone*. To check whether its eventual effects on European national judges might revive the interest of the US Supreme Court for ruling on the matter, eliminating uncertainty and reviewing also its interpretation of causation in damages actions. This potential scenario would ascertain the ability of competition law to drive further harmonization beyond its original national boundaries, even if in very mediate and non-institutional terms. But such a result would also highlight the overt relevance of its influence on modern legal thinking.

**SLIDE-TO-UNLOCK COMPETITION IN THE HIGH TECH MARKETS: RETHINKING IPRs IN THE
DIGITAL REVOLUTION ERA ***

Roberta Cossu[†]

ABSTRACT

The paper's primary aim is to investigate the current functioning of the patent system in those markets. In order to do so, it analyses the recent so-called patent bubble that animated the mobile Internet hi-tech industry. First, it correlates the contractual dimension of the bubble, i.e. the huge patent portfolio acquisitions that took place in 2011, to its judicial dimension, i.e. the following numerous patent lawsuits among industry's incumbents and new entrants. The paper more carefully analyses the lawsuits involving Samsung and Apple in ten jurisdictions around the world to argue for the emergence of a new litigation model according to which producing entities assert own patents in a troll-like manner. The paper intends to show that recent IP law and policy attempts to reform the system have been too soft. Finally it concludes with a desperate call for a patent law reform that could be able to remodel the IP system, since it was designed for the first industrial revolution and has unsuccessfully tried to fit into the new business world that the digital revolution is nowadays writing.

Keywords: abuse of patents, smartphone wars, patent reform

JEL: K21, K4, O3

SUMMARY: 1. A CLOSER LOOK AT THE INTERNET MOBILE INDUSTRY: THE 2011 MAJOR PATENT ACQUISITIONS AND THE 2012 MAJOR PATENT LITIGATIONS 1.1 THE APPLE/SAMSUNG LITIGATIONS: A TOUR AROUND THE WORLD IN TEN JURISDICTIONS 2. THE GAP BETWEEN PATENT AND COMPETITION LAW AND POLICY THAT LEADS TO EXCESSIVE PATENT LITIGATION 2.1. FIRST ATTEMPTS TO ADDRESS THE GAP IN THE US AND IN THE EUROPEAN SYSTEMS 2.2. OPPORTUNITIES FOR POLICY: THE GOOGLE/MOTOROLA MERGER VIS-À-VIS THE SAMSUNG COMMITMENTS TO THE EUROPEAN COMMISSION 3. CONCLUSIONS ON A DESPERATE CALL FOR A PATENT SYSTEM REFORM.

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1. A CLOSER LOOK TO THE MOBILE INTERNET INDUSTRY.

The management of technological innovations plays a fundamental role for firms that compete in hi-tech sectors, since innovations are a key factor for success, differentiation, progress and then competitive advantage. Just like in any other market, interaction strategies are based on a smart and wise management of key resources, sources of competitive advantage. In high-tech sectors, the main strategy results in the accurate protection of innovations through a broad and diverse range of tools, where IPRs and their regulation become crucial. Hence, this also holds for the mobile Internet industry, although this market shows further peculiar features that are worth discussing.

Layne-Farrar (hereinafter "LF") developed a very compelling narrative in her survey about patent infringement litigation in telecommunications: «it is not just "trolls" shaping the patent landscape today; "giants" and "dwarves" are in the thicket as well¹». The terms "trolls"² and "patent thicket"³ are not new in the literature on these markets. Nevertheless, it is worth explaining better what the author means by "giants" and "dwarves". Giants are multinational companies that hold large portfolios of patents which are relevant for the mobile telecommunications sector, mainly the production of devices such as smartphones and tablets. Whereas dwarves are big companies operating in other high-tech sectors which try to enter the mobile Internet industry by leveraging their exclusive rights to a few relevant patents for the production of the named devices. Therefore, the nicknames do not relate to the size of the companies *per se* (as they

1 It was the study that induced my first reflections on this topic and it is the main reference of this introductory paragraph. LAYNE-FARRAR, *The Brothers Grimm Book of Business Models: A Survey of Literature and Developments in Patent Acquisition and Litigation*, 2012, p.1.

2 A non-producing entity (NPE) is usually identified as a "troll" in the industry jargon. As specified in the 2011 FTC Report on IP: «The term NPE also commonly refers to firms that obtain nearly all of their patents through acquisition or purchase in order to assert them against manufacturers. Such firms are sometimes called "trolls" by detractors. For clarity, this report refers to these firms as "patent assertion entity" rather than the more common "non-practicing entity" (NPE) to refer to firms whose business model focuses on purchasing and asserting patents. The literal definition of non-practicing entity is broad enough to encompass the start-ups, universities, and design houses.», see US Federal Trade Commission, *The evolving IP marketplace: aligning patent notice and remedies with competition*, 2011, p. 60. While the term "patent thicket" refers to « an overlapping set of patent rights requiring that those seeking to commercialize new technology obtain licenses from multiple patentees», see SHAPIRO, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard-Setting*, 2001, p. 1.

3 Products covered by patent thickets are usually multi-patent products which present densely overlapping exclusive rights held by multiple patent owners, as defined by ADDY, DOUGLAS, *Mind the gap: economic costs and innovation perils in the space between patent and competition law*, 2012, p. 7.

intuitively might seem to suggest), but rather on the relative size of their exclusive rights to relevant innovations. These allegories are indeed quite helpful to fully realize the roles played in the market by incumbents and new entrants in the mobile Internet industry. This industry was born from the marriage of the mobile phone and the Internet device industries imposed by the technological convergence Internet-PC-mobile. Two principal events re-shaped the young industry's global competitive field in the recent years: the major patent portfolio acquisitions in 2011 and the major patent lawsuits that followed.

Surviving in such a patent thicket is already an arduous task in itself. It can be perceived as even daunting if we further take into consideration that it is populated by giants who are armed with huge patent portfolios as shields to protect themselves from attacks by newcomers. It is then easy to understand why dwarves, who tried to enter the market recently, had first to find a way to climb these high entrance barriers. The reaction has thus been to acquire equal or even bigger shields to compete in the mobile Internet industry, which started revealing its promising economic potential to outsiders approximately from 2010⁴.

It is intuitive to understand that major operators of the market, both incumbent and new entrants, were collecting shields and weapons because they wanted to be ready in case of war. Such a war duly broke out the following year and it moved the battlefield from the negotiation tables to the courts.

At this point, competing was already much more than just producing and distributing rival products. The strategic interaction within such an industry necessarily involved the detention of a large volume of IPRs to achieve a

4LF extensively reported and commented the "great patent bubble" of 2011. The author describes four major acquisitions that represent significant dots from which it is possible to extrapolate a trend of increasing sophistication and entropy. These deals namely are: the acquisition of Novell by CPTN Holding LLC (alias a consortium including Microsoft, Apple, EMC and Oracle), of Nortel by Rockstar Bidco. (alias Microsoft, Apple, EMC, Ericsson, RIM and Sony), the Google-Motorola merger, the acquisition of Nokia by Mosaid. See again LAYNE- FARRAR, cit., pp. 10-17. In brief, after the Internet bubble, some technology and software firms got bankrupted or else needed to auction off some assets to pursue significant restructuring. This was also the case of Novell and Nortel that got immediately acquired by consortiums of telecommunication's "giants" when that industry was merging to the mobile PC. In the surge of the mobile Internet, Google tried to enter the market but was excluded twice from the so-called "Micropple" patent club that won the first two deals above-mentioned. As a dwarf in this nascent industry, Google needed a strategy to compete that was fulfilled by the acquisition of Motorola. This only deal increased its patent portfolio of mobile Internet-relevant rights from 2000 to 17000 (plus 7500 application). The last mentioned deal, Nokia-Mosaid, is the most sophisticated one because it did not raise competition authorities' concerns, unlike the other three. Nevertheless, it let Microsoft enter the deal passively by a highly sophisticated negotiation scheme that involved also a third intermediate entity, Core Wireless.

substantial power in forcing and concluding cross-license agreement, or else judicial settlements, at the most profitable conditions. This was partly inherited by the praxis of the telecommunication sector.

LF summarized in a very helpful table the legal battles which took place in between 2011 and 2012 over relevant patents for the telecom industry. She found that 16 out of 24 reported actions had Apple, Google or Microsoft as a party, i.e. the dwarves that had spent the year 2011-2012 desperately looking for some patent portfolios to acquire⁵. Another piece of striking information derivable from the table is that ten suits involved Apple and some Android-device manufacturers. This suggests that most likely the real underground battle is once again about operative systems, as it was for Microsoft Windows at the time of the first personal computers' ("PC") advent. This is surely due to a broadly recognized truth: consumers' loyalty towards a new technology is mainly induced by the tool that helps them using the technology itself, rather than its single physical components. In essence, the interface - and its own many ways to inter-operate with as many more applications as possible - is the most competitive asset.

This peculiarity is one of the many reasons why it is interesting to analyze closely a litigation involving Apple against an Android-device manufacturer. Among all of them, those involving Samsung are more significant because they present all the main recurrent features of current smartphone patent wars and, at the same time, they involved an unusually high number of jurisdictions on a global level. Furthermore, they present the additional feature that is the nature of the relationships - i.e. a supply partnership which has never been disturbed by the ongoing litigation and which tied these two operators together outside of ten courtrooms.

1.1 THE APPLE/SAMSUNG LITIGATIONS: THE TOUR AROUND THE WORLD IN TEN JURISDICTIONS

1.1.1. USA

In late April 2011 Apple sued Samsung as a further step in a long line of IP lawsuits against Android-device manufacturers, as already mentioned above. At the time,

⁵Ibidem, cit., p. 20.

Samsung was the Apple provider of DRAM and SSDs for Mac Books and two generations of processors for iPhone, iPod, iPad and Apple TV. Apple claimed that Samsung copied Apple's smartphones in a wide range of elements, from interfaces to packaging design. Its claim was brought under many statutes, namely patent infringement, federal and state unfair competition, trademark infringement, and unjust enrichment. More specifically, Apple invoked the enforcement of seven utility patents, three design patents, trademarks on some iOS system icons, trade dress registrations and packaging for iPhone, iPod and iPad, allegedly infringed by Samsung through its production of all Galaxy smartphones and tablets⁶. As a consequence of such structured complaint, Apple asked the Northern District of California court a total award of damages that should have included treble antitrust damages plus Samsung's wrongful profit restitution, money for corrective advertising and Apple's attorney's fees⁷. A few days later, Samsung reacted by counter-suing Apple and making the fight international: it claimed the infringement of ten standard-essential patents ("SEPs") over wireless data transmission and 3G technology in Korea, Japan and Germany⁸. The main purpose of such a legal strategy was clearly to add new theatres for the conflict, so as to show the concrete power and ability to threaten Apple back with its means. In its countersuit, Samsung claimed "against" Apple a different kind of patents, standard-essential ones, which usually fall under different rules of licensing and enforcement since their bigger attitude to foreclose markets is widely recognized⁹.

6 As in the original Complaint, *Apple Inc. v. Samsung Electronics Co.*, case C 11-1846, North California District Court, filed on 15 April 2011, pp. 6-16.

7 *Ibidem*, pp. 16, 17.

8 See Reuters, *Samsung countersues Apple over iPhone, iPad*, posted on 22 April 2011, at <http://www.reuters.com/article/2011/04/22/us-samsung-apple-idUSTRE73L0DG20110422>.

9 See for instance PETROVČIČ, *Competition law and standard essential patents. A transatlantic perspective*, 2014, pp. 26-28. The author specifies the problem in a dedicated paragraph entitled to "Antitrust concerns with industry standards". She very clearly explains that «there is an inherent risk that participants will use the standardization process as a tool to foreclose competitors from the market. By restricting the access to the standardization process, or making biased selection of technologies, participants can exclude rival's technologies from the standard. Further, *if the standard becomes a de facto requirement for the participation in the market, participants might use the standard as a tool to foreclose companies from the downstream market*. It is thus clear that standardization activities might be considered unlawful under competition law [...] In the 2000s, however, the use of standards has raised new concerns. The focus was ... rather on the unilateral conducts ... of SEPs owners. [...] Once a patented technology has been selected and implemented in the standard, the use of the patent covering that technology becomes essential - a SEP. The concept of SEPs is strictly related to the FRAND commitment. Just like any other patent owner, the SEP owner would have, in principle, the statutory right to exclude third parties from the use of its patented technology... SSOs generally adopt specific rules that aim at facilitating the access to the standard... Only if the the owner agrees to license

The additional lawsuits will be discussed separately below. It is worth adding here that Samsung later counter-sued Apple also in California. In order to persuade the jury of Apple's equal or even worse anticompetitive behavior, Samsung argued that Apple is a new player in the mobile industry and so it needs to use older players' dating research outcomes, such as Samsung's or Sony's ones for instance. In this reconstruction, Apple needed to use SEPs to actively compete in the market for which it should have concluded industry-standard or cross-license agreements. Finally, Samsung asserted two 3G standard patents and three utility patents for which Apple did not pay regular royalties.

The Californian Apple v. Samsung lawsuit ended in August 2012. In the meantime, several injunctions prevented one or the other party from undertaking some strategic business practices or decisions. Hence, each of them tried to influence the ordinary course of the competitor's business management through the court's orders along all the proceeding. In the end, the jury awarded Apple 1,049 billion dollars for damages, against a requested amount of 500 million dollars lost profits plus 2 billion dollars disgorgement of Samsung's wrongful profits and financial damages linked to Samsung's accused products' sales. It also found Samsung patent counterclaims did not deserve any monetary compensation¹⁰. This latter decision was determined by the fact that Apple managed to prove Samsung's asserted 3G patents were exhausted. Samsung patents were used for producing chips that Apple indeed installed on its smartphones, but bought from Intel, which was the entity that actually paid regular royalties on the asserted technology. Moreover, Samsung's move to assert such SEPs at global level became a double-edged sword on an international scale, raising the US and EU competition authorities' concerns. Since standard patents qualify as industry-essential inputs, they must be licensed under fair, reasonable and non-discriminatory (FRAND) terms. Accordingly, also their use in litigation should be subject to some cautions.

its patent under FRAND terms, will the SSO typically consider implementing the patented technology in the standard...In the last decade, however, ... there has been an increasing number of disputes concerning SEPs. As explained, competition authorities have expressed concerns that the SEP owner might engage in opportunistic practices that are harmful for the manufacturers, the standardization process, and ultimately the consumers». [emphasis added]

¹⁰ As it is possible to read in the Amended Jury Verdict, Apple Inc. v. Samsung Electronics Co., case C 11-1846, North California District Court, released on 24 August 2012, p. 15.

The same judge who presided over the case, Lucy Koh, six months later vacated 400 million dollars of that award, responding to Samsung's complaints. In March 2013, she ruled that the jury was wrong in some of the damages calculations and that they could not be sorted out without a new trial¹¹. This damages re-trial was perceived as an appeal by the public opinion, although the infringement was already established as the law of the case. It indeed was a way to keep on requiring injunctions that apparently interested parties more than the liability or damages issues.

Nevertheless, it did pave the way for the real appeal to the United States Court of Appeals for the Federal Circuit. It is interesting to note that a second Apple v. Samsung action started with a preliminary injunction request¹² and a new complaint¹³ about patent infringement that proceeded in parallel with the re-trial and the appeal of Apple v. Samsung I. The Apple v. Samsung II jury verdict was released on 5 May 2014 and surprisingly awarded just 119 million damages to Apple¹⁴. That time Apple decided not to appeal, but rather to propose a motion for permanent injunction over Samsung¹⁵. Such injunction would include the products at issue in the prior trial, but would also involve any «software or code capable of implementing any infringing feature, and/or any feature not more than colourably different therefrom¹⁶», thus including software or code found in newer (even future) devices.

At a first look, it is possible to note that Apple v. Samsung I was more about the diversity of patents involved (utility and design patents v. SEPs) and its major breakthrough was not the billionaire film, but rather the new ways of profiting by injunctions. This trend was confirmed by the comparative static analysis of the two Apple v. Samsung actions.

11 See the Order of 1 March 2013, Apple Inc. v. Samsung Electronics Co., case C 11-1846, North California District Court, available at <http://cand.uscourts.gov/C11-1846/casedocs>.

12 See the Order granting motion for preliminary injunction of 29 June 2012, Apple Inc. v. Samsung Electronics Co., case C12-0630, North California District Court.

13 See Jury Trial Demand – Amended complaint for patent infringement of 31 August 2012, Apple Inc. v. Samsung Electronics Co., case C12-0630, North California District Court.

14 See the final Damages verdict of 5 May 2014, Apple Inc. v. Samsung Electronics Co., case C12-0630, North California District Court.

15 See Public Version of Apple Motion for Permanent Injunction Against Samsung of 15 May 2014, at <http://de.scribd.com/doc/225938808/14-05-24-Public-Version-of-Apple-Motion-for-Permanent-Injunction-Against-Samsung>.

16 *Ibidem*.

1.1.2. KOREA AND JAPAN

As above-mentioned, Samsung counter-suing strategy against Apple American litigation focused on asserting SEPs in three countries, for very clear reasons. First of all, it chose South Korea for this is the home country of the company. Secondly, the choice of Japan came that is the market where Apple is the dominant smartphone seller. Thirdly, in Germany it requested a Europe-wide ban by enforcing European patent rights that cover its 3G/UMTS technology.

The Asian lawsuits that Samsung initiated in August 2011, while firstly counter-suing Apple, ended around the end of the American litigation. The Korean court recognized that each party had infringed the other party's rights; therefore they awarded damages to both companies and ordered temporary sales bans on the respective infringing products in South Korea. Among the banned products, there were not any of the latest models of both producers¹⁷.

The Tokyo District Court concluded that Samsung's Galaxy smartphones and tablets did not violate Apple asserted patents. In this case, Apple was ordered to reimburse Samsung's legal costs¹⁸.

In the end, the Asian disputes were not remarkable. Unlike the United States, these jurisdictions do not allow patent disputes to be held before juries¹⁹. Therefore, the outcomes of the litigation are usually less unpredictable and more moderate.

1.1.3. THE EUROPEAN FRONT: GERMANY, THE NETHERLANDS, FRANCE AND ITALY

After the Asian courts, Germany²⁰ was the European country that Samsung chose for the European assertion of its 3G/UMTS SEPs against Apple. Apple immediately

17 See Seoul Central District Court, *Samsung Electronics Co., Ltd. v. Apple Korea Ltd* (case no. 2011 Kahap 39552); *Apple Inc. v. Samsung Electronics Co., Ltd.* (case no. 2011 Gahap 63647), as reported and explained by Mueller, *List of 50+ Apple-Samsung lawsuits in 10 countries*, posted on FOSS Patents Blog, 28 April 2012.

18 Tokyo District Court, *Samsung Electronics Co., Ltd. v. Apple Japan, Inc.* (case no. 2011 (Yo) No. 22027); *Samsung Electronics Co., Ltd. v. Apple Japan, Inc.* (case no. 2011 (Yo) No. 22028); *Apple Inc. v. Samsung Japan Corp.* (case no. 2011 (Yo) No. 22048); *Apple Inc. v. Samsung Japan Corp.* (case no. 2011 (Yo) No. 22049), as reported and explained by Mueller, *cit.*, 28 April 2012.

19 See for instance TAKENAKA, *Comparison of U.S. and Japanese Court system for patent litigation: a special court or special divisions in a general court?*, 1999.

hit back by filing a complaint²¹ for a ban of Samsung Tablets allegedly infringing its iPad design. The “Risk” round played here favored the Apple’s move. The Landgericht of Düsseldorf accepted Apple request for a preliminary injunction which banned the sale of Samsung Galaxy Tab 10.1 in Europe on the basis of claimed infringements of two interface features²². After Samsung’s allegations and the unfavorable opinion expressed from the Netherlands on such an EU-wide ban, the court had to restrict the ban order to the only German market, but it also extended it to include the Galaxy Tab 7.7. A few months later, the judge of Düsseldorf upheld the temporary ban, making it final²³. Such a judgment on trade design ruled that Apple design was not the only possible technical solution to produce the device at issue. *De facto*, it forced Samsung to redesign the Galaxy tablet or either to retire it from the German market. In this way, Samsung had to suffer significant losses in terms of unsold pieces and obviously the redesigning and producing costs of the new “German” tablet, which differentiates itself from Apple’s one mainly because of a “less rectangular shape”, with more rounded angles.

In the meantime, the Mannheim regional court ruled against two Samsung’s claims that alleged Apple infringed its SPEs²⁴. Moreover, the interpretation of the Apple right to that interface feature was narrower than expected; therefore it tried to seek compensation in other German courts, hoping in more favorable interpretations. Hence, Apple tried again to assert its rights on interface features, such as the “slide-to-unlock” and the “over-scroll bounce” commands, before the

20 The preference for Germany as the European *forum* was a rational choice. A comprehensive study conducted across four European jurisdictions (Germany, France, the Netherlands and the UK) found that Germany hear the largest number of cases, both in absolute and in relative (country-sized) terms. See CREMERS, ERNICKE, GAESSLER, HARHOFF, HELMERS, McDONAGH, SCHLIESSER, VAN ZEEBROECK, *Patent litigation in Europe*, 2013, p. 59. A considerable number of patents tend to be litigated in multiple jurisdictions, due to the high fragmentation for the European legislation on the matter. Though the majority of them are litigated only in Germany, which is also the country where infringement cases last longer and some courts statistically are more patent owner-friendly.

21 As reported by Mueller, *Apple’s complaint that led to the EU-wide preliminary injunction against the Galaxy Tab 10.1*, posted on FOSS Patents Blog, 10 August 2011, where he also uploaded a copy of the complaint.

22 See Decker, Kjetland, *Apple Wins Order Against Samsung Tablet in EU*, posted on Bloomberg.com, 10 August 2011.

23 See Mueller, *Preliminary injunction granted by German court: Apple blocks Samsung Galaxy Tab 10.1 in the entire European Union except for the Netherlands*, posted on FOSS Patents Blog, 9 August 2011.

24 Landgericht (regional court) Mannheim, *Samsung Electronics GmbH v. Apple, Inc. and Apple GmbH* (case no. 7 O 247/11), and *Samsung Electronics Co. Ltd v. Apple Inc.* (case nos. 7 O 19/12, 7 O 54/12, 7 O 53/12, and 7 O 18/12), as reported by Mueller, *cit.*, 28 April 2012.

Munich Landgericht²⁵ and the Düsseldorf Higher Regional Court²⁶. Unlike the first time, Apple did not succeed. More specifically, it did not manage to obtain another ban on the re-designed Samsung's tablets; therefore its German monopoly had to end.

At the same time, the opposition of the Netherlands for an EU-ban granted by a German court made the two companies realize that European IP law is still highly fragmented, unlike the European market. Therefore, in order to win the EU market, they needed to resort to several national tribunals. Accordingly, Apple started seeking for injunctive relief in the Netherlands, while Samsung initiated lawsuits in France and Italy.

The Dutch judge expressly denied a request of injunction to ban the selling of Apple's smartphones and tablets, stating that 3G technology is a standard and so Samsung should have licensed it on FRAND terms, which it did not²⁷. The French²⁸ and Italian²⁹ courts, invoked after the release of iPhone 4S in order to strategically obtain a sales ban before Christmas, similarly denied to grant such injunctions and did not have any follow-up. In the Italian preliminary decision, it is possible to read an argument similar to the "Intel defense" used in the American litigation. The patent exhaustion doctrine is again cited against Samsung's claims over patented technologies needed to produce chips.

Without being exhaustive, these are the more relevant disputes which took place on the European front, the main implication of which has been the ability to raise the attention of the European competition authority. The EU Commission opened an investigation on Samsung's practices, the offensive assertion of SEPs, at the beginning of the year 2012. The DG Comp's anticompetitive concern was whether the many injunctive reliefs sought by Samsung in several national European courts, in the context of its global patent war against Apple, could actually configure an

25 Landgericht München I (Munich I Regional Court), *Apple Inc. v. Samsung Electronics GmbH* (case no. 21 O 26022/11), as reported by Matussek, *Apple Loses German Court Bid to Ban Samsung Galaxy Tab 10.1N, Nexus Phone*, posted on Bloomberg.com, 1 February 2012.

26 Landgericht Düsseldorf, *Apple Inc. v. Samsung Electronics GmbH* (case nos. 14c O 292/11), as reported by Matussek, *Apple Loses Second Bid to Ban German Sales of Samsung's Galaxy Tab 10.1N*, posted on Bloomberg.com, 9 February 2012.

27 Rechtbank 's Gravenhage, *Apple Inc. v. Samsung Electronics Co., Ltd.* (case no. KG 11-730 and 731) as reported and explained by Mueller, *cit.*, 28 April 2012.

28 Tribunal de Grande Instance de Paris, *Samsung Electronics Co. Ltd and Samsung Electronics France v. Apple France et al.* (case no. 11/10464).

29 Tribunale di Milano, *Ordinanza, Samsung Electronics Italia s.p.a. v. Apple Inc.* (N. R.G. 45629-1/2011) e *Ordinanza Samsung Electronics Italia s.p.a. v. Apple Inc.* (N. R.G. 59734/2011).

abuse of its SEPs - apt to distort competition in the mobile device sector. Moreover, the concern included the view of this conduct as a violation of Samsung's irrevocable commitment to license any SEPs relating to European mobile telephony standards on FRAND terms³⁰. Such an abuse would be classifiable as a species of the practices that fall under the general prohibition stated by article 102 TFEU, against the abuse of a dominant position which may affect trade and prevent or restrict competition. It would also conflict with the Commission's Guidelines on standardization³¹. According to the Guidelines, Standard setting organizations (SSOs), including ETSI, require the owners of patents that are essential for the implementation of a standard to commit to license these patents on FRAND terms in order to ensure effective access to the standardized technology³². At the end of 2012, the Commission issued a Statement of Objections disclosing its preliminary view in the ongoing investigation and stating that, in the exceptional circumstances of the case, these practices constitute an abuse of a dominant position within the meaning of Article 102 of the TFEU and Article 54 of the EEA agreement³³. Samsung did not agree with the concerns expressed in the statement of objections, nevertheless it offered commitments pursuant to Article 9 of Regulation (EC) No 1/2003 to meet the raised anticompetitive concerns³⁴, in the fall 2013. The Commission made Samsung's commitment proposal public and gave one month for third parties to send comments and observations on it (the so-called "market test") before deciding for either its acceptance or its refusal. In this proposal, Samsung expressly commits not to seek an injunction of its existing and future mobile devices' SEPs for five years before any European national court if the potential licensee decides to comply with its own designed licensing framework

30 Pursuant to Decision 128/1999/EC20, of the European Parliament and of the Council of 14 December 1998 on the coordinated introduction of a third-generation mobile and wireless communications system (UMTS) in the Community (OJ L 17, 22.1.1999, page 1), the European Telecommunications Standards Institute (ETSI) was appointed to approve or develop the European standards needed to deploy UMTS services. Samsung gave its commitment to ETSI (alias the European SSO) in December 1998. As indicated in the Commission decision of 29.4.2014, C(2014) 2891, para 60, «in line with Article 6.1 of ETSI IPR policy, it committed expressly to grant irrevocable licences».

31 Communication from the Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, Official Journal C11, 14 January 2011, p. 1.

32Ibidem.

33 See the Commission press-release, *Antitrust: Commission sends Statement of Objections to Samsung on potential misuse of mobile phone standard-essential patents*, Brussels, 21 December 2012.

34 See the Commitments Offered by Samsung to the European Commission, Case COMP/C-3/39.939 – Samsung Electronics enforcement of UMTS standard essential Patents, Brussels, 27 September 2013.

for the determination of FRAND terms of either unilateral or cross licensing. The most interesting feature of the proposal is indeed Samsung's own designed licensing framework which includes: « (i) a negotiation period of up to 12 months; and (ii) a third party determination of FRAND terms, in the event no licensing agreement or alternative process for determining FRAND terms has been agreed upon at the end of the negotiation period. The third party determination of FRAND terms will consist of the submission of the dispute to arbitration or to court adjudication in order to determine the FRAND terms of either a unilateral licensing or cross-licensing agreement³⁵». The proposal will be extensively commented later on in this work. It will also be compared to the Google/Motorola commitments that accompanied the merger of those two companies decided by the FTC and raised very similar anticompetitive concerns about the SEPs use.

1.1.4. UK AND AUSTRALIA

For the sake of completeness, it is worth mentioning that Samsung did not let the Commonwealth path unexplored. In the UK, it attempted to ask for the British High Court of Justice to declare pre-emptively that its products do not look like Apple's ones. The British court then stated no confusion is possible since Samsung tablets are not as "cool" as Apple's ones³⁶. Moreover, Samsung asked for a behavioral injunctive measure to make Apple publicly stated that the Galaxy tablet actually does not infringe Apple's design rights, probably to make up for market reputation reasons. It obtained just an order for Apple to publish a disclaimer on its website, citing the fact that, according to the British court's preventive assessment, Samsung did not copy the iPad. Moreover, the British judge agreed that the contrast in appearance and design between the two companies' products was sufficient, so that the "informed user" – the ordinary test applied in such cases – would perceive them as different.

In Australia, a court initially granted a preliminary injunction requested by Apple against Galaxy tab's sale. Apple hoped to see it confirmed before Christmas, but it

³⁵ *Ibidem*, para.8.

³⁶ As it is possible to read in the decision of the UK High Court of Justice, Chancery Division, Samsung Electronics (UK) Limited & Anr v. Apple Inc., HC11C03050, July 2012.

was actually denied by the Australia High Court that invoked an anticipated trial instead³⁷.

1.1.5. PRELIMINARY COMMENTS

Looking at the whole picture, it is possible to extrapolate the main characteristics of these legal strategies. First, this fight is not about protecting rights as much as about aggressively also competing inside of courtrooms. Secondly, Samsung, a giant, to respond to the assertion of utility and design rights of Apple, the dwarf, by raising SEPs. It looks more like arm wrestling than a cautious legal strategy since it raises additional anticompetitive concerns next to IP law ones. Third, through all these aggressive actions, both parties meant to show each other their respective strengths and force the other one to settle opportunistically at the most favorable conditions or either to shut the rival out of the market by legal means. Surprisingly, neither of the two results happened.

After suing each other for the IP rights of the same technologies around the world, Apple reported significant victories in the wars conducted in the United States and Germany and won a few battles in Australia, while Samsung did not win any war, but a very few minor battles in Japan, Korea and the United Kingdom. This story shows that both of them are not hard to sue in developed countries' national courts, where a "sound" IP system has been put in place.

Finally, it is important to note that Apple only claimed that Samsung infringed some of its design rights on the smartphone and tablet's aesthetics, e.g. trade dress. However, it never invoked more substantial IP rights, like those protecting its operative system iOS, not even as counter-suing strategy. This would have indeed meant to start a "proxy" fight against Google-Android.

Hence, another feature that this analysis highlights is that the patent wars over devices' characteristics are conducted publicly in court rooms, while the wars over devices' OS are still carried out under-cover. After seeing the epilogue of the Microsoft antitrust saga, it is also evident why nobody among the giants and

37 Federal Court of Australia, New South Wales District Registry, General Division (Sydney), Apple Inc. v. Samsung Electronics Ltd. Co. (case no. NSD1243/2011).

dwarves mentioned in this work is dying to become the champion of the next generation antitrust villains.

2. THE GAP BETWEEN PATENT AND COMPETITION LAW AND POLICY THAT LEADS TO EXCESSIVE PATENT LITIGATION.

Competition law and patent law interact following two opposite trajectories: on the one hand, both of them aim at encouraging innovation, on the other hand, the first one fights monopolies while the second one grants them (under some specific circumstances). The literature that investigated their interaction dates back decades³⁸. In fact, the intrinsic attitude of IPRs to foreclose markets is widely acknowledged, as well as the danger of their exploitation in order to win the competitive race unfairly.

The general question has always been about the width of the scope of competition law to intervene in such cases. Ideally, in order to promote innovation and enhance consumer welfare, both competition and IP laws should be aligned in terms of enforcement policies³⁹. Eventual interferences of competition law in a patent system, which works properly, are in fact undesirable. However, if patents are leveraged for anticompetitive purposes, they may lead to increasing or unnecessary litigation⁴⁰, unfair licensing and consequently to higher prices, etc. This kind of consequences justifies an antitrust intervention.

38 *Inter multi*, see ANDERMAN, SCHMIDT, *EC competition policy and IPRs*, in *The interface between the intellectual property rights and competition policy*, 2007, p. 37, where the authors state «EC competition policy and IPRs are widely recognised to be complementary components of a modern industrial policy. Both pursue a common aim of improving innovation and consumer welfare although they do so by using different means [...] At first sight there seems to be a potential clash between the methods used by the two systems of legal regulation to achieve their common aims». In the same book, see also PERITZ, *Competition and its implications for intellectual property rights in the United States*, p. 125, where the author similarly observes and further argues that «at the federal level of US law, both intellectual property protection and antitrust policy share a common goal of encouraging innovation. But observers agree that this common goal is achieved by different approaches - antitrust by fostering competition and patent and copyright policy by granting rights to exclude rivals. Still this distinction of means is not absolute: antitrust permits some exclusionary strategies and intellectual property policy fosters some competition. In consequence, both approaches must be understood as balancing property protection and competition, exclusion and access and, ultimately, private rights and public benefits».

39 As argued for instance by MEURER, *Patent Litigation, Licensing, Nonobviousness, and Antitrust*, in *Antitrust Law And Economics*, 2010.p*

40 The seminal paper on «the process of dispute resolution as an equilibrium in the interaction of self-interested decision makers» is COOTER, RUBINFELD, *Economic analysis of legal disputes*, 1989. A strand of economic literature that investigates more closely patent litigation originated from that contribution. See among others, LANJOUW, SCHANKERMAN, *Characteristics of patent litigation: a window on competition*, 2001, that studied how the frequency of court cases reflects firms' strategies for appropriating innovation rents even though the cost of engaging in litigation over intellectual property assets

This is precisely the scenario above-described, when the 2011 major patent acquisitions and the following excessive patent litigation - and the Apple/Samsung ones in detail - have been presented. Such undesirable scenario is most likely to occur, if and when low quality patents (with vague and broad content, more often found invalid) are at stake because they tend to lead easily to pretextual litigation. In the typical situation of the mobile Internet industry, where hi-tech products are covered by multiple patents, the undesirable effects are highly amplified.

The problem of poor quality patents is neither new nor easy to solve⁴¹. Its causes are twofold. On the one hand, patent offices are overloaded with applications. The technological progress is driven by a high-speed succession of technologies that are launched in the markets even before past ones can exhaust their commercial potential. Therefore, patent offices cannot provide the same quality of criteria assessment as in the past. On the other hand, patent applicants - or hi-tech firms in general - try to obtain the vaguest and broadest content for each and every patent filed. In this way, they try to achieve the greatest potential protection at the least cost or effort, because vague contents are more likely to lead to eventual favorable judicial interpretation. Hence, there are two sources of inefficiency in the patent system: one relates to an administrative inefficiency and the other one relates to opportunistic behaviors and rent-seeking activities of patentees. All these joint inefficiencies concur at encouraging wild patent litigations and at the same time undermine the intrinsic value of the existing patent system⁴².

2.1. THE EMERGENCE OF A NEW LITIGATION MODEL: THE DWARF/GIANT LITIGATION

diminishes their value as an incentive to invest in research. On the strategic use of patent litigation, see SOMAYA, *Strategic determinants of decisions not to settle patent litigation*, 2003, where he investigates two strategic uses of patent litigation: as isolating mechanism to protect valuable strategic stakes and as defensive tool to obtain access to external technologies through mutual hold-up.

41 A review of common arguments for this problem is presented in PICARD, VAN POTTELSBERGHE, *Patent office governance and patent system quality*, 2011. *Contra*, see the position taken by Lemley, *Rational ignorance at the Patent Office*, 2001, when the author challenges conventional wisdom demonstrating that strengthening examination process is not cost-effective, therefore it cannot be a good solution to the problem of low patent quality.

42 The undesirable consequences of such a pathologic systems have been addressed in detail by LEMLEY, SHAPIRO, *Probabilistic patents*, 2004. The authors affirm that a theory of probabilistic patents is necessary to understand the current patents' misuse in litigation, the altered incentives of patent holders and the antitrust limits on agreements between rivals that settle (or not) actual or threatened litigation.

The existing gap between competition and patent law *de facto* allows forms of undesirable patent litigation. The recent literature focused mostly on the phenomenon of "troll" litigation⁴³. This paper recalled a literature that classified new patent thicket entities, such as giants and dwarves (e.g. Samsung and Apple). The analysis of the Samsung/Apple lawsuits showed that a new model of litigation is spreading as an alternative form of competition in the mobile Internet industry. The "dwarf/giant" model shares some features of the "troll" litigation, but not all of them. In fact, they are producing entities, incumbent and new entrants, that litigate in a troll-like manner, even though an underlying core productive business is at stake.

A problem of hold-up recurs in both troll and dwarf/giant litigations⁴⁴. The eventual hold-up threat is further exacerbated in the case of multi-patent products⁴⁵. Especially, those covered by SEPs because there lays the danger of market foreclosure. Intuitively, integrated devices are more exposed to opportunistic behavior - such as hold-ups - than single-patented ones. Moreover, most of the new mobile devices try to maintain compatibility with previous older standards to assure interoperability of different generations of products in the same market. This means that most of the devices offered in the mobile Internet market are not only multi-patent, but also multi-standard, dramatically increasing the critical mass of IPRs involved and at stake per single product.

On the other hand, the asymmetry of litigation risk⁴⁶ among giants and dwarves is less present. As observed in the Apple/Samsung litigation, when litigants are both device manufacturers, they face a symmetrical risk. Both of them hold massive patent portfolios that they can use as shields or weapons, depending on the offensive or defensive strategy they decide to undertake. Moreover, both of them have a core productive activity at stake.

The same conclusion does not hold for troll litigation that involves non-producing entities with no underlying real economy business at stake. Trolls solely engage in patent litigation and licensing, therefore their resources are expressly destined to

43 See ADDY, DOUGLAS, cit., pp. 2-3.

44 Ibidem, p. 17.

45 See SOMAYA, TEECE, WAKEMAN, *Mapping Solutions to Technological and Intellectual Property Complexity*, 2011, p. 48.

46 See ADDY, DOUGLAS, cit., p. 14.

these purposes. Hence, they do not suffer for temporary deviation of resources from core business activities.

This argument should lead a rational operator to engage less in excessive litigation. However, threats of injunctions and consistent damages awards are attractive drivers of excessive litigation. They are able to alter the decision-making of rivals or even their survival in the market; therefore they incentivize patentees to engage in anticompetitive practices, also when they are giants and dwarves.

The use preliminary injunctive relief in dwarf/giant litigation enhanced a debate that was already present in the literature on troll litigation⁴⁷. They represent a further reason to rediscuss the use of injunctive relief as a general remedy in patent cases. A giant or a dwarf that asserts a SEP as well as trade dress, as demonstrated by the Samsung/Apple litigation, may foreclose a market through the abuse of injunctions. This additional circumstance represents an extension of the traditional patent hold-up and should also represent an exception to the default rule.

The situation is sometimes worsened by the application of judicial doctrines like the "entire market value" doctrine⁴⁸, which is often enforced in US patent lawsuits. This judicial doctrine awards damages proportionally to the value of the entire contested product rather than only to the value of the infringing component. The rule makes sense in the context of old inventions, typically single patented. In high-tech industries where multi-patented products are the norm, it qualifies as a source of overcompensation for patent owners. Moreover, it increases the incentives for rent-seeking activities, trolling and misbehavior of aggressive competitors.

It is also true that both of the US Apple v. Samsung cases held before juries did not perform any better than the worse judicial doctrine. One of the few upsides of a patent infringement suit is seen in the possibility of having an additional, more costly, but also more certain, patent validity test. Though, juries usually do not challenge patent validity. Indeed, in the mentioned cases, they assumed twice the

⁴⁷The main debate took place after the eBay case law, see for its reconstruction DENICOLÒ, GERADIN, LAYNE-FARRAR, PADILLA, *Revisiting injunctive relief: interpreting eBay in high-tech industries with non-practicing patent holders*, 2008. Among patent remedies against patent holdup for a defense of injunctive relief as a general remedy that might be restricted in patent holdup cases as an exception, see COTTER, *Patent holdup, patent remedies and antitrust responses*, 2009, p. 1179-

⁴⁸*Idem*.

validity of all patents asserted by both parties. In contrast, ten European courts found Apple had not invented "slide-to-unlock", the star patent at Samsung trial, while two American juries found it perfectly valid⁴⁹. It is worth adding that juries might suffer of home-country bias (and this partially justifies the Samsung counter-suing strategy, at least in Korea). Furthermore, the damages awards decided by juries vary sensitively and especially if the plaintiff is also found guilty of infringement, as in *Apple v. Samsung II*.

Summing up, negative spillovers of the current patent system situation led to hi-tech markets with unbearable entrance barriers, inflated values associated with patents, inflated values associated with the underlying hi-tech products. This is an economic scenario where no single entity is now able to develop all the research for a new technology AND no single entity is able to buy all the patents needed to produce a new technology.

This patent system was designed for the industrial revolution scenario, when single inventors and single patents did matter. It is thus not surprising that the same system cannot keep up with the current scenario.

Last but not least, the existence of the gap facilitates dramatically rent-seeking activities because it allows patent holders to litigate not just in multiple jurisdictions but even in multiple IP agencies and competition authorities⁵⁰. The degree of forum/agency shopping that high-tech markets' global players are able to achieve by leveraging on IP and competition laws is significantly broad.

49 As reported by Mueller: «On August 24, 2011, Judge Brinkman of the Rechtbank 's-Gravenhage (The Hague District Court) denied Apple a preliminary injunction with respect to "slide to unlock" because he [doubted its validity](#) and found it trivial (original decision, in Dutch). On July 4, 2012, Justice Floyd of the England and Wales High Court held that "[a]ll the claims of [the European slide-to-unlock patent] are obvious in the light of Neonode". Apple appealed the UK decision, but Lord Justice Richards, Lord Justice Lewison and Lord Justice Kitchin of the England and Wales Court of Appeal unanimously affirmed Justice Floyd's decision with respect to slide-to-unlock. In the meantime, on April 4, 2013, Presiding Judge Sredl and Judges Merzbach, Baumgardt, Dr. Thum-Rung and Dr. Forkel of the Bundespatentgericht (Federal Patent Court of Germany) -- three of whom are *technically*-trained judges (engineering and science degrees) -- declared all claims of the European slide-to-unlock patent (including various amendments proposed by Apple) invalid (original decision, in German)», see Mueller, *10 European judges found Apple had not invented slide-to-unlock (star patent at Samsung trial)*, posted on FOSS Patents Blog, 2 April 2014.

50 It is worth mentioning, once for all, the recent role of the International Trade Commission in the Apple/Samsung war for instance. One of the sales ban granted by ITC had huge echo in the press after the President Obama overturned it. See the *In the Matter of Certain Mobile Electronic Devices (Samsung v. Apple; investigation no. 337-TA-794, complaint)*, ITC-794 Final Determination of 4 June 2013, available at http://www.usitc.gov/secretary/fed_reg_notices/337/337794_notice06042013sgl.pdf; and see the US Trade Representative Letter Vetoing ITC-794 Exclusion Order of 3 August 2013, available at <http://www.scribd.com/doc/157894184/13-08-03-USTR-Letter-Vetoing-ITC-794-Exclusion-Order>.

The increasing complexity of markets does not find a correspondence in terms of the adequacy of the underlying legal system. However, the only economic reason why such a regulated monopoly-granting system has been designed was indeed to make those markets work smoothly and perform better, in terms of enhanced competition and innovation for the final benefit of the consumers.

3. FIRST ATTEMPTS TO ADDRESS THE GAP IN THE US AND IN THE EUROPEAN SYSTEMS.

Many ways have been explored in the effort to fix the bad functioning of the patents for high-tech markets. The first ones arose spontaneously in the market practice, like the so-called “defensive patent aggregation” or “patent pooling”. It evolved mainly in the 2011 massive patent aggregation tendency registered in the mobile Internet industry. Next to these (cooperative or non-cooperative, still opportunistic) private responses, it is worth mentioning the creation and then regulation of the SSOs. They share the merit of having developed and implemented a scheme from which all participants can benefit. They required operators to commit to license SEPs at FRAND conditions.

While some judicial doctrines both in the EU and the US addressed the problem of trolling⁵¹, a proper regulation on the use of SEPs and threat of injunctions still lacks.

In the US, after a long discussion and consultation, a legislative response has been adopted, the Leahy–Smith America Invents Act (AIA). It did not address directly the trolling problem, but its section 34 instructed the Comptroller General of the United States to conduct a study of the consequences of litigation by non-practicing entities or by patent assertion entities during the first of the AIA enactment⁵². It also required reporting the results to the Congress, including eventual recommendations for any changes to the law that will minimize any negative impact of the litigations subject to study. Therefore, even though AIA provisions came finally into force on March 2013, they failed to address patent assertion issues that, during the legislative *iter*, had become a major source of inefficiency.

⁵¹To know more about see Addy, Douglas, cit. ***

⁵²See the AIA, available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr1249enr/pdf/BILLS-112hr1249enr.pdf>, p. 57.

Only three months later, the Executive Office of the President released a specific policy statement, entitled "Patent assertion and US innovation". In the Executive Summary, the Office explicitly acknowledged - next to trolling - also the phenomenon of what this paper calls "dwarf/giant" litigation model. In fact, it affirms that «while aggressive litigation tactics are a hallmark of patent assertion entities, some practicing firms are beginning to use them as well⁵³». Consequently, the Administration specifically committed to develop and implement policies aimed at «fostering clearer patents with a high standard of novelty and non-obviousness; reducing disparity in the costs of litigation for patent owners and technology users; and increasing the adaptability of the innovation system to challenges posed by new technologies and new business models⁵⁴».

On the other hand, the competition authorities had to deal with the problem more often, but they never took the chance to state a clear policy on the issue once for all. They waited for a big event to appear on the horizon, in order to express their opinions on the matter.

In a very early stage, it is actually worth to report that some passages inserted in the 2011 US FTC Report on the IP marketplace⁵⁵ or in the European Commission's guidelines on horizontal cooperation agreements⁵⁶ primarily recognized the existence and the role of SSOs and the necessity of FRAND terms for SEPs licensing. Later, the authorization of the Google-Motorola merger represented the right opportunity for both the US FTC and the European Commission to express their views on the role of FRAND terms and the need of addressing the strategic use of injunctions, at least in the context of SEPs litigation.

3.1. OPPORTUNITIES FOR COMPETITION POLICY: THE GOOGLE/MOTOROLA MERGER VIS-À-VIS THE SAMSUNG COMMITMENTS TO THE EUROPEAN COMMISSION.

The Google/Motorola decision is an important step towards the acknowledgment of the impact that wild patent wars are likely to have on competition. This holds

⁵³See the "Patent assertion and US innovation" Report available at http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf, p.1.

⁵⁴ *Ibidem*.

⁵⁵ 2011 FTC IP Report, cit.

⁵⁶ Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, Official Journal C 11 of 14.1.2011.

true although they should better be regulated through another branch of law - patent law - and enforced through a dedicated policy body.

The eventual anticompetitive concerns that such a huge amount of patents immediately transferred into Google's hands could have raised were significant and hard to assess. Both EU and US authorities felt the need to specify under which circumstances FRAND licensing commitments cannot be enough to prevent standard-essential patent holders from abusing their market power. As in the Samsung/Apple battle all over the world, most of the lawsuits might be initiated solely on the purpose of requesting injunctions to obtain a sales ban on products or at least to retard the launching of new products.

Hence, the European Commission specified that the threat of injunction against a potential licensee of good faith, which most likely means a standard implementer willing to take a FRAND license, may impede competition by forcing such a potential licensee into agreeing on a license characterized by more onerous terms than FRAND ones, and thus exploiting the market power granted by the ownership of SEPs. This has been defined as a prudent position⁵⁷, since the alternative would have been a *per se* prohibition for standard-essential patent holders to seek offensive injunctions. It is still unclear how to assess the good faith of the licensee who does not deserve to be threatened by injunctions.

The consent order granted by the FTC has been even more «Google-specific»⁵⁸ and detailed even narrower circumstances under which Google and Motorola could eventually claim for injunctive relief. Such possibility is admitted whether: 1) the potential licensee is not subject to the US jurisdiction; 2) the potential licensee clearly stated the unwillingness to conclude any FRAND license with Google or Motorola; 3) the potential licensee refuses such a license agreement set by a court or ADR; 4) the potential licensee fails at demonstrating its willingness to conclude a FRAND license⁵⁹. Far from setting a standard rule, such as the shy attempt made by the European Commission with the unclear definition of "good faith licensee",

57As commented by GERADIN, *Ten Years of DG Competition Effort to Provide Guidance on the Application of Competition Rules to the Licensing of Standard-Essential Patents: Where Do We Stand?*, 2013, p. 15.

58 *Idem*, p.19.

59 See the FTC Order, p. *

the FTC indeed tightened the hands of Google, concretely preventing it from resorting injunctions in the future⁶⁰.

Both authorities expressed, among other things, an unfavorable opinion on the injunctive relief practices in the context of standard-essential patent licensing. They partially clarified the eventual future and concrete competition policy applications, but they did not make any general policy statement. Nevertheless, these opinions had some effects.

It is worth noting that Google/Motorola merger's authorizations were decided during the still pending Samsung/Apple investigations. This circumstance is important because it is after the European Commission's decision on this merger that Samsung withdrew all the ongoing injunction requests in Europe. Unluckily, this move was not neither enough nor well-timed to convince the Commission not to issue the above-mentioned Statement of objections.

Hence, it is interesting to compare the conditions that the FTC found acceptable in the Google/Motorola merger to those stated in the Samsung Commitments to the European Commission, accepted on 29 April 2014.

For a period of five years, Samsung committed not to seek any injunctions in the European Economic Area (EEA) on the basis of any of its SEPs, present and future, that relate to technologies implemented in smartphones and tablets against any company that agrees to a particular framework for licensing the relevant SEPs⁶¹. The Korean company also designed a licensing framework that prescribes: a negotiation period of up to 12 months; and, if no agreement is reached, a third party determination of FRAND terms by a court if either party chooses, or by an arbitrator if both parties agree on this⁶².

The first comment regards the five-years committing period that sounds absolutely too short since anticompetitive concerns related to SEPs abuse are imprescriptible. Secondly, the licensing framework has been actually re-designed to address the concerns of third parties raised during the publication period before acceptance. The first version was made to induce to the royalty's quantification through arbitration rather than by court, thus suggesting Samsung's probable preference for this system of dispute resolution. In the beginning, it indeed looked

60 See GERADIN, cit., 2013, p. 19.

61 See the Commitments, letter A, pp. 1-3, and for the duration, letter D, para. 14, p. 7.

62 See the Commitments, cit., pp. 4-7.

like Samsung was trying to avoid being fined and simultaneously to still find a way to conclude the best deal to exploit its SEPs in the next 5 years with the EU Commission's *placet*.

It is meritorious that the Commission took the opportunity to state again that «a patent holder, including a holder of SEPs, is generally entitled to seek injunctions as part of the exercise of its IP rights. The seeking of injunctions cannot therefore, in itself, constitute an abuse of a dominant position. The exercise of an exclusive right by its owner may, however, in exceptional circumstances and in the absence of any objective justification involve abusive conduct. The list of such exceptional circumstances is not exhaustive. The Commission primarily concluded that the exceptional circumstances in this case are: « (i) the UMTS standard-setting process; and (ii) Samsung's commitment to ETSI to license its UMTS SEPs on FRAND terms and conditions⁶³».

This should clear up any doubt about the possibility for SEPs-related offensive injunctive relief activity to be considered as exclusionary practices under EU competition law. Yet this represents just a small step in a longer path.

4. CONCLUSIONS ON A DESPERATE CALL FOR A PATENT SYSTEM REFORM.

The analysis of the recent history of the mobile Internet industry shows the current the complexity of actual hi-tech products and the management of their exclusive rights. Although nowadays IPRs are heterogeneous and able to provide highly nuanced protections, they nevertheless also enhance a certain ground for quarrels with no holds barred. At an earlier stage of this patent system's degeneration, the ambiguous validity of exclusive rights on technological innovations led to patent wars which were conducted to reach settlements as a more socially costly and inefficient surrogate for royalties negotiation, with the only upside of including additional patent validity tests.

The Samsung/Apple battle(s) showed that the current trend in patent litigation among hi-tech operators is mainly driven by the strategic use of injunctive relief. The easiest conclusion to draw from the factual analysis leads to observe, in fact, that the two firms were not particularly worried about the eventual damages

63 See the Commission decision on Samsung commitments of 29.4.2014, Case AT.39939 - Samsung - Enforcement of UMTS standard essential patents, C(2014) 2891 final, p. 6.

awarded, not even if determined by an uninformed and non-technical organ like a jury. They did not care about reaching a last-minute settlement at all. Instead, they cared to interfere with each other's product management all over the world. There is enough evidence to conclude that these practices are - or at least perceived by operators to be - indeed more profitable than paying billionaire fines.

It is intuitive to roughly estimate how much Apple gained (and Samsung lost) from a product ban as the one granted from a German court over the Galaxy Tab. That single injunctive measure allowed Apple to launch its new iPad in a market in which no significant rival product was sold for all the time Samsung needed to re-design its last generation tablet. It is easy to conclude that in the luckiest cases such injunctions are able to grant even short-term monopoly conditions. This shows that even the assertion of some non-SEPs - like design patents or trade dress - can potentially foreclose markets temporarily through aggressive injunction-seeking activity.

As long as the forum-shopping degree achievable is wide enough to include all the developed countries national courts AND agencies, market participants are allowed to multiply these opportunities to win and/or lose legal battles. The variety of nuanced views of different enforcers may make this strategy appealing. This justifies the reaction Samsung had when it counter-sued Apple in three different nations, before filing a claim in the same Northern District of California court. A way to prevent forum/agency shopping could be to institute centralized and specialized courts to which devolve entirely the competence on IP litigations. This would avoid the down sides analyzed in general civil litigations (especially those involving juries) and the excessive overlap of competencies among too many judicial and policy bodies. In this sense for instance, the proposal for a European Unified Patent Court would be very welcome in the case it could finally eliminate the fragmentation in the IP system that affects the European single market.

In the literature, the debate usually focuses on whether the best solution should come in the form of patent remedies or antitrust remedies, because of the above-mentioned interaction of these two branches of law on the matter.

I personally think that the situation is severe and delicate at the same time and besides it is no more fixable through time-to-time interventions.

From the antitrust perspective, I think that competition policy makers could not help the situation more than issuing specific guidelines dedicated to the careful assessment of the dominance abuse affected through aggressive patent (SEPs and non-SEPs) assertion. As already stressed out, the strategic abuse of injunctive relief when no SEPs are at stake should also be addressed since even the assertion of a trade dress can produce undesirable misuse of patent litigation, as Apple's initiatives against Samsung showed. Even if enforcers attempted to address the abuse of SEPs in specific enforcement cases, like the Google/Motorola merger above-discussed, guidelines are a "stronger" soft law tool and it can provide a higher degree of certainty on policy makers' intentions than case-by-case decisions.

As any other bad market-functioning, the inefficiency of the patent system - in the end - produces anticompetitive effects, but it is not a competition law-specific issue. Therefore, providing a final solution falls beyond the scope of competition law.

Most of the observed system's inefficiency lies on the IP law and policy side. As above-recalled, this is exemplified by the fact that trials are sometimes the only real screening of a new patented technological innovation's validity. This represented the first sign that IPRs traditional categories have been stretched too far, so that pathologic outcomes of an inadequate system have become pathogenic. Potential solutions range from policy changes to IP law structural reforms⁶⁴. Among potential policy changes it is possible to list a stricter way of assessing patentability standards by patent offices; for instance in the case of technological innovations, greater emphasis could be placed on a new approach to the non-obviousness standard - rather than on the novelty standard - and on a wider and more comprehensive concept of commercial exploitation. Though such a change

64 This view is absolutely not new. Scholars who have worked or are currently working on such proposals are many. The most interesting proposals advocate for a switch from a property to a liability rule in protecting innovations. See, among others, an experimental study that challenged the traditional assumption that property rules outperform liability rules by showing that it is actually the opposite. The study was conducted by TORRANCE, TOMLINSON, *Property rules, Liability rules and patents: experimental view of the cathedral*, 2012. Though, the most innovative reform has been suggested by BELL, PARCHOMOVSKY, *Reinventing copyright and patents*, 2014, p. 43. Their self-tailored system might successfully solve the excessive patent litigation and troll-like opportunistic behaviors by putting a fee only after initiating an infringement action. This would increase the marginal cost of the first lawsuit thus disincentivizing initial litigation. Moreover, the system let the creator free to put a cap to all damages at the price of infringement that he prefers. Therefore, the whole design of the system is focused on setting the proper incentives to avoid any form of perverse use of IPRs.

would result in higher administrative costs of dealing more carefully with each and every patent file and would be likely to have a non-neutral impact on innovation and social welfare at large, its secondary effect would be to heighten the barriers to enter in an industry that already presents high sunk costs associated to entry.

A complementary change on the enforcement's side could be the development and implementation of new judicial doctrines to overcome the suboptimal outcomes that case laws such as the misuse defense produced. Also, this kind of change would not be likely to be effective enough, since judicial doctrines are not stable (they can be overturned), agencies can apply policies differently and thus nullify the eventual positive effects on the industry and, moreover, operators themselves can circumvent their potential of action through forum (and now even agency) shopping strategies. In this sense it is also possible to read the increasing recourse to ITC decisions on IP policy matters.

Some - yet not definitive - improvements might be led by a reform on litigation procedure that would design restrictions on injunctive relief; however this would entail a re-design of rights solely for the purpose of a smoother and less anticompetitive patent litigation and could thus produce more harm than good.

Such negative externalities are not present whether a change in the law instead of policy is enacted. Cons of this second solution though are to be found in the excessive length of the legislative *iter*, as seen in the case of the America Invents Act that was born already too old since, during the period of its approval, the patent wars most problematic scenario had already turned into a dwarf/giant repeated battles rather than just early troll-like litigations.

It has been claimed already that the old IPRs system should definitely overcome the traditional distinction among liberal and mechanical arts forged to serve the needs of the XIX century industrial revolution⁶⁵. It should elaborate a new distinction specifically dedicated to hi-tech innovations, since they are not as easily definable or protectable as past inventions or works of art were. For the sake of the IP law systematic, it would be better not to keep on stretching existing categories to fit the needs of contemporary hi-tech markets since the potential outcome could be just to fill it with more undesirable inconsistencies and alter it inefficiently. The main question that such patent law reform should address is

65 See JOHNS, *Piracy: The Intellectual Property Wars from Gutenberg to Gate*, 2010, p. 43.

whether patents are still suitable to protect software-like inventions. The reform is needed to re-think the system in order to make it fit the needs of the digital revolution era and beyond, possibly until the already announced advent of the artificial intelligence; otherwise, the technological evolution will sooner or later determine the system's collapse, or vice versa.

For the time being, the implication of such bad market-functioning can go well beyond the unnecessary mentioned social costs. If we take a look at the bigger picture, it is easy to see how important the role of hi-tech industries is in terms of global economy nowadays. It is sufficient to think about the financial indicators that are strongly related to hi-tech firms' behaviors, such as the NASDAQ for instance, or all the participations in hi-tech businesses held by investment funds.

To maintain the financial sector parallelism, the disruptive potential of the economy, embedded in such wild patent "management" strategies, can, in my opinion, ultimately lead to a crisis of the industry due to the disproportion among the real economic value of products and the inflated value associated to the exclusive rights over the production of such products, which is relatively comparable to the disconnection incorporated in the derivative financial products that burst the housing bubble, which has been the driver of the current financial crisis.

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EUROPEAN BANKING UNION: ARE THE RECENT SINGLE BANKING SUPERVISION AND RESOLUTION TRULY EUROPEAN? LESSONS FROM THE EU COMMISSION'S APPLICATION OF STATE AID RULES ON FINANCIAL INSTITUTIONS*

Roberta Cossu[†]

ABSTRACT

The paper analyses the European financial crisis management provided by the Commission in its state aid policy. Three main phases of such crisis-specific enforcement of competition rules can be distinguished, namely the rescue, restructuring and banking union eras, and each one of them will be discussed in a separate paragraph. Final conclusions will comment the new financial institutional architecture for the after-crisis Europe and will try to isolate main lessons from the recent state aid policy on financial institutions to argue for the need to design and enforce the single supervisory mechanism and the single resolution mechanism in a way that would allow them to be joined by as many European Union countries as possible and not just by euro-area ones, for the final benefit of the integrity of the single market for financial services.

JEL Classification: K21, G01, G2, L49

Keywords: State aid, Financial crisis, Banking union

SUMMARY: 1. INTRODUCTION TO THE IMPACT OF THE FINANCIAL CRISIS IN EUROPE 2. THE EUROPEAN CRISIS-SPECIFIC STATE AID POLICY 2.1 THE "RESCUE" ERA 2.2 THE "RESTRUCTURING" ERA 2.3 THE BANKING UNION ERA 3. THE LESSONS FROM THE CRISIS-ENFORCEMENT OF STATE AID POLICY 4. CONCLUSIONS.

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1. INTRODUCTION TO THE IMPACT OF THE FINANCIAL CRISIS IN EUROPE.

In order to assess the response of European institutions to the financial crisis, it is appropriate to start analysing the state aid policies for the financial sector which the European Commission designed since 2008. In fact, it is easy to agree with those who found that their application shaped the post-crisis architecture of the financial sector¹. In this sense, their understanding is essential to comprehend the current situation and mostly to design further proposals of intervention or reform.

As we all know now, the financial crisis started producing effects at global level in 2008, being 2006 the moment in which the US housing bubble burst. The first setbacks naturally occurred to those financial institutions whose assets were most exposed to (subprime) mortgage-backed securities or collateralised debt obligations. In Europe, the US subprime crisis generated a first wave of government bailouts starting from the British Northern Rock² and the German Sachsen LB³.

Since then the Commission tried to assure a timely and efficient policy intervention to firms in difficulty by state aid rules tools, clearing as soon as possible all the notified aid measures. The preferable and better-targeted means to intervene immediately appeared to be the Restructuring and Rescue Guidelines⁴. They have been developed in 1994 and updated in 2004 to aid firms from all sectors other than steel and coal. Those policy orientations were elaborated to grant access to compatible (i.e. lawful) state aids to those firms in difficulty. Since the guidelines recognize that the exit of inefficient firms is a normal part of the operation of the market, the rationale behind such exceptions to the general state aid prohibition can assume the broader connotation of generic social and political reasons, as well as the necessity to maintain a competitive structure in the market whether the exit of the firm could lead to a higher undesirable concentration or even a monopoly situation⁵. The R&R

1 Among others, see HELLESTERN, KOENIG, *The European Commission's decision-making on state aid for financial institutions - good regulation in the absence of good governance?*, in ECLR, 2013.

2 See *Restructuring aid to Northern Rock* (2008/C 43/01) , Commission decision C 14/08 (ex NN 70/07) [2008] OJ C43/01.

3 See *Restructuring aid to Sachsen LB* (2008/C 71/06), Commission decision C-9/08 (ex NN 8/08) [2008] OJ C71/14.

4 See the European Commission Communication on Community guidelines on State aid for rescuing and restructuring firms in difficulty (hereinafter the "R&R Guidelines"), [2004] OJ C244/2.

5 *Ivi*, para. 4.

Guidelines aids can be distinguished in rescue and restructuring aids⁶. The former is granted by the State to shortly assist an ailing firm for the time needed to implement a restructuring or a liquidation plan, i.e. to lead to an orderly pursuance or either end of the business activity. They consist of loans or guarantees lasting up to six months and should be restricted to the least time needed to keep the firm in business for the rescue period. The latter, instead, is based on an articulated plan aimed at restoring the firm's long term viability. The plan shall include several elements, ranging from the financial restructuring (in form of both capital injections and/or debt reduction) to the structural measures (as for instance divestment of activities or behavioural commitments). Restructuring aids are relatively more onerous for the beneficiary since they require the receiver to make a real and aid-free contribution to the restructuring. This contribution shows that market operators, such as owners and creditors, find the beneficiary's return to viability feasible, and it also limits the burden of the State (and thus the eventual related distortion of competition) to the minimum.

According to the 2004 updated version of the guidelines, the contribution should amount to at least 25% of the restructuring costs for firms ranging from small to medium size, to 40% for medium-sized enterprises, and for large undertakings the percentage shall be established on a case-by-case basis but it should normally be at least 50%⁷. In exceptional circumstances and in the case of extreme hardship the thresholds for small and medium-sized enterprises can be reduced to 20% and 35% respectively⁸.

Moreover, it is worth underlining that the Commission acknowledged that such tools potentially are the most competition-distortive and generate the most controversial state aid cases. Therefore, their use must always be considered exceptional and

⁶The novelty of the approach adopted in 2004 is reported at para. 6 where it is stated that: «the 1999 guidelines made a distinction between rescue aid and restructuring aid, whereby rescue aid was defined as temporary assistance to keep an ailing firm afloat for the time needed to work out a restructuring and/or a liquidation plan. In principle, restructuring measures financed through State aid could not be undertaken during this phase. However, such strict distinction between rescue and restructuring has given rise to difficulties. Firms in difficulty may already need to take certain urgent structural measures to halt or reduce a worsening of the financial situation in the rescue phase. These guidelines therefore widen the concept of “rescue aid” in order to allow the beneficiary to undertake urgent measures, even of a structural nature, such as an immediate closure of a branch or other form of abandonment of loss-making activities», R&R Guidelines, cit.

⁷ *Ivi*, para. 44.

⁸ *Ibidem*.

strictly allowed on a "one time-last time" principle basis, «to avoid the use of repeated rescue or restructuring aids to keep firms artificially alive⁹».

As already mentioned, the most significant application cases of such discipline to the first wave of harms caused by the 2007 subprime crisis in Europe are undoubtedly represented by Sachsen LB and Northern Rock, also because of the echo they had in the press at the time. In these cases, the Commission adopted an approach that was subsequently enforced in all the other cases that were notified before October 2008. By that time, the issuance of a dedicated communication became necessary to ensure systematic policy interventions in the financial industry.

As mentioned above, in the beginning was Northern Rock¹⁰. It was the 5th largest British mortgage lender for residential real estate. In August 2007, it became unable to meet its funding needs due to the subprime crisis. Upon its request, on 14 September the Bank of England granted emergency liquidity assistance to Northern Rock against sufficient collateral and a penal interest rate¹¹. After releasing the news on the ELA measure granted by the national central bank, an old-style bank-run further aggravated Northern Rock difficulties and spread concerns of eventual contagious effects leading to a wider crisis, reinvigorating 1929 ghost. Thus the UK Treasury announced guarantee arrangements backed by state resources for all existing accounts in Northern Rock on 17 September 2007. On 9 October 2007, it extended the guarantee to new retail deposits and, together with the Bank of England, modified the terms and conditions of the emergency liquidity assistance, losses from which were from that date also covered by a Treasury indemnity¹². Upon the UK's notification, in December the EU Commission concluded that the measures complied with EU rules and constituted rescue aid¹³.

Then Sachsen LB came¹⁴. The US subprime crisis affected Sachsen LB through its off-balance special purpose vehicle Ormond Quay. The SPV is an accessory corporate used as a typical means to fulfil temporary and narrow tasks and at the same time to isolate their implicit financial risk. More specifically, banks use such a tool to fund at

9 *Ivi*, para. 5.

10 See *supra* note 2 and also the European Commission Press Release, IP/07/1859, 05/12/2007, and the European Commission Memo, MEMO/07/545, 05/12/2007.

11 See the European Commission Press Release, IP/07/1859, cit.

12 *Idem*.

13 *Idem*.

14 See *supra* note 3 and also the IP/08/849, and the European Commission Memo, MEMO/08/363, 4 June 2008.

cheaper rates than those they can find themselves in the markets. Sachsen LB used Ormond Quay to invest in activities, such as asset-backed securities, including US subprime mortgage-backed securities. In return, it guaranteed for the credit lines provided by commercial banks to the SPV for its liquidity needs and received Ormond Quay's surplus as an annual fee. When the refinancing market dried up, Ormond Quay's credit line providers withdrew, it was unable to refinance itself and Sachsen could not provide the credit facilities it had pledged. The solution to the situation was found in a combination of a liquidity measure and the sale of Sachsen LB. The liquidity measure consisted of a banking pool (including ten German *landesbanken* and the savings bank association, Dekabank), which committed itself to buy Ormond Quay's commercial papers up to the needed amount of EUR 17,1 billion. Each bank of the pool absorbed part of the toxic assets in its own name and account so as to be individually liable. The second part of the plan disposed the sale of Sachsen LB to LBBW (Baden-Württembergs Landesbank). A structured portfolio of EUR 17,5 billion of its "bad" activities, including Ormond Quay, was excluded from the sale and transferred to a newly created SPV, guaranteed by the State of Saxony for EUR 2,75 billion¹⁵.

After Germany had notified the measures, the Commission opened an in-depth investigation to check whether they met all the requirements set by the R&R Guidelines. In its final decision, the Commission stated that the liquidity measure did not satisfy the "market investor" test¹⁶. This means that, at the time, the demand for mortgage-backed commercial papers was totally dried up; hence, there was no efficient market for such an investment. It could have better assessed as a rescue aid compatible with the single market, given the nature of the subjects involved in the banking pool, all agencies under public law. Moreover, it did not last more than six months, it did not exceed the minimum necessary to keep the bank alive up to the restructuring plan implementation and the total amount was not beyond the admitted thresholds.

¹⁵ See the European Commission Press Release IP/08/314***

¹⁶ As it is possible to read in SLOCOCK, *The market economy investor principle*, Competition Policy Newsletter, n. 2002, June 2002, p. 23 : «The essence of the MEIP is that when a public authority invests in an enterprise on terms and in conditions which would be acceptable to a private investor operating under normal market economy conditions, the investment is not a state aid». See also GILLIAMS, *Substantive competition issues*, 2013, p. 261.

The significance of these early decisions is due to the fact they all represented policy opportunities for the Commission. Therefore, they have been used also as ways to disclose the Commission's underlying policy intentions, even beyond the actual case on which it had to decide, in order to inform on the European crisis management and simultaneously calm the markets down. The reason is partly, intuitively, related to the panic experienced during the Northern Rock bank-run, and partly linked to the fact the Commission was receiving a steadily increasing number of notifications by Member States for government bail-outs. Those measures became necessary because of the spreading of the crisis' effects, which determined the above-discussed crisis in inter-bank lending and the consequent liquidity problems for all the main European financial institutions. All these notified measures were assessed by the European competition authority as rescue aids. The objectives were twofold: to consent that beneficiaries could immediately receive the necessary liquidity to cope with the regular needs of the business activity and to postpone the submission of restructuring plans to a later stage, after the emergency.

Similarly to the Sachsen LB case, and due to financial difficulties arising from the US subprime crisis in July 2007, also IKB was granted two risk shields, capital injections and liquidity facilities¹⁷. In the context of the restructuring, the bank was sold to the US investment fund Lone Star in August 2008¹⁸. Or again, in late July 2008 this was the case for the Danish Roskilde¹⁹ that was granted by the Danish National Bank of a liquidity facility, which was guaranteed by both a fund set up by the private sector, *Det Private Beredskab*, and the Danish state, on the "Sachsen LB" model. Later on the European Commission authorised EUR 35 billion loan guarantees granted by the German Federal Government, together with a group of German financial institutions, to Hypo Real Estate in order to help it cover its refinancing needs until April 2009²⁰.

However, the natural end of such first intense state aid policy wave induced by the early subprime crisis has been determined by two main events. First of all, the contagion involved the collapse of Lehman Brothers and Bear Stearns at the end of the summer 2008, thus the concern for the crisis to achieve a systemic dimension

17 See *Restructuring aid to IKB* (2009/775/CE), Commission decision C 10/08 (ex NN 7/08) [2009] OJ L 278/32.

18 See the summary of the case in the European Commission Press Release IP/09/1235, 17/08/2009.

19 See *Rescue aid to Roskilde* (2008/C 238/02), Commission decision NN 36/08 [2008] OJ C 238.

20 See *Rescue aid to Hypo Real Estate* (2008/C 293/01), Commission decision N 44/2008 [2008] OJ C 293.

became even more likely than before. Secondly, the approach of the Commission started showing all its limits in addressing a temporary crisis, which was lasting more than expected and achieving a global scale. The exhaustion of such a policy approach (or better of the application of the 2004 R&R Guidelines in such fashion to the late 2008 stage of the crisis) is perfectly illustrated by the Bradford & Bingley case²¹ and the Irish Banks guarantee scheme²². In response to the September 2008 events, which deteriorated its liquidity position, Bradford & Bingley was downgraded by rating agencies. This circumstance made its refinancing attempts almost impossible and thus led to the withdrawal of its license to accept deposits by the UK financial market authority²³. The related package of measures was notified on September 30th and approved in 24 hours over the weekend by the Commission. It was specifically designed to protect retail depositors and it was comprehensive enough to include the nationalization and winding down on the bank, the sale of its retail deposit book and branches along with a matching cash element to Abbey National, the provision of a working capital facility and guarantee arrangements. On 30 September 2008, the Irish Prime Minister announced a similar decision to guarantee all deposits and debts but for all eligible Irish banks and their subsidiaries abroad, namely six institutions in total. After being contacted by the Commission, on 3 October, Ireland notified the scheme. Then, it was subjected to reviews and discussions for ten days, by both the EU and the Irish authorities, before being approved in an amended non-discriminatory version that involved all banks operating in Ireland, instead of just six of them.

According to the relevance of the last discussed events, the ECOFIN Council on 7 October 2008 concluded it was necessary to take measures «to enhance the soundness and stability of the banking system in order to restore confidence and the proper functioning of the financial sector²⁴». In the same meeting, it was stated that one of such measures should have been the recapitalization of systemically relevant financial institutions because of its attitude to ensure depositors' protection and

21 See *Rescue aid to Bradford and Bingley* (2008/C 290/01), Commission decision NN 41/2008 [2008] OJ C 290, p. 2.

22 See *Rescue Guarantee scheme for banks in Ireland* (2008/C 312/01), Commission decision NN 48/2008 [2008] OJ C 312.

23 See also the summary in the European Commission Press Release, IP/08/1437, 01/10/2008.

24 See European Commission Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (hereinafter "2008 Banking Communication"), [2008] OJ C 270, para. 1.

restore financial stability. Moreover, it should have been better granted under EU principles rather than under national legislation in order to guarantee a uniform application in the single market. At this stage of the debate, the Commission offered to issue promptly updated state aid policy guidelines tailored to the recent needs that the European financial sector showed.

The legal basis for such a soft law intervention was found in the Treaty provision set by the article 107 TFEU, which states the general prohibition on granting aids by Member States to firms in the single market. At the point 3 (b), though, it also specifies that aids which are meant «to remedy a serious disturbance in the economy of a Member State²⁵» may be considered compatible with the internal market under certain conditions. Then, by declaring the 2008 crisis as a "serious disturbance to the economy", the Commission acknowledged the crisis was likely to have a systemic impact on financial institutions. Hence, state aids in the sector were not just aimed at helping ailing banks rather than at avoiding the increase of systemic risk in the European financial markets. By doing so, the Commission also met the necessary prerequisite to start delivering a timely and effective state aid policy to help European banks to cope with the evolving crisis scenario.

2. THE EUROPEAN CRISIS-SPECIFIC STATE AID POLICY.

It is important to highlight that the present one has not been the first financial crisis that developed in a systemic banking crisis which the human history recorded. Such situations have involved any country and it has been estimated that the amount of «banking system failures has been at least as great in developing transition countries as in the industrial world²⁶». This datum suggests that so far no institutional framework - regardless of whether it has been put in place in a developing rather than in a developed country - has been able to prevent such crises from producing negative systemic spill-overs. Their ultimate burden ultimately rest on national budgets, i.e. taxpayers, with explicit outlays that have to be absorbed by higher

25 Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, [2012] OJ C 326, art. 107 (3) b.

26 See HONOHAN, KLINGEBIEL, *Controlling the fiscal costs of banking crises*, World Bank Policy Research Paper 2441, September 2000, p. 3.

taxation or spending cuts, and implicit ones that can be expressed in terms of foregone economic output²⁷.

A vast body of literature investigated banking systemic crises²⁸, thus it is possible to individuate a consistent body of research that classifies alternative crisis resolution tools in two main categories. There are short-term "containment phase" policies (needed at the crisis burst) and medium-term "rehabilitation and restructuring phase"²⁹. Both of them aim at addressing the industry's difficulty in order to restore the regular course of business of the distressed financial institutions in the long term, or to lead their ordinate closure, nationalization or liquidation in case those short/medium-term policies would fail.

Among short-term policies, it is possible to include emergency liquidity support provided by central banks and state guarantees aimed at restoring confidence in the sector and avoid the crisis transmission to the real economy³⁰. Whereas among the medium-term ones, it is possible to include: repeated capitalizations, asset resolution strategies, public debt relief programs and even several degrees of forbearance or accommodating enforcement of financial regulations by authorities, such as for instance more tolerance in applying banking activity's authorization³¹.

A similar pattern can be found while studying the evolution of the first European institutional response to the current financial crisis. Among the banking communications on state aid policy issued from 2008 to 2013, it is indeed feasible to classify them in three main eras. A first "rescue era" aimed at fulfilling an ordinate and uniform recourse to state aids in the first emergency waved by the US subprime crisis. A second "restructuring" era dealt with the implementation of consistent plans to help distressed institutions to which state guarantees had been granted to phase-out of the aiding schemes and go back to their regular business management. Finally, a third "banking union" era proposed a reformed institutional framework. This stringer response intends to provide a more uniform and central supervision of the

27 See HONOHAN, KLINGEBIEL,, cit., p.3.

28 Having regard to the most recent contributions, see among others ABIAD ET AL., *Handbook of Safeguarding financial stability: political, social, cultural, and economic theories and models*, 2013, p. 278 ff.; and for a comprehensive though non recent literature review see BALDACCI, GUPTA, MULAS-GRANADOS, *How Effective is Fiscal Policy Response in Systemic Banking Crises?*, IMF WP/09/160, 2009, pp. 5-8; CLAESSENS, KLINGEBIEL, LAEVEN, *Resolving Systemic Financial Crises: Policies and Institutions*, World Bank Policy Research Paper 3377, August 2004, p. 6; HONOHAN, KLINGEBIEL, cit., p. 5 ff.

29 HONOHAN, KLINGEBIEL, cit., p. 5.

30 *Ibidem*.

31 *Ivi*, pp. 6,7.

financial and banking services European market and a single resolution mechanism to help eventual irrecoverable institutions to neatly exit the market without causing any nuisance to the prosecution of competitors' activity.

In the following paragraphs, this paper exposes synthetically the main features of the communications as just classified. The intention is to highlight elements that helped the Commission to deal successfully with the crisis and its systemic effects, thus preserving the European banking sector and preventing its collapse³². The review of such insights could be useful to assess better the proposals for a single banking resolution mechanism, that in the next months are going to be subject to approval in order to complete the banking union project. It may be worth recalling that the temporary relaxation of the general state aid prohibition operated by the Commission at the time of the crisis has been inspired mainly to limit competition distortions at market level and moral hazard at single operator level, stating the historical and on-going recognition by European authorities that these are the essential dangers behind state aid grants.

2.1. THE "RESCUE" ERA (2008-2009)

The European Commission issued the first Banking Communication³³ on 25 October 2008. It begins explicitly acknowledging the impact of the 2007 US subprime crisis in

32 This is also the opinion expressed in LO SCHIAVO, *The impact of EU crisis-related framework on state aids to financial institutions: from past practice to future prospects*, 2013, p. 167.

33 The Communication is a soft law tool that falls under the general category of the so called "atypical" legal acts of the European Union. The mainstream legal doctrine defines as atypical those acts which are routinely part of the institutional procedure of a EU body even though they are not expressly regulated in the Treaty. This kind of acts emerged in the practice in order to guarantee that EU bodies could fully operate according to their complex division of tasks and competencies set up in the Treaty but also to overcome the rigid procedure of adopting typical legal acts. As SENDEN observed «the concept of soft law may be used to embrace those features of a mature legal system which give that system its flexibility and dynamic character». Thus the extensive recourse to soft law has been also interpreted as a reaction to the need for a more flexible regulatory system whenever other more typical legal instruments fail to address volatile market issues in a timely manner. Nevertheless, such tools are often criticized because of their intrinsic soft - therefore non-binding - attitude to produce legal effects, specially by Member States in which a civil law system is in force and soft law is seen as a likely carrier of inconsistencies. Thankfully, the European Court of Justice intervened to clarify this point by elaborating the concept of soft law efficacy for *post legem* acts like the Commission's communications and guidelines. More specifically the ECJ recognized that such acts are not only able to produce effects ("*conformativi*") on the issuing institution but also to characterize as lawful those conducts of privates or Member States that are undertaken in observance of the issued acts. Therefore, any initiative that the Commission undertakes by means of communication or any other soft law tool qualifies as a an effective action, even though in the narrower limits of a «true soft law act» rather than those delimited in the traditional hierarchy of the sources of law. As a main reference on the atypical acts of European Union law, see DE LUCA, *Gli atti atipici nel diritto dell'Unione europea*, 2012, pp. 27, 28

the European financial system and assumes the principles elaborated by the above-mentioned ECOFIN meeting of the 7 October 2008 as its further policy's base.

The main conveyed message relates to the declaration of the financial crisis as a serious disturbance of Member States' economies and the intention of carrying on applying the 2004 R&R Guidelines on the article 107 (3) b basis instead of the one until then provided by the article 107 (3) c.

The legal basis change may look formally minor, but it is practically very relevant. Whereas the article 107, paragraph 3, letter c refers to «aid to facilitate the development of certain economies», the same article and paragraph at the letter b deal with «serious disturbance in the economy of a member state». This means that, under the latter, the banking sector becomes a "special" subject of state aid rules and the Commission is therefore allowed to adopt a more flexible enforcement approach³⁴.

The increased flexibility was needed because of the specific consequences of the crisis that had already «stretched the possibilities under the R&R Guidelines to their logical limits³⁵».

A further significant departure from the R&R framework concerns the established aid procedure. Previously, a government aid was assessed under a full ex-ante control requiring both prior notification to the Commission and the withhold of implementation until compatibility was decided (average duration of two months). While, according to the 2008 Communication, the assessment timetable has to speed-up in order to avoid «economically imprudent and politically unacceptable temporal constraints³⁶».

The Commission expressly committed to ensuring the swift adoption of decisions upon complete notification. It committed to deliver within 24 hours and over a weekend, when deemed necessary and consistently with its slightly earlier actions and policy statements³⁷.

and 141; and also, as cited by DE LUCA, see BEVERIDGE, NOTT, *Law making in the European Union*, 1998; SENDEN, *Soft law in European community law*, 2004, p. 266 e ss; COSMA, WHISH, *Soft law in the field of EU competition policy*, in *EBLR*, 2003, p. 33.

34 On the flexible approach see DOLEYS, *Managing state aid in a time of crisis: Commission crisis communications and the financial sector bailout*, 2012, p. 555; HELLSTERN, KOENIG, *cit.*, p. 1; HANCHER, *Bailouts in the Financial Sector: the Compatibility with the EU State Aid Rules*, 2011, p. 133.

35 As written by HANCHER, *cit.*, p. 132.

36 As written by DOLEYS, *cit.*, p. 556.

37 See the 2008 Banking Communication, *cit.*, para. 53.

Besides, thanks to the flexible approach, the Commission firstly dared to outline a definition of fundamentally sound or healthy banks. Fundamentally sound banks were those suffering temporary distress caused by the crisis and the induced liquidity dry-up. They were distinguished from distressed banks for endogenous reasons. According to this distinction, the Commission suggested two different lines of enforcement. Fundamentally sound banks should have been aided to restore viability through the implementation restructuring plans, while the situation of distressed banks, which engaged in risky and inefficient asset-management strategies, should first have been addressed through rescue aids³⁸.

Furthermore, the European competition authority went far enough to design a sort of hierarchy of R&R Guidelines' potential tools. First of all, guarantee schemes were advised to cover bank liabilities in order to address the emergency situation that the Lehman Brothers' collapse quickly exasperated in the months that directly preceded the issuance of the Communication. Thus, it was meant to conciliate the objectives to re-establish financial stability and to protect retail depositors. While protecting depositors though, those schemes are also able to benefit shareholders and risk-capital investors unduly. Hence, they had to be designed in order to last up to the minimum necessary, to be audited each six months by Member States, which have to then submit the review to the Commission, and, in the end, they could not be extended over two years' total duration³⁹. In order to minimize distortions of competition, specific behavioural constraints might have further been imposed on beneficiaries to prevent them from engaging in aggressive expansion to the detriment of non-aided competitors⁴⁰.

Recapitalisation schemes are listed as a second measure available and controlled winding-up and liquidity assistance by public funds, even provided by central banks, are left as last or residual measures.

In its comprehensive recognition, the 2008 Communication did not forget to illustrate a way to make irrecoverable institutions exit the market. This specific part on the crisis-resolution tool had not been further specified until the 2013 communication. This fact shows how the Commission's crisis-management had been much more rescue-oriented than impartial. Nonetheless, the European authorities would have

38 *Ivi*, para. 14.

39 *Ivi*, para. 24-26.

40 *Ivi*, para. 27.

been tied to perform only the assessment and approval of controlled liquidation carried out in the context of a guarantee scheme, where public funds are needed to help the bank to be dismissed without generating financial chaos⁴¹. That assessment's purpose was to control that such publicly-funded contribution would not ultimately benefit shareholders and creditors, in order to avoid moral hazard, and would not last too long, in order to limit the distortion of competition to the minimum.

The call for a more accurate design of guarantee schemes rather than other potential action tools was grounded on the increased demand for such form of aid by Member States. At the same time, it tried to contain their attempts to favour national institutions⁴². The attitude of the schemes designed by the Communication to control for discrimination, as well as for distortions to competition, shows that the Commission had a timely and effective understanding of the current trends.

Right after the release of the 2008 Banking Communication, a second Irish deposit guarantee scheme was notified. Furthermore, a similar British, German and Danish initiatives followed, together with several ad-hoc packages for Dexia, Fortis, JSC Parex Banka, IKB, ING and Aegon. This information is sufficient to infer the scope of the need of the European banking sector for such intervention. In total, the Commission received notifications for aids amounting to EUR 2 trillion just by the end of November 2008 - six weeks after the Lehman Brothers default⁴³.

By the end of the year, recapitalisation schemes were presented by three Member States (UK, Germany, and Greece) under the 2008 Banking Communication, as well as individually by ING and JSC Parex Banka⁴⁴. Typically, recapitalisation through capital injections can be authorized according to the "market investor" principle, which prescribes that governments can provide capital at the same terms and conditions of a private investor. A private market operator invests taking into account the risk profile of the capital-seeking firm and this choice is reflected in the price remuneration.

During the stage of the crisis that was characterized by collapsed inter-bank lending and dried-up credit market, pricing risks was indeed an arduous task. The favour of

41 See HANCHER, cit., p. 137.

42 *Ivi*, p. 135.

43 As reported by DOLEYS, cit., p. 556.

44 See Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (hereinafter "Recapitalisation Communication"), [2009] OJ C 10, note 3.

the 2008 Banking Communication for the guarantee scheme as an action's tool did not sufficiently clarify this issue.

Nevertheless, it became suddenly *à la page* when France proposed a preventive recapitalisation scheme to relieve balance sheets of its six main "fundamentally sound" retail banks by pricing securities at a 8% rate⁴⁵. The Commission expressed reserves on the "preventive" nature of the recapitalisation as well as on the proposed rate, stating that a remuneration below 10% confers unfair competitive advantages to beneficiaries⁴⁶.

During the meeting that took place on 2 December 2008, the ECOFIN recognised the evolution in the trend and called for urgent adoption of further guidance on precautionary recapitalisations to sustain credit. Three days later, the Commission issued the so-called "Recapitalisation Communication"⁴⁷. These orientations provided guidance for new recapitalisation schemes and opened the possibility for adjustment of existing recapitalisation schemes aimed at restoring financial stability. The financial stability threats should have been resolved by ensuring lending to the real economy and dealing with the systemic risk of possible insolvency⁴⁸.

The new policy elaborated the distinction among "fundamentally sound" and "distressed" banks, set out in the 2008 Banking Communication, specifically for the recapitalisation purposes, following the Recommendations of the Governing Council of the European Central Bank. In the Recapitalisation Communication, the Commission explained the shared view according to which fundamentally sound banks may require capital injections for reasons other than those affecting banks in distress, due to the adoption of risky and inefficient business models. These further reasons included the need of higher capital ratios to compensate the negative perception of past underestimation of risk in the public and to bear the increased cost of funding, instead of restricting lending just to avoid risks and the potential further undermining of capital ratios⁴⁹. Those banks were then authorized to recapitalize

45 See *Republic of France Capital-injection scheme for banks* (2009/C 106/04), Commission decision N 613/2008 [2009] OJ C 106.

46 As reported by DOLEYS, cit., p. 558.

47 See the European Commission Communication on the recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (hereinafter "Recapitalization Communication"), [2009] OJ C 10/2.

48 *Ivi*, para.3.

49 As stated in para. 18: «In addition, while acknowledging that the current exceptional market rates do not constitute a reasonable benchmark for determining the correct level of remuneration of capital,

below the 10% rate thresholds but on «correspondingly significantly reduced conditions on public support in the longer term, provided that they accept terms on the redemption or conversion of the instruments so as to retain the temporary nature of the State's involvement, and its objective of restoring financial stability/lending to the economy, and the need to avoid abuse of the funds for wider strategic purposes⁵⁰». Moreover, the pricing of State recapitalization measures, in such uncertain times and market conditions, was placed under a benchmarking screen. According to the methodology proposed by the ECB Recommendations, «a pricing scheme for capital injections based on a corridor for rates of return for beneficiary banks which, notwithstanding variations in their risk profile, are fundamentally sound financial institutions⁵¹». Accordingly, higher rates were imposed on distressed banks, being the institutions that posed a greater risk of distortion to the competitive market scenario.

The Recapitalisation Communication also adds further behavioural restraints susceptible of application to the recapitalisation of banks in distress. They include restrictions on dividends and executives' compensation. Surprisingly, the Recapitalisation communication does not condition the approval of recapitalisation measures to good banks on the restructuring plan's submission, unlike the past Commission's approach on 2004 R&R Guidelines' application and 2008 Banking Communication's issuance.

The concrete application of the measure has been quite successful, if it is taken into consideration that by March 2010 the Commission approved recapitalization schemes in 14 Member States. Their total volume, including ad hoc measures, amounted at about EUR 503 billion (equal to 4% of the EU GDP)⁵².

At the beginning of 2009, some Member States showed interest in complementing the interventions approved under the Banking and the Recapitalisation communications' approach with some other measures to relieve banks' impaired assets. While the US

the Commission is of the view that recapitalization measures by Member States should take into account the underestimation of risk in the pre-crisis period.»; therefore the application of the market economy investor principle has been *de facto* relaxed by the Recapitalization Communication.

50 *Ivi*, para. 15.

51 *Ivi*, para 17.

52 See HANCHER, cit., p. 137.

was designing a similar instrument⁵³, the Commission - in consultation with the ECB - issued a third communication⁵⁴ built on the Eurosystem Recommendations released on 5 February 2009⁵⁵. The comprehensive scope of the communication focused on «issues such as (i) transparency and disclosure requirements; (ii) burden sharing between the State, shareholders and creditors; (iii) aligning incentives for beneficiaries with public policy objectives; (iv) principles for designing asset relief measures in terms of eligibility, valuation and management of impaired assets; and (v) the relationship between asset relief, other government support measures and the restructuring of banks⁵⁶».

The third communication initially acknowledged that the financial sector's rescue packages approved as of October 2008 contributed to financial stability by avoiding the risk of financial meltdown. It supported the on-going functioning of inter-bank lending, but it had limited or minimum impact on lending to the real economy⁵⁷. One of the reasons of such reduced impact, which led to undesirable deceleration in credit growth, has been found in the persistent market uncertainty over the value of impaired asset-backed papers, still present in the credit institutions' balance sheets⁵⁸. Impaired assets relief measures were so needed to isolate such assets off-balance and thus reduce the need to maintain high capital ratios as a precautionary measure against further write-downs⁵⁹. In fact, asset relief measures are likely to clear up the uncertainty over the quality of financial institutions' balance sheets and at the same time to avoid a vicious circle of repeated rounds of recapitalisation to cover further eventual asset impairments⁶⁰. In this regard it is easy to understand why asset relief measures have been suggested and more often used as necessary complements of the other aid measures described in the previous communications.

Such measures can take the form of asset purchase or asset insurance. The first system involves the segregation of impaired assets from good assets. The result is

53 For a comprehensive explanation of the US way of dealing with the crisis of the financial industry, see GUYNN, *Resolution planning in the United States*, 2013.

54 See the European Commission Communication on the treatment of impaired assets in the Community financial sector (hereinafter "Impaired Assets Communication"), [2009] OJ C 72.

55 *Ivi*, Annex 1.

56 *Ivi*, para. 4.

57 *Ivi*, see para. 5.

58 See DOLEYS, *cit.*, p. 559.

59 *Ibidem*.

60 Impaired Assets Communication, para. 7.

achieved by creating an asset management company (bad bank or risk shield) for each beneficiary. Hence, the impaired assets would be transferred to a separate legal entity, while the assets that stay in the ailing bank and eventual losses would be shared between the good bank and the State⁶¹.

Specific issues recur under both schemes and relate to the correct assessment of assets and the price of State support on the basis of evaluation. In order to allow beneficiary banks to concretely share burdens, prices must be based on a transfer value sufficiently close to the identified real economic value⁶². Therefore, burden-sharing should be full and ex-ante in order to make the measure effective and not too onerous for public budgets. In case this is not possible to achieve, time-delayed forms of participation to losses may be designed as claw-back or first loss/residual loss sharing clauses, respectively for asset purchase or insurance⁶³.

Residual features and principles recall what already developed in the previous communications: asset relief measures can be granted for a six-month period under some conditions. The conditions for each institution, which accessed to asset relief schemes, essentially are to commit to present details of the assets' evaluation, in conformity to the indications elaborated by the Commission in consultation with the ECB, as well as a restructuring plan on the return to viability⁶⁴.

Member States had generally favoured guarantee measures over asset purchases, suggesting that net advantages of the former are greater for governments and beneficiaries. The 60% of the EU total aggregate portfolio of asset relief measures is made up of second-loss insurance schemes, while just 40% refers to purchases schemes⁶⁵. The explanation to such ratios has been found in the fact that «asset guarantee leaves the upside to the banks and does not require first loss tranche to be fully written down, while an asset purchase usually secures funding for the bank⁶⁶». Moreover, in much greater disproportion, Member States favoured individual measures (92%) over national schemes (8%). Such a datum made some commentators say that the response to the Impaired Assets Communication was

61 *Ivi*, Annex II, para. 1.

62 *Ivi*, annex IV.

63 *Ivi*, para. 24.

64 See HANCHER, cit., p. 140.

65 See BOUDGHENE, MAES, *Relieving banks from toxic or impaired assets: the EU state aid policy framework*, in *Journal of European competition law and practice*, 2012, pp. 12-13.

66 *Ibidem*.

mute⁶⁷, since just Germany, UK and Ireland proposed an asset relief programme and just the latter concretely used it. Against this interpretation, it can be argued that asset relief tools show a complementary nature that allows them to be well used in combination with other state aid measures. It is actually easier to assume that their low “success” could possibly be inferred to some degree of the States' reluctance in engaging neatly and proactively to such commitment while they were facing daily emergencies. Through these lenses, it is also easier to understand the greater amount of applications for individual rather than national asset relief schemes.

2.2. THE “RESTRUCTURING” ERA (2009-2012)

After the release of the Impaired Assets Communication, the crisis management provided by the Commission's state aid policy reached a mature stage that allowed the European competition authority to start designing a resolution-oriented crisis policy. Despite the fact that economic conditions in the financial sector did not show significant signs of recovery, the moment was indeed profitable for such a policy development because then many rescue-aided institutions were submitting their restructuring plans, as required by the previous communications' indications.

In evaluating such plans, the Commission developed again a consistent approach which is exemplified by the measures taken in the Commerzbank decision⁶⁸, at the beginning of 2009. After acquiring the Dresdner Bank, Commerzbank became the second largest private bank adopting the business model of universal bank in Germany. This concretely means that its activity included commercial and investment banking and it was mainly provided to retail clients and small/medium enterprises, in Central and Eastern Europe. When the US housing bubble burst, it incurred losses that mainly derived from the Dresdner Bank ABS portfolio. Therefore, it applied to benefit from the German government's recapitalisation scheme for fundamentally sound banks, thus receiving a capital injection of EUR 18 billion in December 2008⁶⁹.

A subsequent business plan setting out measures to restore the viability of the bank was presented to the Commission. The plan focused on the core activities of retail and

67 DOLEYS, cit., p. 560.

68 See *Restructuring aid to Commerzbank (2009/C 147/01)*, Commission decision N 244/2009, [2009] OJ C147/4.

69 See the summary of facts provided by the European Commission Press Release IP/09/711, 07/05/2009.

corporate banking, which had always been steadily profitable, and implied to divest volatile investment banking and commercial real estate activities, as well as reconsidering its risk management and corporate governance strategies. Several measures aimed at keeping the aid to the minimum necessary and thus at minimizing eventual distortions to competition. This was the rationale behind the divestments of activities, the sale of subsidiaries (including the sale of Eurohypo, an important European player in the real estate and public finance business) and the suspension of dividend and interest payments to holders of hybrid capital⁷⁰. In addition, the bank was subjected to a general ban for three years on acquisitions of potential competitors, both financial institutions and other businesses. Furthermore, a behavioural measure prevented the bank from undertaking business initiative - including deposit taking - under more favourable price conditions than those of its principal three competitors in markets and products, where it holds a market share above 5%⁷¹. The Commission found the proposed plan compatible with the single market, because Commerzbank's funding situation had been stable throughout the crisis and it still held significant liquidity buffers. Besides, both the structural (i.e. large-scale divestments, amounting to roughly 45% of its balance sheet total) and behavioural (i.e. the ban on acquisition) measures limited the aid to the minimum necessary and ensured an adequate burden sharing, minimizing anticompetitive concerns.

Following the European Council meetings that took place between March and June 2009, the European institutions renovated their commitment to restore the functioning of the European financial system and the confidence of the markets in it. The year 2010 was a year of huge changes for the institutional architecture of the European financial sector and those also implied a sort of evolution of the state aid policy applied by the Commission. When first signs of distress transmission from the banking sector to the sovereign debts started, the European authorities decided to intervene on two sides: on the institutional framework of the monetary union⁷² and

70 *Idem*.

71 *Idem*.

72 Mainly through the creation of new dedicated institutions, such as the European Financial Stability and the European Stability Mechanism (see the Regulation (EU) n. 407/2010 of the Council, 11 May 2010, in [2010] OJ L 118), the redesign of the Pact on stability and growth and of the state balance sheets discipline (6+2 Pack and Fiscal compact measures) and a stronger coordination among economic policies (for instance the introduction of the Eurosummit), as synthesized by CAFARO, *L'azione della BCE nella crisi dell'area dell'euro alla luce del diritto dell'Unione europea*, 2013, pp.6-7.

on the transmission mechanism of the monetary policy⁷³. These are the reasons why the ECB started playing an important and interesting fresh role, next to the Commission, in the European innovative way of dealing with the crisis.

a. The first institutional changes to the European financial supervisory architecture

For the better understanding of the further exposition, it is worth prolonging the detour to clarify how the institutional architecture changed in Europe, during the "restructuring" state aid policy era. Indeed, the reforms on financial oversight and supervision of the financial sector have been quite significant. Following the recommendations of the Larosière High Level Group⁷⁴, on 7 September 2010, the ECOFIN established the European Systemic Risk Board, ESRB, as an independent authority for macro-prudential supervision, which started being operational in December 2010 in Frankfurt am Main⁷⁵. Simultaneously, other regulations on the establishment of the European Banking Authority, EBA, of the European Insurance and Occupational Pensions Authority, EIOPA, and the European Securities and Markets Authority, ESMA, had also been approved⁷⁶. All these authorities together joined the European System of Financial Supervisors (ESFS). The ESFS can be seen as the first official step towards the implementation of a more centralized control of the industry at European level, of which the banking union project at the present moment represents the younger stepsister. Both of them aimed at providing a finally integrated financial framework and, in a more ambitious and sophisticated plan.

b. The post-ESFS communications of the Commission

73 On the transmission mechanism of the monetary policy of the ECB during the crisis, see CICCARELLI, MADDALONI, PEYDRÓ, *Heterogeneous transmission mechanism. Monetary policy and financial fragility in the Euro area*, March 2013.

74 For a more detailed description of the first institutional response to the crisis on financial supervision, see the chapter authored by DI NOIA, FURLÒ, *The new structure of financial supervision in Europe: what's next?*, in *Financial regulation and supervision. A post-crisis analysis*, 2012, pp. 172-192.

75 See Regulation (EU) n. 1092/2010 of the European Parliament and the Council on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, 24 November 2010, (2010) OJ L 331.

76 See again CAFARO, cit., p.7.

While new European institutions were established, the Commission kept on updating its state aid policy through the issuance of new communications. On 23 July 2009, a fourth Communication⁷⁷ was released about restructuring plans' design and implementation. After recognizing the systemic dimension of the present financial crisis originated by the US subprime crisis, the so-called Restructuring Communication did not modify the criteria under which restructuring plans had so far been approved. Though, it did integrate those criteria through the specification of some conditions aimed at improving the predictability on how the Commission intends to assess the plans' compatibility with the systemic crisis. The conditions basically reflected the recurrent features of plans that the Commission approved since early 2009.

According to the intentions showed in decisions such as the one on the state aid to Commerzbank⁷⁸, the Commission specified that restructuring plans had to present a full diagnosis of the beneficiary's economic state and then to propose a complete strategy to achieve the return to viability. It further explicitly stated that «long-term viability is achieved when a bank is able to cover all its costs including depreciation and financial charges and provide an appropriate return on equity, taking into account the risk profile of the bank». And, last but not least, it should also be able to compete in the marketplace for capital on its own merits⁷⁹.

The plan's expected outcome had to be tested under base case and stress scenarios, taking into account future eventual macroeconomic conditions⁸⁰. The stress test design had to be elaborated by the recently created Committee of European supervisors according to EU-wide parameters, and further eventual insights should have been specifically addressed in the plan.

From a more operational perspective it was recommended that, because structural remedies were not advisable, at least intermediate behavioural measures should have been taken into account in the plan's proposal⁸¹. Behavioural measures kept following the indications provided in the previous communications. Previous

77 Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (hereinafter "Restructuring Communication"), [2009] OJ C 195.

78 See *supra* note 63.

79 Restructuring Communication, *cit.*, para. 13.

80 *Ivi*, para. 8 and para. 13.

81 *Ivi*, para. 7.

indications held also for the adequacy of burden sharing. Finally, after the restructuring plan design, its implementation should require a reliable but flexible timetable.

An interesting characteristic distinguishes the Restructuring Communication from the others above-analysed. It set out an express duration of the policy orientation it contains, up to the end of the year 2010⁸². For the first time, the Commission tried to predict a deadline for its crisis-specific state aid policy. The suggestion of a close end of the markets' turbulence was not confirmed by facts. Most likely, it was intended to redirect market expectations to optimism, together with the near future intention to project the phasing out of the supportive framework.

Unluckily, such a prevision was way too optimistic. Hence, in 2011, the Commission had to reformulate its policy. This time the Commission had to take into account that the pressure on sovereign debts (induced by the governments' bailouts) made the markets' volatility persistent, despite the slight economic recovery that Europe experienced in 2010.

A first exit strategy was promoted by the ECOFIN on 2 December 2009. It involved a progressive reduction of state-supported measures, starting from the abolition of the distinction between fundamentally sound and distressed banks and the consequent abandonment of schemes for banks which had already reached stability.

Nevertheless, the exit had to be accompanied by two prolongations of the conditions set out in the Restructuring Communication that had to postpone the initial deadline, i.e. 31 December 2010, up to December 2011⁸³ and - at last - to December 2012⁸⁴.

2.3. THE BANKING UNION ERA (2013 – on-going)

The 2013 Banking Communication⁸⁵, effective from the 1st August 2013, explicitly connects to the 1st and 2nd Prolongation communications. The policy statement

82 *Ivi*, para. 49: «This Communication is justified by the current exceptional financial sector crisis and should therefore only be applied for a limited period. For the assessment of restructuring aid notified to the Commission on or before 31 December 2010, the Commission will apply this Communication».

83 See European Commission Communication on the application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis (hereinafter “1st Prolongation Communication”), [2010] OJ C329.

84 European Commission Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis (hereinafter “2nd Prolongation Communication”), [2011] OJ C 356.

acknowledges that it is necessary to pursue the process of aligning the legal framework to the market evolution, which started in June 2010 with the increase of the guarantee fee⁸⁶. By that, the Commission meant to re-state that the crisis had reached, and not left yet, the sovereign debts. It deemed necessary to retain some support facilities for banks but also to further develop some conditions and procedures in order not to indulge too much. After reminding that the legal basis for such communications and the overarching objective of financial stability still held, the communication is dedicated to set out the necessary mentioned adaptations for the compatibility of crisis-related State aid to banks. More specifically, it replaced the 2008 Banking Communication's guidance for liquidity support, it adapted and complemented the Recapitalisation and Impaired Assets Communications, and it supplemented the Restructuring Communication's guidance on burden-sharing by share-holders and subordinated creditors. Furthermore, it established a new principle according to which no recapitalisation or asset relief could be granted before restructuring plan's approval, and set a permanent authorisation procedure of these measures. Last but not least, it provided guidance on liquidation aid⁸⁷.

The new recapitalisation procedure represents the more important sign of novelty in this policy update. First of all, the capital short-fall is pointed as a necessary pre-requirement to activate the procedure. Secondly, a comprehensive definition of capital short-fall is provided at para 28. It states it has to be «established in a capital exercise, stress-test, asset quality review or an equivalent exercise in the Union, euro-area or national level, where applicable confirmed by the competent supervisory authority». Therefore, a Member State should pre-emptively demonstrate that all the other alternative measures have been already exploited and a competent authority must assess that the bank capital ratio meets the minimum regulatory capital requirements⁸⁸. Only then, the State would be invited to submit a capital raising plan⁸⁹ before or together with the restructuring plan. Moreover, it should specify capital raising measures (ranging from rights issues to earnings retention⁹⁰) and

85 See Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (hereinafter “2013 Banking Communication”), [2013] OJ C216/1.

86 *Ivi*, para. 21.

87 *Ivi*, para. 24.

88 *Ivi*, para. 43.

89 For further description *ivi*, para. 32-34.

90 As listed punctually *ivi*, at para. 35.

burden-sharing measures by shareholders and subordinated creditors of the aided bank⁹¹. As soon as the short-fall is identified, the involved Member State should enter into restructuring aid pre-notification contact with the Commission in order to quickly establish a capital raising plan and thus minimise the cost of the intervention. The losses should be first absorbed by equity, by contributions of hybrid capital, and subordinated debt's holders to the maximum extent⁹². In this way, shareholders and creditors burden sharing shall be ensured in order to limit moral hazard. Besides, the Commission has declared it will not require contributions from senior debt holders, such as owners of insured and uninsured deposits and bonds⁹³. Just in case the bank capital ratio would no longer meet the minimum regulatory capital requirements, the Commission would expect the subordinated debt to be converted or written down before allowing state aids⁹⁴.

Furthermore, in order to keep minimising the need for state aid and simultaneously providing disincentive to banks' moral hazard, the new Banking Communication deals with the responsibility of the management. The para 37 sets the incentives by prescribing that the top management of a bank having received aid should be replaced when appropriate and sets out a cap on total remuneration, in line with the rules of the Commission's Capital Requirements Directive IV⁹⁵, as long as the entity is under restructuring or relying on state support⁹⁶. The following paragraph states that total remuneration may not exceed 15 times the national average salary in the Member State where the beneficiary bank is incorporated, or 10 times the average salary of employees in the beneficiary bank⁹⁷.

Finally, the 2013 Banking Communication “codifies” the Commission's case practice on liquidation aid. The policy document in particular sets out the criteria for authorising liquidation aid and orderly winding down schemes, directly addressing the case for selling a bank during the orderly winding down procedure. Hence, it directly advocates the power of approving liquidation aid schemes for banks while it

91 *Ivi*, para.29.

92 *Ivi*, para. 41.

93 *Ivi*, para. 42.

94 *Ivi*, para. 44.

95 Directive 2013/36/EU of the European Parliament and the Council, 26 June 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [2013] OJ L 176/338.

96 See 2013 Banking Communication, cit., para. 37.

97 *Ivi*, para. 38.

is provided that such schemes comply with the communication's requirements. Moreover, in order to enter the orderly liquidation procedure, the financial institution has to provide a detailed liquidation plan, symmetric to the restructuring plan that is needed to enter a restructuring procedure.

From September to October 2013, the Commission had adopted decisions approving a restructuring plan for 44 banks, 23 approving winding down plans and one negative decision requiring the recovery of the aid granted⁹⁸.

Nevertheless, the most striking innovation in the communication is that it makes express reference⁹⁹ to the Bank Recovery and Resolution Directive¹⁰⁰, BRRD, which has been approved on 15 May 2014 and published on the Official Journal of 12 June 2014. The 2013 Communication acknowledges that since the beginning of the crisis, the European Union has made many regulatory and institutional changes to address the emergency and at the same time to improve prevention, management and resolution of banking crises. In this sense, it is possible to interpret also the European Council's initiatives like the implementation of the single supervisory mechanism and the single resolution mechanism for a banking union and the agreement of Member States over a stability mechanism¹⁰¹. In addition, the adaptation of the state aid policy has become key also to ensure that a smooth passage to the new system the BRRD will provide and not just safeguard the integrity of the market by providing sounder restructuring and stronger burden-sharing for European aided banks.

a. The second institutional changes to the European financial supervisory architecture

For the sake of clarity, a second digression on the undertaken measures confined to the euro-area is needed. The BRRD is meant to provide an integrated legal framework for bank resolution to all European Union countries. Based on the BRRD, a proposal

98 For further information on these actions see the European Commission Memo MEMO/13/762, 03/09/2013.

99 See 2013 Banking Communication, cit., para.13.

100 Directive 2014/59/EU of the European Parliament and the Council, of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, [2014] OJ L 173/190.

101 *Ivi*, para. 12.

for a single resolution mechanism¹⁰² was released by the Commission on the same day the 2013 Banking Communication was issued. Simultaneously, the regulation on a single supervisory mechanism¹⁰³ was approved at the end of the summer 2013. The ECB, which has been granted by an enlargement of its mandate that now includes the micro-prudential bank supervision at European level, worked on the elaboration of the internal framework regulation to be released at the end of the summer 2014.

Joining the SSM has been mandatory for Member States whose currency is the euro while an opt-in option has been left for the Member States outside of the Euro-zone. This option could have been attractive for the latter, in general terms of market reputational factors or because some of them are already adopting convergence policies in order to join the euro-area in the future. Though, the complex design of the mechanism to allow their eventual participation to the board works in the opposite direction as a disincentive¹⁰⁴. One is tempted to think that, at least from an organizational perspective, the second added task of bank supervision to the ECB institutional mandate would be likely to affect the first original one and the other way around. This could happen, despite the constantly-claimed need and intention to keep a clear separation between the two. In this way, a beneficial use of eventual positive synergies, due to more complete flow of information on the financial industry, would be wasted¹⁰⁵.

102 Proposal for a regulation of the European Parliament and the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council, 10.7.2013, COM(2013) 520 final, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0520:FIN:EN:PDF>.

103 Council regulation (EU) No 1024/2013, 15 October 2013, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, (2013) OJ L 287/63.

104 For more information, see an in-depth analysis of the key aspects for non-euro area countries in the Draft SSM Regulation written by DARVAS, WOLFF, *Should non-euro area countries join the single supervisory mechanism?*, 2013, p. 3.

105 On synergies and conflicts between ECB's tasks, see DARVAS, MERLER, *The European Central Bank in the age of banking union*, 2013, pp. 16,17. The authors analysed the major issues of the ECB's mandate enlargement and stated that «there is potential synergy between monetary, micro- and macro-prudential policies. [...] But there is a potential for conflicts of interests too, for example, in a situation when an interest rate increase is needed for monetary policy purposes but such an increase would have a critical impact on the balance sheets of banks». Moreover, they argued that a strict organisational separation of monetary policy and bank supervision within ECB, which was a major goal of SSM regulation, would not allow an appropriate flow of information that would facilitate the achievements of the goals of price and financial stability, as it was the case of the recent Bank of England re-organisation for more cooperation and coordination across different policy areas.

Furthermore, the design of the SRM, locked in combination with an SSM as such, would of course result in nothing more than an additional euro-area dedicated initiative. Hence, the European financial legal and institutional framework would involve: 1) the financial sector-specific state aid policy that would be still implemented by the Commission uniformly in all the European Union countries, 2) the BRRD that will set a single framework applicable to all the European Union countries which will let free to choose individually how to receive in each domestic legal system the special insolvency regime for institutions it provides; 3) the SSM that institutionally will provide a centralized micro-prudential bank supervision at European level through a network headed by the ECB and constituted also by all the Euro-zone countries national central banks, NCBs, as national agencies; 4) the SRM that institutionally will provide the application of the BRRD content in the Euro-zone countries through a network headed by a single resolution authority at central level and constituted also by national resolution agencies. The national resolution agencies of countries outside the SRM will mediate with it, through the EBA institutionalized intercession¹⁰⁶, in order to ensure the consistency of the approaches.

From the synthetic summary above, it is possible to conclude that both the Commission's state aid policy and the BRRD will share the task of ensuring uniform rules or enforcement at Union level for the sake of the internal market's integrity. On the contrary, in order to make the SSM and SRM operational as soon as possible, the banking union will more likely work just for the euro-area Member States of the Union. This will lead to some degree of divergence in the approaches. Thus, it also reveals a deeper intention to safeguard financial stability in the Euro-zone rather than improve the prevention, management and resolution of banking crises in all the internal market, unlike in the 2013 Banking Communication wording¹⁰⁷.

3. THE LESSONS FROM THE CRISIS-ENFORCEMENT OF STATE AID POLICY

106 See the provisional text adopted by the Parliament on 15 April 2014 of the Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council.

107 *Supra* note 94.

Competition and financial regulation may appear to pull in different directions¹⁰⁸. This is even more true when competition meets financial stability¹⁰⁹, as happened in the last financial crisis. In both cases, commentators are usually more concerned for the possibility that state aid enforcement might de facto regulate the financial sector thus supplanting financial regulation, rather than just complementing it¹¹⁰. At the beginning of the “rescue era”, two models were mostly discussed in the debate on the future of banking resolution. A model of state aid control as a complement of a European Banking Resolution Authority opposed to a model of state aid control as a partial substitute for a European Banking Resolution Authority¹¹¹.

Given the difference of the aims of the two regulations, the second model seems more advisable. In the absence of a single resolution authority, though, European state aid control had to partially substitute the missing authority¹¹². It did it with a very balanced grace. It never crossed the boundaries of its scope to invade those of financial regulation directly. In the end, it accompanied the internal market in the transition from the previous fragmented financial regulation to the next financial supervisory architectures. In particular, the progressive introduction of a well definite form of burden sharing, through the issuance of the communications above-discussed, paved the way for the European bail-in. It was an effective action both in terms of gradual enforcement strategy and in terms of forward-looking education of the market operators. The challenge of addressing the moral hazard induced by the “too-big-to-fail” problem was indeed significant.

From an economic perspective, it has been argued that financial crises represent market failures; therefore, crisis-state aids shall be considered as efficient measures¹¹³. Moreover, crisis-driven state aids tend to be less distortive and to produce less moral hazard than usual¹¹⁴. Both outcomes are due to exceptional

108 As literally stated, among others, by DE CECCO, *State aid law meets financial regulation*, 2011, p.68.

109 See KAVANAGH, COPPI, *Competition and financial stability: friends or foes – an unresolved debate*, 2013, p.338.

110 Idem.

111 As described by DEWATRIPONT, NGUYEN, PRAET, SAPIR, *The role of state aid control in improving bank resolution in Europe*, 2010, pp. 6-7.

112 Evidences are the conditions set out in the different phases of crisis-management that aimed both at addressing moral hazard issues and at preventing distortion of competition. See the detailed analysis provided by GERARD, *Overview –Managing the financial crisis In Europe, in Competition law in times of economic crisis : in need of ajustment?*, 2013, pp. 243-249.

113 See KAVANAGH, COPPI, cit., pp. 334-335.

114 Ibidem, pp. 336-337.

nature of the aids, but also to the exceptional conditions of the individual operators 'financial situation and of the market as a whole.

The best characteristics of the Commission's crisis management through the use of state aid policy were the timeliness and flexibility of an effective and uniform approach that limited discrimination and distortions in the single market, and simultaneously also moral hazard. The key factor of success in achieving all these goals – while substituting a missing authority – was indeed being “firm on the principles – flexible on procedure”¹¹⁵. Again, timeliness and flexibility are also the most recommended qualities in the assessment of the new European framework for managing bank crises¹¹⁶.

Last but not least, the successful Commission's experience in applying competition policy is fostered by the working of the European Competition Network which historically contributed at institutional level to achieve such a success and nowadays constitutes an exemplary model as a European solution to deal with the implementation of laws that are designed to address specific market failures in order to ensure the market itself smoother free operation. It has above all shown how concrete law enforcement does matter as much as good law design in order to achieve the aimed results and how concrete law enforcement in turn relies on good institutional design and resources.

4. CONCLUSIONS

The EU Commission's state aid policy approach described above has challenged and successfully overcome various trials posed first by the bursting of the financial crisis, by its systemic development and finally by the most recent design and implementation of the banking union. The success of the approach in dealing with the financial industry's crisis is proven by the fact that among over 400 state aid measures approved since 2008 under the crisis-specific policy; just 4 of them have

115As formulated by VAN BONIN, *Procedure issues*, 2013, p. 301.

116 See Micossi, Bruzzone, Carmassi, *The new European framework for managing bank crises*, 2013, write as a first recommendation: «that the assessment that a bank is failing or likely to fail and no private or supervisory alternative is available should be left to the ECB, and endorsed by the SRB and the Commission, with a fast-track procedure for the initiation of resolution completed within a weekend», p. 1. [emphasis added]

been appealed¹¹⁷. This means that the "concerted method" which involved Member States and sometimes also hearing from financial institutions themselves (particularly on behavioural measures) during the design and approval of a compatible aid have been very effective. The high degree of consensus achieved over measures made the recourse to judicial review unusually infrequent and thus it led to a broader homogeneity on the effectively taken actions and reduced the eventual inequality in the treatment of operators.

Advantages of a uniform approach are well known in the European context and they historically have been main drivers of integration in this portion of the world. Most of the benefits of less disparity among market operators are essentially translated in less distortion of competition which - in European antitrust philosophy terms - means a fostered internal market.

On the basis of such observations, I join the views of the majority of commentators, European institutional bodies included, who warmly welcomed the banking union project as a final means to restore the financial industry by regulating that market failure which the most recent crisis made it impossible to still ignore. The European proposal to finally «break the link between banks and sovereigns» is correctly aimed at finding an original institutional solution to restore the financial stability in the European market and the confidence in the European financial institutions once for all.

It is worth outlining, though, that the BRRD proposal entirely reflects the DG Comp efforts in terms of broader uniformity of rules for the sake of the internal market, while the SSM, SRM and SBRF proposals focus on the implementation of the BRRD dispositions in the Euro-zone (and the eventual joining of the non-euro area Member States of the Union). The plan towards a more genuine economic and monetary union could have then been split in two separate sections or even two different statements since apparently the two-speed Europe is ready to become also a two-path Europe, if the non-participating members would decide to spontaneously adopt a consistent approach at least among themselves, or even multiple-path one, if they would not do so.

117 As noted by LEPRÉVOTE, *Judicial review (States, beneficiary and third parties)*, 2013, p. 309, «as of December 2012, four major cases have been introduced before the European courts as a result of Commission decisions regarding banks pursuant to Article 107(3) (b) TFEU», namely *West LB*, *ING*, *ABN Amro*, and *Banco Privado Portugues*.

The crisis indeed partially modified the intentions of the plan presented by the four-presidents famous Report¹¹⁸. The so-called problem of “ins and outs” exemplifies the transition from a project “towards a genuine economic and monetary union” to a project “towards genuine resilience of the Eurozone”¹¹⁹. At the same time, the Euro-area/internal market asymmetry is listed among the many uncertainty of the banking union¹²⁰.

I think that the banking union's implementation and its stages, as briefly commented in relation to their tangency to state aid policy, are likely to foster the financial stability as much as they are likely to undermine the integrity of the financial services common market.

The coordination between state aid policy and banking union accurately reflects the concrete juxtaposition that the Commission and the ECB experienced while dealing with the crisis management according to their respective margins of action. If we keep on achieving a banking union in all its essential parts as soon as possible at least for the Member States whose currency is the euro, we nevertheless should not ignore that by doing so we are indeed favouring faster financial stability and more integration in the monetary union, rather than more integration in the economic union¹²¹. While the state aid policy approach will keep on being uniform in the internal market because it is still directed to all the European Union's Member States, the same will not hold for non-participating Members of the banking union. This will intuitively lead to a certain degree of discrimination across national solutions on which European governors apparently are willing to give up in order to provide a quick solution to the call for more financial stability.

118 See VAN ROMPUY, *Towards a genuine economic and monetary Union*, 2012.

119 The word game is presented by FUNK, *Towards Genuine Resilience of the Eurozone: An Evaluation of the Partially Germaninspired Response to the Euro Crisis*, 2014.

120 See MOLONEY, *European banking Union: assessing its risks and resilience*, 2014, p. 1662. *Contra*, DE BOISSIEU, *Towards a Banking Union: open issues*, 2014, p.21, where the author joins the view of the ECB Executive Board member Asmussen (who affirmed that the banking union is essential for the ins and desirable for the outs), but he also highlights the uncertainty over the way to allow the outs to participate in the governance.

121 As convincingly affirmed on the eventual participation of non-euro area countries to the SSM by DARVAS, WOLFF, cit., p. 11: «The European banking union project makes sense irrespective of the euro-crisis. It also makes sense for non-euro area countries. In a financially integrated area, like the European Union, differences in national banking policies can tilt the playing field and lead to sub-optimal banking and supervisory decisions. The pre-crisis experience with exuberant banking in some countries, but not in others, and the resulting banking fragility during the crisis and its cross-country implications, further underline the need for more centralisation of banking policies at the EU level».

The call for more financial stability is then just instrumentally a call for more integration and it is able to represent a significant shift in the European ultimate objectives, although it is a silent one, without needing any Treaty change.

The two-speed Europe is facing more than a challenge from the financial market crisis: it is facing a political one which is leading to a two-headed Europe that evolves at two speeds and according to two different approaches, reflecting two institutional philosophies and based on two aims. The European economic union, led by the Commission for the sake of the internal market which is based upon competition law values as pillars, and the European monetary union that is ever-increasingly led by the ECB for the sake of the single currency which will rely upon monetary policy and supervision pillars from now on. While the Commission approach under the single market clause has always been inclusive, the single currency approach has always been exclusive: this was exactly the most delicate danger envisaged when the ECB was chosen to be the European single banking supervisory authority, stating the obvious difficulty of designing a participation mechanism and procedure in the board for representatives of non-euro countries in the SSM, and consequently in the SRAs network.

I think that such a solution will provide an enhanced financial stability but a more inclusive plan would have provided much more than that: by taking the crisis as an opportunity we could have modelled a banking union on the experience of the European Competition Network and by exploiting that expertise and experience we could have drawn an exemplary system, workable for all the European countries, and through it achieved financial stability and further integration in the financial services sector. Such an experience could have been useful to concretely start fulfilling the integration in the market of services that has always been the unsolved weakness of the European single market. The experience could even have inspired long-term effective initiatives for the future.

For all these reasons, I think these measures have to be appreciated since they show a political intention to take care of the problem in a time horizon longer than the short term or emergency one, in order to avoid such crises to have a similar impact again. Though, I believe that a more visionary plan could have had more ambitious long-term objectives in mind. I do acknowledge that any proposal aimed at fostering integration requires Member States to waiver a portion of sovereignty on which

European governments are always quite reluctant to give up, and I do agree with those commentators who outlined the influence that a long political debate to reach consensus over such proposals has on the final feasibility of the same reform¹²². Nevertheless, I think that making a less brave proposal on such matters in order to avoid a long political debate is not a winning strategy at all; correctly thinking about consequences, it is hard to believe that a fostered divergence among the two speeds that lead Europe will not have political consequences rather than just economic ones.

122 See RANDELL, *European banking union and bank resolution*, 2013, p.35. The author in the early 2013 argued for the necessity to complement the banking union with a single resolution mechanism: «the reason why a single resolution authority would not currently receive the necessary political support is that such an authority would have power to make decisions with very significant fiscal consequences for Member States: at its heart, cross-border resolution is all about funding and burden-sharing». For a more comprehensive report on the initial reactions of European national governments to the SRM proposal, see SPEYER, *EU Banking Union. Right idea, poor execution*, 2013, pp. 16, 17.

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**THE CURIOUS CASE OF UMBRELLA CLAIMS BETWEEN ECONOMIC ANALYSIS AND THE ARDUOUS
EMERGENCE OF A EUROPEAN PRIVATE LAW***

Roberta Cossu[†]

ABSTRACT

The decision of the European Court of Justice on the case *Kone* established the possibility of awarding damages for harm stemming from umbrella pricing, thereby, on the one hand, further raising the cost of cartels and, on the other hand, expanding the scope of the European antitrust private enforcement. The curious case of umbrella claims is the last step in the arduous path towards the definition of European antitrust damages. After a brief introduction on the long European debate on the matter, this paper aims at in-depth analysing the wording of both the final decision and the Advocate General's opinion. This analysis will be enriched by a reference to the economic theories and empirical tests that have shown the extent to which the harm suffered by customers of a fringe firm is economically comparable to that suffered by the consumers of cartelists' products. The following section correlates some technical concepts on the institution of liability in the civil law and common law systems (i.e. compensatory damages versus punitive damages) to clear instances of European antitrust policy, mainly the provision of effective deterrence against horizontal agreements. In conclusion, the arguments will be used to investigate the likely impact of an "indirect" rule on compensation of "indirect" harm in the national enforcement by member states, as well as the eventual effect on the principle of causation. Moreover, conclusions highlight once more the existence of a perpetual trade-off between national legal uncertainty and effectiveness of EU rules, which characterizes the application of EU law when both the lack of uniformity of national systems and the failure of the process of harmonization de facto delegate policy- and law-making to the ECJ.

Keywords: umbrella prices, antitrust damages, causation.

SUMMARY: 1. INTRODUCTION ON THE ODYSSEY TOWARDS A EUROPEAN ANTITRUST ENFORCEMENT 2. ANALYSIS OF THE CASE 2.1. BACKGROUND 2.2. THE AG OPINION 2.3. THE JUDGMENT 2.4. COMMENTS TO THE DECISION 3. OVERVIEW OF THE DEBATE ON UMBRELLA

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PRICING 3.1. UMBRELLA PRICING IN THE US ANTITRUST LAW AND ENFORCEMENT 3.2.
UMBRELLA PRICING IN THE ECONOMIC LITERATURE 4. CONCLUSIONS.

1. Introduction on the odyssey towards a European antitrust private enforcement.

The curious case of umbrella claims represents the last step in the arduous path towards a definition of antitrust damages. The recent *Kone*¹ decision contributes to providing a more accurate theory for antitrust standing by including the customers of the fringe firms among the legitimate subjects who can claim cartel damages because of the payment of a supra-competitive price. Since the evolution of a European model of private antitrust enforcement has been an odyssey, a brief summary of its main steps might be useful to understand better the following analysis of the ECJ recent decision.

The issue of full effectiveness of European law (therefore also European competition law) dates back to the day after the ratification of the EEC Treaty, in 1957. The EU law has, in fact, the power to create individual rights, but does not provide protection's mechanisms for such rights². Then it is the duty of member states to find the proper tools and remedies to guarantee their *effet utile*³. The principle of procedural autonomy of Member States must nevertheless respect two external limits: the principles of equivalence⁴ and minimum effectiveness⁵. Both of them are not set out by EU legislation.

¹Judgment of the Court (Fifth Chamber) of 5th June 2014, *Kone AG, Otis GmbH, Schindler Aufzüge und Fahrtreppen GmbH, Schindler Liegenschaftsverwaltung GmbH, ThyssenKrupp Aufzüge GmbH v. ÖBB Infrastruktur AG*, C 557/12.

² See ASHTON, HENRY, *Competition damages actions in the EU*, 2012, p. 9: «it is a fundamental principle that, while it creates substantive rights and obligations, EU law depends upon the Member states' courts to give effect to those rights and obligations. [...] While EU law therefore provides for common rules of substance, the Union legal order does not provide for substantive or procedural rules for the enforcement of EU competition law in private disputes».

³ As in the wording of the article 4(3) TEU, «member states shall take any appropriate measure, general or particular, to ensure fulfillment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union».

⁴ As in the Judgment of the Court of 16 December 1976, *Rewe-Zentralfinanz eG et Rewe-Zentral AG v. Landwirtschaftskammer für das Saarland*, Case 33-76, « It is for the domestic legal system of each Member State to designate the courts having jurisdiction and to determine the procedural conditions governing actions at law [...] it being understood that such conditions cannot be less favourable that those relating to similar actions at domestic nature », para. 3.

⁵ As in Judgment of the Court (Fifth Chamber) of 10 July 1997, *Rosalba Palmisani v. Istituto nazionale della previdenza sociale (INPS)*, Case C-261/95, European Court Reports 1997 I-04025, «reparation of loss or damage laid down by national law must not be less favourable than those relating to similar domestic claims (principle of equivalence) and must not be so framed as to make it virtually impossible or excessively difficult to obtain reparation (principle of effectiveness)», para 27.

They have rather been elaborated by ECJ interpretation and then embodied in more formalized legal acts.

These are just some of the peculiar aspects of the private antitrust enforcement odyssey in Europe. Since the prohibition of anticompetitive unilateral or concerted practices represents the only rules in the Treaty that address parties other than member states, namely business firms, their application has also passed through a peculiar development.

Already in 1966, the Commission ordered a study to investigate the eventually differing rules on the action for damages due to a violation of antitrust law⁶ in place in the six founding states.

The study⁷ concluded on a general availability of the action for damages as a proper tool to restore harms deriving from anticompetitive practices in all legal systems. But it was considered a viable option for the harm only suffered by competitors rather than also to the detriment of customers or consumers as a whole. Despite such a preliminary non-binding conclusion and the persistence of a duty of national courts to enforce such rules in an effective manner, the antitrust private enforcement remained underused. In the end, the choice of explicitly refusing to recognize the particular remedy or the type of remedy by which courts could have provided the *effet utile* did not pay off.

The debate on the so-called modernization of the European competition law that took place in the late 1990s was the turning point of this trend. It emphasized the need of decentralization of the enforcement⁸. The European antitrust policy agenda included two key priorities since then. First, the strengthening of the cooperation between the Commission and the National Competition Authorities (NCAs) in the framework of the European Competition Network (ECN) was planned. Secondly, the empowerment of the

⁶ Namely, the articles 85 and 86 EEC Treaty (now articles 101 and 102 TFEU).

⁷ See European Commission, *Il risarcimento dei danni derivanti da una violazione degli articoli 85 e 86 del trattato che istituisce la CEE*, 1966.

⁸ The process started with the release of the White Paper on modernisation of the rules implementing Articles 81 and 82 of the EC Treaty (formerly Articles 85 and 86 of the EC Treaty), Official Journal C 132 of 12/5/1999, whose declared objective, next to administrative simplification and more effective action, was to enhance the role of national authorities and courts in implementing competition law in a uniform manner. Among the many commentators, see EHLERMANN, *The modernization of EC Antitrust policy*, 2000, where the author defines the White Paper as «the most important policy paper the Commission has ever published in the more than 40 years of EC competition policy», p. 3.

private enforcement was deemed a complementary necessity. The Regulation 1/2003⁹ explicitly underlines for the first time the crucial part that national courts play in applying the competition rules. Furthermore, it qualifies such an essential role as a necessary complement of the part played by competition authorities. Finally, it even indicates as an example the award of damages to the victims of infringements as a means to protect subjective rights established by EU law¹⁰.

The modernization then acted through two main channels: the European Court of Justice (“ECJ”) interpretative efforts combined with the beginning of a legislative initiative of the Commission. Both of them enhanced a debate and thus to create a proper *humus* from which a European scheme of private enforcement (and even one of antitrust damages action) could grow. As very well-known, the ECJ took the first very brave step in 2001 with the *Courage* decision where it explicitly stated that «the full effectiveness of Article 85 of the Treaty [now article 101 TFEU] and, in particular, the practical effect of the prohibition laid down in Article 85(1) would be put at risk if it were not open to *any individual* to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition. Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community¹¹». A historical *courageous* decision indeed, since it was the first interpretation of the EU competition law that recognized that damages actions are the tool to seek compensation for harms due to antitrust violations. Moreover, it chose to embrace a very broad definition in terms of standing. The ruling is also significant because it clarified that the right to compensation for breaches of EU competition law «must be guaranteed as a matter of EU law¹²». Hence, it even provided guidance in the absence of specific EU legislation in the field, while it left to Member States to set out the conditions to exercise this right.

⁹ See the Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance), Official Journal L 001 of 04/01/2003.

¹⁰ All the recalled points can be found in the Regulation, *cit.*, para. 7.

¹¹ See Judgment of the Court of 20 September, *Courage v. Crehan*, Case C-453/99, 2001, ECR I-6297, paragraphs 26 and 27, [emphasis added].

¹² See Ashton, Henry, *cit.*, p.9.

In line with this ECJ decision aiming at clarifying and then incentivizing private enforcement, the Commission decided to take a closer look at the actual situation. It appointed Ashurst to study the state of private enforcement in Europe, almost 30 years later than the 1966 investigation on the feasibility of antitrust damages actions. The comparative report released in 2004 highlighted a situation in the EU-25 of «astonishing diversity and total underdevelopment¹³». The report did not just present the state of the enforcement but also explored eventual options to improve it, i.e. to facilitate the use of damages actions. It found that procedural obstacles in terms of proof were particularly high. So it suggested that some jurisdictions might improve by lowering the standard or even reversing the burden of proof (in terms of causation, fault and existence of an infringement)¹⁴. It found that procedural obstacles in terms of proof were definitely high. So it suggested that some jurisdictions might improve by lowering the standard or even reversing the burden of proof (in terms of causation, fault and existence of an infringement). Above all, proving a (traditionally immediate and direct) causal link seemed still a daunting task, as it was in 1966. Causation was harder to prove in the case of harmed individuals that are not direct competitors or purchasers, even though courts in most of the States usually adopt a very much pragmatic case-by-case approach to these issues¹⁵. In a separate document, Ashurst conducted an analysis of economic models for the calculation of damages to provide a comprehensive economic theory. In this exercise, it listed the categories of individuals who might be affected by an antitrust violation¹⁶. Unsurprisingly, the economic perspective led to include many more than the traditional group of direct competitors and direct purchasers. In fact, it listed also: «customers of the direct purchasers (also known as indirect purchasers) if a portion of the overcharge is passed on to them by these intermediate producers; direct buyers from non-cartel producers (so-called umbrella effect); customers who were willing to pay the competitive price but not the cartel price and were thus forced to buy less desirable substitute goods, or simply reduce their total purchases; suppliers of goods or

¹³ See the ASHURST, Study on the conditions of claims for damages in case of infringement of EC antitrust rules, 2004, p. 1. More specifically, it reported «only around 60 judged cases for damages actions (12 on the basis of EC law, around 32 on the basis of national law and 6 on both). Of these judgments 28 have so far resulted in an award being made (8 on the basis of EC competition law, 16 on national law and 4 on both)».

¹⁴ Ibidem, p. 11.

¹⁵ Ibidem, p. 73.

¹⁶ Such as a cartel infringement that leads to increase in industry prices where damages may occur as a result of lower demand for the complementary goods or services as a result of the higher prices charged by the cartel.

services (e.g. inputs) to the cartel conspirators may lose sales or income due to the artificial output restriction enforced by the cartel; and finally suppliers of complementary goods and services to the market where the cartel behaviour occurs¹⁷».

The report's findings uncovered a potential grave concern for the Commission. In fact, EU law uncertainty and uneven or loose application fail at fulfilling and fostering the single market integration.

Following up the Ashurst study, in 2005, the Commission took further action and released its Green Paper on damages actions for breach of the EC antitrust rules¹⁸. Its objective was to set out different options for further reflection and possible action to improve damages actions both for follow-on and stand-alone actions¹⁹, in the light of the principal issues raised by the Ashurst study. Though, it did not address all the indicated procedural obstacles that discourage the recourse to private actions in competition law cases. For instance, the Green Paper did not propose to define explicitly the variety of subjects entitled to claim antitrust damages or to tailor the requirements that must be satisfied to claim damages successfully. It presents only one particular issue related to standing: the eventual use of passing-on defence both for defensive and offensive purposes²⁰. On the requirements, it solely asks whether there is a potential need of further clarification of the causal link principle²¹, but it does not even put out any concrete option.

Just a year later, in 2006 a new ECJ cartel decision, *Manfredi*, did "dot the I's and cross the T's" of *Courage*. The ECJ re-affirmed the interpretation according to which EU law produces direct effects on individuals among whom it creates rights. Therefore *any individual* can seek compensation for losses incurred because of a breach of EU law, in this case art. 81 EC (now 101 TFEU). If not so, the *practical* effectiveness of those rules

¹⁷ ASHURST study, cit., p.

¹⁸A Green paper is an atypical EU legal act. This category of so-called *sine lege* acts includes all those consultative or preparatory acts, similar in structure and function, that contribute to future normative evolutions of the law of the Union. More specifically, the Green paper is a tool used by the Commission to enhance reflection and consultation and thus reach a sort of *pre-consensus* on matters that might become objects of more formal normative proposals. In this regard, Green papers are usually considered a very democratic tool since they invoke and stimulate direct - though preliminary and informal - participation of citizens (specially civil society, interest groups or trade associations) in the Union's decision-making. As well described by DE LUCA, *Gli atti atipici del diritto dell'Unione europea*, Torino, 2012, pp. 35-42.

¹⁹ See European Commission, *Green paper on Damages actions for breach of the EC antitrust rules*, 2005, para 1.3, p. 4.

²⁰ Ibidem, para 2.4, pp.7-8.

²¹ Ibidem, para 2.9, p.11.

would be hampered²². Furthermore, the *Manfredi* ruling went further and made explicit that such a right to compensation exists «where there is a *causal relationship* between that harm and an agreement or practice prohibited under Article 81 EC²³». In order to safeguard the *practical effect* of the cartel prohibition, the ECJ also provided a specific interpretation of the principle of equivalence and effectiveness. First, it affirmed that «in accordance with the principle of equivalence, it must be possible to award particular damages, such as exemplary or punitive damages, pursuant to actions founded on the Community competition rules, if such damages may be awarded pursuant to similar actions founded on domestic law (...). Secondly, it follows from the principle of effectiveness and the right of any individual to seek compensation for loss caused by a contract or by conduct liable to restrict or distort competition that injured persons must be able to seek compensation not only for actual loss (*damnum emergens*) but also for loss of profit (*lucrum cessans*) plus interest²⁴». By doing so, it also attempted a first definition of damages for antitrust cases.

In 2008, as a consequence of the discussion on the Green Paper options, the Commission released a policy statement, the White Paper on Damages actions for breach of the EC antitrust rules²⁵. White Papers usually follow the discussions initiated by Green Papers and are policy-focused. In this regard, for its own admission, the White Paper presents policy choices that consist of balanced measures that are rooted in European legal culture and traditions²⁶. In this perspective, it is not surprising to read that the White Paper describes the European antitrust enforcement of antitrust law as oriented to provide full compensation²⁷.

²² See Judgment of the Court of (Third Chamber) of 13 July 2006, *Manfredi v. Lloyd Adriatico Assicurazioni SpA et al.*, Cases C-295/04 to C-298/04, ECR 2006 I-06619, para. 58-62: «Article 81(1) EC produces direct effects in relations between individuals and creates rights for the individuals concerned which the national courts must safeguard. It follows that any individual can rely on a breach of Article 81 EC before a national court (see *Courage and Crehan*, cited above, paragraph 24) and therefore rely on the invalidity of an agreement or practice prohibited under that article. Next, as regards the possibility of seeking compensation for loss caused by a contract or by conduct liable to restrict or distort competition, it should be recalled that the full effectiveness of Article 81 EC and, in particular, the practical effect of the prohibition laid down in Article 81(1) EC would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition (*Courage and Crehan*, cited above, paragraph 26)».

²³ *Idem*.

²⁴ *Ibidem*, para. 90, 93 and 95.

²⁵ See European Commission, *White Paper on Damages actions for breach of the EC antitrust rules*, 2008.

²⁶ *Ibidem*, p. 3.

²⁷ *Idem*, « Full compensation is, therefore, the first and foremost guiding principle».

Only subsequently, it intends to improve deterrence and preserve strong public enforcement²⁸. Though, it does not go beyond the issues raised in the Green paper. Therefore, it does not address a full comprehensive definition of standing in antitrust damages actions.

In the meantime, a series of subsequent case laws restated the ECJ view taken in *Courage and Manfredi*²⁹ and the policy intentions the Commission stated in the White Paper.

Finally, on 10 November 2014, the Council finally adopted the proposal for a directive on antitrust damages actions. The adoption came after only a year from the presentation of the proposal by the Commission, showing a very timely ordinary legislative procedure. Though the discussion on the issues it regulates is much older, as above-discussed. As former EU commissioner, Almunia said, it nevertheless «marked two firsts. It was the first ever EU-level legislation in the field of the private enforcement of competition law. It was also the first EU legislation in the field of competition law which – as I had pledged – was adopted on the basis of the ordinary legislative procedure with full involvement of the European Parliament»³⁰. The directive mainly addresses the facilitation of private damages actions in terms of access to evidences, the limitation period, and so on, in order to ease the burdens usually placed on victims. But it does not

²⁸ Idem.

²⁹ It is the case of Judgment of the Court (Grand Chamber) of 14 June 2011, *Pfleiderer AG v. Bundeskartellamt*, C-360/09, European Court Reports 2011 I-05161, where the ECJ ruled: « The provisions of European Union law on cartels [...] must be interpreted as not precluding a person who has been adversely affected by an infringement of European Union competition law and is seeking to obtain damages from being granted access to documents relating to a leniency procedure involving the perpetrator of that infringement. It is, however, for the courts and tribunals of the Member States, on the basis of their national law, to determine the conditions under which such access must be permitted or refused by weighing the interests protected by European Union law». Again, in the Judgment of the Court (Grand Chamber) of 6 November 2012, *Europese Gemeenschap v Otis NV and Others*, Case C-199/11, European Court Reports 2012 -00000, the ECJ interpreted antitrust standing extensively as to include the European Commission representing the European Union «before a national court hearing a civil action for damages in respect of loss caused to the European Union by an agreement or practice prohibited by Articles 81 EC and 101 TFEU which may have affected certain public contracts awarded by various institutions and bodies of the European Union, there being no need for the Commission to have authorisation for that purpose from those institutions and bodies». While the Judgment of the Court (First Chamber) of 6 June 2013, *Bundeswettbewerbshörde v Donau Chemie AG and Others*, Case C-536/11, European Court Reports 2013 -00000, ruled that, in the absence of specific EU rules, the national courts must not apply national rules on the right of access to documents relating to national proceedings concerning a cartel in a way that foreclose the possibility of persons believing themselves to be adversely affected by that cartel to recover damages, without weighing up the interests involved. In doing so the ECJ interpreted again the principle of effectiveness in a way the safeguard the right to compensation in a policy perspective that aims at full compensation.

³⁰ See one of his last speeches as commissioner ALMUNIA, *Antitrust litigation – The way ahead*, London 23 October 2014.

address the problem of a missing definition of standing or a workable interpretation of causation. Leaving these latter problems aside implicitly let the door open for another - probably less proper³¹ - supra-national intervention to regulate on such a key principle of the Romanistic law.

Indeed, the recent legislative efforts transpose into law some solutions that were already in the judicial praxis (e.g. passing-on defense, access to evidences of public proceedings), but they did not go far enough as to include also solutions for already existing problem left unsettled. Indeed, it is sufficient to take a look at the amendments that the Parliament introduced to see how the proposal directive got even "milder" through the legislative procedure.

The above-described framework is the stage in which the Kone decision shows all its relevance. It may also represent a reason to explain why on such sensitive topics the de facto harmonization operated by the ECJ is usually more successful and timely than the most proper - and democratic - legislative tools.

However, what has been just observed represents the past, while Kone might represent the first step of the future European antitrust, already few months before the directive on damages actions becomes final.

2. ANALYSIS OF THE CASE.

2.1. Background.

The ECJ took the decision at issue after a request for a preliminary ruling on a follow-on action against umbrella effects of a cartel uncovered by the Commission in 2003.

The "elevator cartel" discovery and sanction

The so-called "elevator cartel" was found responsible for the conclusion of several anticompetitive agreements in a few markets - namely Belgium, Germany, Netherlands and Luxembourg³². Therefore on 21 February 2007, the Commission fined its participants Kone, Otis, Schindler and ThyssenKrupp, all major manufacturers of the

³¹ On the increasing role of the ECJ as an *de facto* harmonizer « and its progressive intrusion into some areas of law that have traditionally been left to the realm of national law», see ZINGALES, *Member State Liability vs. National Procedural Autonomy: What Rules for Judicial Breach of EU Law?*, 2009, p. 19.

³² See Opinion of AG Kokott, delivered on 30 January 2014, *Kone AG, Otis GmbH, Schindler Aufzüge und Fahrtreppen GmbH, Schindler Liegenschaftsverwaltung GmbH, ThyssenKrupp Aufzüge GmbH v ÖBB*, para 5.

elevator and escalator industry³³. In 2007, also the Austrian cartel court (*Kartellgericht*) sanctioned the cartel, and the decision was upheld by the appellate court, in this case the Supreme Court (*Oberster Gerichtshof*), in 2008³⁴. The main findings of the proceedings showed that cartel members had an agreement lasting from 1980s to 2004 whose object was the reciprocal coordination of activities involving up to the half of Austrian market demand for new machinery³⁵. Projects accounting for at least one third of the market volume were allocated by mutual understanding. Almost two thirds of these concerted practices went as planned, and just one third of them was awarded to non-cartelists or to cheating cartelists that made an offer at a lower price. The general outcome of such behaviors was that market prices and market shares stayed steady across all the duration of the cartel³⁶.

The action for damages stemming from the "elevator cartel" umbrella pricing

ÖBB-Infrastruktur brought an action for damages before Austrian civil court claiming the above-described cartel made it pay inflated prices for the elevators purchased across years both from cartel and non-cartel manufacturers³⁷. ÖBB is a subsidiary company of the Austrian Railways (*Österreichische Bundesbahnen*) dedicated to maintenance and construction of railways stations. Therefore, it qualifies as a relevant customer of the elevator and escalator industry. Its claim is in essence against cartel pricing and alleged umbrella effects, and its theory as a plaintiff is that third firms have adapted their prices to a higher level imposed by the "elevator cartel". The Austrian court of first instance dismissed the part of the action regarding losses for excessive prices incurred by dealing with non-cartel manufacturers as unfounded³⁸. Subsequently, ÖBB appealed to the Supreme Court, which is the highest instance in civil matters and seeks to safeguard legal uniformity and certainty as well as development of the law. It is also the court that requested the preliminary ruling on this specific point of law since the treatment of umbrella pricing is far from being clear both in judicial and academic doctrines. Its view on the matter is very similar to the one adopted by the court of first instance. First, the causal link required by Austrian tort law is not adequate. Second, umbrella pricing

³³ See the Judgment, para 6.

³⁴ *Ibidem*, para 7.

³⁵ See Opinion, para 7.

³⁶ *Ibidem*, paras 8-9.

³⁷ *Ibid.*, para 10.

³⁸ *Ibid.*, para 13.

practice is not explicitly covered by the scope of competition law, nor in its content clarification provided by case law yet. Nevertheless it doubted such a loss should be excluded on the ground of domestic law interpretation alone, without any balance with further eventual European law requirements, at least in terms of principle of effectiveness.

The request of a preliminary ruling

The judgment at issue is important since it can provide a more accurate interpretation of the article 101 TFEU and the jurisprudence on antitrust damages actions, also filling gaps left opened by the latest directive on the matter. It is actually crucial to the definition of a European theory of antitrust standing that increasingly differs from the American benchmark. More specifically, it can clarify whether the interpretation of “any person” entitled to claim cartel damages must also comprise those who incurred in losses caused by umbrella pricing. It shall first address whether it is of interest of European competition law to take action against such a practice, the eventual reason of action, and whether it is likely to be consistent with the enforcement apparatus already in place.

2.2. The Advocate General's Opinion.

In its assessment, the AG Kokott firstly specifies that the referring court seeks an interpretation for the enforcement of article 101 TFEU. The additional reference to article 85 of the EC Treaty and 81 EC can be made just for completeness, to take chronological record of the numbering of EU Treaty rules during the "elevator cartel" duration, being the three substantially identical³⁹. The AG Opinion recognizes as settled that nowadays parties who encounter losses due to a violation of article 101 can claim compensation from cartel members⁴⁰. However, it is unclear if umbrella pricing losses may be included among those compensable losses. In order to conclude so, any legal theory requires that a sufficiently close causal link must be established between the actionable misconduct and the loss-to-compensate⁴¹. Kokott argues that the issue of umbrella pricing is a matter of EU law, rather than national law. Therefore, the

³⁹ See Opinion, para 17.

⁴⁰ Ibidem, para 18.

⁴¹ See Opinion, para 19.

justification for awarding damages to umbrella claims must derive from EU law too, rather than national law.

A – Civil liability of cartel members for umbrella pricing: a matter of European Union law

The referring court and the proceeding's parties take the view that umbrella pricing – as antitrust damages in general - is governed by national law but limited by EU principles of effectiveness and equivalence. This view descends from the mainstream interpretation of the *Manfredi* decision.

Contrary to this view, the AG Kokott affirms that «it is not so much the existence of claims to compensation (i.e. the question whether the compensation is to be granted) that is dictated by national law as rather the *details* of application of such claims and the *rules* for their actual enforcement (i.e. the question of *how* compensation is to be granted) that is to say, in particular, jurisdiction, procedure, time-limits and furnishing of proof⁴²».

The right to compensation descends from an interpretation of EU law (and a re-interpretation of Manfredi)

In this sense, a different analysis of *Manfredi* can be provided after reading its para 64 carefully: «in the absence of Community rules governing the matter, it is for the domestic legal system of each Member State to prescribe the detailed rules governing the exercise of that right, including those on the application of the concept of ‘causal relationship’, provided that the principles of equivalence and effectiveness are observed». The competence of national laws qualifies as secondary to the prospective establishment of an EU rule, and it should be limited to the non-substantial rules on the exercise of the rights. The subsequent reference to the inclusion of «the concept of ‘causal relationship’» sets an example for any other procedural requirement to prove the liability. In fact, the discretion of national legal systems might in theory extend up to considering the awarding of punitive damages, though the necessity to respect the principle of equivalence should practically exclude such possibility. The same shall apply

⁴² See Opinion, para 23.

to all the procedural rules, including the explicitly mentioned causal relationship, giving birth to a sort of “mixed” approach to antitrust damages actions and related requirements at European level.

The AG also argued that the civil liability of undertakings for breaches of competition law mirrors the civil liability of Member States for breaches of EU law. Both of them equally anchor to the EU law as the primary source⁴³. And, as the Italian government observed in the written procedure, the same obligation of cartel members to compensate third parties for harms caused by the cartel is a principle of EU law since it stems from the prohibition set out in article 101 TFEU⁴⁴.

Finally, Kokott finds that *Manfredi* stated, as a matter of EU law, both the subjects entitled to claim cartel damages (“any individual”), and the components of damages that shall be awarded (namely *damnus emergens* in form of actual loss, *lucrum cessans* in form of loss of profit, and interest⁴⁵). According to this view, the entire European history of damages actions cannot be presented as having just an incidental tangency to European law at its origin, rather than being an on-going developing legal institution.

The need of uniform application of EU law

Leaving aside the “how” of the compensation that, in its view, is a matter of concurring competence among EU and national law, the AG Kokott focuses the assessment at issue on the “whether” of compensation. More specifically, on “whether” cartel members should be held civilly liable for umbrella pricing, therefore on “whether” they could be sued by fringe firms’ customers. On this point, the AG simply concludes that this is a question that cannot be left to national legal systems alone. The risk is obviously to create an uneven playing field for operating firms of the internal market, and consequently lead them to neutralize such a risk through competitive strategies based on forum shopping. The outcome of such a game would be the undermining of uniform and effective application of EU competition law, which qualifies indeed as an unbearable cost against the single market integration.

⁴³ Ibidem, para 24.

⁴⁴ Ibid., para 25.

⁴⁵ See *Manfredi*, cit., paras 95-96.

B – *The European Union law conditions applicable to the establishment of a causal link*

Following her main arguments, in the following section, the AG reconstructs an EU law framework of conditions to establish a causal link between a cartel and its derived umbrella pricing.

The attitude of “any individual” to claim for antitrust damages, in the formulation of ECJ, is in line with the principle of full compensation that informs the effective application of competition law in the EU. The AG is also of the opinion that this theory of standing has been put out in so general terms in order not to be interpreted narrowly⁴⁶. She also recalls that cartels can harm several categories of economic operators and restrict someone’s standing would hamper the effectiveness of the cartel prohibition⁴⁷. At the same time, the AG believes the existence of a causal link is needed to avoid cartel members to become unlimitedly liable for any loss, even remote. Such an extreme approach would also be able to undermine the prohibition by making it a no longer administrable rule. The anti-competitive practice must indeed be the cause of the loss in the sense of a *conditio sine qua non*⁴⁸.

In the context of non-contractual liability, the AG Opinion is the requirement is satisfied by a *sufficiently direct causal nexus*⁴⁹. The AG interprets a direct causal link as not merely equal to a single causal link. Therefore, in her opinion there is sufficiently directness when, for instance, the cartel activity is at least a contributory cause of the umbrella pricing⁵⁰. The European case-law assumes that the causality may not be interrupted by the action of a third party that also contributes to causing the loss⁵¹. It is immanent in the definition of condition sine qua non that a cause of this fashion represents a necessary yet not sufficient premise. Moreover, even defendants of the case at issue admitted that above all pricing can depend on many factors⁵². And umbrella pricing is not the only practice in which a freely-made corporate decision of a third party is

⁴⁶ See Opinion, para 32.

⁴⁷ *Idem*.

⁴⁸ *Ibidem*, para 33. The requirement is sometimes also called *equivalent* causal link or *but-for* causal link.

⁴⁹ The terminology may differ in the different states (legal causation, *adäquate kausilatät*, *causalità immediata e diretta*, etc.), but the concepts behind it are substantially similar. See Opinion, para 35.

⁵⁰ *Ibidem*, para 36.

⁵¹ *Ibid.*, para 37.

⁵² *Ibid.*, para 39.

considered irrelevant in settled though recent case law. Indeed it is the case of the intermediate traders that pass-on to its customers the loss incurred by paying the cartel price⁵³.

For all the mentioned reasons, the AG Kokott finally argues that, in the case of umbrella pricing, the causal chain is not interrupted by the free price choice of the fringe firm, but it is «*in fact* continued if, when determining his prices, that person is (*also*) guided by the relevant trading conditions and accordingly – and in *entirely foreseeable manner* – follows the price initiative taken by the cartel⁵⁴».

By saying so, the AG intends to propose a criterion for the neglected problem of causation in EU law. Therefore, she specifies that she did not submit this proposal for umbrella pricing only. She actually recalls that such a principle should be developed in a way to make out of it a liability test for actions involving individuals against member states and between private parties in cartel cases⁵⁵. This is the reason why she uses very general terms⁵⁶ in the final formulation of her interpretation of the causation in EU law. In her words, «the criterion of a sufficiently causal link is *in substance* intended, on the one hand, to ensure that a *person* who has acted unlawfully is liable only for such loss as he could reasonably have foreseen. On the other hand, a *person* is liable only for loss the compensation of which is consistent with the objectives of the provision of law which he has infringed⁵⁷».

1. Foreseeability of loss resulting from umbrella pricing.

By embracing the *foreseeability of losses principle*, the AG rejects *in toto* the objections of the referring court and the defendants about the impossibility for the cartel members to predict the price choice of a fringe firm. As already said, she agrees that many factors influence such choice but this is not an excuse for not foreseeing the loss in which such firms shall incur. It is indeed a common business practice to choose own prices by observing market trends⁵⁸. Moreover, foreseeability is enhanced when the cartel market

⁵³ Ibid., para 38.

⁵⁴ Ibid., para 37. [emphasis added]

⁵⁵ Opinion, para 34.

⁵⁶ See for instance the use of “person” rather than well-defined subjects, e.g. firm, purchaser or even state.

⁵⁷ Opinion, para 40. [emphasis added]

⁵⁸ Ibidem, para 46.

share covers a significant proportion for the market, and the more homogeneous and transparent the relevant product is⁵⁹. In both cases, anti-competitive practices put in place by cartel members may have amplified effects in the market. In this specific case, the fact that a tendering procedure was ÖBB way to purchase elevators and escalators does not exempt from causing foreseeable losses to tendering competitors⁶⁰. Then, the AG invites at assuming that losses from umbrella pricing are not atypical or unforeseeable by cartel members and stating otherwise would be incompatible with practical effectiveness of article 101 TFEU⁶¹.

2. Compatibility of compensation for loss resulting from umbrella pricing with the objectives of the competition rules which have been infringed

Again, against the view of the referring court and the defendants, the AG finds unsound the claim that losses from umbrella pricing do not fall under the protective scope of the EU competition law. Since the aim of EU competition law is indeed to create and maintain an undistorted competition in the EU internal market, such losses shall be claimed and compensated exactly in order not to make it artificially altered⁶². In reality, compensation of these losses shall be part of competition law enforcement and is capable of correcting negative consequences brought by infringements on other market participants, in this case consumers that are customers of fringe firms⁶³.

a. Part and parcel of the system of enforcement of the competition rules

The AG briefly reminds that competition law enforcement lays on two pillars, public and private enforcement, and they complement each other in order to ensure effectiveness to those rules. Their application must be tailored in a way that their combined use is not counterproductive to the effectiveness of the competition rules⁶⁴. In fact, one concern emerged in the written and oral exchanges of the proceeding related in particular to the

⁵⁹ Ibid., para 47 and 48.

⁶⁰ Ibid., para 49.

⁶¹ Ibid., para 52.

⁶² Ibid., para 56 and 57.

⁶³ Idem.

⁶⁴ Opinion, para 61.

eventual perverse relationship between civil liability and leniency programmes. The theory is that expanding the recourse to civil liability might make the detection of cartels harder by discouraging cartelists from cooperating with competition authorities⁶⁵. Such a reason, in the Opinion, is rejected because it cannot fully justify the disregard of the interests of injured parties that seek for just compensation. Instead, the AG finds more acceptable to conceive a way to take account of a cartel application for immunity also in civil law actions⁶⁶.

On a minor level, the AG disagrees with some defendants' views according to which liability for umbrella pricing would raise too high costs for undertakings in the market. First, Kone's view considers that one of the European competition law objectives is to enable firms to operate in the internal market in the most cost-efficient manner. According to the European antitrust philosophy, based on the model of competitive social market economy, undistorted competition is the objective, and it does not require any further assessment through cost-benefit analysis⁶⁷. Second, Thyssenkrupp contested that the civil liability for umbrella pricing might deter undertakings from investing in the market. The AG rejected also this argument on the grounds of the fact that any undertaking operating in the internal market must comply with competition rules rather than engaging in illegal practices at the expenses of others. The eventual deterrence of such a firm from entering the market could hardly be undesirable from any legal perspective⁶⁸.

b. Suitability for correcting the negative consequences resulting from the commission of infringements of competition law

Civil liability must be considered suitable to compensate negative consequences stemming from umbrella pricing thus simultaneously strengthen confidence on the EU competition rules⁶⁹. On the point, the AG had to argue against three main objections.

i. *The objection that the loss resulting from umbrella pricing is unintentional*

⁶⁵ Ibidem, cit., para 62 and 63.

⁶⁶ Ibid., para 64.

⁶⁷ Ibid., para 66.

⁶⁸ Ibid., para 68 and 69.

⁶⁹ Ibid. para71.

Some of the parties argued that they did intend raising prices for their customers while they did not do so for fringe firms' customers. According to the AG, their intention must be considered irrelevant when the existence of a causal link is proven, otherwise such a requirement of fault would make impossible to effectively enforce competition rules⁷⁰. . This last argument holds truer for cases as the elevator cartel, when the umbrella pricing was certainly foreseeable, according to the above-mentioned reasoning⁷¹.

ii. The objection that compensation for umbrella pricing does not provide a means of absorbing unlawful profits

The AG recalls that the absorption of unlawful profits is not the aim of compensatory actions rather restitutory actions, as in the case of unjustified enrichment. A claim for compensation fulfills the reparation for a loss suffered from an injuring party's misconduct. Hence, civil liability is the proper functional tool to recover losses resulting from umbrella pricing⁷².

iii. The objection as to the introduction of punitive damages

Finally, the AG addresses the last objection by reminding EU law does not expressly forbid the award of punitive damages, which is always an open option in the on-going debate over the empowerment of antitrust private enforcement. She rejects the argument because civil liability for umbrella pricing would require compensating the created losses, and this would never configure a form of overcompensation⁷³.

C – Concluding remarks

⁷⁰ Ibid., para 74.

⁷¹ Ibid., para 75.

⁷² Opinion, para 78.

⁷³ Ibidem, para 81. Since the public and private enforcement complement one another, it is counterintuitive to argue that the sum of both systems' sanctions might lead to excessive punishment. Otherwise the two pillars should be used alternatively.

The AG Kokott does not conclude on an automatic per se prohibition of umbrella pricing to sanction by civil litigation. Instead, she argued for a case-by-case approach to be implemented by the administration of a specific causal link test. Her solution is not incompatible with the legislative directive on antitrust damages recently proposed by the Commission since it does not address – then not exclude either – the award of compensation from umbrella pricing⁷⁴. In a comparative perspective, the diverging opinions on the topic in US courts, yet not cleared up by the Supreme Court, should not discourage the ECJ in taking a position itself⁷⁵.

Her proposed answer to the request for the preliminary ruling affirms: «Article 85 of the E(E)C Treaty and Article 81 EC preclude the interpretation and application of domestic legislation enacted by a Member State which categorically excludes, for legal reasons, any civil liability of undertakings belonging to a cartel for loss resulting from the fact that an undertaking not party to the cartel, benefiting from the protection of the cartel's practices, set its prices higher than would otherwise have been expected under competitive conditions⁷⁶».

2.2. The Judgment.

The ECJ agreed with the view of the AG and decided to refer the judgment solely to article 101 TFEU, being it substantially identical in content to article 85 of EC Treaty and 81 EC⁷⁷.

The umbrella pricing is one of the possible effects of a cartel and it cannot be disregarded by its members

After referencing the case-law on the matter, the Court addressed the substantial part of the case, namely the umbrella pricing practice. It noted that the market price is one of the main factors taken into account when a firm determines the price of its product. Therefore, when a cartel set artificially supra-competitive prices, the possibility that a cartel competitor will also set its prices above the competitive level cannot be excluded. This distortion of market prices induced by the cartel may affect even the autonomous

⁷⁴ Ibid., para 88.

⁷⁵ Ibid., para 89.

⁷⁶ Ibid., para 90.

⁷⁷ Judgment, para 18.

determination of prices of third parties in a way contrary to competition rules⁷⁸. The distortive effect on prices is thus amplified by spreading outside of cartel members, involving other lawful operators. The Court recognizes that the eventual loss suffered by a customer of a non-catalyst that benefited of umbrella pricing conditions is «one the possible effects of the cartel, that the members thereof cannot disregard⁷⁹». In this way, it denies any possibility of excusing cartel members for unintentional raising prices of outside competitors.

Balance in between the national rules on "causal relationship" and the full effectiveness of article 101 TFEU (the ECJ reinterpretation of Manfredi)

After stating that umbrella pricing is an anticompetitive practice resulting from cartel activity, the core to solve is the problem of awarding damages for related losses in case of "non-cooperative" national law provisions. That is the case of Austrian law: the right to compensation does not exist in the absence of a contractual link with a cartel member, and the intervention of a third party that takes an autonomous pricing decision breaks the causal link for non-contractual liability⁸⁰.

The Court then operates a sort of balance in between the *Manfredi* doctrine and the principle of full effectiveness. The *Manfredi* doctrine assigns domestic civil law provisions to rule on the exercise of the right to compensation, specifically including the concept of "causal relationship"⁸¹. While the safeguard of the effectiveness principle requires that rules on damages actions must not make it in practice impossible or excessively difficult to exercise the right conferred by EU law. And, in the context of competition law, they must not jeopardise the effective application of articles 101 and 102 TFEU. Such a full effectiveness of competition law might be endangered whether the existence of the right of any individual to claim compensation, administered by national law, would depend on the categorical assessment of a direct causal link, disregarding the circumstances of the case. In the wording of the Judgment, in fact, «the victim of umbrella pricing may obtain compensation for the loss caused by the members of a cartel, even if it did not have contractual links with them, where it is established that the

⁷⁸ Judgment, para 29.

⁷⁹ Ibidem, 30.

⁸⁰ Ibid., para 33.

⁸¹ See *Manfredi*, cit., para 64.

cartel at issue was, in the circumstances of the case and, in particular, the specific aspects of the relevant market, liable to have the effect of umbrella pricing being applied by third parties acting independently, and that those circumstances and specific aspects could not be ignored by the members of that cartel. It is for the referring court to determine whether those conditions are satisfied⁸²».

The objection as to the introduction of punitive damages

The Judgment also addresses the objection on the eventual informal introduction of punitive damages by accepting the compensability of umbrella claims. The ECJ pointed out that rules on non-contractual liability do not make the amount of compensation depend on the unlawful profits of the infringer but rather on the loss suffered by the injured party. In this sense, the redress of losses from umbrella pricing does not lead to enrichment of claimants but rather to reparation of their harm⁸³.

The objection on the counterproductive effect on leniency programmes

Besides, the ECJ tackles the problem of the disincentive for cartel members to apply for leniency programmes, contrary to the principle of effectiveness. The Judgment noted that such programmes are developed by the Commission through a Notice of Immunity, which is a legal act that is not binding for Member States. Therefore, this argument cannot limit in any way claims to compensation of damages for infringements of article 101 TFEU before national courts⁸⁴.

ECJ Ruling

In conclusion, the Court rules that « Article 101 TFEU must be interpreted as meaning that it precludes the interpretation and application of domestic legislation enacted by a Member State which categorically excludes, for legal reasons, any civil liability of undertakings belonging to a cartel for loss resulting from the fact that an undertaking

⁸² Judgment, para 34.

⁸³ Ibid., para 35.

⁸⁴ Ibid., para 36.

not party to the cartel, having regard to the practices of the cartel, set its prices higher than would otherwise have been expected under competitive conditions⁸⁵».

Preliminary comments to the decision.

First commentators divide into two teams: those who believe this judgment will have a significant impact on antitrust follow-on actions⁸⁶ in Europe, and those who strongly argued it is a poor way to defend the EU law effectiveness ineffectively⁸⁷.

Kone directly descends from Courage and Manfredi

The *Kone* decision is evidently placed in the same path originated by *Courage* and continued by *Manfredi*. The first merit of this judgment is to re-state the major clarifications brought by the *Courage-Manfredi* doctrine: the attitude of articles 101 and 102 TFEU to have direct effects thus create rights for individuals that must be safeguarded by national courts⁸⁸; and the relative duty of such courts to apply rules in respect of the principle of equivalence and the principle of effectiveness⁸⁹. It even reported the *Manfredi* stress on how important this is for the practical effectiveness of article 101(1) TFEU where the private enforcement is determinant to increase cartel detection⁹⁰. Moreover, it confirmed that the liability of cartel members for the anti-competitiveness inherent their agreement is of the non-contractual type⁹¹. Finally, the *Kone* decision fulfills the last genealogical requirement when it bases its more relevant theses on a legal argumentation solidly grounded on the principle of effectiveness.

The decision at issue is relevant for two interpretative results that affect respectively the specific application of competition law, and the general rules on damages actions for breaches of EU law. First of all, it affirms that umbrella pricing is a business misconduct that falls under the prohibition set out in the article 101 TFEU thus granting antitrust standing to fringe purchasers. Secondly, it clarifies that «the constitutional elements of the right to claim for compensation such as the causal link between the infringement

⁸⁵ Ibid., para 38.

⁸⁶ SCHREIBER, SAVOV, *Kone v. Commission: umbrella damages claim JCELP*, 2014, p. 550.

⁸⁷ See LAMADRID DE PABLO, IBÁÑEZ COLOMO, *Umbrella pricing- Case C-557/12 Kone, or when effectiveness may go too far with little effective consequences*, posted on Chillin' Competition Blog, 11 June 2014.

⁸⁸ See Judgment, para 21.

⁸⁹ Ibidem, para. 25.

⁹⁰ Ibid., para 22.

⁹¹ As observed by SCHREIBER, SAVOV, *cit.*, p. 550; see also Judgment, para 35.

and the damage are subject to EU law and not national law⁹²». Both of these legal policy solutions indeed aim at strengthening the effectiveness of EU competition law by clarifying an unsettled area of antitrust damages actions and *de facto* boosting the development of a European causation.

Umbrella pricing as an antitrust injury

The ECJ found undisputed that umbrella pricing is one of the possible consequences of a cartel and that such a consequence is capable to let fringe-competitors benefit from supra-competitive prices⁹³. Furthermore, it explicitly equates effective and undistorted competition in the internal market with market prices set on the basis of free competition⁹⁴. Hence, it provides a theory of harm where the market price undoubtedly plays a central role. Even though the court considers pricing as an autonomous business decision, it substantially shared the AG Opinion that market price is commonly taken as a benchmark by firms while deciding on it⁹⁵. Accordingly, the pricing choice of a firm that stands under the cartel price umbrella usually takes the above-competitive price as a reference and thus set its own prices at a level rationally inconceivable but for the existence of the cartel.

This view makes the umbrella pricing more than a mere cartel side-effect since it qualifies the distortion of a market price that is a benchmark for the industry as a result contrary to competition rules. Therefore, full effectiveness of article 101 TFEU must be ensured against distortions of competition that can eventually have the shape of market manipulations such as the one a cartel operates by misguiding prices formation in the industry.

After defining the infringement, the ECJ focuses on the damage. It affirms that also the loss suffered by a customer of a non-cartelist who benefited from the economic conditions of the umbrella pricing is one of the possible consequences of a cartel⁹⁶. As stated by the *Courage-Manfredi* rule, full effectiveness of article 101 TFEU also means that any individual can claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition⁹⁷. Accordingly in *Kone*, the ECJ specifies that umbrella claims shall be allowed to compensate for damages caused by the

⁹² Idem.

⁹³ Judgment, para 28.

⁹⁴ Judgment, para 32.

⁹⁵ See Judgment, para 29, and Opinion, para. 46.

⁹⁶ See Judgment, para 30.

⁹⁷ Ibidem, para 21.

anticompetitive market price distortion carried out by the cartel⁹⁸. And the right to compensation for these losses cannot be excluded «because the individual concerned had no contractual links with a member of the cartel, but with an undertaking not party thereto, whose pricing policy, however, is a result of the cartel that contributed to the distortion of price formation mechanisms⁹⁹». The ECJ recognized antitrust standing to those who purchased from the fringe, on the basis of a *direct* harm in the economic sense.

The difficult establishment of a causal link

In order to have a direct harm in the legal sense though, a causal link in between the breach of law and the harm must be proven. As anticipated by the AG Opinion¹⁰⁰, the establishment of a plausible causal link in the case of umbrella pricing is the most controversial part of the judgment. Again following *Manfredi*, according to which detailed rules on the exercise of the antitrust damages actions should follow national standards, the ECJ clearly said that national legislation cannot prevent umbrella pricing victims from claiming compensation solely because the causal link between the loss sustained and the cartel is considered to have been broken by the autonomous decision of the fringe competitors. In this reconstruction, national courts must determine under which market conditions¹⁰¹ a cartel might be found liable to have the effect of umbrella pricing. It is simply assumed that a cartel cannot ignore that its underlying unlawful agreement, under such conditions, might lead to the undesirable umbrella pricing effects¹⁰².

This is the point where the ECJ partially departs from the view of the AG. It does not suggest under which terms such an anticompetitive result is more likely or may be exacerbated, but it just observes their determination is left to national courts. While the AG expressly references the case of homogeneous and transparent products of highly

⁹⁸ SCHREIBER, SAVOV, cit., observed: «the Court not only confirmed that the right for any person harmed by a cartel to claim antitrust damages is directly rooted in article 101 TFEU, but also clarified that the tort liability of cartel members results from the manipulation of the market, but not from the individual contracts concluded in the vertical chain of distribution of cartelised products», p. 550.

⁹⁹ Ibid., para 33.

¹⁰⁰ Opinion, para 19: « From a legal point of view, the issue of whether members of cartels can also be held civilly liable for umbrella pricing hangs on the existence or otherwise of a causal link. The question is whether there is a sufficiently close connection between the cartel and the losses resulting from umbrella pricing caused by a cartel, or whether these are excessively remote losses for which damages cannot reasonably be awarded against the members of the cartel».

¹⁰¹ Generically indicated as «circumstances of the case and, in particular, the specific aspects of the relevant market». Judgment, para 34.

¹⁰² See Judgment, paras 30 and 34.

concentrated industries¹⁰³, the ECJ generically refers to certain conditions «relating, in particular, to the nature of the goods or to the size of the market covered by that cartel¹⁰⁴». The EU law foreseeability test to mitigate the causality assessment, on which the AG founded its own arguments, is then received in the EU case law in a more relaxed version, which partially safeguards the autonomy of the national courts in managing the details of the remedies.

Finally, it is possible to observe that the *Kone* decision continued exactly where *Manfredi* stopped. It indeed deepened the development of the “causal relationship” that *Manfredi* left unreservedly to the domestic legal systems but baptized with a cautious (non-traditional) terminological choice, as to suggest that a causal “relationship” implies a broader definition and a less categorical application than the traditional (direct, immediate, adequate, etc.) causal “link”. The ECJ in *Kone* proved to keep that promise by broadening it *de facto*, and not excusing the disapplication of competition law by the Austrian court solely based on the lack of adequacy of causation. In fact, this judgment impose a sort of obligation on national courts to set aside any national provision that might significantly restrict the exercise of the right to full compensation for damages resulting from market-distortive cartel pricing.

The relationship among public and private antitrust enforcement

In the same line of reasoning, the ECJ rejected the objection against granting standing to fringe purchasers based on the implicit disincentive for firms at assisting authorities in their investigations. The full right to compensation cannot suffer any restriction, even if Commission’s leniency programmes are fundamental for cartel detection and their existence heavily depends on providing incentives for cartel members to cooperate. Therefore, last but not least, the decision fosters the fair balance among private and public antitrust enforcement. The main argument provided outlined the lesser binding force of the legal act that instituted the leniency programmes tool (Commission’s Notice of Immunity) and the Treaty rules¹⁰⁵.

3. OVERVIEW OF THE DEBATE.

¹⁰³ Opinion, para 48.

¹⁰⁴ See Judgment, para 29.

¹⁰⁵ *Ibidem*, para 36.

The importance of the above-discussed judicial decision does not rely on the correctness of the evaluation of the practice as an antitrust injury *per se*, i.e. whether umbrella pricing falls under the scope of competition law. What is probably more relevant is indeed the policy choice to extend antitrust standing to injured subjects other than direct purchasers.

In this sense, the case of umbrella claims resembles the case of passing-on defense, though only in terms of antitrust enforcement policy. Indirect purchasers are those who buy a product from cartel's direct purchasers (then qualified as intermediaries) and therefore those to which the cartel overcharge might be passed-on. The position of fringe-firms' purchasers is at the same distribution level of direct purchasers, even though they do not buy from cartelists. Both categories of purchasers suffer economic losses due to cartel overpricing thus both of them should be entitled to claim damages. From a legal perspective, in the case of indirect purchasers claiming the so-called passing-on defense is a way to provide an unbroken causal chain that satisfies the causation requirement. In the case of those who purchased from the fringe, the causal nexus is broken by the autonomous pricing choice of the fringe-firm, then the harm is deemed too remote rather than direct and immediate. Moreover, from an antitrust enforcement perspective, the antitrust standing can be further narrowed down to fulfill additional policy objectives (e.g. deterrence in the US system).

Hence, the following paragraphs will expose a brief overview of the prior debate on the umbrella theory of antitrust standing. This theory will be analyzed according to the contributions of the economic analysis and those of the US enforcement model. Those insights, together with those of the European law and enforcement model already presented in this work, will be the ground for a critical comparison among different antitrust enforcement models. The aim is to isolate the criteria of the most efficient enforcement model and assess whether the choices made in *Kone* are likely to satisfy them. The following discussion is an essential step to assess the general merit of *Kone*, to predict its most likely aftermath and eventual desirability in the framework of the European antitrust enforcement model.

3.1. Umbrella pricing in the US antitrust law and enforcement.

The section 4 of the Clayton Act disposes the availability of damages actions and injunctive relief for those who have been harmed by an infringement of antitrust law.

Interestingly, its wording mirrors the one of *Courage*¹⁰⁶ when it broadly defines the antitrust standing as to include «*any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws¹⁰⁷». Such a broad definition would allow the recovery of threefold (punitive) of a very wide range of claimants. Therefore, over the years, courts' case law shaped some requirements to restrict standing, narrowing down the potential plaintiffs' range, in order to avoid excessive enforcement.

The Supreme Court recognized such a trend for the first time in 1974, in *Hawaii v. Standard Oil and co.*¹⁰⁸

Initially, this standing restrictive policy resorted on a circumscribed interpretation of the "by-reason-of" language of section 4¹⁰⁹. A "legal causation" standard was required to be fulfilled, beyond the mere causation in fact. The parallelism with the proximate cause required by the general law of torts is evident. Analogously, various other tests tried to achieve the goal. The "target area" test aimed at individuating whether the business misconduct was aimed at harming the actual claimant. One nuanced application of this test included the additional evaluation of some degree of foreseeability.

Furthermore, the interpretation of the so-called *antitrust injury requirement*¹¹⁰, elaborated in *Brunswick Corp. V. Pueblo Bowl-O-Mat*¹¹¹, became more central. According to this case law, the plaintiff must have suffered an «injury of the type the antitrust laws intended to prevent and that flows from that which makes the defendants' acts unlawful. The injury shall reflect the anticompetitive acts made possible by the violation». In other words, also in the US system of enforcement one of the first screenings that courts must assess is to investigate whether the alleged business misconduct falls under the scope of antitrust law. The practical effect of such a test is to foreclose a number of potential claims.

¹⁰⁶ See *Courage*, cit., para 26: « The full effectiveness of Article 85 of the Treaty and, in particular, the practical effect of the prohibition laid down in Article 85(1) would be put at risk if it were not open to *any individual* to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition».

¹⁰⁷ § 4 Clayton Act, 15 U.S.C. § 15.

¹⁰⁸ See *Hawaii v. Standard Oil and co.*, 405 U.S. 251, 263 n.14 (1974) as noted by KAMP, *Monopsonistic price fixing and umbrella pricing as a theory for antitrust standing: a new view of Illinois Brick*, 1981, that reported the wording «The lower courts have been virtually unanimous in concluding that Congress did not intend the antitrust laws to provide a remedy in damages for all injuries that might conceivably be traced to an antitrust violation», p. 53.

¹⁰⁹ *Ibidem*, pp. 53-54.

¹¹⁰ See FIEBIG, *Private enforcement of antitrust law in the United States of America*, 2013, p. 478.

¹¹¹ *Brunswick Corp. V. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977).

The *direct purchaser rule* represents one of the developments in the interpretation of the antitrust injury requirement. Two Supreme Court's decisions designed this standard by deciding two claims on multiparty supply chains. For the first time, in *Hanover Shoe v. United Shoe Mach.*¹¹², the SC addressed the issue of the passing-on defense¹¹³. In deciding, the SC faced two major policy concerns¹¹⁴. First of all, it was afraid that a defensive use of passing-on would have led in the future to longer proceedings, where a defendant would have needed to arduously prove the overcharge involving massive evidence and too complicated theories. Secondly, it thought that placing the right only on the final consumer would have put the effective enforcement at risk by misuse of the treble damage remedy. In this view, the final consumer did not have a sufficient knowledgeable stake to be a proper "private enforcer" and thus able to prevent antitrust violators to «enjoy the fruits of their illegality¹¹⁵». Lower courts had some problems in taking decisions in compliance with the *Hanover shoe* orientation: some took it as a substantial deny of any possible antitrust standing right of indirect purchasers, some others intended its message as a warning against the danger of multiple recoveries and granted standing to indirect purchasers mitigated by apportioning damages¹¹⁶. In a later case on the uncertainty of indirect purchasers standing, *Perkins v. Standard Oil Co.*¹¹⁷, the SC «ruled that no "artificial limitation" should preclude the plaintiff from showing that discriminatory prices had been passed through three levels of distribution in order to favor his competitors in violation of the Robinson-Patman Act¹¹⁸». Unluckily, that case was about the section 2 of the Clayton Act, as amended by the Robinson-Patman Act, and it was not conclusive for claims under section 4.

Almost a decade later, in *Illinois Brick Co. v. Illinois*¹¹⁹ the SC cleared up all doubts by ruling against an offensive use of pass-on theory on the basis of *Hanover shoe*-like policy concerns¹²⁰. It further added that the offensive use of passing-on exacerbates the

¹¹² *Hanover Shoe v. United Shoe Mach. Corp.*, 392 U.S. 481 (U.S. 1968).

¹¹³ As noted by KAMP, *cit.*, 1981, note 32, p. 58: «Passing on is the process "whereby a businessman who has been overcharged adjusts his own price upward to reflect the overcharge".

¹¹⁴ As described by KAMP, *cit.*, p. 58.

¹¹⁵ *Hanover Shoe v. United Shoe Mach. Corp.*, *cit.*, p. 494.

¹¹⁶ See BERGER, BERNSTEIN, *An analytical framework for antitrust standing*, 1977, p. 827.

¹¹⁷ 395 U.S. 642 (1969).

¹¹⁸ See BERGER, BERNSTEIN *cit.*, note 84.

¹¹⁹ *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (U.S. 1977).

¹²⁰ See KAMP, *cit.*, «In ruling against offensive use of the pass-on theory in *Illinois Brick*, the Court echoed concerns it had voiced in *Hanover Shoe*, discussing at some length the enormous difficulty of allocating injury among the links of the distribution chain», p. 59.

problem by raising the possibility of multiple recoveries for the same injury by several customers placed at different layers of the distribution.

These two precedents in conjunction barred the indirect purchasers' standing to sue under section 4 of the Clayton Act. Moreover, the SC interpretation of the legislator's choice on antitrust punitive damages as a preference for vigorous enforcement led to consider optimally deterrent just the direct purchasers' standing. It is though worth mentioning that about half of the individual states adopted "Illinois Brick repealer statutes" in response to Illinois Brick doctrine¹²¹. Those national laws expressly permit indirect purchasers' antitrust standing and have been recognized as valid by the Supreme Court later on¹²². It is interesting to note that declaring the validity of the "repealer statutes" was a tragic epilogue for this unfortunate doctrine. By (sometimes unreasonably) trying so hard the risk of multiple recoveries, the SC «set in motion a series of events that have magnified this risk far beyond what anyone imagined back in 1977¹²³». The judicial and legislative fragmentations make nowadays the duplicative recovery concrete rather than just likely. Furthermore, by trying to increase consistency in the antitrust law application, the SC just proved once more « the arbitrariness of the results flowing from a categorization test for purchasers at different levels in a chain of distribution¹²⁴».

The aftermath of the Illinois Brick doctrine also heated a similarly divided scholarly debate¹²⁵, and it interestingly became a chance for an intellectual duel among Chicago School and Harvard School representatives¹²⁶. Both sides used economic analysis to assess the consequences of the rule at issue on antitrust enforcement in respect of two potentially competing policy objectives, deterrence and compensation.

Landes and Posner argued that keeping the direct purchaser rule as described by Ill. Brick, i.e. without passing-on defense, is consistent with the optimal deterrence theory.

¹²¹ See FIEBIG, cit., note 61, p. 478.

¹²² *California v. ARC Corp.*, 490 U.S. 93, 98 (1989).

¹²³ See BAKER, *Hitting the Potholes on the Illinois Brick Road*, 2002, p. 16.

¹²⁴ See BERGER, BERNSTEIN, cit., p.829.

¹²⁵ AS interestingly reconstructed and commented by DUMBROVSKY, *Passing-on standing matrix in private antitrust enforcement: a reconciliation of economic and justice approaches*, 2013, pp. 4-12.

¹²⁶ See DUMBROVSKY, cit., notes 18 and 19, p. 4, where he reported all the articles of the University of Chicago Law Review and of the University of Pennsylvania Law Review involved in the Chicago School v. Harvard School views on the issue. LANDES, POSNER, *Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? An Economic Analysis of the Rule of Illinois Brick*, 46 U. CHIL. REV. 602 (1979); HARRIS, SULLIVAN, *Passing On the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. PA. L. REV. 269 (1979); LANDES, POSNER, *The Economics of Passing On: A Reply to Harris and Sullivan*, 128 U. PA. L. REV. 1274 (1980); HARRIS, SULLIVAN, *Passing On the Monopoly Overcharge: A Response to Landes and Posner*, 128 U. PA. L. REV. 1280, 1280-1281 (1980).

They share the philosophical premise according to which an economic approach to antitrust enforcement must uphold deterrence as a superior ultimate goal. The reason for such belief is that, intuitively, the lower the number of occurred violations, the less the need to recur to compensatory remedies. Consequently, antitrust standing should be granted just to the most efficient “private” enforcers which are found to be the direct purchasers. They have more information or their search for additional information is easier, i.e. less costly, since they are in a better position in the distributive chain, i.e. closer to the violator. Hence, the potential recovery of treble damages was an intelligent move of the legislator that managed to place incentives in the correct hands. To support this view, the authors further showed that paradoxically more enforcers might lead to less enforcement by applying external economies to this case¹²⁷. Exclusive incentives outperform an inclusive view of standing that might generate beneficial spill-overs that are hard to measure, and therefore to take into account, by single enforcers before acting.

Harris and Sullivan opposed the Landes/ Posner findings by bringing together legal and economic arguments to reconcile deterrence with compensatory justice¹²⁸. They pointed out that since direct purchasers can alternatively (and immediately) recover their losses by transferring the overcharge their relative incentive is weaker than assessed. Moreover, section 4 that who is injured by an antitrust violation may recover threefold the damage sustained. In a compensatory justice perspective, the disposition prevents double redress by mandating not to exceed the maximum cap of treble damages. It also confers the right to sue to those whom the loss occurred, i.e. indirect rather than direct purchasers. Hence, they support a direct purchaser rule with passing-on.

Ill. Brick *de facto* compromised eventual future claims brought by other classes of injured subjects, erecting an apparently insurmountable standing barrier¹²⁹. In the absence of a clear view of the Supreme Court on antitrust standing, lower courts started applying looked at Ill. Brick for guidance in any claim involving standing. This led most of the time to a blind application of the direct purchaser barrier. This was the case for

¹²⁷ See DUMBROVSKY, cit., note 20, p. 4 on LANDES, POSNER, cit., 1979, p. 624.

¹²⁸ Ibidem, p. 5.

¹²⁹ See KAMP, cit., p. 56.

umbrella theory claims, as well as for claims from purchasers of competitors in parallel chains of distribution and market manipulations¹³⁰.

The paradigmatic case on the matter is represented by *Mid-West paper products Co. v. Contitental Groups Inc.*¹³¹ where an umbrella claim was rejected on the basis of the same policy concerns enumerated in *Hanover shoe and Ill. Brick*, namely too complex economic analysis, the risk of «potentially ruinous [multiple] liabilities¹³²» and the impairment of the treble damages remedy¹³³. The dissenting opinion of Judge Higginbotham though inspired some sub-sequent lower court decisions¹³⁴ that upheld umbrella theory claims. They argued that the case of the indirect purchaser is substantially different from the one of the fringe-purchaser¹³⁵. Therefore, the decision on the matter can depart from *Ill. Brick*, even though policy concerns may at first hear sound similar. In allowing umbrella theory, they reminded that the burden of proving the establishment of a causal link rest on the claimants¹³⁶.

Finally, in 1983, the Supreme Court listed some factors that courts should assess in order to grant antitrust standing when it decided *Associated General Contractors v. Carpenters*¹³⁷. The ninth Circuit in *American AD Management v. General Telephone Company of California*¹³⁸ summarized these precepts in a five-point test¹³⁹. This analysis should verify first whether the alleged injury falls under the scope of antitrust law, followed by the assessment of the directness of the injury, the eventual speculative nature of the claim, the risk of duplicative recovery, and finally the complexity in apportioning damages. Given the well-known difference among indirect purchasers and fringe-purchasers, it has been easily demonstrated that umbrella claims satisfy the

¹³⁰ CAVANAGH, *Illinois Brick revisited: an analysis of a developing antitrust jurisprudence*, 1983, p. 104 and following.

¹³¹ *Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 580-86 (3d Cir. 1979).

¹³² *Ibidem*, «Allowing recovery for injuries whose casual link to defendants is tenuous . . . could subject antitrust violators to potentially ruinous liabilities, well in excess of their illegally earned profits, because under the theory propounded by [plaintiffs], price-fixers would be held accountable for [illegal] prices that arguably ensued in the entire industry», p. 586, as reported by CAVANAGH, *cit.*, note 203.

¹³³ See again CAVANAGH, *cit.*, p. 106.

¹³⁴ See *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1166, n.24 (5th Cir. 1979) and *In re Bristol Bay, Alaska Salmon Fishery Antitrust Litigation*, 530 F. Supp. 36, 38 (W.D. Wash. 1981).

¹³⁵ For instance, the problem of apportioning damages, as among direct and indirect purchasers, is not present.

¹³⁶ See *In re Bristol Bay*, *cit.*, p. 39.

¹³⁷ *Associated General Contarctors v. Carpenters*, 459 U.S. 519 (1983).

¹³⁸ *American Ad Management v. General Telephone Company of California*, 190 F.3d at 1054.

¹³⁹ As reported by LAVE, *Umbrella standing: the tradeoff between plaintiff suit and speculative claims*, 2003,, p. 249.

*General contractors-test*¹⁴⁰. The most controversial point is always represented by the directness of the harm that can nevertheless be met if the courts should apply a causation standard other than privity, as for instance a foreseeability standard¹⁴¹.

General contractors had nevertheless the merit to clarify the requirements for antitrust standing. In doing so, it finally put antitrust injury and causation requirements in the correct position as regarding the problem of standing. Unluckily, it did not go far enough to specify those requirements' interpretation extensively enough. Therefore, until the SC will ever pronounce on the eventual possibility for an umbrella claim to satisfy all the five points of the test, fringe-purchasers will keep facing uncertainty over their right to recovery the overcharge they had paid.

Summary

The US antitrust private enforcement is strongly deterrence-oriented. The choice of punitive damages as a correct remedy was determined by a very early preference over deterrence as policy goal. The punishment was meant to be simultaneously exemplary and able to adjust the sanction for the usually low probability of detection of antitrust violations as cartels.

The courts have always interpreted the legislator's choice for treble damages accordingly. In spite of the broad standing granted by the general wording of section 4, they provided various standards over time in order to restrict standing rights. Their concern was two-fold and involved a sort of balance between deterrence and corrective justice: avoiding multiple recoveries for the same harm together with preserving the super-deterrent remedy from being impaired and thus becoming ineffective.

The above-reviewed case laws are the most frequently cited in the literature on the matter. They outlined how the debate over antitrust standing has always boiled down to restrict it to direct purchasers. Such a preference for direct purchasers lessened the eventual rights to recover concrete losses of other categories of potential plaintiffs as indirect purchasers and fringe-firm purchasers.

The outcome is that the harm suffered by fringe purchasers should be borne by them under US law because their claims are usually regarded as non-as-much-meritorious. A SC judicial doctrine that might review its interpretation of proximate causation

¹⁴⁰ Ibidem, pp. 249-257.

¹⁴¹ Ibid., p. 251.

mitigating it with a foreseeability standard might come up with a totally different outcome.

It is interesting to make a preliminary comparative observation. Kone represents for EU law what *Mid-West Papers* has been for US law in terms of allowing in principle umbrella claims. In both systems, legally speaking the main obstacle has been found in providing causation, i.e. directness of harm. And this has been so even despite the different legal traditions (EU mostly civil law, US common law) and the different underpinning main enforcement policy goals (deterrence, compensation).

Therefore I thought it would have been a good idea to take a closer look at the economic theory on the issue at this point. The following review has been developed to assess whether and eventually why it would make sense to allow umbrella damages recovery from an economic perspective. The outcome is of extreme importance because it may signal that a reform of a tort law dogma like causation is indeed needed to make antitrust enforcement effective. And this would imply a departure from a general scheme that had survived since the origin of some legal systems.

3.2. Umbrella pricing in the economic literature.

Hard core cartels are business conducts that have received large research attention; therefore the dedicated literature provides many definitions¹⁴². According to an accurate one, a cartel is «a group of firms who have agreed explicitly among themselves to coordinate their activities in order to raise market price – that is, they have entered into some form of price fixing agreement¹⁴³». The OECD further specified that hard core cartels include all those anticompetitive «agreements between competitors to fix prices, restrict output, submit collusive tenders, or divide or share markets»¹⁴⁴ by allocating customers, suppliers, territories and lines of commerce.

But they have been defined (also) as «the supreme evil of antitrust¹⁴⁵», «unambiguously bad¹⁴⁶», and «the most egregious violations of competition law¹⁴⁷». These various

¹⁴² See for instance the analysis of three definitions proposed by HUESCHELRATH, *Competition policy analysis. An integrated approach*, 2009, p. 52.

¹⁴³ See PEPALL, RICHARDS, NORMAN, *Industrial Organization: contemporary theory and practice*, 1999, p. 345.

¹⁴⁴ OECD, *Hard Core Cartels*, 2000, p. 6.

¹⁴⁵ *Verizon Communications v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 408 (2004).

¹⁴⁶ OECD, *Hard Core Cartels: Third report on the implementation of the 1998 Council Recommendation*, 2005, p. 7.

captivating definitions suggest that such business conducts are considered very noxious. Indeed, cartels are perceived as so noxious that they are deemed illegal in most of the countries in which a sound antitrust law is enforced. Moreover, because of such per se illegality, hard core cartels operate in secret. Then let's see why firms should ever spoil their reputations in engaging to such shameful practices.

According to the oligopoly theory, firms decide to coordinate their activity because this leads to greater profits than acting independently¹⁴⁸. In this way, firms might internalize a negative externality, which is represented by taking price or output decision while ignoring the effect on competitors (classic competitive scenario)¹⁴⁹. Therefore, whenever firms agree to fix the price above the competitive level or, similarly, to reducing output below the competitive level, they take account of how these changes affect each of them. They agree to that as long as they jointly enjoy higher profits derived from higher prices per lesser output quantity. At the same time, such an agreement makes goods and services completely unavailable to some purchasers and unnecessarily expensive for others¹⁵⁰. Hence, cartelization implies positive effects for cartel members at the cost of a sub-optimal use of resources (in form of allocative, productive and dynamic inefficiencies), and at the expenses of consumers.

While the economics of complete cartels is quite developed both in explaining their functioning and their welfare effects, the economics of partial cartels and its welfare consequences is not as much. Partial cartels are cartels whose market share is less than 100%. They operate in a market characterized by a competitive fringe of firms that price under the umbrella of the price imposed by the cartel. Therefore, umbrella pricing qualifies as a consequence of such cartels.

Some theoretical papers have dealt with pricing dynamics of cartel members and non-cartel members. The so-called theory of partial cartels provides both older static and

¹⁴⁷ Ibidem, p. 46, as defined by the wording of the enclosed Recommendation of the Council concerning effective action against hard core cartels (Adopted by the Council at its 921st session on 25 March 1998).

¹⁴⁸ HUESCHELRATH, VEITH, *The impact of cartelization on pricing dynamics*, 2011, p.3.

¹⁴⁹ Idem.

¹⁵⁰ OECD, *Hard Core Cartels: Third report on the implementation of the 1998 Council Recommendation*, 2005, p. 47.

more recent dynamic models¹⁵¹. In this context, a small (accidental) literature on umbrella pricing has been identified¹⁵² and will be synthetically recalled below.

The seminal paper on the topic was written by Selten (1973)¹⁵³, who showed that it may be optimal for smaller fringe firms not to join the cartel, provided that most of industry producers are cartelized. In a quantity-setting oligopoly, equilibrium prices are identical among cartelists and non-cartelists, while individual output and profits may differ. After Selten, many authors developed models to explore extensions of these results. The following static models to investigate this issue under a one-shot game approach divided into two main settings: price-leadership with a competitive price-taking fringe¹⁵⁴ or quantity-leadership with a fringe competing *à la Cournot*¹⁵⁵. This literature suggested a direct relationship between the relative size of the cartel on the market size and its effect on market prices/quantities¹⁵⁶. The lower than 100% the joint market share is, the less it impacts the market; and also the lower the overcharge, the lesser the damages¹⁵⁷. This can be less true according to specific market conditions, for instance in case of heterogeneous rather than homogeneous products¹⁵⁸.

The literature on dynamic models under a repeated interaction framework confirmed these conclusions. *Inter alios*, Bos (2009) wrote a thesis on cartel formation that considers firms with different capacities. He shows that larger firms have a stronger incentive to join a cartel¹⁵⁹. Thus he concludes partial cartels are more likely when the industry comprises firms with uneven sizes. A year later, Bos and Harrington¹⁶⁰ developed a dynamic model for firms producing homogeneous goods with heterogeneous capacities and found that cartel members choose to produce below their

¹⁵¹ The main reference for a more comprehensive literature review is SCHWALBE, *Welfare effects of partial cartels*, 2011.

¹⁵² HUESCHELRATH, VEITH, cit., p. 4.

¹⁵³ SELTEN, *A Simple Model of Imperfect Competition, where 4 Are Few and 6 Are Many*, 1973, pp. 141-201.

¹⁵⁴ See again the review made by SCHWALBE, cit., p. 3. Schwalbe indicates this is the setting of D'ASPROMONT ET AL., *On the Stability of Collusive Price Leadership*, 1983, pp. 17-254; DONSIMONI, *Stable heterogeneous cartels*, December 1985, Pages 451-467; and their follow-ups.

¹⁵⁵ Idem. Schwalbe indicates this is the setting of MARTIN, *Fringe Size and Cartel Stability*, 1990; SHAFFER, *Stable Cartels with a Cournot Fringe*, 1995, pp. 744-754; and KONISHI, LIN, *Stable Cartels with a Cournot-Fringe in a Symmetric Oligopoly*, 1990.

¹⁵⁶ *Ibidem*, p. 8.

¹⁵⁷ Idem.

¹⁵⁸ Idem.

¹⁵⁹ BOS, *Incomplete Cartels and Antitrust Policy: Incidence and Detection*, 2009.

¹⁶⁰ BOS, HARRINGTON, *Endogenous cartel formation with heterogeneous firms*, 2010.

capacity and set a price that serves as an umbrella under which fringe firms produce at capacity. This conclusion also confirms Selten's results.

On the other side, empirical research on the pricing dynamics of cartelization is also rare and mainly devoted to case studies. Hueschelrath and Veith (2011) verified some of the theoretical above-mentioned hypotheses by analyzing evidence from the German cement industry. On the pricing dynamics among cartel and non-cartel members, they found that fringe firms do not overcharge as much as the cartel but still above the competitive but-for price. As a consequence, a damage of these customers seems also likely to take place¹⁶¹.

According to commentators, a more thoroughly welfare analysis of partial cartels is though needed, especially on the relationship between cartel size and market price that becomes central to damages assessment¹⁶². Capuano (2005) pointed out that indeed topic literature on the economics of the fringe has been developed on single dominance issues¹⁶³. This simpler framework led to conclude that the strategic interaction of such a market resolves only in a restriction of the dominant firm market power and profits due to the competitive fringe production of price-taker firms. Capuano instead analysed whether a competitive fringe may affect the sustainability of collusive equilibria, i.e. if in a collusive rather than monopolistic setting the strategic interaction displays further dynamics. He departed from the traditional scenario where business decisions are determined by price increase profitability in favour of one where the main incentive is to deviate from the collusive price. In a Supergames framework, he proved that when collusion is a sub-game perfect equilibrium, the competitive fringe qualifies as a collusive plus factor¹⁶⁴. Moreover, he also found a critical dimension of the fringe that can make collusion Nash equilibrium in the static game¹⁶⁵.

Another strand of theoretical papers developed economic analyses to comment some concrete antitrust enforcement policy choices. Hence, they address umbrella pricing more carefully rather than accidentally, in order to provide theories to support views on whether to grant standing or not to injured subjects other than direct purchasers, including fringe-firm purchasers.

¹⁶¹ See HUESCHELRATH, VEITH, cit., p. 30.

¹⁶² As claimed for instance by SCHWALBE, cit., p. 8.

¹⁶³ CAPUANO, *Abuse of Competitive Fringe*, July 2005, p. 2.

¹⁶⁴ *Ibidem*, p. 3.

¹⁶⁵ *Idem*.

The first wave of these papers arose after the use of the Illinois Brick doctrine to adjudge umbrella claims in some US circuit decisions in the early 1980s.

Blair Maurer (1982) provided an umbrella pricing model where they showed graphically the profit maximizing behaviors of the partial conspiracy and the competitive fringe¹⁶⁶. The market clears at the cartel price and the conspirator respond by restricting the output while the fringe responds by expanding its output. Both dominant firms and fringe firms enjoy higher profits, therefore fringe firms also benefit from the conspiracy to which they do not take part. This happens because raising the price up to the level established by the cartel widens the gap between price and marginal costs and profit-maximising fringe-firms naturally react to that by producing more. Their increase in profits under the umbrella is relatively greater than the one experienced by conspirators. It directly descends by the fact that both per unit profit and output are greater. The authors outlined that, since all customers pay the higher price at which the market clears, each customer who buys at the collusive price is injured by an amount equal to the difference among the actual paid price and the but-for price per unit purchased, irrespective to the seller's identity. Hence, they stated an equivalence among direct and fringe-firms purchasers, affirming that «from the standpoint of both antitrust policy and *widely accepted* economic theory, it seems clear that purchasers from fringe competitors under a price umbrella are *indistinguishable in theory, and sometimes in fact*, from purchasers from the price-fixers¹⁶⁷». Their conclusion directly positions in the same line of the works originated by Selten, even though they do not make reference to any of them. Nevertheless, they used graphic demonstrations to explain the actual economic losses of fringe-firm purchasers in order to argue against the use of the Illinois Brick doctrine of some US Circuit courts in umbrella claims such as *Mid-West Paper Products v. Continental Group* (1979). Highlighting the different scenario and dynamics that originate the damages to fringe-firm purchasers against the background of the case

¹⁶⁶ See BLAIR, MAURER, *Umbrella pricing and antitrust standing: an economic analysis*, 1982, pp. 931-937. For the sake of completeness, eight years later, Blair co-authored with Romano another paper on partial cartels with heterogeneous products. They thought to use the different responses on output levels in equilibrium to develop an output test to discriminate among cartel and non-cartel members. This time the policy implication is to propose a tool to help helping lawyers in the discovery process when not all industry participants are conspirators. See Blair, Romano, *Distinguishing participants from nonparticipants in a price-fixing conspiracy: liability and damages*, 1990.

¹⁶⁷ See BLAIR, MAURER, *cit.*, p. 948. [emphasis added]

of indirect purchaser served to suggest a more careful interpretation of causation in antitrust damages actions.

On the same wave, Van Cott describes the “economics of fringe production” to highlight how the presence of a competitive fringe always¹⁶⁸ mitigates the deadweight loss caused by an antitrust violation¹⁶⁹. He also notes that fringe producers expand their output to face an increased demand diverted by the cartel formation and thus they reduce the cartel market power. In his reconstruction, the competition with the fringe cannot alter the cartel choice but *de facto* the expansion of fringe production reduces the price that it is able to charge. He showed graphically that the final welfare loss is less than a complete cartel loss¹⁷⁰.

The triangular area commonly associated to a cartel deadweight loss is reduced to a trapezoid area. This unusual trapeze-shaped deadweight loss includes a smaller triangle-shaped loss in allocative efficiency generated by the cartel plus a rectangle-shaped loss in productive efficiency attributable to the fringe. Furthermore, he recognized the fringe «fulfills a socially desirable function¹⁷¹» because its competitive behavior reduces the cost of someone else’s anticompetitive behavior thus they should not be held liable for the productive inefficiency associated to the overcharge they practice. On the contrary, those who behaved anti-competitively should bear all the costs connected to the unfair exercise of market power, «both the cost the result from its own pricing and those that result from the response of the fringe¹⁷²». Even though he thought umbrella pricing should then satisfy the definition of antitrust injury, he finally argued against granting antitrust standing to fringe purchasers on the basis of the fact that they are not the most efficient plaintiffs in an optimal deterrence perspective. Hence, in the end he proposed a differently designed damages rule for the case.

In the same year, Landes published his seminal paper on optimal sanctions for antitrust violations¹⁷³. He started from acknowledging that some concentrations of market power might lead to beneficial cost savings. Therefore not all violations should be deterred, but just those which generate deadweight losses greater than cost savings, i.e. more

¹⁶⁸ Literally «even in the weakest case», VAN COTT, *Standing at the Fringe: Antitrust Damages and the Fringe Producer*, April 1983, p. 772.

¹⁶⁹ VAN COTT, *cit.*, p. 769.

¹⁷⁰ *Ibidem*, fig. 3, p. 770.

¹⁷¹ *Ibidem*, p. 773.

¹⁷² *Idem*.

¹⁷³ LANDES, *Optimal sanctions for antitrust violations*, 1983.

efficiencies than inefficiencies¹⁷⁴. It called this the "net harm rule" according to which the optimal penalty should be equal to the harm minus cost savings and adjusted for the probability of detection¹⁷⁵. In his paper, Landes applied the rule to some disputed antitrust issues as also the case of cartels with less than 100% market share¹⁷⁶. He found the key question is whether to include the overcharge practiced by the fringe competitors in the cartel's optimal penalty or not and his negative answer strongly depends on the cost assumptions of his model.

In general, he finds that in such case the penalty may vary from the area of the cartel overcharge plus the area of the deadweight loss to the entire trapezoid area (including the fringe overcharge). This latter situation would occur when the marginal costs are constant and equal to the cartel price, in a way that excludes the possibility of positive net cost savings. He summarized this principle concisely stating that «if the competitors are no less efficient than cartel members, no recovery [for customers who bought from competitors of the cartel at a higher than competitive price] should be allowed¹⁷⁷».

Twenty years and several other divergent lower courts views on the issue¹⁷⁸ later, Lave (2003) proposed a similar graphic demonstration in an oligopoly setting with three firms where two decide to collude and the third one acts as a competitive fringe. He argued that «the decline in demand for colluding products is simultaneous with the increase in demand for umbrella products price [in a frictionless economy]¹⁷⁹» thus umbrella damages are as direct as direct purchasers damages and they should be identically compensated. His analysis is less nuanced than those of Van Cott and Landes, as well as his policy proposal: granting antitrust standing to fringe purchasers should be the most efficient choice even in an optimal deterrence perspective and he proves so by dismantling the usual objections against such a measure point by point.

There are good chances that *Kone* will be for Europe what *Illinois Brick* has been for the US, as a doctrine able to stimulate further investigation on umbrella pricing¹⁸⁰. A

¹⁷⁴ Ibidem, p. 656.

¹⁷⁵ Ibid., p. 658.

¹⁷⁶ Ibid., pp. 666-668.

¹⁷⁷ Ibid., p. 678.

¹⁷⁸ The author collects evidences from two sets of cases. The first set comprises three cases before circuit courts among which one found the defendant liable under umbrella theory. The second set of nine cases before district courts shows five decisions in favor and four decisions against granting such a relief. See LAVE, *cit.*, note 10, p. 225.

¹⁷⁹ Ibidem, p. 238.

¹⁸⁰ Probably because of the *Kone* case relates to the application of Austrian law, a literature in German language has been developed as reported by the AG Kokott in her Opinion, note 10: F.W.

European strand of studies have indeed dealt with this issue during the debate on the damages actions directive and while *Kone* was pending.

Maier-Rigaud and Schwalbe¹⁸¹ provided a comprehensive effect analysis of anticompetitive practices. They observe upstream and downstream effects through all the layers of distribution of the productive chain and their interaction with outside markets. At the same distribution's level, a positive impact is detected on cartelists' competitors that produce the same or a substitute product. The positive impact is related to the presence of "umbrella effects" thanks to which non-cartelised firms (which include fringe-firms but also producers of substitutes) enjoy a higher demand diverted by the cartel higher price. In turn, the higher demand induces those firms to raise their own prices too and increase the supply. As an assumption, cartel arises only when profitable, i.e. when it covers a substantial share of the market. This assumption implies the non-cartelised firms' increase in supply cannot be enough to compensate the cartel's reduction of supply because they provide a smaller part of the industry offer.

At the two subsequent distribution levels, a negative impact is registered on cartel's direct and indirect purchasers due respectively to the overcharge or its passing-on. Next to them though, it is also possible to find direct and indirect purchasers of non-cartelised firms. Since they face higher demand under the price umbrella, it is rational to expect their profit-maximising prices to increase as well. The more homogeneous the products, the closer to the cartel level also the damage to direct and indirect customers of non-cartelised firms will be. Moreover, in this situation non-cartelised firms represent the only link to the cartel, from which they benefit, therefore they are at the same time the best informed and the worst incentivized to disclosure. The authors managed to show that, though total net effects of a cartel are negative because of the presence of welfare losses, cartel particular effects might be positive or negative for different classes of consumers of firms, which find place in different layers of the value chain. Although total net effects of a cartel are negative because of the presence of welfare losses.

Bulst, 'Schadensersatzansprüche der Marktgegenseite im Kartellrecht', Baden-Baden 2006, p. 255; F.W. Bulst, in: W. Möschel and F. Bien (ed.), *Kartellrechtsdurchsetzung durch private Schadensersatzklagen*, Baden-Baden 2010, p. 225 (242 et seq.); G. Meeßen, 'Der Anspruch auf Schadensersatz bei Verstößen gegen EU-Kartellrecht - Konturen eines europäischen Kartelldeliktsrechts', Tübingen 2011, p. 256 et seq.; I. Hartung, 'Umbrella Claims: Schadensersatz bei Kartellverstößen auf Um- oder Abwegen?', in: *ecolex* 2012, p. 497; H. Beth and C.-M. Pinter, 'Preisschirmeffekte: Wettbewerbsökonomische Implikationen für kartellrechtliche Bußgeld- und Schadensersatzverfahren', in: *Wirtschaft und Wettbewerb (WuW)* 2013, p. 228.

¹⁸¹ See Maier-Rigaud and Schwalbe, *Competition damages actions in EU*, p. 224, fig. 8.4b

For the sake of completeness, the authors further mention the case of the competitor of cartel's direct (intermediate) purchasers and the case of the producers of complements of the cartel product. In the first case, that firm also experiences higher demanded quantity sold at higher price because of a diverted demand from cartel's indirect purchasers. Therefore, also its customers are harmed unless the increased demand does not make the production somehow more cost-efficient, which is a competition-enhancing side-effect. In the second case, the complements' producers experience a reduced demand connected to the reduction in demand of the principal (or cartel) products. Therefore, these firms are harmed by the cartel even if nothing has been directly or indirectly passed-on by the cartel and their inputs' market remains untouched. The authors signal these two further cases in order to show also that the cartel does not produce a crystallized amount of harm that can be pass-on, up or down the value chain, in a fixed value. The amount of damage can indeed pass-on in amounts that are rather relative and through different layers also of outside markets. Hence, the current measures to quantify damages, namely overcharge and passing-on, are far from capturing total damages because they do not consider the total effects, including the umbrella effects.

In another similar contribution, Inderst, Maier-Rigaud and Schwalbe (2013) investigated some market conditions to check whether they might affect the magnitude of the effects that spring under the umbrella of the cartel price¹⁸². They concluded that umbrella effects may be present in many occasions: when the fringe takes the price or adjusts prices strategically, when firms compete on quantity or on price, when products are more or less differentiated. More notably, they found that, while the fringe strategic or non-strategic reaction is indifferent to the magnitude of the effects, they instead depend positively on the degree of substitutability among products. But they also found that umbrella effects may happen even outside the antitrust-relevant market because a significant and persistent price increase may make less costly non-substitutes be perceived as substitutes unlike in a regular effective competition scenario. They concluded «cartel size and market coverage, the size of cartel's price increase and

¹⁸² For instance, they tested these hypotheses: whether the industry competition is on price rather than quantity, whether the goods are homogenous rather than differentiated, whether the non-cartelised firms act strategically or as price takers, and whether they sell to final consumers or to other firms that compete with each other. See Inderst, Maier-Rigaud, Schwalbe, *Umbrella effects*, p. 4.

umbrella effects are closely interlinked¹⁸³» and invoke further researchers to provide an equilibrium analysis to verify the consistency of such results.

Summary

The economic research contributions on umbrella pricing are partly derived by studies on the theory of partial cartels and partly by studies devoted to assess critically some concrete enforcement choices. The first kind of studies provided insights on umbrella pricing accidentally, while the second kind addressed the issue more closely.

It is possible to derive some main conclusions from the literature above-reviewed.

First of all, most of real-world cartels do not comprise all the producers of an industry, i.e. they are partial. In a partial cartel scenario, cartel members set a price above the competitive level and restrict their output. Fringe-firms sell under the umbrella price (i.e. price equally or slightly below the cartel) and expand their output. Firms of both kinds increase their own profits and overcharge their own customers, which are economically harmed similarly.

Secondly, this interaction produces a deadweight loss inferior to the one observable in a complete cartel scenario. It has a trapezoidal rather than triangular shape, which is composed by the (relatively smaller) allocative inefficiency due to the cartel and a loss in productive efficiency due to the fringe production. Therefore the presence of a competitive fringe minimizes the deadweight loss typically associated to a cartel from one side, while from the other side the fringe contributes to it as induced by standing under the umbrella. Hence, the inefficiency generated by the cartel is combined with the inefficiency of the fringe production. The total inefficiency induced by the cartel then takes the form of several effects that impact negatively on the economy at various levels of the distribution chain of the relevant market and even in some outside markets.

Finally, the presence of umbrella effects does not depend on specific market conditions, meaning that in a partial cartel scenario with price-taking fringe firms they always occur. Instead, umbrella effects' magnitude might depend on some specific market conditions on which further research is needed, like for the case of homogeneous rather than heterogeneous products. Even the variety of the umbrella effects would need further research to be properly assessed, since many are still mere assumptions, like the

¹⁸³Ibidem, p. 20.

alleged alteration of the perceived substitutability after a sizeable and persistent price increase.

4. CONCLUSIONS.

After reading on the umbrella pricing debate, the first consideration, which pops up, is related to the re-establishment of a correct hierarchy of antitrust goals.

The design of antitrust enforcement strongly depends on the belief that the negative market consequences of an antitrust violation cannot be corrected spontaneously by the market itself. Therefore, agencies and courts must apply remedies to right wrongs. The remedies are optimal when they can restore the social welfare loss. At the same time, they should make anticompetitive conducts clearer and unattractive to potential antitrust violators. By that, deterrence of such undesirable behaviours may also decrease the number of cases, for the benefit of a reduction in enforcement administrative costs. An ideal division of tasks among public and private antitrust enforcement finds that agencies are better suited to clarify the content of antitrust law and policy, punish and deter; while damages actions are better suited to fulfill compensation¹⁸⁴. Hence, an optimal private antitrust enforcement should aim at providing damages to redress economic losses suffered by victims because of the antitrust violation and restore regular conditions of competition in the market involved. Once the economic analysis has been individuated as the best tool to evaluate antitrust infringements, and then it should be used to approach further issues related to enforcement. In the case of public enforcement carried out by agencies, this is an easier outcome to achieve. Instead, in the case of private enforcement carried out by courts this has always created impracticality (especially in European civil law regimes) or misinterpretations (as in the US). The specific challenge faced by the importation of economic analysis in private enforcement is exactly the one to keep methodological coherence without impairing the systemic coherence. The latter configures the detaching of antitrust torts from general torts by trading justice considerations for the integrity of the economic approach¹⁸⁵. Hence, economic analysis should at first be used to individuate the damages as well as the person that is in the best position to claim

¹⁸⁴ WILS, *The Relationship between Public Antitrust Enforcement and Private Actions for Damages*, 2009, p. 15.

¹⁸⁵ See DUMBROVSKY, *cit.*, p. 3.

them, and, only later, the way damages should be allocated to victims in order to compensate and deter. Each legal system shall be free to choose the proportion in which to prefer compensation over deterrence or vice versa, but only after an economic analysis of the practice has been conducted. Addressing and limiting social welfare loss from distort competition is the principal goal of antitrust enforcement. It is also superior to its particular objectives: deterrence and compensation¹⁸⁶. Such a choice has sometimes rather philosophical (than policy) nuances that are perfectly represented in the above-mentioned debate among Landes/Posner and Harris/Sullivan. Landes and Posner affirm that «if most antitrust violations were deterred, the occasions for compensation would be few. The converse is not true: even if the victims of antitrust overcharges were fully reimbursed, the social inefficiencies of the violations would persist¹⁸⁷». On the contrary, Harris and Sullivan think that «deterrence is a troublesome question. First, there is little theoretical or empirical information to help one decide whether direct or more remote purchasers are more likely to challenge overcharges. Second, matters of complexity and judicial capacity obviously also bear on the matter, though not in any direct way. Finally, it may ultimately be necessary to make some trade-off between maximizing compensatory justice and maximizing deterrence. Yet, policy judgments about deterrence should be informed by empirical and institutional factors¹⁸⁸».

Umbrella pricing contributes to the total harm created by the cartel, to start with the economic theory. Indeed, the cartel total harm is composed by the overcharge paid by cartel purchasers plus the overcharge paid by fringe-purchasers plus the deadweight loss. More specifically, according to Landes, an optimal sanction for antitrust violation shall include all these components, when they are not exceeded by cost savings and when they are all present, i.e. whenever the fringe is made of price-taking firms that price under the cartel umbrella and above the but-for price. Moreover, if the probability of detection is less than 1, Landes thinks that the sanction should be adjusted accordingly. Then barring umbrella claims means providing a sub-optimal sanction for partial cartels under those conditions and that a part of the harm they generate is charged on some consumers, the fringe-consumers. Furthermore, there are no other

¹⁸⁶ Ibidem, p. 20.

¹⁸⁷ LANDES, POSNER, cit., 1979, p. 605.

¹⁸⁸ HARRIS, SULLIVAN, *Passing On the Monopoly Overcharge: A Comprehensive Policy Analysis*, 1979, p. 273.

persons that are better or worse placed to incur in the costs of this litigation and that should thus be preferred to them as claimants. Fringe-competitors indeed benefit from taking the above-competitive cartel price and direct purchasers can claim for the redress of their own overcharge only¹⁸⁹. Excluding fringe overcharges configures a sort of discount on the cartel sanction. The cartel activity is responsible for the way it leads the market prices. This might realize an unfair transfer of resources from fringe-purchasers to fringe-firms in the form of the overcharge the latter practice that is as economically inefficient as the cartel's one. The productive inefficiency of the cartel induces a productive inefficiency of the fringe to the detriment of fringe-purchasers. Therefore, the measure of damages should be adjusted in order to include a higher productive inefficiency (beyond the one of the cartel) and lesser allocative efficiency due to the counter-action of the fringe.

The US views on non-direct purchasers' claims have been biased by the interpretation of the legislator's preference for strong deterrence and a misinterpretation of the concept of optimal deterrence. The eventual undesirable consequences of the inertia of indirect purchasers and fringe-purchasers have been cut out of the debate without having been adequately assessed. It has been noted that direct consumers may not be always the most efficient enforcers. For instance, in the case of indirect purchasers, Dumbrovsky cogently observed that forbidding the passing-on defense indeed maximizes the incentive in cartel discovery and litigation, but at a very high price¹⁹⁰. The concentration of this power in the hands of one class of purchasers, though the best-informed ones, may lead in fact to opportunistic behaviors. The direct purchasers might pass-on the overcharge to indirect purchasers and wait for the best moment to sue in order to extract higher rents. In this case, the treble damage incentive creates a perverse effect by making the most efficient private enforcers a collusive cost-plus factor.

As above-discussed, also the presence of the competitive fringe fosters the stability and the duration of the cartel. It is intuitive that every factor that realizes such an outcome directly cooperates at increasing the social welfare loss determined by the cartel activity over time. According to Van Cott, the fringe should not be held liable for a distortion of competition that descends from antitrust violation committed by others. Especially since the fringe contributes to minimize the deadweight loss, even if again unwarily. He finally

¹⁸⁹ ASHTON, HENRY, cit., p. 11.

¹⁹⁰ See DUMBROVSKY, cit., p. 11.

pointed out also that «a system of antitrust law that seeks to enhance economic welfare should employ a measure of damages that forces antitrust violators to internalize the full economic cost of their actions and thus deters anticompetitive conduct that produces a net loss in economic efficiency¹⁹¹». Therefore, it is possible to conclude that from an economic perspective the loss from umbrella pricing should be part of the damages in a view of antitrust enforcement that intends to preserve methodological coherence. In this sense, the solution proposed by the ECJ in its preliminary ruling on Kone sounds a much more coherent solution than those the lower courts adopted in the US, waiting for a final clarification of the SC to come.

How to include this value in a measure of damages is a problem of systemic coherence and of policy values that have informed the enforcement philosophies over time. In the US as in the EU the main problem at systemic level is represented by the standard of causation. A mitigation of this standard with a collateral evaluation of the foreseeability of the harm seemed in both legal systems the most workable solution in theory. In practice¹⁹², in many countries such a modernization of the standard can have redundant echo beyond antitrust torts until general torts with not always desirable - and to some extent unpredictable - consequences. If the underlying policy objectives are added to the reasoning, it is not surprising anymore to understand why the full-compensation-oriented EU enforcement showed more willingness to promote such a systemic change than the deterrence-oriented US. In fact, the US debate provided a huge variety of standards and alternative measures to protect their super deterrent remedy. The conclusion was that the treble damages created to be optimally deterrent proved to be under-deterrent instead, when leaving fringe-purchasers uncompensated and cartels partially unsanctioned. Much of the merit of Kone nevertheless still has to be proven too. For the time being, it is possible to applause to a brave decision that will enhance a more thorough research and debate on cartel effects with a new, more attentive look.

¹⁹¹ See VAN COTT, cit., p. 785.

¹⁹² Many objections have been moved against the practicability of the ECJ solution. In PARDOLESI, *Il nuovo corso del "private enforcement" del diritto della concorrenza: sovrapprezzo praticato da impresa estranea al cartello e risarcimento del danno*, 2014, p. 342. the author highlights the main obstacles that an action for of umbrella damages would meet under Italian law. Such obstacles closely resemble those reported in the interpretation of Austrian law made by the *Oberster Gerichtshof*. In particular, there is a contraposition among scholars who think that the fault of the cartel breaks the causal relationship and those who believe that the causal link is interrupted by the malice (dolo) of the misconduct. Nevertheless, the equalization of the foreseeability of umbrella effects to the malice sounds a too forced theory of civil liability. The presence of a social cost does not imply that the harm should be restored, being the welfare loss something other than the mere sum of the individual losses.

If Kone succeeds in leaving a mark in the national competition damages actions, its effects will go well beyond that. And very interestingly it will represent an unusual case of success of the economic analysis in European. It would determine a change in the way private rights can be protected in European courts, which have always been reluctant in accepting economic arguments to inform their decisions. And it is susceptible to do so at EU level simultaneously, becoming a concrete new source of Europeanisation of private law.

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