

# Enhanced Roles of Private Actors in EU Business Regulation and the Erosion of Rhenish Capitalism: the Case of Antitrust Enforcement

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## Abstract

The 2004 antitrust reform is the most important change in the history of EU competition policy. It amounts to a major shift in both the mode of regulation (towards private enforcement) and the substance (towards the Anglo-Saxon model). These changes erode crucial elements of the Rhenish variety of economic organization.

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## Introduction

The increasing role of private actors in business regulation is an established topic in discussions about global governance. In the context of the literature around private authority in international affairs (Cutler *et al.*, 1999; Hall and Bierstecker, 2002), a wide variety of private regulation and enforcement has been identified, ranging from voluntary codes for ‘good corporate conduct’ or technical standardization, to the self-regulation of certain industries. The EU is among the driving forces of the process towards institutionalizing the role of private actors in international business regulation. Examples of this are the private International Financial Reporting Standards and International Standards on Auditing (Dewing and Russell, 2004), the regulation of the ‘dot.eu’ internet top level domain by Eurid, a private company (Christou and Simpson, 2005), or the launch of Fin-Net, a private Europe-wide out-of-court complaints network for financial services (Ronit, 2005). The current emphasis on private actors in rule setting and enforcement goes much further than

traditional lobbying in allowing business a dominating role in EU regulation, thereby representing a new quality of developments away from public authority.

In order to conduct an in-depth study of these processes, the 2004 reform of EU antitrust enforcement is selected as a case study. This reform was announced as the most radical legal and cultural ‘modernization’ in the history of European competition policy (Ehlermann, 2000). It came in the form of a package of both substantial and procedural changes. One of the core components consists of replacing the more than 40-year-old Regulation 17/62 with Regulation 1/2003. This measure abolished the long-standing administrative notification regime under which companies could have ensured in advance through the European Commission that a planned commercial agreement did not fall into the category of a cartel or other restrictive business practices prohibited under Article 81 (TEC). The main burden of antitrust enforcement has now shifted to the private sector: the business community cannot rely anymore on the sanction-free notification procedure, but has to assess by itself whether a planned economic transaction infringes on the law or not. In order to correct for wrong assessments, the reforms aimed at stimulating private enforcement in the form of civil antitrust disputes before the courts.

In the context of the current ‘privatization’ of important aspects of EU business regulation, the reform constitutes a crucial case given the central character of competition policy as ‘the most important organizing principle in the capitalist world’ (Cini and McGowan, 1998, p. 2). As there is no other supranational policy field in which the Commission possesses comparable far-reaching powers, it raises the question of why the Commission has been inclined to devolve important functions to private actors. Moreover, how can the implications of this pivotal change in competition law enforcement be interpreted? In order to evaluate the significance of these developments, the article suggests understanding the shift towards private enforcement of EU business regulation with regard to its potential impact on the Rhenish variety of capitalism. Drawing on the basic distinction between the Anglo-Saxon and the Rhenish type, the article presumes that each of these capitalist production systems is characterized by specific comparative advantages and institutional complementarities, i.e. the elements are interdependent and cannot easily be changed or transferred (Albert, 1993; Hall and Soskice, 2001; Crouch and Streeck, 1997). Within the EU, the Rhenish variant is still the most widespread model, not only because of the weight of the German economy, but also because most of the old EU-15 – with the notable exception of the United Kingdom – can be associated with this form of ‘co-ordinated market economies’ (Hall and Soskice, 2001, p. 19).

The 'variety of capitalism' model is particularly well-suited for assessing the significance of changes within economic regulation: new regulations have to be compatible with the basic institutional features of the existing model, which allows for evaluating the recent antitrust reform within its broader context. However, its rather static, comparative character is unable to account for transnational developments, including those forces that threaten to erode the distinct national models. This erosion – if discussed at all – is mainly attributed to anonymous market forces of economic and financial globalization (Berger and Dore, 1996; Cerny, 1997; Streeck, 1997). The article therefore suggests complementing structural explanations with a more actor-based account. From this perspective, the erosion of the 'Rhenish variety' is very much intensified by current changes in EU business regulation, in particular the growing reliance on private actors.

The article starts off by discussing the different legal and ideological traditions of antitrust control by positing them against the background of the Rhenish versus the Anglo-Saxon way of organizing economic life. Section II demonstrates that the reform amounts to a major shift in terms of the mode of regulation (towards private enforcement) and the substance of regulation (towards the Anglo-Saxon model). Section III unravels the interests of three important actors that for different reasons have driven this process: the Commission, the legal profession and shareholder rights organizations. The concluding part argues that the privatization of vital components of business regulation is not only confined to the case of competition control. Comparable patterns can be identified across a series of issue areas, which are driven by similar interest coalitions and together tend to erode some crucial elements of the Rhenish variety of capitalism.

The argument has implications for a range of audiences: the ongoing reliance on private actors represents a new phenomenon that did not receive sufficient attention from scholars on EU regulation in general and new modes of governance in particular. Likewise, debates on transnational private authority did not tackle the catalysing role of the EU or the repercussions for national capitalist models. Correspondingly, the variety of capitalisms literature largely ignored the role of EU regulations as a force of erosion for the Rhenish model. So have the effects of reforms in specific policy fields (such as competition policy) on capitalist models as a whole. Finally, students of EU competition policy may benefit from a politico-economic assessment of the current reform. Hitherto, the literature on the new regulation is dominated by epistemic communities with a rather narrow technical and legalistic focus (with the notable exception of Wilks, 2005). Through the lens of the variety of capitalisms approach, the magnitude of ongoing changes can be highlighted.

## I. Antitrust Control and the Variety of Capitalisms

In a nutshell, the Rhenish model is characterized by a fairly balanced and consensual relationship between labour and capital, the supporting role of the state and availability of patient capital being provided by major banks (*'Hausbanken'*) or internally generated funds – all features conducive to a relatively long-term perspective with regard to the economic wellbeing of firms. Stable ownership and control structures provide firms with considerable protection against hostile take-overs, which particularly benefits small- and medium-sized enterprises (SMEs). All of these factors are favourable to the long-term investment in human resource development that is crucial for the Rhenish specialization in high skill and quality products. Conversely, the Anglo-Saxon ideal type features more adversarial capital-labour relations, comparatively short-term employment, a limited role for the state, a predominance of financial markets for capital provision, an active market for corporate control and much more emphasis on short-term price movements on stock markets. This model yields comparative advantages in mass production based on low skills and low cost, also in sectors with a premium on radical innovation such as biotechnology or high-end services as *inter alia* corroborated by the British production system (Schmidt, 2003, p. 544).

When translating the central features of the 'Rhenish' and the 'Anglo-Saxon' model of economic organization into the field of competition control, the distinction between contrasting policy paradigms and different modes of enforcement is essential.

### *Competing Paradigms: the Freiburg versus the Chicago School*

Competition control is located at the interface between enabling and constraining the scope of freedom enjoyed by market players. It constitutes a sensitive area where a great variety of interests clash. As an instrument of public market intervention *par excellence*, it needs to be understood in terms of established legal and economic philosophies that influence policy objectives and conceptions of how to interpret and enforce competition law. With regard to 'competition' paradigms, two corresponding schools have been most influential: the German *ordo-liberal* school of law and economics based in Freiburg, which has not only been prominent in post-war Germany, but also in the setting of the EU, and the Chicago School, which has dominated US antitrust practices from the 1960s onwards (Budzinski, 2003).<sup>1</sup>

<sup>1</sup> Although European competition laws were mainly introduced as a response to pressures from the US, the interpretation, the focus and the enforcement tools remained very much distinct (Dumez and Jeunemaitre, 1996).

As both schools are predisposed towards a capitalist market economy, they are not mutually exclusive in their tenets. However, they strongly configured different varieties of economic organization.

Underlying the spirit of German *ordo-liberal* ideas is the perception that capitalism needs to be organized and economic power controlled (Albert, 1993, pp. 117–19; Streeck, 1997, p. 37). Markets are presumed not to be self-regulatory, but jeopardized by ‘market failures’, such as the abuse of excessive market power, restrictive business practices and collusive agreements between corporate actors. Public market intervention in the form of competition control is conceived necessary for the preservation of an open and free economic life and in a wider sense also a pluralistic democracy. Hence, the state should provide for a pro-active and strong institutional framework that safeguards market players from the anarchy of free markets and preserves the proviso of a ‘thoroughly and continuously policed competition order’ (Budzinski, 2003, p. 15). In this vein, the concentration of market power has been propagated as a particularly inhibiting factor for the diversity and entrepreneurial freedom of SMEs (Albert, 1993, p. 119). The protection of ‘competitors’ received central attention and was perceived as a prerequisite for the smooth running of a competitive market structure with many equally matched players. Thus, even though a company has achieved a dominant position through competition with others, it might abuse this position in the future and hinder the unfolding of competitive forces. Rather than privileging certain interests above others, the competitive order should serve the economic wellbeing of a broad variety of socio-economic constituencies. Some forms of inter-firm collaboration may be acceptable (or even desirable), in particular if these serve the diffusion of technology within the economy (Hall and Soskice, 2001, p. 26). The multi-goal and long-term orientation bestows a philosophical framework for a balanced interventionist strategy in the administration of anti-competitive conduct, representing a regulatory analogue of the more generic ‘Rhenish model’ of a social market economy (see Table 1).

Although the overall influence of German *ordo-liberal* scholars in other economic regulatory policies has waned since the 1960s, it continued to have a remarkable stronghold in EU competition policy (Gerber, 1998; Budzinski, 2003; Hölscher and Stephan, 2004). The *ordo-liberal* idea of public market intervention is reflected in the fact that EU competition laws were designed to serve primarily the long-term project of market integration, by also including wider socio-economic policy purposes, such as the occasional alleviation of employment problems of certain sectors or regions and the restructuring of ‘sick’ industries (Jarman-Williams, 2001). The radical doctrine of curbing economic power concentration was never

Table 1: Competition Policy Features of the Rhenish and the Anglo-Saxon Model

	<i>Rhenish Model</i>	<i>Anglo-Saxon Model</i>
Influential schools of economic thought	<i>German Ordo-Liberalism</i> <ul style="list-style-type: none"> <li>• long-term efficiency</li> <li>• multiple-goal (i.e. SME protection; R&amp;D collaboration)</li> </ul>	<i>Chicago School</i> <ul style="list-style-type: none"> <li>• short-term efficiency</li> <li>• single goal (i.e. price reduction for consumers)</li> </ul>
Institutional setup and enforcement traditions	<i>Civil Law Tradition</i> <ul style="list-style-type: none"> <li>• administrative control model</li> <li>• enforcement by public authority</li> <li>• ex-ante authorization</li> <li>• political and legal reasoning</li> </ul>	<i>Common Law Tradition</i> <ul style="list-style-type: none"> <li>• court model</li> <li>• enforcement by (private) litigation</li> <li>• ex-post control</li> <li>• economic reasoning</li> </ul>

Source: Authors' own data.

realized, the Commission tried to accomplish the ideal of a balanced market structure by providing SMEs with special protection from fierce competition through subsidized loans, R&D support and financial guarantees (Motta, 2004, p. 16). In its 1986 Report, DG Competition formulated its policy mission in terms of creating an 'environment within which European industry can grow and develop [. . .] and at the same time take account of social goals', while the 'abusive market power of a few should not undermine the rights of the many' (Commission, 1987). This distrust of 'bigness' is revealed in the particular attention given to combating the abuse of dominant market positions at the European level, a prohibition spelled out in Article 82. Renowned cases are the Boeing-McDonnell Douglas and the GE-Honeywell mergers, which the Commission initially blocked in 1997 and 2001, respectively. Whereas the US authorities approved the deals unconditionally, the Commission argued that they would lead to dominant positions and inhibit market entry for newcomers.

Conversely, the maxims of the Chicago School had a strong influence on the US antitrust system.<sup>2</sup> According to this paradigm's central tenet, public market intervention is intrinsically at odds with a free market ideology. As a monetarist response to Keynesianism, Chicago scholars propagated the

<sup>2</sup> The long-term impact of the Chicago School is reflected by the fact that some of its prominent scholars have been elected as judges at the US Supreme Court and that a vast majority of federal judges has participated at the Chicago Trainee Program (Schmidt and Rittaler, 1986–82). Moreover, the Chicago policy recommendations have been encapsulated in the formulation of the 1982 and 1984 Merger Guidelines, as well as in the subsequent 1992 revision (Gavil *et al.*, 2002, p. 64).

deregulation and liberalization of markets (Budzinski, 2003, p. 9). As markets largely regulate themselves, public market intervention should be the exception and restricted to the minimum necessary. Henceforth, the instrument of competition control should focus foremost on the protection of free competition, rather than 'competitors'. The ultimate determining factor for assessing anticompetitive conduct should be consumer welfare maximization, underpinned by rigorous economic modelling based on neo-classical price theory – a cornerstone of the Chicago School (Fox, 1997, p. 340). The single goal orientation with regard to mere price reductions for consumers is reverberated in a short-term view of economic efficiency, another important yardstick of the Chicago theorem. Following from a commitment to a 'survival of the fittest' logic, it propagates a permissive attitude towards 'size' – provided that prices remain competitive and 'economies of scale' can be realized. Market performance is considered more important than market structure. Consequently, not the concentration of market power as such, but collusive agreements with clear negative effects on consumer welfare, cartels and other restrictive business practices should constitute the focal point of competition control. Long-term economic concerns, such as the diffusion of technological innovation through inter-firm collaboration, do not play an important role in the Anglo-Saxon variety of competition control (Hall and Soskice, 2001, p. 31).

*Modes of Enforcement: the Anglo-Saxon 'Common Law' Tradition Versus the Continental European 'Civil Law' Tradition*

Not only the basic guidelines governing competition law differ considerably between the US and the EU, but also the enforcement practices. Again, these differences can best be understood in the different institutional arrangements of the variety of capitalisms. The distinction between the Anglo-Saxon versus the Rhenish way of enforcement follows in broad lines the contours of the classification of common versus civil law made by scholars of comparative law (see Table 1).

The common law tradition underpins the institutional setup of Anglo-Saxon competition authorities (Gerber, 1998). Competition law enforcement is a case-orientated endeavour in which courts constitute the ultimate resort for stopping anticompetitive conduct and lengthy judicial precedence is crucial for the interpretation of its scope and content. In what is generally referred to as the court model or the 'bifurcated judicial model' (Trebilcock and Iacobucci, 2002), the antitrust agency is merely equipped with investigatory powers. For instance, in the US, the leading example of a common law scheme, the Federal enforcement agencies cannot block an

anticompetitive conduct by themselves, but have to litigate all cases before the courts likewise to private plaintiffs. Hitherto, more than 90 per cent of all formal US antitrust actions were brought to the courts by private litigators (Kemper, 2004, p. 9; Wils, 2003, p. 477). The strong role of private enforcement in US antitrust prosecution is due to a range of systemic features that make it particularly attractive for initiating legal proceedings against corporations, such as damage compensation, class actions, contingency fees, criminal prosecution and leniency schemes: a successful plaintiff in the US can not only be awarded the costs of suing (expert fees and attorney's fees), but up to three times the damage suffered (treble damages). Moreover, plaintiffs can group together and sue collectively (class actions) and professional litigators may offer contingency fees or sell legal services under 'no-win-no-fee' conditions. In combination with criminal sanctions (imprisonment of CEOs) and leniency schemes (immunity from prosecution for those who first confess to having participated in a collusive agreement), incentives are high to bring antitrust infringements to the US courts. Consequently, the regulation of business conduct relies significantly on *ex post* enforcement by private plaintiffs, rendering the US common law tradition a market-oriented model with 'private attorney generals'. The basic objectives of competition policy and the mode of enforcement are closely intertwined. Both parts of the Anglo-Saxon system rely on the critical notion that public market intervention should be confined. Moreover, both assume that collusive behaviour should be prosecuted exclusively on the basis that other market actors clearly were negatively affected. The focus on one decisional criterion for judging anticompetitive conduct necessarily follows from the litigation-oriented approach – otherwise the discretionary power of the courts would be too excessive. Consequently, there is no place for broader long-term concerns, neither in the policy paradigm, nor in the enforcement, as private litigants are motivated by short-term profits.

In Continental Europe the civil law tradition is more prominent. Although judicial precedence increasingly plays a role in the interpretation of competition laws, competition law enforcement is foremost a 'clause-centric' approach (Hwang, 2004, p. 114), bound to general and abstract legislation complemented by detailed regulatory frameworks. In civil law countries, specialized competition authorities, rather than courts, are the main decision-makers – a model that has been termed the administrative control model, or 'integrated agency model' (Trebilcock and Iacobucci, 2002). Competition authorities tend to be equipped with far-reaching discretionary powers. Common are regimes of *ex ante* authorization according to which companies have to notify agreements to competition authorities in advance – not only mergers, but also commercial agreements. Due to the

bureaucratic and administrative character, *ex post* enforcement by private litigants is far less important. Courts are merely involved in case market actors appeal against decisions taken by competition authorities. Again, competition law principles and the mode of their enforcement are closely interrelated with the basic institutions of Rhenish capitalism. The *ordo-liberal* legacy is reflected in the institutionalization of powerful public enforcement agencies with wide-ranging enforcement competencies that 'order' the economy and balance the decision-making according to broader political views. Moreover, the *ex ante* authorization practice provides companies with the necessary stability in the pursuance of long-term strategies.

The traditional EU model of antitrust enforcement constitutes a patent case of the integrated agency model, following the civil law tradition of its founding Member States and in particular an approach adapted from German law (Wilks, 2005, p. 433). The Commission has the authority to act as an investigator, prosecutor, judge, jury and executioner altogether. It can directly stop a merger or a commercial agreement, impose fines up to 10 per cent of a company's annual turnover, request modifications of a notified proposal, or even require the break up of a conglomerate and force it to sell some of its divisions (Bannerman, 2002, p. 8). There is no other first pillar policy in which the Commission enjoys similar wide-ranging executive powers. Its virtual monopoly over EU competition law enforcement and the absence of facilitating features similar to those of the US explain why private antitrust litigation, although always possible, never became a widely applied practice. Compared to the 9:1 private–public enforcement ratio of the US, the image is reversed in Europe: public authorities enforced 95 per cent of the competition cases. Only in 5 per cent of the cases did private actors take the initiative to bring an action to court (Kemper, 2004, p. 9). The Commission's multi-goal integration focus manifested itself in the favourable treatment of SMEs, the permission of inter-firm collaboration in R&D through a generous system of exemptions, as well as of temporary government subsidies to rescue industrial sectors in recession, such as coal and steel, sugar, the motor vehicle or shipbuilding industry. Moreover, whereas in the US price-fixing and bid-rigging between competitors, so-called white-collar crimes, were prosecuted under criminal law, in the EU 'crisis cartels' were sporadically permitted in order to allow certain industries to deal with chronic overcapacities (Fox, 1997, p. 342). Together with the overwhelmingly administrative character of the notification and a generous exemption system, the business community could count on a high degree of legal certainty and public support for the pursuit of long-term strategies.

## II. The 'Modernization' in Perspective: From Rhenish to Anglo-Saxon Capitalism

### *Regulation 1/2003*

The procedural framework for the application of Article 81 governing the fight against cartels 'if trade between the Member States is affected and which have as their object or effect the prevention, restriction or distortion of competition within the common market' has until recently been stipulated in Regulation 17 dating from 6 February 1962. It ruled that companies with such a Community dimension could notify to the Commission all kinds of envisaged commercial agreements and contractual business practices (other than mergers), including production and R&D joint ventures, licensing and franchising contracts, marketing and sales agreements, information exchange and technology transfers. The Commission reviewed each of these notifications and gave formal 'clearance' by either prohibiting the deal, or by granting individual or block exemptions as specified under 81(3), concerning deals that 'promote technical or economic progress' or 'improve the production or distribution of goods' – two notions that leave ample space for interpretation. The logic of this system was that everything not permitted was forbidden. Once the Commission gave its approval or exemption decision, the deal was automatically immune from legal prosecution. As this created a safe-harbour procedure for business, it has become conventional practice to notify commercial agreements falling under Article 81, amounting to hundreds of cases per year (Hwang, 2004).

With the replacement of Regulation 17/62 with Regulation 1/2003 on 1 May 2004, the notification and authorization system for Article 81 has been abolished. Companies cannot rely anymore on the official approval of the Commission, but have to assess by themselves whether a business agreement infringes Article 81(1), or whether the agreement is exempted under 81(3). Moreover, by declaring the whole of Article 81 together with Article 82 on the abuse of dominant positions directly applicable, national competition authorities (NCAs) and national courts have to enforce European law in parallel to their national competition laws for all cases categorized under the rather elastic notion of 'affecting cross-border trade'.<sup>3</sup> From the perspective of competence struggles, national jurisdictions will take over a much larger share of competition enforcement, including major antitrust cases. The decentralization element in Regulation 1/2003, however, distracts from the fact that

<sup>3</sup> Although NCAs and national courts could always apply Article 81 (and 82), they could not grant exemptions, which provided little incentives for national bodies to co-operate in the enforcement of EC competition law (Jones and Levin, 2003, p. 13).

the reform has also led to a fundamental shift of competition policy principles, with potentially wide-ranging consequences for Rhenish capitalism.

### *The Move to Anglo-Saxon Competition Law Enforcement*

The two institutional dimensions of the recent reform, i.e. the abolishment of the notification regime for commercial agreements and the devolution of enforcement competences to the national level fundamentally transform the way in which anticompetitive agreements are prosecuted at the EU level. Whereas the notification procedure provided companies with a regime of an administrative *ex ante* authorization by a public authority, its abolishment introduces a system of *ex post* control based on private self-assessment and more litigation opportunities for private plaintiffs. Companies are not only expected to ‘police’ themselves, but also their competitors, distributors and suppliers by bringing antitrust infringements to the courts – so are consumers. In combination with the decentralization of the enforcement to the national level, private plaintiffs can start legal proceedings also before the national courts – hence court access is made much easier. Thus, the new regime introduces greater reliance on private ‘market intelligence’ in spotting anti-competitive practices and less market supervision and intervention by public authorities. This constitutes a considerable step of convergence towards the US model, which for commercial agreements never had a similar notification regime in place.

Factual evidence on the private antitrust litigation referring to Articles 81 and 82 at the national courts in the EU-25 reveals that since the enactment of Regulation 1/2003 private plaintiffs have indeed made use of their right to litigate. Already in the first two years a majority of 51 per cent of all national court judgements was initiated by private plaintiffs (pending judgements excluded).<sup>4</sup> This stands in stark contrast to the situation before the reform, where only 5 per cent of all competition cases in the EU were brought to the courts by private actors (see above).

Although the reform does not (yet) touch upon national enforcement practices, the conversion towards the Anglo-Saxon common law competition enforcement model is likely to be driven a step further by the introduction of stronger incentives for private plaintiffs to litigate. Commissioner Kroes is quite overt in this respect: ‘[. . .] the comprehensive enforcement of the competition rules is not yet complete – not enough use is made of the courts’ (Kroes, 2005b). Director General Lowe expects a gradual increase in private suits, which he anticipates to become ‘as effective as in the US, if not more

<sup>4</sup> The percentage has been calculated for the time from 1 May 2004 to 10 May 2006 on the basis of the National Court Cases Database with regard to Articles 81 & 82 of the EC Treaty (Commission, 2006b).

so' (*Financial Times*, 2004, p. 7). DG Competition presented its ideas on how to 'increase the scope for private enforcement' in a Green Paper promoting the introduction of 'Damages Actions for Breach of the EC Antitrust Rules' (Commission, 2005). The current situation of damage claims for infringements within the field of EU antitrust rules is noted to present a picture of 'total underdevelopment'. The Commission proposed 36 possible options referring to the introduction of an explicit system of damage relief for private plaintiffs. Hence, the decision for increased private enforcement is likely to pave the way for further legal modifications at the national level. Jurisprudence by the European Court of Justice (ECJ) has taken the first step with regard to damage compensation. In the seminal *Courage vs. Crehan* decision of 20 September 2001, it ruled that 'any individual' injured from an agreement in violation of Article 81(1) must be able to obtain compensation for the economic losses suffered from an anticompetitive conduct from the other party (Gerven, 2005, p. 2; Reich, 2005). As the rulings of the ECJ produce direct effects, i.e. rights for individuals that can also be evoked before the national courts, they create the legal basis for damage actions.<sup>5</sup> The ECJ's pro-active role manifested in its conclusions from the *Crehan* case: '[t]he existence of [. . .] a litigation right strengthens the working of the Community competition rules [. . .] [and] actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community' (Schoneveld, 2003, p. 440). Also the Commission believes that once a system of damage relief is introduced at the Member State level, private parties will go much further in bringing actions to the courts than competition authorities (Monti, 2004). Thus, the current discussion on further legal modifications is likely to bring the Rhenish model of competition law enforcement one crucial step closer to the US-style competition culture.

### *A Shift to Anglo-Saxon Competition Policy Principles*

The sweeping reform of one of the core pillars of European competition control not only contains a shift in the mode of regulation (from public to private enforcement), but also in the substance of regulation (from ordoliberalism to the Chicago School). In the EU, much more importance is now given to short-term consumer welfare considerations, which underpin the application of a single measure for anticompetitive conduct that can be entrusted to courts and private litigants. The move away from the public

<sup>5</sup> In the EU there have been only 12 competition cases in which damages payment has been awarded since 1962. Only three Member States have damage claim statutory; however, 12 allow such claims (McDavid, 2005).

multi-goal perspective is further reflected in the reformulation of the European test for concentration, the so-called 'Dominance Test', in a way that it addresses all mergers and co-operative agreements that 'significantly impede effective competition'. This comes close to the US 'Substantive Lessening of Competition Test', which implies that as long as mergers or monopolies are efficient, they should be permitted – even if it is 'at the expense of competitors' and if it 'leads to further market concentration' (Davidow, 2002, p. 495). The re-wording of the Dominance Test towards the narrow efficiency concern – a point of reference that is considered concomitant to consumer welfare by the Chicago School – radically breaks with the European tradition of pursuing broader goals in competition law enforcement (e.g. the protection of competitors from the concentrated power of dominant companies).

The 2004 competition reform entails a shift away from the previous administrative and legalistic approach towards increased use of economic reasoning as a focal point for decision-making, which constitutes another crucial point of convergence towards the Chicago model (Hwang, 2004). Increasingly, rigorous economic analyses underpin antitrust assessments (e.g. extensive empirical and econometric measurements on product markets and market shares, simulation models and price calculations, damage analyses). The growing number of economists in the Commission's staff members is reinforcing this trend (McGowan, 2000), so is the establishment of a post called the Chief Competition Economist tasked with the responsibility of providing the Commission with 'independent economic viewpoints'. In combination with private self-enforcement and facilitated court access, however, large parts of the burden of judging anti-competitive conduct on the basis of economic evidence will have to be carried by companies and national courts. On the whole, these features confirm the remark on the reform by James Rill, former US Deputy Attorney General for Antitrust: it is 'as close as it could get to the US-style without copying the whole caboodle' (Rill, 2003).

#### *Likely Implications for the Future of Rhenish Capitalism within the EU*

Given the short implementation period and the incomplete character as regards further legal modifications, there is no hard empirical evidence yet on the broader effects of this 'modernization'. Nonetheless, the 'varieties of capitalism' approach can serve as a basis for informed speculations about likely consequences. From this perspective, the double shift towards the Anglo-Saxon model of antitrust policy principles and enforcement threatens to undermine the very basis of the Rhenish variety of capitalism within the EU. By giving much more emphasis to short-term consumer welfare and private enforcement, the Rhenish focus on long-term strategies and broader

conceptions of economic efficiency will be difficult to maintain. The volatility induced by private enforcement makes strategic long-term investments or commercial collaborations more risky. Business is exposed to the risk of being sued and the consequence of damage payments and, in the worst-case, hostile take-overs or bankruptcy. With the abolition of individual exemptions, inter-firm collaboration not covered by block exemptions is made far more difficult, particularly if only consumer welfare maximization constitutes the appropriate benchmark.

Together, these changes tend to erode the Rhenish comparative advantages in high skill and high technology products, which *inter alia* are based on incremental innovation sustained by long-term investment. At the same time, they do not replace the Rhenish model with a viable alternative (i.e. a full shift to the Anglo-Saxon model), since many features of this variety of capitalism are neither present, nor necessarily desirable in Continental Europe (e.g. deregulated labour markets, low-cost hiring and firing, no-co-determination rights). Following the logic of institutional complementarities, however, hybrid models are inherently unstable, if not unviable. Establishing a pan-European hybrid is thus more problematic than maintaining either a clear Anglo-Saxon or a clear Rhenish model (Cernat, 2004, p. 161). Instead, the continuing diversity of production systems '[. . .] is a strength for Europe, not a weakness, given the comparative advantages of the different national varieties of capitalism in different industrial sectors' (Schmidt, 2003, p. 549). Finally, Anglo-Saxon superiority is not patently obvious, even if a more pragmatic perspective was chosen: 'Which is the better strategy: more state regulation (and hence more civil servants in charge of enforcement) or less regulation (hence more lawyers to deal with the increase in litigation)?' (Albert, 1993, p. 10).

In fact large parts of the European business community see more harm than actual good in the new situation of enhanced litigation possibilities for private plaintiffs at the national court level. Although 'a uniform and reliable' set of competition rules and practices 'effective throughout the entire EU' provides companies with a level playing field, corporate actors fear that the new regime leads to a situation of increased legal insecurity and significant transaction costs (ICC, 2003). As the legal boundaries between a sales-strategy and a restrictive vertical agreement are not always straightforward, private self-assessment becomes a risky enterprise. It means that companies have to analyse carefully the markets in which they operate, which introduces new costs with regard to special econometric analyses on market positions, market shares and financial data. Assessing anticompetitive conduct is not an exact science and there are no precise guidelines on what accounts as an infringement. Due to the abolition of the *ex ante* notification regime, judicial

precedent on commercial agreements, especially with regard to sanctioning and damage awards, still has to come. Early jurisprudence may require its share of victims until the legal situation is clarified. As outlined above, the reform is incomplete. The proposed system of private enforcement will only come to full effect if further measures such as the introduction of specific provisions on damage rewards and class actions are implemented. Industrial interests therefore strongly counterbalance efforts for further legal modifications that enhance the possibilities of litigation (i.e. UNICE, 2006; DIHK, 2006; HDE, 2006; VCI, 2006). US business leaders, represented by US Chamber of Commerce, have already alerted their European counterparts on the downside of an excessive litigation culture. With the asbestos cases in mind, which have cost more than 70,000 jobs, they in particular warn against the introduction of class actions and high-priced trial lawyers in Europe (Donohue, 2003).

While the EU is putting much effort in converging towards the US model of competition control, somewhat ironically, US enforcers have much criticism for their own system (Wils, 2003). Even though US authorities have traditionally put much effort in narrowing the distance between the European and the US antitrust model, these efforts have never been directed at promoting the US system of private enforcement (Davidow, 2002, p. 493). In fact, in response to pressures by the US business community, the Bush administration is currently even trying to forbid certain litigation practices at the federal courts in the hope of curtailing a claimant's culture that has run out of control.

### **III. From Brussels to Chicago: the Politics of Private Regulation**

The reform was conducted under the realm of the reinvigorated discourses on the Lisbon agenda. Private enforcement of competition law is reasoned to contribute to the 'competition for competitiveness strategy' by raising the awareness of competitors and consumers on competition law infringements. The mere threat of private litigation should cause sufficient deterrence to achieve ultimately a better compliance with European competition law (Monti, 2004; see also Kroes, 2005a). In contrast, the previous notification system is perceived to be overly inefficient, thereby wasting valuable staff resources.

As demonstrated above, however, the positive implications of these reforms for the comparative advantages of the European economy are less sure, at least in the case of the Rhenish variety of capitalism. A politico-economic assessment of the immediate consequences of competition policy reforms adds some further doubts on the official 'efficiency' tale by identifying three types of

actors that benefit most substantially from recent measures, namely the Commission, the legal profession and shareholder interests.

*The Commission's Broader Agenda – Brokering Integration in Competition Matters*

In addition to shifting the centre of gravity from public authorities to private market players, the reform was intended to allow the Commission to strengthen its grasp on national competition policy (see also Wilks, 2005). Through making the whole of Articles 81 and 82, governing the fight against cartels and the abuse of dominant positions, directly applicable, two birds were killed with one stone. First, next to offering private litigants more opportunities to bring legal actions to national courts, it anticipates an increase in the credibility and legitimacy of the European competition law enforcement, which in the past has fiercely been criticized as being a bastion of uncontrollable Commission power. Second, the re-allocation of competences constitutes an attempt to catalyse intra-EU convergence in a field where accomplishing a fully-fledged harmonization has never been politically feasible. The establishment of the European Competition Network (ECN) is one of the key supporting features in this regard. Within this framework, the NCAs and the national courts are required to co-operate with their European counterparts, co-ordinate the investigation and prosecution of restrictive business agreements and exchange information. From an integrationist perspective, one could easily conclude that the ECN provides a mode of governance in which national jurisdictions are structurally integrated into the European model. Although competition authorities and courts have already co-operated before on a more informal basis, the ECN introduces a more formal way of co-operation. Article 11(6) in combination with Article 16 of Regulation 1/2003 have conveyed extensive controlling functions to the Commission, such as the right to intervene and withdraw proceedings in case conflicting decisions are expected, i.e. 'decisions running counter to the decision adopted by the Commission' – a stipulation that provides considerable room for interpretation. The well-established NCAs have fiercely criticized the prospect that the Commission can theoretically trespass, deviating national proceeding. In particular, in Germany the reform has led to an intensive academic expert debate. Officials from the longstanding ordoliberal camp feared that they would become 'semi-autonomous vassals' of the Commission (Bannerman, 2002, p. 38; Mestmäcker, 1999; Möschel, 2001; Deringer, 2003). In this regard the reform displays also signs of a process of 'European integration through the back-door', as there is only one common reference point towards which NCAs

are allowed to converge, that is the EU model. The preamble of Regulation 1/2003 is straightforward in this respect. It says that the goal of the modernization is 'to establish a renewed system which ensures that competition in the common market is not distorted and that Articles 81 and 82 of the EC Treaty are applied effectively and uniformly throughout the community'. Nevertheless, under the previous monopoly position of the Commission with regard to cases with a community-dimension, NCAs found themselves marginalized in the prosecution of smaller antitrust cases. With the decentralization prompted by Regulation 1/2003, the enforcement powers of national authorities have also increased substantially, which explains why it was possible to have the reform adopted by the Council. As the DG Competition is unlikely to supervise NCAs comprehensively and national courts in the EU-27, powerful national competition authorities, such as the German *Bundeskartellamt* and the British Office of Fair Trading (OFT), are likely to maintain their own course in competition law enforcement.

Notwithstanding, the heterogeneously structured national jurisdictions and the distinct procedural practices may also raise the potential for conflict, something the Commission is very well aware of, as it is currently financing specific competition law training for more than 700 national judges in order to streamline the jurisdictional enforcement (Commission, 1996). The strategy entails that in a two-tier system, in which NCAs and national courts have to apply national and European laws in tandem, the prospect for clearing the way for European-wide laws and practices increases. It constitutes an opening move by the Commission for diminishing the significance of national competition laws and bringing the EU one step closer to a common competition culture – one that increasingly privileges private enforcement. This move has been described as an 'extraordinary coup' (Wilks, 2005, p. 437) by the Commission, since it not only 'Europeanizes' the national competition regimes under the misleading heading of 'decentralization', but also effectively hides this effect behind a 'facade of administrative functionality and legal necessity' (Wilks, 2005, p. 437).

### *The Stakes of the Legal Profession*

The liberal professions such as lawyers, accountants, tax consultants or notaries are frequently underrated as political actors. Organized in associations or bars aiming at the protection of the profession's good reputation, they regulate on a national level the conditions of entry, establishment and education and set the margins of tariffs for particular services and restrict the scope of activity and, at times, even advertising. Their main function is

to safeguard and, if possible, extend their jurisdiction, usually to the disadvantage of adjacent professions (McDonald, 1995). Currently, there is much pressure from transnationally organized law companies to enhance the level of inter-professional competition by liberalizing the protected professions in Europe. With a stake in offering a combination of legal and advisory services from different professional disciplines, law companies seek not only a harmonization of legal practices between different national settings, but also new markets for their multidisciplinary services. Correspondingly, private practitioners specialized in Community law and their bars from both EU and non-EU law societies have constituted an important force in shaping the course of the new regime. As regular and influential guests at the preparatory stages of the reform, they displayed their expertise in the form of lengthy advisory reports to Commission officials and pushed strongly for harmonized rules and enhanced private litigation possibilities in competition cases.<sup>6</sup>

The US experience with private self-enforcement depicts best the motivational grounds for the involvement of private antitrust counsellors in defining the course of European competition law: it simply constitutes their 'bread and butter' (Calvani, 2004, p. 18). As not many corporate actors possess in-house expertise in competition matters, the demand for legal services offered by law and/or other professional services companies increases. Next to navigating companies through legal actions with specialized litigators, professional services companies are provided with a market for judicial advocacy, tailor-made compliance programmes and specific market analyses. Hence, private enforcement in competition matters is providing companies specialized in competition questions with a major additional source of income. The US-style litigation system demonstrates that often more than half of the compensation awards of legal actions against anticompetitive conduct disappear into the pockets of professional litigators.<sup>7</sup> Against the background of Bush's anti-litigation stance, rent-seeking US law companies increasingly lobby for the necessary legal prerequisites at the respective jurisdictions in order to expand the lucrative market for legal services into Europe. The legal

<sup>6</sup> Exemplary is a study conducted by the law company Ashurst on behalf of the European Commission's DG Competition, which forms the basis for the Green Paper on Damage Actions. It identifies major judicial obstacles in EU Member States and puts forth a range of suggestions for national reforms that aim at facilitating private enforcement, including the introduction of US-style class actions.

<sup>7</sup> This can end up in bizarre outcomes, such as reported by credit cardholder Brian M. Carney, who has been awarded \$30,000 in the class action case *Schwartz v. Citibank*. He has not been informed about the trial nor has been aware about having been treated unfairly, nor has he given his permission to sue in his name the Citibank for a late processing of payments. 'His' lawyers, however, garnered \$9 million of the \$18 million compensation payment (Carney, 2005).

community – including representatives from across the Atlantic – contributed a vast number of positive and detailed responses to the Commission's Green Paper on how to increase private enforcement in Europe (Commission, 2006a).

### *Claims for More Market Justice: the Shareholder Value Perspective*

Shareholder rights organizations 'bandwagon' onto these developments. Recent corporate scandals such as Enron, Parmalat and Ahold have heightened the demand for increased 'market justice'. With a stake not only in antitrust litigation, but also different types of securities fraud, shareholder rights organizations and institutional investors have long requested legal reforms such as the introduction of class action lawsuits in Europe (Hollinger, 2005; Sherwood and Tait, 2005). In combination with criminal sanctions, class actions provide an opportunity for shareholder plaintiffs to compel the resignation of 'traitorous' CEOs and ultimately influence the composition of management. In this respect, the competition overhaul and its offshoot of further legal modifications finds itself at the cutting edge of corporate governance reforms in Europe, which aim at strengthening the position of shareholders *vis-à-vis* management. Although a company's involvement in antitrust investigations can negatively impact on the value of stocks, investors have a clear stake in altering the balance of power within companies to their benefit. Correspondingly, investors' associations and the financial press have warmly supported the recent reform in EU competition policy.

## **Conclusion**

### *The Trend Towards an Enhanced Role of Private Actors in EU Business Regulation*

The article has demonstrated that current changes in EU antitrust regulation can be understood as a substantial shift from the Rhenish to the Anglo-Saxon variety of capitalism. From this theoretical perspective, changes in policy goals and enforcement practices threaten to undermine the comparative advantages of the organized market economies within the Union. Short-term efficiency considerations are likely to take precedence over wider socio-economic concerns, such as the protection of SMEs or technology transfer through inter-firm collaboration. Not only the substance of antitrust regulation, but also its mode has been attuned with the *laissez-faire* variety of capitalism, in which regulatory tasks are delegated to private (professional) actors.

Current changes in EU antitrust regulation cannot be ascribed to the efficiency pressures of economic globalization. Nor have political pressures from the US coerced the EU into these reforms. Rather, they reflect a conscious attempt of the Commission to further harmonize antitrust matters within the Union. While a direct assault on the vestiges of national regulation would have been politically obstructed, the alliance with professional organizations and shareholder interests finally proved successful. Regulation 1/2003 is nearly entirely based on the 1999 Modernization White Paper by the Commission that was accepted without any major modification by the Council, in spite of its far-reaching consequences. The expertise provided by legal specialists played a crucial role in persuading the representatives of the Member States (Wilks, 2005, pp. 435 and 447).

Arguably, the allocation of regulatory tasks to private actors is an important component within this strategy. Because of its presumably professional and technical character, so-called 'privatized' regulation is difficult to attack on political grounds. At the same time, the use of an apolitical image serves to hide the wider consequences of the new regulation, thereby preventing the mobilization of negatively affected groups. Finally, the 'dinosaur' of the administrative notification system is hard to defend in the current intellectual climate – a climate where the replacement of public by private agencies is conceived to be more efficient in many countries and sectors.

The increasing role of private actors in business regulation, as well as its causes and consequences, is not limited to the issue of competition law enforcement alone, but provides a crucial case for a much broader trend within the European Union. Exemplary are the policy areas of accounting and banking supervision.

### *The Private Regulation of Accounting*

Since 1 January 2005, all stock exchange listed companies in the EU have to use International Financial Reporting Standards (IFRS) as designed by the International Accounting Standards Board (IASB). Whereas accounting standards have previously been set at a national level by nationally constituted actors from the public or private sector, the process will now be managed internationally by a London-based organization whose parent foundation is a private company incorporated in Delaware and mainly financed by the Big Four accounting firms. Not only the mode of regulation has changed with the introduction of IFRS, but also its substance. Similar to competition policy, accounting standards are not neutral towards different models of capitalism (Perry and Nölke, 2006). The rather conservative, debtor-oriented accounting standards of the German '*Handelsgesetzbuch*'

that can be attributed to the strong role of the German banks within Rhenish capitalism have now given way to more investor-friendly Anglo-Saxon standards. The introduction of IFRS will make long-term investments based on hidden reserves more difficult to defend against demands for a short-term return on company capital. The driving forces of this process are similar to those in the field of competition policy: shareholder interests, professional service firms (the Big Four), as well as national and international associations of accountants (Dewing and Russell, 2004, pp. 310–11). The Commission appreciates the opportunity for the introduction of unified EU accounting standards, regardless of the affinity between IFRS and Anglo-Saxon capitalism. Earlier attempts at a European harmonization of accounting standards instigated by the Commission, such as the two directives on accounting regulation of 1978 and 1983, were clearly less successful. Again, the decision for Anglo-Saxon standards cannot solely be attributed to external pressures, since the US regulators have chosen not to recognize the IFRS standards, but rather stick to their own Generally Accepted Accounting Principles (GAAP), at least for the time being (Dewing and Russell, 2004, pp. 311–12).

### *The Incorporation of Private Actors in Banking Regulation*

Similar observations can be made in the case of banking regulation, in which bond rating analysts constitute a central force in the shift towards private business regulation. The EU is in the process of adapting the proposed Basel II rules for banking supervision (Lütz, 2002, p. 202), which mandate rating agency outputs for less sophisticated banks. Although rating competition has intensified since the 1990s, the two major US-based agencies of Moody's Investor Service and Standard&Poor's still largely dominate this profession. Private third-party enforcement of debt rating has an extensive history in the US (Sinclair, 2005; Kerwer, 2005; Mattli and Büthe, 2005). Correspondingly, rating agencies favour the Anglo-Saxon model within their operations, including a rather short-term investment horizon and a preponderance of investor concerns. These most recent developments may further undermine the Rhenish model, in particular with regard to the financial basis of '*Mittelstand*' companies, one of the backbones of Rhenish capitalism. Due to the limited level of internally generated funds and the strong reliance on debt financing for investment, the German SMEs are currently threatened in their core operation. Basle II and the increasing role of rating agencies make it difficult for highly indebted companies. Following from their risk profile, credit costs considerably increase – a process that has already been set in motion during recent years. Many of these companies may be forced to

mobilize funding by 'going public' or selling shares to private equity companies (Lütz, 2002, p. 198). This may lead to further pressures of 'short-termism' that are not compatible with the Rhenish model. Again, there is a certain irony involved here, since the US has reserved for itself a right to exempt certain groups of banks from the Basel II rules, although this regulation is very much embedded in the more generic Anglo-Saxon model. The Commission, in contrast, makes good use of the opportunity for a harmonized banking supervision within the Union, even if it undermines an important element within Rhenish capitalism.

*'Isn't it Ironic, Don't You Think?'*

There are several signs of convergence in European business regulation towards the US model which are driven by the EU (Dewing and Russell, 2004, pp. 311–12). In all cases, the Commission was one of the core drivers of a process that is to the benefit of (US-based) professional service firms, US institutional investors and the Anglo-Saxon variety of capitalism more generally. It is not without irony that at the same time the US regulators have decided to stick to their own regulatory framework (GAAP/accounting, carve outs in Basle II), or even reverse the direction of the reforms that the EU is taking (class actions, litigation culture). But current EU reforms may undermine the comparative advantages of the very variety of capitalism that can be found in large parts of Continental Europe. Both the shift in the mode of regulation (an increasing emphasis on private professional organizations) and in its substance (an increasing affinity with Anglo-Saxon economic reasoning) are instrumental in this regard.

The privatization of certain facets of EU business regulation has gained ground through a deliberately depoliticized, professions-based interest constellation that disregards more eminent political features of this form of economic organization (Dewing and Russell, 2004, p. 300). It should not be a surprise that attempts by the EU to introduce Anglo-Saxon standards in the form of public regulations, such as the European Works Council Directive, the European Company Statute Directive and the 13th Takeover Directive, have led to somewhat uneasy compromises, given the high visibility of these issues and the corresponding political controversy (Cernat, 2004). In contrast, the private-authority based regulations discussed in this article have led to a clear decision in favour of the Anglo-Saxon model. While more explicit political attacks on the basic institutions of Rhenish capitalism are not (yet) feasible, the enhanced role of private actors in EU regulation increases the chances for the erosion of these institutions – 'through the back door'.

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