The *Allianz Hungária* case

The ECJ's judgment could have ugly consequences

by ***Dan Harrison****

Oscar Wilde observed that "no object is so beautiful that, under certain conditions, it will not look ugly". In its recent judgment in *Allianz Hungária* (Case C-32/11, judgment of 14 March 2013), the EU Court of Justice (ECJ) appears to have applied that reasoning to a set of vertical arrangements between motor insurers and car repairers in Hungary. The potential implications of the judgment are themselves ugly.

The arrangements in question involved purchases by two insurers – Allianz and Generali – of repair services for damaged vehicles of the insurers' policy holders. Allianz's agreements contained provisions that increased the rates payable for repairs if the repairers sold insurance policies to their customers – effectively acting as brokers for the insurers – and Allianz's policies made up a certain percentage of those sales, or exceeded certain volume targets. Generali offered similar incentives, albeit not expressed in written contracts. While not explored fully in the judgment, this appears to have given repairers a dual incentive to focus on selling the policies of Allianz and Generali to their customers: selling more Allianz policies would mean higher repair payments from Allianz and, assuming the insured customers were likely to return to that same repairer in the future, a greater volume of repairs to which those rates would apply. A related feature of the arrangements was that – at least for Allianz – the individual agreements with repairers were entered into on the basis of hourly rates contained in a separate framework agreement that had been agreed with a trade association (GÉMOSZ) that represented authorised dealer repairers, and which negotiated those rates on their behalf.

Following an investigation by the Hungarian competition authority, an infringement finding and a series of appeals, the Hungarian Supreme Court requested the ECJ to give a preliminary ruling on the question of whether the arrangements in question were to be treated as having the object of restricting competition. While the agreements in question fell to be considered solely under Hungarian competition law (the absence of an effect on trade between member states meant that article 101 was inapplicable), the ECJ considered that the similarity in substance between the national and EU prohibitions, and the importance of consistent application of competition law in the EU, allowed it to offer a ruling on the referred question.

The ECJ ruled on the factors that the referring court should take into account when assessing whether the arrangements in question did indeed have the object of restricting competition. Its judgment has three novel and unwelcome areas of difference to earlier case law.

Identifying an object restriction by its effects

Agreements that are deemed to have the object of restricting competition are prohibited by article 101(1), regardless of their effects. This means that a competition authority can dispense with the difficult task of having to prove actual or likely anticompetitive harm, and that parties to the agreement are subjected to a form of strict liability. For this reason, the types of agreements that have been categorised as "object restrictions" have been those that are well recognised as being "by their very nature, injurious to the proper functioning of normal competition" (see, for instance, *Beef Industry Development Society*, Case C-209/07). When entered into between competitors, they include price-fixing, bid-rigging, market sharing and the disclosure between competitors of future pricing intentions. The scope of "vertical" agreements – for instance, between a supplier and purchaser – that have been identified by the Commission and the Union Courts as object restrictions is much more limited, extending only to resale price maintenance, bans on internet sales and certain types of restriction on the customers and territories to which a distributor is permitted to sell.

Case law of the Union Courts is clear that identifying an object restriction is not purely about the abstract form of the agreement. The "economic and legal context" in which the parties operate is relevant too. However, they have also been clear that this contextual assessment cannot extend to an analysis of the actual or likely effects of the agreement in question. To do so would blur, and render meaningless, the distinction between object and effect infringements.

Yet this is precisely what the *Allianz Hungária* judgment does. In particular, the ECJ stated that, when determining the economic and legal context, "it is also appropriate to take into consideration the nature of the goods or services affected, as well as the real conditions of the functioning and structure of the market or markets in question". It went on to rule that the referring court should determine whether "it is likely that, having regard to the economic or legal context, competition on the market would be eliminated or seriously weakened following the conclusion of those agreements" and that "[in] order to determine the likelihood of such a result, that court should in particular take into consideration the structure of that market, the existence of alternative distribution channels and their respective importance and the market power of the companies concerned".

These factors go considerably further than those considered to comprise the economic and legal context in previous case law. Contextual factors relating to market structure and market power of the parties have been put forward by companies under investigation as possible reasons why a seemingly harmful agreement should, in the specific circumstances of the case, not be treated as an object restriction. However, they have been invariably rejected by the Commission and Union Courts, as being relevant only to an analysis of an agreement's effects, and not to whether an anticompetitive object exists

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(see, for example, *Brasserie Nationale v Commission*, Cases T-49/02 and T-51/02).

The *Allianz Hungária* case, in contrast, concerns an agreement of a type that would not normally be considered harmful, but which nonetheless appears to have been deemed an object restriction because of the market structure and the market power of the parties. The type of restriction in question is a form of "quantity forcing", aimed at inducing repairers to maintain or increase their supply of brokerage services to the insurers. It is entirely benign in most vertical distribution arrangements. So benign, in fact, that even in its most severe form – an exclusive supply obligation prohibiting any sales to other customers – it falls within the scope of the Commission's automatic block exemption for vertical agreements, provided the supplier and purchaser do not exceed the 30% market share thresholds set out in that exemption. Given that Allianz and Generali had a combined 70% share of the Hungarian car insurance market, at least one of them must have had a share of less than 35%, so exceeding the 30% threshold by only a relatively small margin, if at all. Advocate General Cruz Villanón's opinion in the case was that the agreements between the insurers and repairers should not be treated as object restrictions, in part because they appeared to have a lower capacity to restrict competition than other types of vertical agreement, such as single branding and exclusive supply, that have been found by case law not to constitute restrictions by object. Unfortunately, however, this sensible opinion was not followed by the Court.

Was it the ECJ's intention to create a new category of agreements that are often (or even usually) benign, but which fall to be treated as object infringements when entered into by parties with high market shares, or in concentrated markets? If so, that would have alarming implications for legal certainty and would magnify compliance costs for a wide variety of distribution arrangements. Competition authorities would be permitted to dispense with proving harmful effects for categories of vertical agreement not previously considered object restrictions, simply by carrying out a cursory assessment of the relevant market conditions. Companies with substantial market shares, including those that are not dominant, may be deterred from entering into a variety of benign or procompetitive arrangements.

If that was the Court's intention, it lacks compelling legal and policy justifications. As regards legal justification, the EU Court of Justice cited its recent *Expedia* judgment (Case C-226/11). That case, however, did not concern the distinction between object and effect restrictions, but rather the application of the de minimis doctrine – ie the proposition that some arrangements are of such economic insignificance that they cannot be considered to have an appreciable effect on competition, and therefore fall outside the scope of article 101(1). While that doctrine has been applied to object restrictions – albeit inconsistently, and now subject to some doubt as a result of the *Expedia* judgment (see, in particular, paragraph 37 of that judgment) – that assessment is conceptually unrelated to the determination of whether a restriction has an anticompetitive object in the first place.

Policy justifications seem equally lacking. Quite apart from the lack of inherent harmfulness, one of the striking features of the fact pattern in *Allianz Hungária* is how easily it would have lent itself to an effects analysis. There are no obvious reasons why the Hungarian competition authority could not have assessed:

- the loyalty-inducing effects of the remuneration mechanisms, including whether other insurers were prevented from offering comparable commissions; and
- whether the cumulative effect of the agreements containing those pricing mechanisms resulted in appreciable anticompetitive foreclosure of the car insurance market, taking into account insurers' possibilities of selling through other channels.

In doing so, it would have been able to draw on a detailed body of case law and guidance relating to the assessment of the effects of networks of actual or de facto exclusivity (such as *Langanese Iglo* (Case T-7/93) and *Van den Bergh* (Case T-65/98)) and the loyalty-inducing nature of rebates and commissions (such as the Commission's guidelines on exclusionary abuses under article 102). In those circumstances, why should the competition authority be permitted to dispense with proving anticompetitive effects?

Agreements linking two markets and undermining domestic regulatory requirements

The ECJ observed that the agreements in question "link the remuneration for the car repair service to that for car insurance brokerage". It went on to state that such a link can "constitute an important factor in determining whether that agreement is by its nature injurious to the proper functioning of normal competition, which is the case, in particular, where the independence of those activities is necessary for that functioning" and that "it is necessary to take account of the fact that such an agreement is likely to affect not only one, but two markets, in this case those of car insurance and car repair services, and that its object must be determined with respect to the two markets concerned."

The Court considered that, on the facts of the present case, the link between remuneration for car repair services and the volume of insurance policies sold by the repairers could amount to an object restriction of the insurance market, in particular where "domestic law requires that dealers acting as intermediaries or insurance brokers must be independent from the insurance companies" and must "offer the policyholder the insurance which is the most suitable for him amongst the offers of various insurance companies". It was for the referring court to determine "whether, in those circumstances and in light of the expectations of those policyholders, the proper functioning of the car insurance market is likely to be significantly disrupted by the agreements at issue in the main proceedings".

The ECJ seems here to have applied article 101 as a means to address gaps in the effectiveness of domestic consumer protection laws, and to deter breaches of those laws. The implications of this move are unclear, but potentially troubling. For example, does this ground for identifying an object restriction apply only where activities in two separate markets are somehow linked? Or could the simple offer to a broker of a commission that is higher than those available from rival suppliers be considered sufficient to undermine their legal obligation of independence? If it is the latter, the judgment could cause upheaval in a considerable number of regulated sectors.

Moreover, by applying to arrangements that "game" or usurp a particular regulatory system, the judgment expands the scope of article 101 to cover conduct of a type that previously has only been considered under the article 102 prohibition on abuse of dominance (for instance, the European Commission's infringement finding against AstraZenenca, or the Gaviscon decision of the UK's Office of Fair Trading). If non-dominant companies operating in regulated sectors must now take steps to avoid such conduct, that would create significant new compliance costs and risks for them.

Vitiation of follow-on agreements

As noted above, the car repairers' trade association GÉMOSZ had negotiated recommended hourly rates with Allianz that were used as the basis for the prices payable under individual agreements concluded with each car repairer. On this point, the ECJ stated:

> "In the event that the referring court holds that the decisions taken by GÉMOSZ during that period in fact had as their object the restriction of competition by harmonising hourly charges for car repairs and that, by the agreements at issue, the insurance companies voluntarily confirmed those decisions, which can be assumed where the insurance company concluded an agreement directly with GÉMOSZ, the unlawfulness of those decisions would vitiate those agreements, which would then also be considered a restriction of competition by object."

This aspect of the judgment has implications for follow-on contracts that are entered into further to a prior and separate agreement that infringes article 101, such as a vertical sales agreement that includes a price that was fixed by a horizontal cartel to which the supplier is a party. The usual position in relation to such follow-on agreements is that they might be unenforceable as a result of their link with the prior anticompetitive agreement, but that this is a matter for national courts. As the ECJ stated in *Ciments et Bétons* (Case 319/82), "the consequences of [automatic nullity of an agreement under article 101(2)] for other parts of the agreement are not a matter for Community law. The same applies to any orders and deliveries made on the basis of such an agreement and to the resulting financial obligations."

The *Allianz Hungária* judgment seems to contradict this principle, by ruling that a prior anticompetitive arrangement – such as an agreement between suppliers on a recommended price – may "vitiate" a follow-on sales agreement, if the customer had some knowledge of the prior agreement, and so "voluntarily confirmed" it. Consequently, parties to such agreements face the possibility that their contracts are void as a matter of EU law, as opposed to national contract laws, which vary in this regard. That would have unfortunate implications for purchasers under long-term agreements, who may be content to rely on a right to pursue damages for losses incurred as a result of cartelised prices, but would not wish to see their sales agreement rendered void and unenforceable, for example for reasons relating to security of supply, or other advantageous terms of the agreement. Of even more concern is the Court's suggestion that the follow-on agreement is itself a restriction by object. This would render the purchaser liable to competition law fines for its participation in an anticompetitive agreement, and to damages actions from its own customers, notwithstanding that it was the seller that committed the sin of price-fixing.

It is rare for customers to be aware of prior collusion by their suppliers, but where they are, it seems unnecessarily harsh to tar them with the same brush, particularly if there is no suggestion that they participated in that collusion. There may be a number of reasons why a purchaser is unconcerned by a recommended price agreed between its suppliers, for example if (as appears to have been the case in *Allianz Hungária*) it is non-binding and serves as a basis for efficient negotiations with a large number of suppliers. Translating that ambivalence into culpability would create some perverse implications. In particular, customers may be deterred from asserting their right to claim damages for fear that they are found to be liable themselves, or cannot assert valuable contractual rights as a result of potential unenforceability.

Conclusion

It is possible that this judgment represents a new drive by the EU's highest court to expand the category of object agreements and relieve competition authorities of the (ever increasing) burden of carrying out complex economic assessments in non-cartel cases. However, given the adverse implications outlined above, it is submitted that this is unlikely to be the case. While the Union Courts are highly averse to departing expressly from their previous case law, there are factors in this judgment that will at least allow it to be distinguished in the future, so that it does not become a wide-ranging authority for those implications.

For example, the judgment indicates that each of the three grounds above (market effects, impact on independence and vitiation by earlier collusion) is a separate, alternative way for the referring court to establish the object nature of the restrictions in question (paragraphs 48 and 50 refer to the agreements also amounting to an object restriction if the relevant considerations apply). However, the facts of the case suggest that there were in practice substantial links between them, and that this influenced the Court's reasoning. For instance, it is difficult to see how insurers without substantial market power could undermine brokers' independence to an extent that was injurious to competition. Moreover, the Court's finding that the agreements between insurers and car repairers may be vitiated by the prior collusion between car repairers suggests that the Court considered that these agreements could not be considered in isolation, such that without the prior collusion its conclusions on the quantity-forcing mechanisms might have been different.

Read this way, the judgment would simply be an authority for the proposition that an agreement may be an object restriction if it corresponds to the specific facts of this case, and should not be construed more widely. It is hoped that this is how the Union Courts will interpret the judgment in the future. To have created one controversial new category of object restriction would be unfortunate; to have created three would be decidedly ugly.