



# POTENTIAL COMPETITION AND PAY-FOR-DELAY REGULATION

*An analysis of EU competition law's approach on  
anti-competitive patent dispute settlements  
in regards to the concept of potential competition*

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January 8, 2021  
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# 1. Introduction

## 1.1 Background

In 2009, the European Commission published their findings of a pharmaceutical sector inquiry. Besides the scrutiny that the field of health care already received, the Commission expressed its dedication to aim its arrows at potentially anti-competitive agreements between firms that delay market entrance.<sup>1</sup> The issue revolves around a pharmaceutical company that obtains patents on medicines and exploits them to their fullest extent. Since the patent gives this company the exclusive right of producing and selling the medicine, the company in question is able to build the market to its desired optimal structure, often leading to a successful product in their portfolio. The exclusive right and these accompanying benefits are of a finite nature. As soon as the patent expires, firms that acknowledge the lucrateness of the market enter. Via close re-enactment of the ex-patent holder's business model and competing with a low price, market entrants are bound to acquire a significant part of the market share that previously belonged to the exclusive exploiter. As the initial producer notices its turnover declining, the value of intellectual property rights to the prosperity of a business is underlined.

With the knowledge of how fundamental a patent can be to their success, it should not come as a surprise that pharmaceuticals attempt to extend the duration of their patent – or at least its perks – wherever possible. While there is not much a patent holder can do to extend the duration of its patent (other competitors are simply legally able to enter the market as soon as the patent expires), it can sometimes ensure that the patent is enjoyed to its fullest extent, since this might be challenged by potential market entrants. This is where the aforementioned potentially anti-competitive agreements become relevant. As the potential market entrants (or 'generic manufacturers') are constantly searching for ways to commence their sales, they soon arrive at legally challenging the patents that form the obstacle. In particular, invalidation of a patent can accelerate the process. Their success in such a legal dispute is likely. An American study showed that generic manufacturers in the U.S. prevailed in 73 percent of patent invalidation claims.<sup>2</sup> Under this threat, a settlement is a fortunate outcome for the patent holder. The parties might for instance agree that the generic manufacturer enters the market before patent expiration, but later than would be the case if the invalidation claim succeeded. This results in only one competitor before patent expiration from a moment that is significantly closer to the expiration date than would happen if the invalidation proceedings are found in favour of the generic manufacturer.

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<sup>1</sup> 'Antitrust: shortcomings in pharmaceutical sector require further action' (European Commission, 8 July 2009) [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_09\\_1098](https://ec.europa.eu/commission/presscorner/detail/en/IP_09_1098)

<sup>2</sup> Christina M. Curtin, 'Generic Drugs: The Pay-for-Delay Problem' (Nova Science Publishers, 2011) 3;

While these settlements might fall within the scope of a genuine patent settlement, they might become an issue of competition law as well. In particular, competition is harmed by these agreements since entrance of generic manufacturers on average drive the price down by 40 percent.<sup>3</sup> This is where competition law regards the division of consumer surplus, which would have been created if the generic manufacturer entered the market, between the two firms in the agreement as potentially distortive of competition. This could lead to the settlement being defined as a ‘pay-for-delay’-agreement instead of a genuine dispute settlement. The Commission regulates the agreements amongst others by means of Article 101 of the Treaty of the Functioning of the European Union (“TFEU”), which states that agreements shall be incompatible with the internal market of the Union if it has as its object or effect the distortion of competition.<sup>4</sup> Assessing whether pay-for-delay agreements meet the prerequisites of this article is complex, because the distortion of competition must be measured in a market that is not yet competitive in practice. The original manufacturer namely has a temporary monopoly on the market due to its patents. Nonetheless, the Commission acknowledges the harm that the agreements can create and ensures their regulation by resorting to the concept of potential competition. By this notion, the scope of Article 101 TFEU is broadened and competition between the parties in the agreement does not need to be actual, but may be potential as well.<sup>5</sup> Thus, the scope is broadened from actual competitors to actual and potential competitors.

## 1.2 Problem statement

Potential competition is a concept that is gradually receiving more attention in legal literature and in restriction by object/effect cases. This is not the least caused by the priority position that pay-for-delay agreements currently hold for the Commission.<sup>6</sup> This might misleadingly create the perception that potential competition is a novel concept in EU competition law. However, quite the opposite is true. The discussion of how potential competition is to be interpreted goes back as early as the previous century.<sup>7</sup> Already in its early stages, these discussions anticipated several factors which should determine whether potential competition is present, such as the swiftness of entry and the significance of entry barriers.<sup>8</sup> For decades, competition authorities, attorneys and academics contemplated how this prospective, legal condition to a restriction should be substantiated.<sup>9</sup> The contemporary pay-for-

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<sup>3</sup> Inquiry press release (n 1)

<sup>4</sup> Consolidated Version of the Treaty on the Functioning of the European Union (2012), Art. 101

<sup>5</sup> Case C-307/18, *Generics (UK) Ltd. v Competition and Markets Authority* (2020), para. 32

<sup>6</sup> Inquiry press release (n 1)

<sup>7</sup> See, *inter alia*, Case C-234/89 *Stergios Delimitis v Henninger Bräu* (1998), para. 21; Joined Cases T-374, T-375, T-384 and T-388/94 *European Night Services and Others v Commission* (1991), para. 137

<sup>8</sup> Luis Ortiz Blanco, ‘Market Power in EU Antitrust Law’ (Hart Publishing, 2011), 59

<sup>9</sup> See, to this extent, e.g. Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements (2001), 49; Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European

delay scrutiny seeks a new application of this concept. Due to the relevance of patents in these disputes, the tension between intellectual property law and competition law poses new challenges to potential competition. Amongst others, it is disputable whether a patent can be perceived as a legal entry barrier and whether the agreements in themselves indicate that there is potential competition. Although academic literature extensively elaborates on the role of potential competition within pay-for-delay restrictions<sup>10</sup>, there is little comparison to the earlier, general notions of potential competition. That is why this thesis shall focus on the potential competition concept from a historical perspective. Through an initial discussion of potential competition in general after which the focus will be pay-for-delay agreements in the pharmaceutical sector, the thesis aims to analyse whether and how the notion of potential competition in regards to pay-for-delay agreements is applied in a different manner than potential competition as a broader concept within EU competition law. With the aid of the research questions and according structure described below, this will create a deeper understanding of whether and how the pharmaceutical sector requires the application of potential competition in a different manner than the way it has been applied outside of this field.

### 1.3 Research questions & Methodology

To effectively contribute to existing literature and analyse the problems in question, the following research question and supplementary sub-questions will form the foundation of this thesis:

*“What is the role of potential competition in establishing a restriction of competition according to Art. 101 TFEU for pay-for-delay agreements in the pharmaceutical sector?”*

- *How does the interpretation of pay-for-delay agreements and EU competition law in general resemble and deviate from seminal competition and innovation theories?*
- *What has been the function of potential competition in Art. 101 restrictions in general?*
- *How has the concept of potential competition been implemented and adjusted for the sake of pay-for-delay agreements in the pharmaceutical sector?*

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Union to horizontal co-operation agreements (2011), 130; Case T-360/09, *E.ON Ruhrgas and E.ON v Commission* (2012), para. 86;

<sup>10</sup> See, to this extent, e.g. Maria José Schmidt-Kessen, ‘Paroxetine – The EU Court of Justice Rules on Pay-For-Delay Settlements for the First Time’ (Competition Policy International, 23 February 2020) <https://www.competitionpolicyinternational.com/paroxetine-the-eu-court-of-justice-rules-on-pay-for-delay-settlements-for-the-first-time/>; Pablo Figueroa & Alejandro Guerrero, ‘EU law of competition and trade in the pharmaceutical sector’ (Elgar Competition Law and Practice series, 2019), 134

The substantive part will begin by exploring two concepts that are of fundamental importance to pay-for-delay agreements: competition and innovation. Both notions are heavily intertwined in these agreements as competition law and intellectual property law, the legal frameworks that scrutinise the agreements, attempt to stimulate and safeguard both of them. To understand the underlying tension and dynamic between competition and innovation, this chapter will address the pivotal theories that describe how competition influences innovation. By means of these theories, it becomes clear whether competition stimulates or discourages innovation. The circumstances that are relevant for this relationship, such as market structure, will similarly be addressed. As the chapter develops, competition law will be included in the discussion. At this stage, current competition law in general will be compared to the traditional theories to find out whether they resemble or deviate from each other. Zooming in further, the final sections involve pay-for-delay agreements to give insight into what role competition and innovation play in their domain. Analysing the interplay of competition, innovation and pay-for-delay agreements will create a better understanding of these concepts which will function as a foundation for the rest of the thesis before exploring potential competition.

The second substantive chapter of this thesis will emphasize potential competition in the broad sense. Specifically, it will explore the definition of potential competition, its importance to Article 101 restrictions and how it is established. This part will not be prejudicial to a specific sector that has received scrutiny of competition authorities. Rather, there will be an emphasis on potential competition in general. Additionally, specific attention will be paid to the development of the concept throughout time. Here, discussions on how earlier perceptions of potential competition were revised are included, such as the importance of the likelihood of entry. Also, the chapter focusses on what is held as essential to distinguish between potential competition and non-competition.

Thereafter, the analysis will zoom in on the pharmaceutical sector and pay-for-delay agreements. By thoroughly discussing the specifics of pay-for-delay agreements and the pharmaceutical sector in general that make them a novel issue for competition law, it will simultaneously become evident whether and how pay-for-delay agreements have changed the concept of potential competition. Elaborate analysis will be applied on the three landmark cases that pay-for-delay litigation have produced thus far (although not all conclusively): *Lundbeck*, *Servier* and *Paroxetine*. This is the chapter that displays the most comparative elements as well. In particular, it will be evaluated how the Commission and/or Court's approach to potential competition shows contrast in relation to earlier conceptions. Where relevant, interesting opinions and academic critique from literature on the authoritative actions will be incorporated to create a nuanced rhetoric.

Ultimately, it will be demonstrated how these chapters are connected and what this entails for the main research question. Apart from answers, it will simultaneously be considered which questions are yet to be answered on this topic, whether this is expected to be done by the academic, judicial or political branch.

## 2. Competition & innovation theories

### 2.1 Seminal theories on competition and innovation

Law is often structured after certain convictions that our societies hold to be true and fundamental for general welfare. If these convictions are indeed generally accepted as the norm, our public institutions enforce the protection of these ideas through law. While the belief that losses should be compensated is one of the cornerstones of torts<sup>11</sup>, criminal law can partially be explained as a response to the need for security.<sup>12</sup> Likewise, competition law is strongly influenced by particular theories on how market competition should be managed and regulated, specifically in regards to innovation. Addressing those pivotal ideas will increase the understanding of competition law and of why it is structured as it is. In addition, comparing the traditional theories to modern applications of competition, such as the subject of this thesis, allows for an interesting perspective on how current competition law both resembles and deviates from its foundations.

#### 2.1.1 Schumpeter

Joseph Schumpeter is one of the leading academics who wrote on the crossroads of competition and innovation. Schumpeter is widely known for his pessimistic outlook on perfect competition. He expressed that perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency.<sup>13</sup> One of the aspects of perfect competition that he found troublesome related to the size of undertakings that operated on an effectively competitive market. He was convinced that larger corporations are bound to be more sturdy and therefore willing to accept the financial risks involved with innovation.<sup>14</sup> As oligopolies and monopolies are generally more suitable market structures for these large firms, fully competitive markets are discouraging innovation. Although this perspective can be interpreted as somewhat anti-competitive, he was not ignorant of the disadvantages that the aforementioned market structures cause. But regardless of higher pricing and restrictions on output, he was convinced that larger firms with significant market shares are a prerequisite for rapid technological progress.<sup>15</sup> Therefore lower prices, limitless output and other factors present in a competitive market have to be sacrificed if innovation is to be prioritised. Despite the notoriety that Schumpeter's view gained, the empirical evidence to support his theory has

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<sup>11</sup> Walter van Gerven, 'Cases, Material and Text on National, Supranational and International Tort Law' (Hart Publishing, 2000) 13

<sup>12</sup> Johannes Keiler & David Roef, 'Comparative Concepts of Criminal Law' (Intersentia, 2<sup>nd</sup> edn., 2016) 6

<sup>13</sup> Sidney G. Winter, 'The Logic of appropriability: From Schumpeter to Arrow to Teece' (Elsevier, 12 October 2006), 1101

<sup>14</sup> *Ibid.*,

<sup>15</sup> Tom Nicholas, 'Why Schumpeter was Right' (The Journal of Economic History, vol. 63, n. 4, Cambridge University Press, 27 February 2004) 1023

remained fragile.<sup>16</sup> What is more, numerous rebuttals of ‘Schumpeterian innovation’ have been acknowledged. First, agency problems that are more present in large firms can damage the effectiveness of R&D. Second, organisational inertia (i.e. bureaucracy) tends to make large firms resistant to change and unable to respond to radical change. While this opposition has impeded Schumpeter’s impact, part of his legacy does remain intact. His writings namely did correctly point out the positive relation that market shares and innovation can have. It has particularly been proven that firms innovate because of the expected profits from a monopoly.<sup>17</sup> Undertakings are more likely to invest in R&D if they have a reasonable expectation of considerably more profit due to this innovation. The benefits that are derived from imperfect competition are therefore an incentive to innovate, confirming that Schumpeter’s persuasion that anti-competitive market aspects can be necessary to stimulate innovation.

### **2.1.2 Arrow**

In the debate on what market structures are ideal to safeguard innovation, Arrow is arguably the author who is traditionally known to be juxtaposed to Schumpeter. Their involvement in these debates is caused by the fact that Arrow strongly opposes Schumpeter’s ideas on competition and innovation and is therefore placed on the other side of the spectrum. Rather than acknowledging the benefits of imperfect competition to innovation, he states that the only ground for arguing that monopoly may create superior incentives to invent is that appropriability may be greater under monopoly than under competition.<sup>18</sup> Even this particular incentive, i.e. the greater profits that a monopolist might enjoy, should in Arrow’s opinion be read cautiously in the context of a discouraging monopolist environment in relation to innovation. Arrow supports his pro-competitive claims by referring to a monopolist’s interest in maintaining the status-quo. Specifically, a monopolist is by its very definition in a position of earning substantial profits due to their firm grip on the market, thus making their role in the market less likely to be interested in instigating change.<sup>19</sup> Conversely, he poses that firms that are in perfect competition have a negligible market share and have, as a result, much to gain. This increases their motivation to innovate, as a successful invention could trigger a great expansion of their business. Thus, Arrow assumes a ‘lazier’ attitude from firms with significant market shares. Furthermore, Arrow relates to the concept of creative destruction to explain how competitive firms gain more from innovation. Creative destruction defines the process in which useful, new technologies replace the old,

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<sup>16</sup> *Ibid.*, 1024

<sup>17</sup> *Ibid.*

<sup>18</sup> Carl Shapiro, ‘Competition and Innovation: Did Arrow Hit the Bull’s Eye?’ (University of Chicago Press, March 2012) 361 <https://www.nber.org/system/files/chapters/c12360/c12360.pdf> accessed on 20 October 2020

<sup>19</sup> *Ibid.*, 362

outdated ones and simultaneously replace their output.<sup>20</sup> In a monopoly, creative destruction does not significantly benefit the incumbent operator as it simply concerns an old technology exploited by the incumbent which is replaced by another technology. On the contrary, the innovator in a competitive market is not the only exploiter of the old technology. Possessing the new technology therefore adds significant profits for the competitive firm that introduces it, rather than a mere replacement of turnover which takes place in a monopoly.<sup>21</sup> It should, however, be noted that creative destruction instigates such a drastic change in the market, that it is questionable whether this can be categorised as a mere replacement. Though the old turnover might in practice be replaced for a majority by the new turnover, a new technology that is so innovative that the old technology is redundant could be interpreted as a new market rather than just a replacement.

### 2.1.3 Other views

For a more nuanced view on the dynamics between market structures and innovation, it might be helpful to address some of the most noteworthy views deviating from Schumpeter and Arrow, rather than just contrasting their opinions. Since this discussion is both relevant in economic academic literature and in part the rationale for the existence of competition law, there is no lack of opinions different than those of Schumpeter and Arrow. In fact, innovation proves to be more important than any other economic efficiency in fostering growth<sup>22</sup>, suggesting rightfully that there should be plenty of ideas on how innovation can be optimised.

One of these views was proposed by Aghion a.o. They tested whether a higher degree of competition could stimulate innovation as well as discourage it. This seemingly impossible outcome was reconciled by differentiating markets. On the one hand, Aghion defined “neck-and-neck” markets, where competitors operate at similar technological level. On the other hand, a “leader-and-follower” market occurs when a significant gap in technological development is visible between competitors.<sup>23</sup> Here, it became apparent that the ‘escape competition’ effect that is in line with Arrow, wherein competitors innovate to get ahead of the competition, is common in “neck-and-neck” markets. However, the “leader-and-follower” structures demonstrated the Schumpeterian effect, in which innovation is higher when there is less competition visible. Hence, Schumpeter and Arrow were both right in concluding that less and more competition leads to an increase of innovation. The starting point is the essential element that was missing from their analyses: a competitive market needs competition to

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<sup>20</sup> Ricardo J. Caballero, ‘Creative destruction’ (MIT Economics), 1 <https://economics.mit.edu/files/1785> accessed on 20 October 2020)

<sup>21</sup> Michael A. Carrier, ‘Two Puzzles Resolved: Of the Schumpeter–Arrow Stalemate and Pharmaceutical Innovation Markets’ (Iowa Law Review, 1 February 2008), 404

<sup>22</sup> *Ibid.*, 399

<sup>23</sup> Philippe Aghion a.o., ‘Competition and Innovation: an Inverted-U Relationship’ (Quarterly Journal of Economics, 1 May 2005)

innovate, while lesser competitive markets such as duopolies actually benefit from their lower degree of competition to stimulate innovation.

Differentiation once again provides a new perspective when the difference between drastic and non-drastic innovations are assessed. Drastic innovations are those that constitute such an improvement on the existing product that the latter is fully replaced, as it does not have any functions left due to the superior, new product. This concept is similar to the process explained by creative destruction earlier in this chapter. Non-drastic innovations are of a complementary fashion, in the sense that they are a worthy supplement to the current market, but do not create such a gap with the existing product that makes it lose its commercial value.<sup>24</sup> As pointed out by Arrow, drastic innovations are more likely to occur in competitive markets, because their added value is entirely new. Monopolists are not as much incentivised by drastic innovations due to the fact that their introduction would only replace the current product which they already monopolise, suggesting a smaller increase of profits – if any increase at all. On the contrary, non-drastic innovations are more of a stimulant in monopolies. Not only do they complement their current product and thus can be accumulated to their profits, but the undertaking can also expect the full return on their investment since it already monopolises the market. For an undertaking in a competitive market, the prospect of non-drastic innovations is more cumbersome: it will result in smaller profits than drastic innovations in addition to the knowledge that the gains from their own innovation will be divided among itself and the competitors.

Hart interestingly focussed on the role of management in combination with competition. He found that a higher degree of competition is related to a lessening of managerial slack.<sup>25</sup> Pro-competitive market aspects thus seem to promote better functioning firms. While it is uncertain whether managerial slack necessarily damages innovation, it does spark the idea that there are other motivations to consider than just the potential profits that a firm might yield based on the market in which they operate. Managers can namely base their behaviour on varying interests, such as simply keeping their firms stable in order to secure their jobs rather than maximising profit. If this is true, then Schumpeter's and Arrow's theories (which in essence hold the prospected profits as the core incentive for innovation) are too simplistic. A firm can e.g. have an incentive to innovate in a competitive market because this will greatly increase their current, negligible market position following Arrow's thinking or wish to innovate due to the expected returns following Schumpeter, but whether this actually influences their behaviour in practice could be prevented by the interests of individual managers.

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<sup>24</sup> Carrier (n 22), 407

<sup>25</sup> Oliver D. Hart, 'The Market Mechanism as an Incentive Scheme' (The Bell Journal of Economics, Vol. 14, No. 2, 1983) 381

## 2.2 Competition law and the seminal theories

The seminal theories on competition and innovation are arguably not shy of academic relevance. Arrow, Schumpeter and other intellectual protagonists on the interplay of competition and innovation have successfully kept the discussion alive for over half a century. Though, what is relevant in theory might not have any practical application. For that particular reason, this section aims to explore whether these theories are brought into practice through EU competition law that is currently applied within and across Member States. Attempting to find practical applications of what the academics prescribed will help in achieving this.

An evident resemblance between theory and practice is the tension between Schumpeter and Arrow versus the tension between intellectual property law and competition law. Schumpeter emphasised the essence of monopoly profits as a reward in order to encourage innovation. Intellectual property law embodies this incentive, since it rewards temporary exclusive rights to the innovator to exploit their work. Therefore, the law intervenes and stimulates innovation by imposing an artificial monopoly. Refraining from doing so would demonstrate the idea that a competitive market on its merits has enough incentives to promote innovation, but by means of implementing intellectual property rights it is evident that this idea is not acknowledged. Intellectual property law and Schumpeter thus both display the belief that technological progress is encouraged by monopoly profits. However, it should be noted that Schumpeter's advocacy of anti-competitive market structures is not indefinite. Schumpeter is namely a firm believer of the aforementioned creative destruction. The idea that a new technology destroys the value of the incumbent commodity is in his perception a strong motive especially for monopolists and oligopolists to innovate, since creative destruction could damage their current success. In order for creative destruction to have a chance to realistically occur, the incumbent operator should have a realistic fear of competitors that can deliver the new technology.<sup>26</sup> Monopolies, including those facilitated by means of intellectual property rights, are therefore not per definition ideal from the Schumpeterian perspective if this discourages creative destruction. On the other hand, Arrow's concerns are addressed by competition law itself. Though the objectives of competition law are plural<sup>27</sup> which makes it impossible to attribute all competition law instruments to the goal of stimulating innovation, it is true that all competition law instruments that further effective competition essentially are structured as Arrow's theory would prefer. Due to Arrow's belief that competitive pressures optimise an innovation-enabling environment, a legal framework that protects these competitive pressures surely boosts the achievement of his theory. This means that there are numerous competition law measures that resemble Arrow. The merger control doctrine, by means of

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<sup>26</sup> James Otteson, 'What Adam Smith Knew : Moral Lessons on Capitalism from Its Greatest Champions and Fiercest Opponents' (Encounter Books, 2014) 149

<sup>27</sup> Richard Whish & David Bailey, 'Competition Law' (Oxford University Press, 9<sup>th</sup> edn., 2018), 19-20

the Merger Regulation, prohibits mergers that form an impediment to effective competition.<sup>28</sup> Price-fixing agreements are even assumed to restrict competition and are prohibited solely on the basis of the objective of the collusion.<sup>29</sup> Essentially, Arrow's theory and the competition law framework can be demonstrate significant overlap, because the Treaty of the European Union imposes that the internal market shall function as a highly competitive market.<sup>30</sup> The European Union was therefore founded with the idea that its economy will be a competitive one, which facilitates a market in which Arrow's concepts can be brought into practice. However, there are competition law practices that demonstrate that the overlap is not absolute. For example, an abuse of dominance is penalised when certain conduct deviates from undistorted competition.<sup>31</sup> While the distortive elements are prohibited which advocates Arrow, dominance in itself is accepted. Dominance can even be appreciated in EU law as this can be a result of efficient undertakings. An appreciation of dominance rather resembles Schumpeter, because of the latter's conviction that rents as a result of market dominance incentivise innovation. Additionally, competition law reflects the findings of Aghion to a certain extent as well. Aghion established that competitiveness is only useful for innovation if the market is already "neck-and-neck". In EU competition law, effective competition is definitely encouraged as aforementioned. However, monopolies and oligopolies are not per definition opposed. While market dominance is countered via e.g. the Merger Regulation<sup>32</sup> and the abuse of dominance doctrine<sup>33</sup>, this cannot be perceived as a definitive prohibition of these market structures. In particular, these doctrines respectively only prevent *ex ante* formation of powerful firms and penalise their behaviour *ex post* under certain conditions. There is no instrument that dissolves monopolies or oligopolies simply for dominating the market. In fact, these firms are appraised from an economic perspective as this is generally proof of an efficient undertaking.<sup>34</sup> Competition law is not intended to regulate properly-run businesses. This in part explains why there are only *ex ante* and behavioural measures against these firms. Aghion's ideas can be reconciled within this framework. He expressed that innovation is optimised in a competitive market as well as in monopolies and close variants. As competition law allows for all of these markets to flourish once they reach their structure, it seems like the EU institutions took Aghion's research at heart.

While these instances show great incorporation of innovation in competition law, there are similarly several reasons to assert that innovation is not properly considered in this field of law. Kerber referred

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<sup>28</sup> Council Regulation (EC) 139/2004 on the control of concentrations between undertakings (2004) OJ L24/1, preamble 5

<sup>29</sup> *Ibid.*, 127

<sup>30</sup> Consolidated Version of The Treaty on European Union (2012), art. 3(3)

<sup>31</sup> Whish & Bailey (n 27), 197

<sup>32</sup> Merger Regulation (n 87), art. 2(1)(a)

<sup>33</sup> TFEU (n 4), art. 102

<sup>34</sup> Whish & Bailey (n 27), 21

to a mechanism that revolves around pricing: the SSNIP-test.<sup>35</sup> Without abbreviating, the “small, but significant and non-transitory increase in price”-test checks whether an increase in price will cause consumers to switch alternative products that can be substitutes. It functions as a tool for market definition. The test only incorporates products that fall within the boundaries of the market at that moment. Future, innovative products are not included. The regular process of constantly adapting markets with new entrants and technological progress is not considered. Likewise, Kerber found that the institutions prioritise price competition which sacrifices solid incorporation of innovation. He uses merger simulation models to support this statement. Since merger decisions are decided *ex ante*, simulation models are applied to predict what the market effects of the potential merger would be. This model is based on the price/quantity equilibrium, comparing the *ex ante* mergerless equilibrium with the *ex post* situation including the merged entity. Unfortunately, this model fails to incorporate any indicators that measure detriments to innovation. As a result, the consequences of the merger for consumer welfare focus on price rather than technological progress. On the other hand, it must be noted that this paradigm has been shifting lately. The landmark case *Dow/DuPont* concerned a merger where the Commission was concerned about innovation competition rather than price competition. Since Dow and DuPont both were major market players that had a strong R&D department, worries were that the merger would lead to less competition for innovative products and ultimately, less competition.<sup>36</sup> The Commission accepted the merger on the condition that DuPont would divest their entire R&D department before fusing with Dow. By means of this case, the innovation theory of harm was born, which holds that even horizontal mergers whose static effects are benign may be regarded as anticompetitive in a dynamic perspective, as mergers generally stifle innovation.<sup>37</sup> Kerber’s concern that innovation is on a lower step in the hierarchy of competition law objectives than pricing is hereby addressed.

Another concern for the protection of innovation was addressed by Colleen Cunningham’s paper on killer acquisitions. This phenomenon describes acquisitions executed by large firms. Rather than acquiring smaller companies to enhance their product or gain expert personnel, they engage in these acquisitions with the sole purpose of discontinuing their innovative projects to pre-empt future competition.<sup>38</sup> This concept can be interpreted as an investment by incumbent operators to secure

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<sup>35</sup> Wolfgang Kerber, ‘Competition, Innovation, and Competition Law: Dissecting the Interplay’ (MAGKS Joint Discussion Paper Series in Economics, 12 October 2017) 4

<sup>36</sup> ‘Mergers: Commission clears merger between Dow and DuPont, subject to conditions’ (European Commission Press Release, 27 March 2017) [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_17\\_772](https://ec.europa.eu/commission/presscorner/detail/en/IP_17_772) accessed on 23 October 2020; See, for the full case, ‘Commission Decision declaring a concentration to be compatible with the internal market and the EEA Agreement (Case M.7932-Dow/DuPont, provisional version)’ [https://ec.europa.eu/competition/mergers/cases/decisions/m7932\\_13668\\_3.pdf](https://ec.europa.eu/competition/mergers/cases/decisions/m7932_13668_3.pdf)

<sup>37</sup> Vincenzo Denicolo & Michele Polo, ‘The innovation theory of harm: an appraisal’ (Working Paper Series, March 2018), 1

<sup>38</sup> Colleen Cunningham a.o., ‘Killer Acquisitions’ (19 April 2020), 52 [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3241707](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3241707) accessed on 25 October 2020

their future market dominance. Mergers and acquisitions are often viewed as a positive development from an economic perspective, hence their legality. The acquiring firm is likely to be in a better position to exploit technologies, making the fusing firms able to realise synergies.<sup>39</sup> An acquisition can therefore entail that an innovative concept that would have failed to reach its potential otherwise due to a lack of expertise or financial resources will now be developed optimally. As a result, these deals can benefit consumer welfare significantly. However, Cunningham indicates that the wrong motivation of an acquiring firm can defeat this purpose. By researching pharmaceutical markets, the authors were able to prove that acquisitions in which both parties had overlapping drug development projects, the projects of the acquired firm were less likely to be continued, particularly when the acquirer has strong incentives to protect the existing market power. The paper further poses that killer acquisitions weaken the impact of creative destruction. Since killer acquisitions annul innovative firms, the idea that new technologies rapidly replace the old, incumbent ones is in practice often prevented. Cunningham perceives these acquisitions as a threat to innovation and an issue that competition law has yet to address effectively. Nobel prize-winning economist Jean Tirole reaffirmed the importance and imminent threat of these acquisitions.<sup>40</sup>

In summation, EU competition law arguably resembles much of the landmark theories on competition and innovation. Whether it is Schumpeter, Arrow or Aghion's assertions on how competition and innovation influence one another, there are numerous applications of competition law within the Union that overlap with these traditional, economic ideas. While there evidently is incorporation of innovation issues in competition law as described above, there are threats to its protection and promotion such as overreliance on pricing competition and killer acquisitions.

### **2.3 Pay-for-delay agreements and the seminal theories**

The reason why revisiting the theories discussed earlier on in this chapter is useful is because those theories were curious about the crossroads of competition and innovation. Similarly, though less voluntarily, the regulation of pay-for-delay agreements requires an assessment of the interplay between these two concepts as well. Because pay-for-delay agreements arise as a result of patent dispute settlements, but receive competition law scrutiny due to their anti-competitive results, both the importance of competition and innovation seek an assessment to determine how the two should cooperate in order to regulate these agreements properly and without prejudice to one or the other.

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<sup>39</sup> *Ibid.*, 1

<sup>40</sup> Jean Tirole, 'Competition and the Industrial Challenge for the Digital Age' (Toulouse School of Economics, 3 April 2020) [https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/by/tirole/competition\\_and\\_the\\_industrial\\_challenge\\_april\\_3\\_2020.pdf](https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/by/tirole/competition_and_the_industrial_challenge_april_3_2020.pdf) accessed 25 October 2020

The comparison between Schumpeter versus Arrow and intellectual property law versus competition law previously discussed can be further extended to the subject of pay-for-delay agreements. The litigation of pay-for-delay agreements in the EU as exemplified by *Lundbeck*, *Servier* and *Paroxetine* tries to answer where the line should be drawn as to where the scope of intellectual property law ends and that of competition law begins. Differently put, they try to determine at what point the exclusive rights, that are implemented to incentivise firms to innovate due to their lucrative profits as advocated by Schumpeter, becomes harmful to competition. On the other hand, they seek to establish when effective competition, which similarly stimulates innovation by enabling small competitors to gain significant ground through innovation as advocated by Arrow, could be overregulated and harm the scope of intellectual property law.

*Lundbeck* conveys the message of trying to maintain the balance that currently exists between intellectual property and competition. As will be further explained in chapter 4, the Court confirmed that the payments from Lundbeck to the generic companies could not have been obtained through patent enforcement since they go beyond the scope of intellectual property law.<sup>41</sup> Rather than stating that competition prevails over patent protection, it is explained that the payments have nothing to do with patent protection. By distancing these payments from intellectual property law, the Court is able to refrain from commenting on a conflict between intellectual property law and competition law. Instead, it has to be perceived as an illegal practice infringing competition law. Thus, it is not an issue between a patent and effective competition, but an issue between illegal behaviour and effective competition. This line of reasoning is repeated in *Lundbeck*. When Lundbeck expressed that there was no potential competition possible due to their active patents, which makes any market entrance by a generic company illegal and as a result the competition illegal, the GC rebutted by describing that patents are indeed presumed to be valid, but this does not as a corollary mean that entry by a generic competitor is deemed illegal.<sup>42</sup> While the GC could have resorted to a more extreme outcome that patent protection is irrelevant when potential competition is distorted, thus placing competition law above innovation, it chose a creative way of arguing that active patents do protect originators from competition but competition is not illegal. Again, this suggests that the Court wanted to refrain from making any statement in regards to the hierarchy between intellectual property law and competition law. Although this is a reasonable explanation for the GC's attitude towards pay-for-delay agreements, there might also be a practical reason for its seemingly conflicting conclusion that both confirms the protection of IP rights though not resulting in illegal competition. This is based on the different routes to market entrance that will be explained further in chapter 4. It revolves around the notion that, even

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<sup>41</sup> See, to this extent, the discussion of *Lundbeck* and *Neolab* on page 34 of this thesis.

<sup>42</sup> See, to this extent, the discussion of *Lundbeck* and patent validity on page 33 of this thesis.

with a valid patent, potential competitors can enter the market successfully, e.g. by strategically adjusting the product to circumvent the specifics of the incumbent's patent. In this presumed situation, the patent is indeed assumed to be valid while potential competition is not illegal. Whether Schumpeter's or Arrow's theories are more in line with the reasoning in these cases is therefore hard to decide. However, the outcome of the cases indicate recognition for Arrow's ideas as distortions of competition were found and penalised. On the other hand, as previously indicated, it is not necessarily true that this leads to less support for the Schumpeterian view in this dispute. Since Schumpeter firmly believes in the essence of creative destruction, a protection of effective competition is not directly a discard of his theory, because the threat of creative destruction and thus some form of competition is essential. Especially since regulating pay-for-delay agreements promotes competition while simultaneously safeguarding intellectual property and thus Schumpeter's preferential monopoly profits, cases such as *Lundbeck* follow Schumpeter's vision as well.

Furthermore, it is especially interesting to consider what the impact of pay-for-delay agreements is on innovation. A variety of academics have been discussed to address what the relation between competition and innovation is, but do pay-for-delay agreements have a degree of influence on innovation as well? Analysing its specifics, one might doubt a strong relation between the patent settlement agreements and innovation. In particular, the Commission aimed its arrows on pay-for-delay agreements due to their ability to maintain high prices. Commissioner Neelie Kroes was mainly concerned about what these agreements cost for the European taxpayer due to the extended period of high pricing attributable to market exclusivity.<sup>43</sup> Additionally, the innovative incentives that might be created when competition is enhanced according to Arrow seem less relevant here. The entrants in question are generic manufacturers, who have a specific business model to copy the product in existence and as a result save R&D and branding costs to market a cheaper alternative. Arrow's praised effects are thus not applicable here, because innovating would defeat the purpose of generic manufacturers. Generic companies are not concerned with 'getting ahead of competition', but rather focus on cutting costs while providing the exact same product. Lastly, pay-for-delay agreements are an expansion of market exclusivity and therefore monopoly profits. In accordance with Schumpeter's theory, this would only strengthen the innovative incentives. While there are evident disadvantages for consumer welfare as a result of pay-for-delay agreements – particularly related to pricing – it can be reasonably argued that the damage to innovation is less noticeable.

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<sup>43</sup> 'Antitrust: shortcomings in pharmaceutical sector require further action' (n 1)

## 2.4 Conclusion

This chapter revisited some of the essential academic theories behind competition law, namely those on the relation between competition and innovation. Schumpeter and Arrow are traditionally known as the most acknowledged authors on this subject, not the least because they directly oppose each other's views. While Schumpeter believes in the power of firms with significant market shares because this incentivises them to obtain great profits from an innovation, Arrow prefers competitive markets due to their negligible market shares, causing the potential of having more to gain from a relative perspective. Moreover, he asserts that small firms will create entirely unexplored profits, while large operators only replace their current ones. These two traditional views created a spectrum where many others were able to manoeuvre on with both converging and diverging view. Two of the most noteworthy were Aghion a.o. and Hart. Aghion found a structure that reconciled Schumpeter in Arrow by differentiating between "neck-and-neck" and "leader-and-follower" markets. Through this distinction, it was proven that both theories are true, assuming that the starting point is effective competition in Arrow's case and a monopoly other less competitive markets in Schumpeter's case. Hart took more of a behavioural approach to the issue. He argued that managerial incentives significantly influence innovation. Thus, the aforementioned theories that only focus on the market structure in combination with profit maximisation might be too simplistic. All that has been written on the dynamics between innovation and competition has not been in vain, because there are clear indicators that competition law resembles much of these seminal theories.

One of these indicators is the direct reflection of Schumpeter and Arrow on intellectual property law and competition law. Schumpeter's advocacy for monopoly profits is reflected in intellectual property, which grants exclusive rights to exploit an innovation. Similarly, Arrow's ideas are visible in competition law, which promotes effective competition. If we zoom in a little further, accordance can be found between Aghion a.o. and the specifics of competition law, due competition law's framework which respects both competitive markets, oligopolies and monopolies as soon as they reach this structure. Unfortunately, there are quite some aspects that suggest a lack of incorporation of innovative considerations, such as an overreliance on pricing mechanisms and the emerging phenomenon of killer acquisitions that currently receives no competition law scrutiny, or any legal scrutiny for that matter. Ultimately, this chapter considered a comparison between pay-for-delay agreements and the seminal theories. Here, the Schumpeter-Arrow dichotomy once again can be prolonged by the tension between intellectual property and competition law. While this tension is omnipresent in pay-for-delay cases, the Court in *Lundbeck* refrained from commenting on a conflict between the two. Additionally, the regulation of pay-for-delay agreements does not seem to impact innovation significantly. The intention of the Commission with prosecuting these agreements namely can be explained by its opposition to

high prices in the pharmaceutical sector. Further, the typical market in which these agreements are concluded tend to lack innovative entrants.

### 3. Potential competition

### 3.1 Article 101 TFEU

Before potential competition is discussed, it is wise to consider the broader framework under which it operates. This will create a better impression of why potential competition is an essential legal condition and to which puzzle it is an important piece. The puzzle is Article 101 of the Treaty on the Functioning of the European Union, which finds agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market to be incompatible with the internal market.<sup>44</sup> The prohibition of these practices was installed because the Commission acknowledges that these practices might lead to competitive problems, amongst others caused by fixing prices or output or market sharing. If these practices enable the parties to maintain, gain or increase market power, this is likely to negatively impact markets with respect to prices, output, product quality, product variety or innovation.<sup>45</sup> An example of an agreement that could fall under the scrutiny of this article is a price-fixing agreement. If competitors agree to keep the market price artificially high, this results in higher consumer expenses that would have been the case in a scenario of effective competition. Since consumer welfare is a primary purpose of EU competition law<sup>46</sup>, an unnecessarily high price is to be avoided. On the other hand, other negative consequences might also occur since high prices might for instance incentivise competitors to limit output due to the higher prices that safeguard their turnover to a certain extent. Article 101 TFEU can be perceived as an instrument to avoid such negative impacts on the internal market.

As any other legal provision, a restriction of competition according to Article 101 TFEU requires a number of accumulative conditions that need to be met before the Commission can conclude that there has been a restriction of competition. A restriction seeks to prohibit:

- Agreements between undertakings, decision by associations of undertakings and concerted practices which;
- May affect trade between Member States and;
- Which have as their object or effect the prevention, restriction or distortion of competition;
- Within the internal market.

It is the third condition of this accumulation that is of special interest for the purpose of this thesis. Apart from the establishment of the infringing activity (i.e. the agreements which may affect trade and create distortion), it must be ascertained that there is actual or potential competition that is distorted.

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<sup>44</sup> TFEU (n 4)

<sup>45</sup> Guidelines (2011) (n 8), para. 3

<sup>46</sup> Whish & Bailey (n 27), 19-20

The concept of competition in this sense thus determines whether the parties that engaged in the infringing activity are in a position to affect the competition in a particular market, whether this competition be actual or potential.<sup>47</sup>

### 3.2 Potential competition

A restriction of competition under Article 101 TFEU notably requires actual or potential competition. While the practices listed under Article 101 TFEU often occur between parties that are *de facto* competitors and can consequently be categorised as actual competitors, this is not necessarily sufficient for a thorough market analysis. As previously stated by the General Court, potential competition needs to be examined in addition to competition to obtain a full picture of the conditions of competition.<sup>48</sup> This explains the idea that assessing potential competition can be an effective tool to gain a deeper understanding of a particular market. On a different note, potential competition has been applied instead of actual competition as well. In *Toshiba*, the General Court concurred that the parties considered each other to be ‘at least potential competitors’.<sup>49</sup> Potential competition can therefore be utilised to lower the threshold for practices to be found restrictive under Article 101 TFEU. If, for instance, an agreement is investigated by the Commission but one of the parties to the agreement has not actually entered the market, the competition authorities would not be able to find a restriction if actual competition is the only doctrine. Potential competition provides an outcome in these scenarios. As a result, potential competition can be a supplement as well as a substitute to actual competition. For the purpose of this thesis, there will be an emphasis on the latter function, as this is the use of potential competition that is most relevant for pay-for-delay agreements as discussed in the forthcoming chapters.

Potential competition defines the idea that competitive constraint can be exerted through a party that has not entered the market yet, but is likely to do so. Since this threat is realistic, competition can potentially be restricted. Therefore, a restriction of competition can take place via an agreement according to Article 101 TFEU if one of the parties is not even in the relevant market. In their Guidelines, the Commission provided more clarity on what potential competition exactly entails. For an undertaking to be regarded as a potential competitor to another undertaking, it must be likely that that undertaking would undertake the necessary additional investments or other necessary switching costs to enter the relevant market in case of a small but permanent increase in relative prices. In this situation, the absence of the potentially anti-competitive agreement or concerted practice in question

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<sup>47</sup> Moritz Lorenz, ‘An Introduction to EU Competition Law’ (Cambridge University Press, 2013) 96

<sup>48</sup> *European Night Services* (n 6), para. 137

<sup>49</sup> Case T-519/09, *Toshiba v Commission* (2014), para. 231

is assumed.<sup>50</sup> While this does create extra guidance, many terms in this sentence do not give an unambiguous answer to the question of when there is potential competition. When is undertaking steps for market entry a likely choice for a party? How substantial should the additional investments be to decrease this likelihood? When is a price increase small enough to include potential competitors and at what point does it become too large and might attract non-potential competitors?

Helpful indicators in any assessment of potential competition are the barriers to entry.<sup>51</sup> The aforementioned 'necessary additional investments or other necessary switching costs' as described in the Guidelines are determined by these barriers. Barriers to entry can be a wide variety of obstacles that stands between an undertaking and its market entrance. If these barriers are excessive, an undertaking might be discouraged to engage in the market to the extent that market entrance is not likely anymore. As a result, this party would not be a potential competitor. This indicates that entry barriers and potential competition are closely related and consequently one of them can have valuable implications for the other. Entry barriers are a broad definition and can be caused by a variety of factors. First, legislative or regulatory measures might create them.<sup>52</sup> Legal monopolies, state subsidies, import duties and intellectual property rights are all exemplary of legal measures that put either the undertaking already active on the market at an advantage or, conversely, the potential market entrant at a disadvantage. Intellectual property rights deserve special notice as there is often a strong tension between these rights and competition law. The similar objectives that IP law and competition law aspire to, such as innovation, misleadingly suggest their cooperation. In practice, however, the two are regularly found on constraining each other from a legal perspective. Intellectual property rights are in their core tools to confer exclusive rights upon undertakings. These rights might be legal monopolies which can result in *de facto* monopolies, the very market structure that competition law aims to prevent.<sup>53</sup> Both fields of law therefore tend to conflict when IP rights stimulate anti-competitive behaviour or when the measures of competition law infringe upon intellectual property law. Pay-for-delay agreements are one of the most prominent exhibits of such a conflict as will become evident in the following chapter. Additionally, barriers of entry can arise from the peculiarities of a specific market. For example, an undertaking already present in the market could have unique access to raw materials essential for the product. The investment for a potential entrant to have similar access to the material in order to compete properly might include the acquisition of expensive land or complex logistics, if access is even possible. Similarly, economies of scale enable the

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<sup>50</sup> Guidelines (2011) (n 8), para. 10

<sup>51</sup> Case 85/76, *Hoffmann-La Roche* (1979), para. 48

<sup>52</sup> Market Power in EU Antitrust Law (n 7), 60

<sup>53</sup> Claus-Dieter Ehlermann & Isabela Atanasiu, 'The Interactions between Competition Law and Intellectual Property Law' (Hart Publishing, 2007) 66

settled undertaking to minimise their marginal costs and therefore lower their price. A considering market entrant would have to be able to increase output rapidly in order to obtain the same scale benefits or resort to other solutions for cost minimisation, creating a significant entry barrier. Apart from legislative/regulatory and market-specific barriers, potential entrants have proven to be discouraged from market entrance by current competitors and their ability to act in a restrictive manner and vertical integration of these competitors.<sup>54</sup>

The Commission further prioritises that, if the entry barriers are surmountable, the swiftness of entry of the potential ascender is pivotal. This means that the entrance of the latter should be able to be effective in a rapid manner. On this issue, it is especially the perspective of the incumbent undertaking that matters, for this undertaking should perceive the possibility of potential entrance as imminent enough to see this as a threat which subsequently can create a constraint on this party's behaviour.<sup>55</sup>

### **3.3 Interpretation of potential competition**

With a better understanding of what potential competition is, we can start analysing how it is brought into practice. Throughout time, the body of EU jurisprudence has shaped the notion of potential competition into detail. The following cases have been pivotal to the current understanding of the concept and are bound to be referred to in cases where potential competition play a role.

#### **3.3.1 *European Night Services v Commission* (1998)**

European Night Services was the name of a joint venture, created by various national railway companies to offer nightly, international train transportation. The Commission claimed that the agreements that founded ENS were restrictive of competition.<sup>56</sup> In response, the General Court annulled the Commission's argumentation that pleaded a restriction of actual competition because the national railway companies enjoyed legal monopolies within their countries meaning that an international cooperation including these state-specific markets could only be concluded with the participation of those national companies.<sup>57</sup> Thereafter, the General Court rejected the Commission's approach to potential competition. The Commission namely found that there was potential competition as other joint ventures such as ENS that could be formed are now restricted by ENS's presence. The General Court opposingly stated that this was merely a hypothetical. Arguing that potential competition is present should rather be based on evidence on the structure of the market, taking into account the applicable economic context. Only then could potential competition be

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<sup>54</sup> *Ibid.*

<sup>55</sup> Guidelines (2011) (n 8), para. 10, specifically its footnotes

<sup>56</sup> *ENS v Commission* (n 6), para. 22

<sup>57</sup> *Ibid.*, para. 141

accepted, due to the fact that this would be based on real, concrete possibilities of market entrance.<sup>58</sup> The Commission failed to do so, leading to the General Court ruling in favour of ENS. This case is seen as a landmark in holding the Commission to a high evidentiary standard when assessing potential competition and has as a result been cited in over a hundred Advocate-General Opinions.<sup>59</sup>

### **3.3.2 *Visa v Commission* (2011)**

The second case concerns a dispute between two financial undertakings. Visa, a large market player in credit card services, denied Morgan Stanley access to their credit cards based on internal by-laws that justify such a rejection if an applicant is a competitor.<sup>60</sup> These by-laws were interpreted as a decision by an association of undertakings and as such were categorised under Art. 101 TFEU. After the Commission ruled against Visa, the latter appealed on numerous points including the application of potential competition. In particular, it argued that the Commission had assumed potential competition solely on the basis of Morgan Stanley's intention to enter the market without assessing its actual ability to do so.<sup>61</sup> This actual ability must be demonstrated by an economically viable strategy. The General Court responded that the Commission rightfully supported its potential competition claim with Morgan Stanley's experience in the credit card market. Moreover, the Court held the intention of the potential entrant as relevant, but not pivotal. Furthermore, Visa complained that the Commission failed to include an analysis that proved that Morgan Stanley would be able to enter the market within a year. To this, the General Court explained that this was unnecessary as the one-year period is only illustrative to the idea of a swift entry.<sup>62</sup> Therefore it was left open what precisely constitutes a swift entry, appealing for further reference to the Commission's reasonableness and reliance on the context of the matter.

### **3.3.3 *Hitachi v Commission* (2011)**

Various undertakings were under competition law scrutiny due to their involvement in a cartel. This cartel maintained output quotas for the respective participants in the cartel. In its assessment of potential competition, the General Court held notable value to the perception of the incumbent undertaking. In the agreements forming the cartel, it became apparent that European undertakings would refrain from entering other markets in exchange for the Japanese undertakings committing to doing the same for European markets.<sup>63</sup> This demonstrated that the European undertakings

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<sup>58</sup> *Ibid.*, para. 142

<sup>59</sup> Alex Nourry & Dan Harrison, 'The great train victory: the enduring significance of the GC's judgment in European Night Services' (Competition Law Insight, 6 June 2017)

<sup>60</sup> Case T-461/07, *Visa Europe Ltd & Visa International Service v Commission* (2011), para. 6

<sup>61</sup> *Ibid.*, para. 155

<sup>62</sup> *Ibid.*, para. 189

<sup>63</sup> Case T-112/07, *Hitachi Ltd v Commission* (2011), para. 8

considered the threat of Japanese market penetration on their domestic markets to be real. The perception of the European competitors led the Court to the conclusion that the market in fact were not impenetrable, leading to potential credible competition.<sup>64</sup>

### **3.3.4 E.ON Ruhrgas v Commission (2012)**

E.ON Ruhrgas and its French counterpart GDF Suez cooperated on the production and exploitation of a gas pipeline. The Commission found anti-competitive aspects in the agreements founding the cooperation. In response, the parties attempted to rebut this by stating that they were not potential competitors when these agreements were finalised.<sup>65</sup> Concerning the German market, the undertakings claimed that GDF was not a potential competitor due to legislative measures and exclusive rights that indirectly created a *de facto* monopoly for Ruhrgas. The Commission had previously stated that there was potential competition since the German market was not a legal monopoly. The General Court rejected this view, by stating that a *de facto* monopoly, in addition to a legal monopoly, can also prevent an undertaking from having real, concrete possibilities to enter the market and compete effectively.<sup>66</sup> If a *de facto* monopoly actually allowed for possibilities of market entrance by competitors, the Commission failed to demonstrate this and rather relied on a mere hypothesis. Furthermore, the Court elaborated that there was also a lack of evidence pointing towards market entrance that could occur sufficiently quickly for it to be a threat to the incumbent undertaking.<sup>67</sup>

### **3.3.5 Toshiba v Commission (2014)**

Toshiba and a variety of European undertakings engaged in a so-called 'Gentlemen's Agreement'. This form of a cartel concerns an agreement in which undertakings refrain from penetrating each other's market in exchange for the commitment that the other undertakings will refrain from doing so as well. Toshiba appealed to the fact that the General Court found a restriction by object based this market-sharing agreement, arguing that it failed to ascertain beforehand whether any entry to the EEA market represented an economically viable strategy for Japanese producers.<sup>68</sup> Not only was this argument rejected by the Court of Justice due to the evidence that Hitachi was planning on entering the EEA market, but it simultaneously explained that the cartel in itself strongly indicates a competitive relationship between the parties.<sup>69</sup> This was held to be an element of the relevant economic and legal

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<sup>64</sup> *Ibid.*, para. 226

<sup>65</sup> *Ruhrgas v Commission* (n 8), para. 83

<sup>66</sup> *Ibid.*, para. 105

<sup>67</sup> *Ibid.*, para. 114

<sup>68</sup> *Toshiba v Commission* (n 49), para. 30

<sup>69</sup> *Ibid.*, para. 31-33

context. The pure presence of a cartel here therefore did not seem to be probative in the establishment of potential competition, but surely held a supportive role.

### 3.3.6 Case law analysis

The body of case law on potential competition within the context of Article 101 TFEU restrictions includes valuable contributions that support a more detailed understanding of how this concept is to be interpreted in legal disputes within the European Union. The accumulation of most pivotal cases described above creates the opportunity of summarising what has been held as essential by the competition authorities in their assessment on this subject. Apart from the fact that this creates an enhanced definition of potential competition, it similarly stimulates legal certainty. Namely, due to the progression of case law, undertakings have a better grasp of what market conditions would make their activity restrictive or not within the meaning of Article 101 TFEU. Moreover, it created thorough legal tests which give the Commission and appellate courts a more systematic approach in its assessments.

Two reoccurring themes that repeatedly received attention in these cases and are at the core of the issue are the evidence necessary to establish potential competition and the weight that the perception of the parties carry. *European Night Services* set a trend in motion that expects a high evidentiary burden on the Commission, by stating that potential competition cannot be assumed purely hypothetically, but should rely on evidence relating to the structure of the market. This should imply real, concrete possibilities of market entrance before one can be categorised as a potential competitor. *Visa* concretised this idea further. Specifically, it found that the potential competitor should have the actual ability to enter the market and this should be based on an economically viable strategy. Thus, an emphasis was put on the economic aspect and the language shifted from a looser ‘possibilities’ to a strict ‘ability to do so’. *E.ON Ruhrgas* finally confirmed this mentality that prioritises market-relevant evidence by proclaiming that even in a situation of a *de facto* monopoly the obligation of evidence proving an actual ability to market entrance cannot be circumvented. The message that the relevant institutions try to convey is therefore clear: potential competition is a notion that should steer clear of all assumptions and hypotheticals and, vice versa, is expected to be based on elaborative evidence, particularly evidence which is relevant to the structure of the market and its legal and economic context.

On the other hand, a continuing discussion that seems apparent is that of the perception of the parties and to what extent this is relevant for ascertaining or rejecting potential competition. *Visa* noted that the intention of the potential entrant is important, but not decisive. On the perception of the currently market-present undertaking, *Hitachi* established that this can in fact make or break potential

competition, by describing that the cartel agreement in question by object displays a threat of potential entry that is experienced by the undertaking, for there would be no other reason for the undertakings in question to engage in this cooperation. This exemplifies that the perception of an undertaking and according behaviour can actually hold much value to the competition authorities in their consideration of whether there might be potential competition among undertakings. In *Toshiba*, the Court similarly posed that a cartel in itself is a strong indicator of a competitive relationship. However, in this case there was already probative evidence present, which unfortunately makes it impossible to assume whether the Court would have found the perception of the parties sufficient to find potential competition. Thus, it is evident that whether the undertakings, both incumbents and potential entrants, find market entrance probable is incrementally found to be important. Whether these perceptions are independently able to decide whether there is potential competition is however disputable, as *Hitachi* is the only case in which this was visible for potential competition cases in general so far. Of course, this indicates that the other aspects and facts of the case are extremely important as they might indicate otherwise. In general, it can be stated that this issue lacks the systematic approach that has been developed on the heightened evidentiary burden on economic/legal context evidence relating to the structure of the market as aforementioned. Therefore it will be interesting to see how the jurisprudence will evolve on this topic in the years to come.

### **3.4 Conclusion**

Potential competition operates as an essential legal condition in the broader framework of Article 101 TFEU, which prohibits amongst others agreements that distort effective competition. This article, applied as either a restriction by object or effect, is practiced when the agreements in question are suspected to counteract the purposes of competition law, such as consumer welfare and innovation. In relation to actual competition, potential competition can function as a supplement and an alternative. Potential competition can be defined as the idea that competitive constraint can be exerted through a party that has not entered the market yet, but is likely to do so. Since this threat is realistic, competition can potentially be restricted. For assessing whether this concept is present, barriers to entry and swiftness of this entry have proven to be pivotal indicators. Furthermore, case law teaches us that potential competition is a notion that should steer clear of all assumptions and hypotheticals and, vice versa, is expected to be based on elaborative evidence, particularly evidence which is relevant to the structure of the market and its legal and economic context. The Commission and Courts are also consistently interested in the intentions of the involved undertakings in assessing potential competition. However, the variety of conclusions in jurisprudence on this topic does not construct a systematic approach towards these intentions or how valuable they are. Their constant

presence in the cases and their ambiguity do on the other hand suggest that this might receive further clarification in cases to come.

#### 4. Pay-for-delay agreements

#### 4.1 Competition and intellectual property

One of the reasons why pay-for-delay agreements are legally such an interesting issue can be explained by referring to the intersection of two fields of law where they find themselves: intellectual property law and competition law. It is therefore helpful to analyse where the two collide to understand what is at stake during the prosecution of pay-for-delay agreements. As briefly mentioned in the previous chapter, the similar objectives that IP law and competition law aspire to, such as innovation, misleadingly suggest their cooperation. In practice, however, the two are regularly found constraining each other from a legal perspective. Intellectual property rights are in their core tools to confer exclusive rights upon undertakings. These rights might result in *de facto* monopolies, the very market structure that competition law aims to prevent. Both fields of law therefore tend to conflict when the abuse of IP rights facilitates anti-competitive behaviour (such as pay-for-delay agreements) or when the measures of competition law infringe upon intellectual property law. Unprecedented and unparalleled growth in capitalist economies can be attributed to competitive pressures that force firms to investment and innovation, which provide incentives for the rapid dissemination and exchange of improved technology throughout the economy.<sup>70</sup> Both innovation and competition are therefore indispensable, meaning that their respective fields of law are forced to cooperate to the best of their abilities.

While there is a clear tension between intellectual property law and competition law, there is also an argument to be made that advocates that they improve one another. Both frameworks namely tend to be more successful in jurisdictions where the other is effective as well.<sup>71</sup> The tension and conflicts between them could, as a result, be perceived as sacrifices for the benefit of the otherwise effective legal frameworks knowing that both frameworks actually stimulate the effectiveness of its counterpart with their practices, including where there is opposition between the two.

A particular cause that is proposed to explain the sometimes troublesome dynamic is the difference in focus concerning short- and long-term effects. Competition law namely generally attributes value to the effects that undertakings have on the market within a brief period of time, while intellectual property rights are concerned with stimulating innovation in the long run by granting short-term IP rights.<sup>72</sup> Consequently, intellectual property prefers granting short-term legal monopolies to benefit long term innovation, even though competition authorities oppose monopolies in its entirety and thus creating tension.

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<sup>70</sup> William Baumol, 'The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism' (Princeton University Press, 2004)

<sup>71</sup> Mattias Ganslandt, 'Intellectual Property Rights and Competition Policy' (Emerald Group Publishing, 2008), 3

<sup>72</sup> H.J. Hovenkamp, 'IP and antitrust policy: A brief historical overview' (University of Iowa Legal Studies, 2005)

This begs the question of what can be done to optimise the interplay of competition law and intellectual property law. One theory proposes that they are optimal colleagues as long as IP rights are used in the manner for which they are created. Thus, as long as these boundaries are not overstepped, antitrust intervention is redundant.<sup>73</sup> This idea is specifically persuasive considering that anti-competitive conduct by means of IP rights often can be explained by abuse of these rights, including but not limited to using IP rights to control and monopolise a secondary market for which the right was not granted, refusal to license and enforcing unjustified royalty rates. Pay-for-delay agreements can also be added to this list, as the delay of market entry inflicts a practical extension of the market exclusivity that goes beyond the envisioned term of a patent. This demonstrates a discrepancy between the intended use of IP rights and what is actually brought into practice. Regardless of the prevalent view on the relationship between intellectual property and competition, every unique problem that brings this discussion to the forefront is bound to have unique aspects which ignites a different perspective on the concept. As the cases analysed in this chapter will show, this forces our judicial institutions repeatedly to decide on how these issues, such as pay-for-delay agreements, are handled and what role is expected for the two fields of law.

#### **4.2 The pharmaceutical sector**

Pay-for-delay agreements are often found in a unique sector, namely that of pharmaceuticals. Sectors inherently have differentiating aspects that regulators need to consider before any measures are implemented, because they can distinguish a market to an extent that legislation might be suitable for one sector, but inappropriate for another. For instance, issues of net neutrality are particularly a problem in telecommunication. By contrast, the discussion of whether data is a tool of measurement just like turnover which can be used to determine the market power of an undertaking is a discussion that surrounds big tech companies. Analysing the dynamic between EU competition law and the pharmaceutical sector thus goes a long way in understanding how potential competition faces new challenges when it is applied to this sector.

A remarkable disadvantage for pharmaceutical companies is the relatively narrow timespan in which they can exploit their patent, i.e. commence sales to recuperate their investments. A patent lasts 20 years. This term is a trade-off to stimulate both innovation and high prices.<sup>74</sup> Setting this term requires preciseness, because a short term will discourage innovation due to the fact that innovative firms will not be able to recoup their investments while a long term will ensure high prices and consequently harm consumer welfare for an extensive period. The balance herein is therefore essential. Unfortunately, pharmaceuticals are not able to enjoy their exclusivity to their fullest extent. This is a

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<sup>73</sup> Moritz Lorenz & Peter Chrocziel, 'Intellectual Property and Competition Law' (Kluwer Law International, 2016) 99

<sup>74</sup> 'EU law of competition and trade in the pharmaceutical sector' (n 9), 11

result of the lengthy procedures that fall in between patent filing and market authorisation.<sup>75</sup> Amongst others, the pre-clinical development phase and clinical trials only enable the producers to market their products ten years after their patent is filed. To compensate for lost time, the Supplementary Protection Certificate was introduced to complement the ineffective patent regulation for medicinal products. By applying for this certificate, the patent duration can be extended by a maximum of five years.<sup>76</sup> Although this evidently enlarges the period which incentivises undertakings to innovate, it is still a quarter less time of effective exclusivity compared to the desired 20 years of a patent. While engaging in pay-for-delay agreements can have a variety of reasons, this is certainly one that should be kept in mind to understand what the driving factors are for these illegal practices, as the patent holder might be more inclined to illegally extend their period of exclusivity when their investments are not fully recuperated.

The patent holder of pharmaceuticals is in an even more undesirable position if the in-hospital demand is considered. In-hospital demand refers to the segment of the market where hospitals purchase directly from the manufacturer, rather than having a national health insurance company or other party function as the intermediary.<sup>77</sup> Hospitals generally have more buyer power than out-of-hospital demand, i.e. buyers apart from hospitals, such as large drug store chains and national insurance companies, due to their ability to realistically decrease demand because they actually have the expertise to decide whether there might be alternative treatments. Insurance companies simply have to comply with the demands of doctors and their other clients, making their threat to buy less effectively less realistic. Furthermore, hospitals have more budgetary constraints which make them a logical customer of generic manufacturers. In-hospital purchasing is becoming increasingly popular and therefore the pharmaceutical market is becoming increasingly competitive. Even patented medicines notice competitive restraint as hospitals seek alternatives outside of the product market with the same therapeutic use if the price is excessive.<sup>78</sup> These indicators all imply a less favourable environment for an undertaking in medicine to innovate and exploit a patent.

Although these aspects of the pharmaceutical sector discourage market exclusivity and therefore innovativeness, other factors stimulate quite the opposite. Specifically, the pharmaceutical market is characterised by price inelasticity.<sup>79</sup> As mentioned above, the demand side of medicine generally consists of insurance companies or hospitals. These organisations establish their purchases based on

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<sup>75</sup> *Ibid.*, 12

<sup>76</sup> Council Regulation 1768/92 concerning the creation of a supplementary protection certificate for medicinal products (1992), L182/4, art. 13(2)

<sup>77</sup> 'EU law of competition and trade in the pharmaceutical sector' (n 9), 32

<sup>78</sup> *Ibid.*, 33

<sup>79</sup> Amalia Athanasiadou 'Patent Settlements in the Pharmaceutical Industry under US Antitrust and EU Competition Law' (Kluwer Law International, 2018) 281

what doctors need for their patients. Doctors are both unaware and ignorant of the prices, as their objective is solely the well-being the patients. As a result, the demand does not react significantly to a change in price. The market therefore distinguishes itself from products where the consumer strongly incorporates the price in deciding whether or not to buy a product. Due to the irresponsiveness of demand to price adjustments, a patent holder who has market exclusivity can reap the benefits by increasing the price knowing that their sales will not be affected. However, this effect is limited by strong regulatory measures. Many Member States have pricing policies that should be met before a pharmaceutical can market its product. These pricing policies aim to ensure that patients have access to necessary medicines and that health budgets are kept at reasonable levels.<sup>80</sup> Thus, pharmaceutical patent holders can be stopped from enjoying the price inelastic market since national authorities can intervene if these prices are excessive.

In addition to the implications that the pharmaceutical sector poses for innovation and the competitors themselves, they impact competition law and its objectives as well. This becomes evident when emphasis is put on one of the pillars of EU competition law: consumer welfare. While controversy and discussion is significant on the definition of competition law's objectives,<sup>81</sup> consumer welfare has been confirmed to be one of the core goals.<sup>82</sup> Consumer welfare refers to the individual benefits derived from the consumption of goods and services. In theory, individual welfare is defined by an individual's own assessment of his/her satisfaction, given prices and income.<sup>83</sup> Thus, the benefits derived from goods in combination with its price are a key indicator for assessing consumer welfare. Pharmaceuticals are of particular influence on consumer welfare if this knowledge is incorporated. First, the benefits arrived from the goods produced in this field are indispensable. The Pharmaceutical Sector Inquiry unambiguously confirms the importance of this sector:

*“The pharmaceutical sector is essential for the health of Europe’s citizens who need access to innovative, safe and affordable medicines.”<sup>84</sup>*

As derivable from this quote, the pharmaceutical sector is of the utmost importance for the health of the European people. The benefits derived from goods, as prescribed to be necessary for adequate

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<sup>80</sup> *Ibid.*, 230

<sup>81</sup> Ariel Ezrachi, 'EU Competition Law Goals and The Digital Economy' (University of Oxford, 2 November 2018) 3, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3191766](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3191766) accessed on 14 October 2020

<sup>82</sup> Joined Cases T-213/01 and T-214/01 *Österreichische Postsparkasse and Bank für Arbeit und Wirtschaft v Commission* (2006), para. 115

<sup>83</sup> 'Glossary of Statistical Terms' (OECD, 15 March 2002)

<https://stats.oecd.org/glossary/detail.asp?ID=3177#:~:text=Consumer%20welfare%20refers%20to%20the,satisfaction%2C%20given%20prices%20and%20income> accessed on 14 October 2020

<sup>84</sup> 'Pharmaceutical Sector Inquiry: Final Report' (European Commission, 8 July 2009), para. 1

consumer welfare, are therefore to be categorised as crucial. This simultaneously explains why this sector has been prioritised by the EU institutions: the consequences of an ill-functioning pharmaceutical market are simply too severe to neglect, as Europe's citizens need access to innovative, safe and affordable medicines. The second element of consumer welfare explains that the benefits derived from goods are relative to price and income. For instance, certain goods might be perceived by an individual to have remarkable benefits, but these benefits are limited in terms of consumer welfare if the price is excessive. Competition law is therefore burdened with the responsibility of ensuring fair pricing. What should be noted on this matter is that the pharmaceutical sector characterises itself as highly regulated regarding pricing. Generally, Member States have at least some form of influence on pharmaceutical pricing or actually set the price for at least some categories of medicine.<sup>85</sup> The variety in the policies regulating pricing is vast. While some countries prescribe a unilateral, statutory manner of pricing, others impose a comparative method that seeks to reflect on prices in neighbouring countries. Furthermore, Member States may choose to set a price at wholesale level and leave retail prices up to their own discretion. Conversely, other governments decide to intervene at the stage of the consumer price. Generic competitors play a key role in ensuring lower prices too. As mentioned earlier, generic entry has proven to drive the price down in pharmaceutical markets. Moreover, regulatory measures are often imposed to ensure this effect. The 'generic price link' is a measure which requires generic market entrants to lower their price at least a particular percentage in relation to the price of the originator.<sup>86</sup> Setting the price higher than this quota will result in a rejection of market entrance. Market authorities therefore stimulate the effects on pricing that generics cause, as this enhances consumer welfare.

Although this high level of sector-specific regulation might indicate that competition law has no role to fulfil since there is already plenty of governmental interference, the Sector Inquiry lists numerous examples (under which pay-for-delay agreements) that demonstrate that even a highly regulated sector can still be one that competes ineffectively. However, it does add to the perception that the pharmaceutical sector is governed through a unique legal framework that requires a customary competition law approach to handle anticompetitive issues.

#### **4.3 Pay-for-delay agreements**

With enhanced knowledge on the pharmaceutical market, it is now possible to consider pay-for-delay agreements within this context with a better understanding. There are several court cases that enable us to analyse how the previously discussed concept of potential competition is implemented for the

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<sup>85</sup> S. Vogler & J.E. Martikainen, 'Pharmaceutical Pricing In Europe' (Springer International Publishing, 2015) 352

<sup>86</sup> *Ibid.*, 359

sake of these anti-competitive agreements. *Lundbeck*, *Servier* and *Paroxetine* are the respective cases that fulfil this particular function. These cases are emphasised because they all received scrutiny by a judicial body of the EU. Whether it is the GC or the CJEU, these cases enable us to analyse how the Commission decides whether a pay-for-delay agreement distorts competition, but simultaneously observe how the judiciary reviews the former's approach. Furthermore, cases that are taken to court tend to receive more attention, resulting in more academic perspectives on the disputes which allow for a nuanced view for the purpose of this thesis.

#### **4.3.1 *Lundbeck v. Commission* (2016)**

Lundbeck is an 'originator' company, meaning that their activities are not solely the production and sales of medicine, but also R&D in order to innovate pharmaceutical products.<sup>87</sup> The latter segment enabled them to obtain the necessary patents concerning the active pharmaceutical ingredient ("API") citalopram, which serves as an antidepressant. The patents were active in jurisdictions across various Member States. In 2002, Lundbeck entered into six agreements with four generic undertakings regarding citalopram. The Commission found that these agreements were restrictive of competition by object. It reached that conclusion by an accumulation of findings that were established and common among all agreements. First, the pay-for-delay agreements were concluded between parties that were at least potential competitors. Second, Lundbeck transferred significant values to the generic companies that were linked to the limitations on the latter's entry to the citalopram market. Third, these values corresponded to or exceeded the estimated profit that the generic companies would make had they entered the market. Fourth, the limitations that were imposed on the generic companies by means of these payments could not have been obtained through patent enforcement since they go beyond the scope of intellectual property law.<sup>88</sup>

By 2002, most of Lundbeck's patents in the European Economic Area ("EEA") would have expired. They expressed their awareness of the fact that this paved the way for market entrance by generic competitors in their strategic plan for 2000, stating that generics were expected to have captured a substantial market share in 2002. The Commission found this to be proof of competitive pressure exerted on behalf of the generics. Further, assessments showed that there was a 60 percent chance that the patents in question would have been found invalid if a patent dispute would have arisen. By ultimately identifying eight different routes in which market entrance by a generic company would have been possible and plausible, the Commission found Lundbeck and the other parties to the agreements to be restrictive of potential competition.<sup>89</sup>

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<sup>87</sup> Case T-472/13, *Lundbeck v. European Commission* (2016), para. 2

<sup>88</sup> *Ibid.*, paras. 61-67

<sup>89</sup> *Ibid.*, para. 97

In order to assess whether this is indeed sufficient to speak of potential competition, the General Court (“GC”) relied on precedent that was set in earlier potential competition issues, such as *ENS* and *Visa*. (thoroughly discussed in chapter 2). It found that the perception of the originator company is relevant, but factual evidence and market structure analysis should be decisive. Lundbeck’s objections to the establishment of potential competition consisted, amongst others, of the argument that the patents made the potential competition illegal. It insisted that competition law cannot overrule intellectual property rights by stating that there was some form of competition while the patents conferred a legal monopoly on Lundbeck, thus contradicting the very essence of a patent. The GC responded by describing that IP rights are in fact presumed to be valid, but this does not as a corollary mean that entry by a generic competitor is deemed illegal.<sup>90</sup> An ‘at risk’ entry, i.e. market entrance where patents are potentially infringed, is not necessarily unlawful. As a matter of fact, the GC found that the Commission correctly elaborated on the probability of a successful invalidation claim and possible entry routes because this establishes real, concrete possibilities to enter the market as *Visa* prescribes. Additionally, litigation procedures from Lundbeck in case of market entrance by the generics was far from certain due to their own awareness of their weak patents. Lundbeck’s arguments on potential competition were rejected in their entirety and potential competition as determined by the Commission remained intact.<sup>91</sup> The case, however, is still pending as Lundbeck appealed to the Court of Justice of the European Union (“CJEU”). Advocate-General Kokott has revealed that her opinion reflects that of the GC, specifically that it is not for competition authorities to determine the strength of the relevant patents but rather focus on whether there are real, concrete possibilities to enter the market.<sup>92</sup> It is deemed likely that the CJEU will follow Kokott’s perspective as this is also in line with the Commission and the GC.<sup>93</sup>

The impact of *Lundbeck* to a certain extent is still to be determined since it has not reached its conclusion. However, discussion on what this entails is omnipresent. One perspective is that it has expanded the scope of Article 101 TFEU, for this is the first case that does not reject unlawful competition as a possible categorisation under potential competition.<sup>94</sup> As explained above, the presumed validity of relevant patents suggests that potential competition could be unlawful, but is still accepted as a valid assessment of competition. Therefore, this expansion entails that even a possibly

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<sup>90</sup> *Ibid.*, para. 121

<sup>91</sup> *Ibid.*, para. 330

<sup>92</sup> Opinion of Advocate General Kokott in Case C-591/16P *Lundbeck v Commission* (4 June 2020), para. 46

<sup>93</sup> Pat Treacy & Olivia Henry, ‘The Opinion of Advocate General Kokott in Case C-591/16 P H. Lundbeck A/S and Lundbeck Ltd v European Commission delivered on 4 June 2020’ (InformaConnect, 24 June 2020) accessed on 11 September via <https://informaconnect.com/the-opinion-of-advocate-general-kokott-in-case-c-59116-p-h-lundbeck-as-and-lundbeck-ltd-v-european-commission-delivered-on-4-june-2020/>

<sup>94</sup> Pablo Ibáñez Colomo, ‘Pay-For-Delay and the Structure of Article 101(1) TFEU: Points of Law Raised in Lundbeck and Paroxetine’ (Journal of European Competition Law & Practice, Vol. 10, Issue 10, 2019) 606

unlawful competitive relation is sufficient in the assessment of Art. 101 TFEU, which had not been accepted in earlier cases. On the other hand, the case made a clear distinction for future reference concerning when a patent dispute settlement is not problematic for competition. This is because the Commission elaborated on a settlement between Lundbeck and Neolab, which was perfectly legal since the payment from Lundbeck to Neolab could be explained as a compensation to refrain from seeking damages.<sup>95</sup> These settlements can therefore be assumed to be genuine as long as the transaction can be traced back to an objective that is not to delay generic entrance.

#### **4.3.2 *Servier v. Commission* (2018)**

Originator company Servier was suspected to have engaged in five patent settlement agreements that infringed competition law as established in Article 101 TFEU. When the Commission in fact found competition to be restricted by Servier and the other parties to the agreement, Servier decided to take the case to the GC. Amongst others, Servier argued that the Commission erred in its establishment of potential competition. In particular, the Commission was ought to have failed in its assessment by solely determining whether there was an absence of an insurmountable barrier to market entry rather than assessing whether there are real, concrete possibilities.<sup>96</sup> The Court rejected this claim because the Commission applied the insurmountable barrier-test as a supplement to analysing whether there are real, concrete possibilities, instead of using it as an alternative as Servier claims. The GC further confirmed that the perception of the incumbent operator (Servier) is to be asserted as relevant but not decisive in establishing potential competition. Though the perception of the incumbent indicates a competitive restraint, the subjective nature of this test makes it too fragile to be pivotal. The GC confirms the notion of this supplementary relevance that the incumbent's perception seems to have as argued in *Hitachi* and *E.ON Ruhrgas*. More interestingly, the legal dispute revisited one of the core issues of *Lundbeck*, i.e. the relation between active patents of the originator and potential competition. On this subject, the GC confirmed *Lundbeck's* conclusions by expressing that there is neither a presumption of invalid patents nor a presumption that patents shall block market ascendance in its entirety. Also, the same structure was applied to confirm that generic companies could potentially enter the market, namely by describing a number of possible market strategies that could be applied to enter the market (e.g. an 'at risk' launch or commencing an invalidation claim).<sup>97</sup>

What did stand out was the detailed description of what would constitute an insurmountable barrier when the incumbent operator has potentially blocking patents. The GC explained that this will only form an insurmountable barrier if an infringement of the patent has already been established.

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<sup>95</sup> Amalia Athanasiadou, 'Lundbeck v. Commission: The first decision of the European General Court on reverse payments' (Jusletter, October 2016) 6 [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2851449](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2851449) accessed on 13 September 2020

<sup>96</sup> Case T-691/14, *Servier v. Commission* (2018), para. 317

<sup>97</sup> *Ibid.*, para. 352

Conversely, as long as the generic company has the opportunity to claim invalidation, the patents in question shall not form an insurmountable barrier.<sup>98</sup> Thus, while *Lundbeck* emphasised when potential competition can be established in combination with patents in the pharmaceutical sector, *Servier* confirmed when the two cannot be combined on the condition of established invalidation.

#### 4.3.3 *Paroxetine* (2020)

Rather than appealing to a Commission decision, *Paroxetine* concerns a preliminary ruling referred to CJEU by the UK competition authorities. Quite like the previous cases, an originator company, in this case GlaxoSmithKline (“GSK”), faced the expiration of their patents and thus the threat of market entry by generic competitors for Paroxetine, a prescription-only antidepressant. Anticipating this competition, GSK concluded several allegedly anti-competitive agreements with the emerging generics. The appellate body of the UK competition authorities (Competition Appeal Tribunal) referred the dispute to the CJEU. Specifically, the CJEU was asked whether parties are in potential competition when they are in a *bona fide* patent dispute settlement.<sup>99</sup> In accordance with the ‘real, concrete possibilities’ condition, the Court held that the referring tribunal should incorporate the actual steps taken by the generic company, such as market authorisations and creating adequate stock. Similarly, it can be relevant whether it has considered the presence of patents, whether this be challenging it or contemplating a strategy such as entering the market ‘at risk’. On the existence of a pending patent dispute between the originator and the generic competitor, the Court adds that this is rather proof of a potential competitive relationship between the parties than an aspect that precludes competition. Moreover, the Court follows the reasoning seen in *Hitachi* on potential competition by stating that the perception of the originator is a strong indicator of a competitive relationship.<sup>100</sup> However, it refrains from expressing that this is decisive, which is similarly in line with case law (see, to that extent, e.g. *Visa* and *Lundbeck*).

Besides the ‘ordinary’, *Paroxetine* reveals a great reliance on circumstantial evidence.<sup>101</sup> The Court states that the very fact that an agreement was concluded between the originator and the generic manufacturer suggests potential competition.<sup>102</sup> Evidently, this seems to lower the threshold for potential competition in pay-for-delay cases substantially. Although this statement is up for

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<sup>98</sup> Amalia Athanasiadou, ‘*Servier v. Commission* (Case T 691/14): 5 Crucial Points of the Second ‘Pay-for-Delay’ Decision of the EU General Court’ (Kluwer Competition Law Blog, 18 December, 2018) accessed on 13 September 2020 via [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3345613](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3345613)

<sup>99</sup> *Generics* (n 5), para. 21

<sup>100</sup> *Ibid.*, para. 42

<sup>101</sup> Alfonso Lamadrid & Pablo I. Colomo, ‘Case C-307/18 Generics (UK) and others v CMA (Paroxetine), a major landmark in the case law (II): pay-for-delay’ (Chillin’ Competition, 28 February 2020) accessed on 13 September 2020 via <https://chillingcompetition.com/2020/02/28/case-c-307-18-generics-uk-and-others-v-cma-paroxetine-a-major-landmark-in-the-case-law-ii-pay-for-delay/>

<sup>102</sup> *Generics* (n 5), para. 55

interpretation on a case-by-case basis, it might suggest that patent dispute settlements are by definition within the delineation of potential competition, because, as stated above, the very fact that there is a patent dispute settlement suggests that the originator and the generic manufacturer have a potentially competitive relationship. This concept is, however, significantly more nuanced considering the fact that a 'mere hypothetical' entrance is not sufficient to establish potential competition. Caution should likewise be paid to this case with the knowledge that the patent on the API had already expired, indicating a weaker bargaining position for the originator company. Had this not been the case, then rejecting potential competition might have been more plausible.<sup>103</sup> API patents namely indicate a stronger patent and thus a more complex hurdle for a potential entrant to overcome.

#### 4.3.4 Case law analysis

*Lundbeck*, *Servier* and *Paroxetine* demonstrate that establishing potential competition between parties to a pay-for-delay agreement is relatively simple. *Lundbeck* has so far shown that a competitive threat perceived by the originator and a weak patent is sufficient to assume potential competition in combination with describing different routes by which the generic might be able to compete. The latter notion was confirmed in *Servier*. This case also confirmed *Lundbeck's* conclusion that valid patents (as presumed) do not result in illegality of the potential competition. In essence, originator companies are thus not able to hide behind their patents to justify anti-competitive agreements. *Paroxetine* goes even further by suggesting that the agreement, whether this is distortive of competition or not, can be proof of potential competition. If this precedent is continued in cases to come, the discussion of potential competition in pay-for-delay cases might become redundant because the very agreement might be sufficient to reject all the rebuttal of potential competition. The task for the Commission is quite easy: prove that a generic producer has real, concrete possibilities to enter the market. All of the above can be utilised to reach this conclusion.

Moreover, the judicial institutions of the EU have carefully interpreted case law on potential competition without significant deviations. Especially the condition of 'real, concrete possibilities' of market entry that was introduced by *European Night Services* constantly echoes in the current cases. The trend of heightened economic and market-based evidence that is expected since cases like *Visa* ('an economically viable strategy') and *E.ON Ruhrgas* ('a mere hypothetical is insufficient') is repeatedly fulfilled by the Commission by, amongst others, providing actual strategies based on the markets in question which could lead to successful competition by a generic company. Additionally, the perception of the incumbent operator holds the same relevant, but not decisive weight in pay-for-delay cases as it did in other potential competition cases. For instance, *Toshiba* held that the existence

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<sup>103</sup> James Fry, 'Paroxetine pay-for-delay ruling in the European court' (Mills & Reeve, 26 February 2020), <https://www.mills-reeve.com/insights/publications/paroxetine-pay-for-delay-ruling> accessed on 13 September 2020

of a cartel indicates a threat of potential competition, which was found to be supportive in establishing potential competition. Likewise, *Lundbeck* showed that a written statement by the originator expecting competition goes a long way in proving potential competition.

#### **4.4 Conclusion**

The prosecution of pay-for-delay agreements is an issue for competition law with a strong role for intellectual property law. While they do need to cooperate since they complement each other positively, they tend to conflict with one another as well. This tension is evident throughout pay-for-delay cases, because on one hand intellectual property law is respected by allowing for patent dispute settlements while on the other hand competition law interferes if these settlements are disingenuous and cause artificially high prices. Allowing either competition law or intellectual property law priority over the other will cause damage to the other field of law. As a result, the judiciary will remain to have the complex task in these cases of ensuring that neither are neglected. The pharmaceutical sector adds peculiar ingredients to this recipe. The narrow timespan of market exclusivity, increasing competition even with a patent and price inelasticity are all factors that can influence the behaviour of both originator companies and generic manufacturers. *Lundbeck*, *Servier* and *Paroxetine* are the first cases that give us a glimpse of how the EU institutions deal with all that is mentioned above. Both the CJEU and the GC continue on the path of precedent on potential competition without contradicting how this was previously interpreted. They did, however, give new insight as to how competition law and intellectual property are combined in these cases: patents are presumed to be valid, but this does not make the market impenetrable for generic manufacturers.

## 5. Conclusion

Pay-for-delay agreements are detrimental to effective competition and its benefits. Because these agreements are concluded in the domain of intellectual property law, they abuse the legal monopolies that they provide for in order to delay other competitors to enter the market. These agreements are particularly harmful in the pharmaceutical sector, due to generic competitors that would have otherwise entered the market and driven down the price significantly. Pay-for-delay agreements are therefore a mechanism to artificially maintain a high price, disadvantaging consumers. The importance of regulating this harm in combination with the novelty of this issue to competition law confirm that the judicial authorities of the EU stood for an interesting challenge once the Sector Inquiry was finalised to properly interpret Article 101 TFEU and more specifically, potential competition. This thesis sought to analyse how this challenge has been handled thus far.

By setting the stage through analysis of seminal theories on competition and innovation in relation to competition law and pay-for-delay agreements, a clearer picture was painted of what is at stake in these disputes. Article 101 TFEU and potential competition are both concepts that have received plenty of attention in EU competition jurisprudence. As a result, it is quite clear what the both of them entail. Before pay-for-delay agreements received legal scrutiny, it was already broadly acknowledged that potential market entrants can exert competitive pressure on incumbent operators, resulting in the idea that agreements between them can restrict competition and thus violate Article 101 TFEU. Additionally, it was demonstrated that potential competition can be proven through evidence concerning the economic context of their competition and, to a lesser degree, the intention of the parties involved. While the above did create guidance for the Commission and the Courts to assess pay-for-delay agreements, new legal issues tend to pose new questions which seek a new perspective. In this case, the guidance was followed meticulously: the general precedent was applied and made concrete to the specifics of *Lundbeck*, *Paroxetine* and *Servier*. The new questions revolved around the ability of patents to block potential competition from occurring, since this would make the competition illegal. To this, the Courts were unambiguous: a patent is presumed to be valid, but so is the legality of potential competition regardless of the former.

The young and small collective of case law does suggest that there might still be some gaps to be filled. This is certainly true. For potential competition in regards to pay-for-delay agreements in particular, it is interesting to see whether the Courts will eventually decide to upgrade party intentions, specifically that of the incumbent, from relevant to probative. This would decrease the need for economic, contextual evidence and give the Commission more options to establish potential competition. *Paroxetine* already briefly flirted with this idea. Furthermore, it is plausible for the discussion

surrounding valid patents and their influence on potential competition to be continued. Will the reasoning of *Lundbeck* be reiterated, which essentially holds that patents and potential competition do not prevent the validity of one another, or could another stance replace this precedent? Regardless of how the legal disputes unfold, it also has to be seen how much of the EU's attention these anti-competitive agreements will receive in the coming decades. Perhaps the Sector Inquiry followed by a couple of heavily publicised cases is enough for the Commission to address the harm that is done to competition and deter future practices. The Sector Inquiry did propose other solutions to solve some of the inefficiencies of the pharmaceutical market, e.g. unifying patent litigation on a Union scale and streamlining the market authorisation process. Similar responses might divert the attention away from pay-for-delay agreements. Conversely, prosecuting pay-for-delay agreements could very well become common practice within the Union, suggesting that safeguarding monopoly profits for incumbent pharmaceutical undertakings in this manner is a dangerous path to embark on.

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