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VIEWPOINT:

“Diamonds are Forever”: a Look into the *Alrosa* Judgment of the Court of First Instance of the European Communities

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“Diamonds are Forever”: A Look into the *Alrosa* Judgment of the Court of First Instance of the European Communities

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On July 11, 2007, the Court of First Instance of the European Communities (“CFI”) issued two important judgments in the field of competition law, *Schneider Electric v. Commission* (cf. T-351/03), and *Alrosa Company Ltd. v. Commission* (cf. T-170/06). The *Alrosa* ruling received much less press coverage than the *Schneider* one, although it is no less remarkable.

In its decision in *Alrosa* (the “Judgment”), the CFI annulled a Commission decision giving legal effect to a commitment by De Beers never to purchase rough diamonds from Alrosa after January 1, 2009. In doing so, it interpreted for the first time a number of substantive and procedural requirements binding on the European Commission when adopting “commitment decisions” pursuant to Article 9 of Regulation 1/2003.¹

In a nutshell, the Judgment confirms that such decisions, which give legal force to commitments offered by undertakings in the course of investigations, must be proportionate to the initial concerns of the Commission. It also establishes that companies that have proposed commitments have a right to understand and comment on the Commission’s reasoning, and to access the Commission’s file, if the Commission rejects their proposed commitments following a formal market testing. Overall, the Judgment sets the stage for the future enforcement of EU competition law by means of “commitment decisions” and will certainly influence the interpretation of those provisions of national competition law modeled after Article 9 of Regulation 1/2003 (“Article 9”). As suggested in Section III below, it might also affect the ongoing debate surrounding the proportionality of merger control remedies, as well as the procedural rights of merging parties, at least potentially.

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¹ Article 9 of Regulation 1/2003 (“Article 9”) allows undertakings under investigation to offer commitments to meet the initial concerns expressed to them by the Commission. In turn, it allows the Commission to make those commitments binding on undertakings by adopting a decision (*i.e.*, sort of consent decree). That decision closes the proceedings without a formal finding of infringement. Article 9 was introduced in Regulation 1/2003 to formalize the practice of the Commission of entering into negotiated solutions with parties to ongoing investigations, in particular in cases involving alleged abuses of dominant position. It has been used in numerous instances since the entry into force of Regulation 1/2003 but the Judgment represents the first time the European Courts interpret the boundaries of Article 9.

I. THE FACTS

In March 2002, Alrosa and De Beers sought clearance from the Commission, pursuant to the “old” Regulation 17/62, for a five-year agreement under which De Beers would purchase an annual volume of rough diamonds from Alrosa, amounting at the time to the entire production exported by Alrosa outside the Community of Independent States (the “Agreement”). De Beers and Alrosa are, respectively, the first and second largest producers of rough diamonds in the world, and have maintained an exclusive supply relationship for some 50 years. In response, the Commission addressed a statement of objections to both parties alleging that the Agreement infringed Article 81 EC, and another statement of objections to De Beers alone alleging that the Agreement also infringed Article 82 EC.

Alrosa and De Beers submitted a joint response to the first statement of objections. Alrosa then approached the Commission, initially on its own and later with De Beers, seeking a negotiated solution. In December 2004, the parties submitted joint commitments to meet the Commission’s concerns providing for a progressive reduction in De Beers’ annual purchases of rough diamonds from Alrosa to an annual amount capped at \$275 million from 2010 onward. The Commission “market tested” these commitments in June 2005 and received observations from 21 third parties.

In October 2005, the Commission informed Alrosa and De Beers that the outcome of the market test was “overwhelmingly negative” and that it would adopt a formal decision, possibly with fines, unless they submitted revised commitments by November 30, 2005, to stop all rough diamond trading between them starting January 1, 2009. Alrosa requested access to the observations made by the third parties, as well as a proper statement of the Commission’s reasoning justifying its revised position, but the Commission initially denied those requests. Then, at the end of January 2006, the Commission provided Alrosa with a non-confidential version of the third party comments, as well as a copy of the unilateral commitment that De Beers had proposed a few days earlier.

On February 22, 2006 – three weeks after Alrosa was given access to the observations of the third parties and to De Beers’ proposal – the Commission adopted a decision making binding De Beers’ unilateral commitment not to purchase any rough diamonds from Alrosa starting January 1, 2009 (see Commission Decision of February 22, 2006 in case COMP/B-2/38.381 – *De Beers*, hereinafter the “Decision”). The Decision refers only to the concerns raised by the Agreement under Article 82 EC. At the same time, though, Alrosa received a letter from the Commission indicating that the proceedings brought against it pursuant to Article 81 EC were discontinued.

II. THE JUDGMENT

In June 2006, Alrosa brought an action for annulment of the Decision, alleging that the Commission infringed: (i) its right to be heard; (ii) Article 9 insofar as that provision does not allow the Commission to adopt a decision making binding commitments to which an “undertaking concerned” has not voluntarily subscribed, *a fortiori* for an indefinite period of time; and (iii) Article 9, Article 82 EC and the principle of proportionality, combined, in view of the excessive nature of the commitment enshrined in the Decision.

A. PRINCIPLE OF PROPORTIONALITY

Alrosa claimed that the Decision was inherently disproportionate because it deprived it from entering into any contracts with De Beers, including on an *ad hoc* basis, for an unlimited period of time, on the apparent premise that any such contracts would constitute an abuse of dominant position on the part of De Beers. The Decision therefore not only impinged on Alrosa’s fundamental freedom to deal with De Beers, the largest purchaser of rough diamonds in the world, but also went beyond any conceivable remedy that the Commission could have imposed pursuant to Article 82 EC. Furthermore, Alrosa asserted that the Decision was not necessary to solve the foreclosure concerns alleged by the Commission in its statements of objections.

The Commission, on the other hand, argued that, because of the nature of Article 9, it was entitled to accept at face value the unilateral commitments voluntarily proposed by De Beers without carrying out a complex assessment of their “necessity” in view of the alleged foreclosure effects. This is notable because otherwise, according to the Commission, some of the efficiency gains realized by having recourse to Article 9 would be lost. The Commission therefore argued that the CFI ought to simply review whether a “manifest breach of the principle of proportionality” was committed, leaving it a wide margin of discretion regarding the appropriateness of negotiated solutions.

In the Judgment, the CFI first stated that commitments proposed by companies are themselves devoid of legal effects; it is the decision adopted by the Commission pursuant to Article 9 that creates such effects by making commitments binding on those companies. Hence, as for any decision of a European Institution creating legal effects, the Commission, when adopting decisions pursuant to Article 9, must comply with the principle of proportionality. However, it is not obliged, as a matter of principle, to limit the scope of such decisions in time and to associate with the offer of commitments all undertakings liable to be affected by them.

Second, the CFI held that in the framework of Article 9 the Commission is bound to carry out an analysis of the market and an identification of the possible infringement so as to establish the basis for its preliminary concerns to an extent that “should be sufficient to allow a review of the appropriateness of the commitment” subsequently offered by the parties (cf. para. 100 of the Judgment). As a result, the Commission would be precluded from prohibiting any future trading relations between two undertakings “unless such a decision is necessary to re-establish the situation which existed prior to the infringement” (cf. para. 103, emphasis added).

The CFI then analyzed whether the Decision complied with the principle of proportionality, which requires that “measures adopted by European Institutions do not exceed the limits of what is appropriate and necessary in order to attain the aim pursued, and where there is a choice between several appropriate measures, recourse must be had to the least onerous” (cf. para. 112). For that purpose, the CFI first circumscribed the aim pursued by the Commission in adopting the Decision, which was to: (i) bring to an end practices which prevented Alrosa from establishing itself as an effective competitor to De Beers on the market for the supply of rough diamonds; and (ii) provide third parties with an alternative source of supply. In a second step, the CFI found that the Commission had failed to carry out a sufficient analysis of the actual concerns raised by the Agreement and held, in turn, that “it is clear from the circumstances of the case that other, less onerous, solutions than the permanent prohibition of transactions between De Beers and Alrosa were possible in order to achieve the aim pursued by the Decision” (para. 126).

In support of its findings, the CFI established the following principles:

- (i) A prohibition on “all purchases” by De Beers from Alrosa is by its nature disproportionate, *i.e.*, it would have been sufficient to prohibit De Beers from reserving to itself the whole or even a material part of Alrosa’s output;
- (ii) The Commission should have examined whether “less onerous” commitments proposed by the parties would have addressed the concerns raised by the practices at issue;
- (iii) Even if those less onerous commitments were insufficient, they could have been amended, including based on proposals from the Commission, in order to effectively resolve the alleged competitive problems, without resorting to the extreme solution of prohibiting all trading relations between De Beers and Alrosa;
- (iv) The Commission cannot invite the parties to propose commitments that would exceed remedies that it could itself impose in a decision finding an infringement, adopted pursuant to Article 7 of Regulation 1/2003. In that respect, it is only in exceptional circumstances that such a decision could prohibit an undertaking

- holding a dominant position to completely and indefinitely cease trading with a third party. In addition, the Commission would not be entitled pursuant to Article 82 EC to force an undertaking, in this case Alrosa, to make significant changes to its commercial structure in order to compete effectively with an alleged dominant company, in this case De Beers; and
- (v) Even though the Commission is not in principle obliged to set a time limit on the effects of its decisions adopted pursuant to Article 9, a failure to do so may cause the decision to exceed what is necessary to achieve the objective sought in a given case.

As a result, the CFI found that the Commission had failed to assess the viability of alternative solutions to the outright prohibition of trades between Alrosa and De Beers, and upheld Alrosa's plea alleging that the Decision infringed Article 9 and the principle of proportionality.

B. RIGHT TO BE HEARD

In essence, Alrosa claimed that the Commission ought to have: (i) given it access to the observations formulated by third parties in the framework of the market test of the first set of commitments; (ii) explained the analysis leading to its view that those initial commitments were no longer sufficient; and (iii) allowed Alrosa to be heard in response to both the third parties' comments and the Commission's "new" position.

In contrast, the Commission argued that Alrosa was not a party to the Article 82 EC proceedings brought against De Beers, but merely an interested third party, which would necessarily limit its rights to be heard. In addition, Article 9 mandates some procedural expediency, in the view of the Commission, because of its objective to alleviate the burden associated with proceedings leading to a formal finding of infringement of EC competition law. Finally, the Commission contended that it gave Alrosa access to the outcome of the market test, and provided Alrosa with the opportunity to express its views on De Beers' proposal.

The CFI first held that the Commission drew an arbitrary distinction between the Article 81 EC proceedings brought against De Beers and Alrosa, on the one hand, and the Article 82 EC proceedings brought against De Beers alone, which gave rise to the Decision. It found that the Commission had treated the two cases *de facto* as a single set of proceedings. As a result, the CFI held that Alrosa should have been regarded as an "undertaking concerned" even though it was not, strictly speaking, a target of the Article 82 EC proceedings and, hence, should have been afforded the rights of defense accorded to parties in ongoing investigations liable to result in a finding of infringement.

Second, the CFI found that, by submitting the initial set of joint commitments to market testing, the Commission had taken the view that they were, *prima facie*, suitable to address the concerns expressed in its preliminary assessment. It is then manifest that the Commission changed its position after having received comments from third parties, since otherwise it would have been able to make the initial commitments binding on Alrosa and De Beers. The CFI held that the Commission therefore had a duty to afford the parties an opportunity to respond to the observations made by the third parties and the other elements justifying its new position, as well as to give them proper access to the case file. However, the Commission failed to do so because it did not give Alrosa access to the third parties' observations until months after the company had requested them and simultaneously with De Beers' unilateral proposal, thus "making it impossible [...] to provide an effective reply and to provide new joint commitments with De Beers" (cf. para. 201).

The CFI therefore upheld Alrosa's plea alleging that its rights of defense had been breached and added that the Commission can depart from its assessment of commitments that it market tests only if the factual background has changed or if that assessment was undertaken on the basis of incorrect information.

III. IMPLICATIONS

The implications of the Judgment can be considered at two levels. The first one is the most obvious: the enforcement of EU competition law by means of Article 9. The second one is more speculative: could the Judgment influence the course of merger control proceedings in the EU?

A. IMPLICATIONS FOR ANTITRUST ENFORCEMENT

The Judgment is a landmark ruling by the CFI because it sets the stage for the future of competition law enforcement by means of Article 9. In contrast with a certain tendency of the European Courts to refrain from being too intrusive in reviewing Commission decisions in the antitrust area, the CFI has dealt with the issues raised by this case in a clear-cut manner and exercised its powers of review in full to correct the Commission's misinterpretation of Article 9 and of its procedural boundaries.

Although it is relatively fact-specific, the Judgment has three main implications: (i) the Commission is bound to abide by the principle of proportionality when adopting a decision pursuant to Article 9, *i.e.*, to ensure that the commitments made binding are necessary to remedy its competitive concerns; (ii) as a result, the Commission is bound to substantiate its concerns in such a way as to enable the parties, and subsequently the European Courts, to appreciate the scope of the remedies necessary to address them; and (iii) when the Commission subjects commitments to market testing, it is deemed to have found them *prima facie* suitable to address its concerns and, in the case of a negative

market test, it has a duty to hear the interested parties, provide them access to the third parties' observations and give them an opportunity to propose new commitments (even though the Commission is not bound to accept them).

Balancing the powers of the Commission to act as prosecutor and judge against fundamental due process requirements has always been at the heart of the role of the European Courts in antitrust matters. Whether the Judgment will have a "chilling effect" on the use of Article 9 by the Commission remains to be seen and is not evident. Rather, the Judgment should enhance undertakings' confidence in coming forward to the Commission with the aim of finding a negotiated solution to ongoing investigations. This is certainly a positive development for antitrust enforcement in Europe.

B. POSSIBLE IMPLICATIONS IN THE AREA OF MERGER CONTROL

Both the substantive and procedural findings of the Judgment might also have implications in the area of merger control in the EU.

From a substantive point of view, the issue of the proportionality of merger control remedies remains relatively unsettled and is currently pending before the European Court of Justice (cf. C-202/06). In *Cementbouw* (cf. T-282/02), the CFI held that parties to a merger were not required to confine themselves to proposing commitments aimed strictly at restoring the competitive situation existing prior to the merger and, in turn, that the Commission was free to "accept all commitments proposed by the merging parties to the effect that they would render their concentration compatible with the common market." In *easyJet* (cf. T-177/04), however, the CFI stated that the Commission should comply with the principle of proportionality when considering merger control commitments so that, *e.g.*, they do not extend to markets not affected by the concentration at issue. The CFI's position in that case seemed to imply that the "voluntary" nature of merger control remedies does not relieve the Commission of the duty to ensure that the remedies remain proportionate to the harm to competition caused by the concentration.

It is unclear, though, whether the Judgment will have an impact on the issue of the proportionality of merger control remedies, which is of course intimately linked with the standard of review applied by the European Courts in the area of merger control. Indeed, the CFI took great care in the Judgment to distinguish the limited discretion of the Commission in assessing the existence of anticompetitive practices under Article 81 and/or 82 EC, and thus in accepting remedial measures pursuant to Article 9, from the broad discretion enjoyed by the Commission in the merger control context. In the latter case, according to the CFI, the wide discretion of the Commission and, as a corollary, the limited level of review of the European Courts, is deemed justified by the prospective nature of the Commission's analysis.

From a procedural point of view, it is well known that companies do not have access to the Commission's file or even to the observations of third parties in the case of remedies proposed in Phase I of merger control proceedings. It is often frustrating for companies to be told by the Commission that the proposed remedy package is insufficient "for the market", without being able to review and comment on the outcome of its market testing. Of course, parties can decide to hold off on further remedies and enter into Phase II, which allows them to access the Commission's file. That choice, however, is often not an option the parties are eager to consider. If the Commission were to be forced to give access to the observations of third parties following the rejection of a remedy package in Phase I, it might allow for a more efficient solution than forcing the parties to incur a burdensome Phase II process. Of course, the whole economy of the merger control procedure would be affected and, as far as "timing" is concerned, not necessarily for the better.

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The CFI's judgment in *Alrosa* is the first one in which the European Courts have annulled a "commitment decision" of the Commission. The *De Beers/Alrosa* story started five years ago, when the parties sought clearance of the Agreement pursuant to Regulation 17/62, and it is unclear what will happen next. Is the Commission going to stay quiet and monitor future trading between the two companies, possibly bringing an infringement action in the future – either *ex-officio* or upon a complaint? Is it going to issue a new statement of objections directed at the Agreement (to the extent that *De Beers* and *Alrosa* were still willing to consider it suitable to their plans)? Is it going to focus on *De Beers*' commercial practices after finding the company to be "overwhelmingly dominant"? No one knows, and diamonds are forever...

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