

European Competition Law Update 2009

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Zurich

Developments in EU Verticals: BER reform and online sales

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BER Reform

- Market share threshold(s): is more really better?
- Territorial restrictions: a missed opportunity?
- Pricing: a more relaxed view?
- Internet sales: the single European market?
- Agents: more room for agency agreements?



Market Share

- Currently “supplier not above 30 %”
- Currently “purchaser not above 30 %” only in case of EU-wide exclusive supply obligations
- Proposal “both supplier and purchaser not above 30 %”
- Definition of relevant markets
- Difficulties of information gathering
- Relationship to direct application of Art. 81 III
- Do benefits of new threshold really justify the additional expense?



Territorial Restrictions

- Hope for change: Prevention of active sales without exclusivity possible
- Draft so far: No change
- Position of German Federal Cartel Office:
Current system too complex
Simplification necessary
Important for uniform application of EC law

Pricing/Resale Price Maintenance (RPM) (1/2)

- Prohibited per se in U.S. since 1911 (Dr. Miles), in EU since 1957 (Art. 81 I lit. a) and in Germany since 1973
- “Rule of reason” for maximum prices in U.S. since 1997 (State Oil) and in EU since 2000 (Verticals BER)
- “Rule of reason” for minimum prices in U.S. since 2007 (Leegin)

Pricing/Resale Price Maintenance (RPM) (2/2)

- Activities in Congress to overrule “Leegin”, outcome unclear
- EU more lenient view only if RPM is needed to
 - = penetrate a new market
 - = coordinate a short-term low price campaign
 - = address loss-leading



Internet Sales I

Meglana Kuneva
Commissioner for Consumer Protection

“We must reflect on the pertinence of restrictions imposed by suppliers to distribute over the internet...

I believe the time has come to look closely at the legitimacy of market partitioning along national boundaries, notably in online retail ... I intend to participate in any debate on distribution over the internet and I intend to put a spotlight on the legitimacy of business models that run against consumer expectations.”



Internet Sales II

Neelie Kroes

Commissioner for Competition

“The people of Europe were promised a union, a place without borders; but on the internet they have not got it...

If this is because the competition rules are not clear enough, I will clarify them. If it is because the competition rules are not up to date, I will update them. And of course, if this is because the competition rules are not being respected, consumers and companies should know I will enforce them.”

Internet Sales III

- Status: Vertical Guidelines No. 50; Court of Appeals Paris (“Pierre Fabre”): Internet must be free for everybody, Internet sales are viewed as passive sales
 - No circumventions:
 - Prevention access to website from abroad
 - Automatic transfer to local website
 - Split prices (however, compensation for specific services admissible)
- ➔ Restrictions possible in particular in the area of selective distribution



Internet Sales IV

- Requirement for a brick and mortar shop
- Restrictions of sales via internet
 - Federal Supreme Court Germany: open, but in any case no obligation to supply mere internet dealers
 - Baker & McKenzie so far: restriction of internet sales to not more than 50 % of all sales admissible
 - Draft Guidelines: no percentage but minimum sales for shop possible



Internet Sales V

- Prohibition to restrict internet sales to a larger extent than shop sales
- Corresponding qualitative criteria okay
- Comparability of shop and internet?



Internet Sales VI

- Own website or Ebay?
 - German cases (LG Berlin, LG Mannheim, OLG Munich)
 - ECJ (“Dior”)
Damage to luxury image may diminish “quality” of goods



Agents

- Definition of agency rather than distinction between genuine and non-genuine agent
- Financial or commercial risk borne by agent
 - Contract specific risks
 - Risks related to market specific investments
 - Risks related to other activities required by principal if indispensable for sale or purchase of contract goods or services
- Agent bears some or all of the relevant risks rather than one of these risks

Switzerland

- Thresholds (market shares)
 - No undertaking has market share > 15% on any market concerned
 - If cumulative foreclosure effect (> 30%) market share must not exceed 5 %
- Passive sales
 - Verticals Notice only covers territories exclusively allocated
- Resale price maintenance
 - Legal assumption rebuttable
- Synthesis report of evaluation group



Developments in Market Dominance Abuse: Intel and Microsoft

Bill Batchelor (Brussels)

Article 82 EC: A Quick Recap

“Dominance”

- Market shares >40% possible, >50% presumed
- Competitors’ size, barriers for new entrants

“Abuse”

- Exclusionary, e.g. exclusivity, tying, loyalty rebates
- Exploitative, e.g. excessive pricing, discrimination

Enforcement Guidelines (2009)

Intel

Intel and Rebates: The Case Law

Exclusivity/requirements rebate

- ✗ buying all or high % requirements

Stretch rebate

- ✗ selling X% more than prior year

Individualised volume target

- ✗ meeting sales target based on estimated requirements

Standard volume targets

- ?/✗ *Michelin II*, BUT: *Heineken*, *Travel Agents*



Enforcement Guidance

Framework for analysis

- % market affected
- Winner takes all markets
- Rebate mechanics
 - How aggressive is the rebate scheme?
- Counter-indicators of exclusion (e.g. aggressive entry and expansion by competitors)
- Efficiencies

REBATE MECHANISM	
Exclusivity	Aggressive ↑ ↓ Gentle
Stretch (Rollback) Tailored Volume (Rollback)	
Objective Volume	
Incremental	

Rollback Rebate “Ready Reckoner”

DOMCO REBATE %	DISCOUNT SMALLCO MUST OFFER TO MATCH DOMCO BASED ON SHARE OF CUSTOMER PURCHASES			
	SMALLCO'S SHARE OF CUSTOMER'S SALES			
	5%	10%	15%	20%
1%	20%	10.0%	6.7%	5.0%
2%	40%	20.0%	13.3%	10.0%
3%	60%	30.0%	20.0%	15.0%
4%	80%	40.0%	26.7%	20.0%
5%	100%	50.0%	33.3%	25.0%
6%	120%	60.0%	40.0%	30.0%
7%	140%	70.0%	46.7%	35.0%
8%	160%	80.0%	53.3%	40.0%
9%	180%	90.0%	60.0%	45.0%
10%	200%	100.0%	66.7%	50.0%

Example assumes: DomCo margins >20%
Key: likely legal; potentially illegal

The Allegations in Intel

Rebate schemes applicable to major PC OEMs and one, albeit major, German retailer

Rebate schemes structure

- Rewarded exclusivity or near exclusivity
- AMD product not purchased *even when free*

EC investigation likely coloured by

- Allegedly covert nature
- Alleged pay-for-delay deals

Intel has said it will appeal

Officials say “fines could have been higher”

Counselling Points

Check for lack of impact:

- *de minimis* impact (e.g. individual customers/<15% market)?
- all or nothing market (e.g. own label supplies or sports event tender)?

Safer options:

- Convert rollbacks to incremental rebates
- Objective volumes (NB para. 45)
- Shift rebate to non-dominant lines
- General discounts
- Pay for specific services
- Reward documented cost savings (e.g. grouped deliveries)

Remember “old guard” countries

Microsoft I, II and III

Microsoft I: Refusal to License

Refusal to licence interface abuse:

Indispensability

“Tends to eliminate” competition

Stifles “new” product or “new features”

Lack of objective justification – no evidence mandatory interface licensing would harm innovation incentives

BUT: innovation defence in para. 89 of Article 82

Guidelines

Microsoft I: Technical Tying

Illegal tying by dominant supplier:

- (i) Ties a separate product – evidence of separate purchases;
- (ii) Does not allow standalone purchase;
- (iii) Practice excludes competitors from tied market – free download or retail sales of rival media players?
- (iv) No objective justification
 - integration benefits evidence (faster running, text to voice conversion) insufficient
 - “Windows standardisation” not a cognisable benefit
 - No examination of the costs to Microsoft of continuing to sell an obsolete product (OS without WMP)

Microsoft I: Valuing the IP

Violation of order for charging unreasonable price for interface information:

- No charge for data reflecting public information
- Innovation only:
 - Patented parts - presumptively innovative
 - Non-patented parts – only 6/173 innovative
- Comparable technology licenses - the remuneration sought should be in line with comparable technology licenses

Initial demands...

- 3.87% of net sales for a patent licence and
- 2.98% for the supply of other information.

...reduced 0.4% of net revenues plus lump sum of USD 10,000 respectively, plus EUR 890m fine

Microsoft II: “Browser Wars” and III Office Suite

14 January 2008 – EC starts investigation

- Browser tying
- Interoperability of Office Suite and Windows Server

15 January 2009 – statement of objections on browsers

- *“tying of Internet Explorer with Windows:*
- *provides Internet Explorer with an artificial distribution advantage which other web browsers are unable to match*
- *shields Internet Explorer from head to head competition with other browsers*
- *ubiquity of Internet Explorer creates artificial incentives for content providers and software developers”*

24 July 2009 – Microsoft offers remedies

- Browsers – the ballot screen option
- Interoperability – additional interface information





Merger Control and Co-operations in crisis / restructuring scenarios

Bill Batchelor (Brussels)

Philippe M. Reich (Zurich)

Restructuring and Other Competitor Agreements in Times of Crisis

EU Competition Rules Still Apply during the Downturn

- Regulators in many jurisdictions have made clear that the recession does not mean competition law enforcement will be any less vigorous
- Neelie Kroes' position is clear:
 - *“Anyone who thinks we are distracted or going soft will find out the truth the hard way.”*
 - *“You will not see us offering special treatment to companies who view a merger as a quick-fix to their problems. The reality is that two turkeys don't make an eagle.”*
- The economic crisis is not a defence against anti-competitive conduct



Overview: Lawful Options

- Transactions – may be subject to merger control
 - Failing firm defence
- Agreements – subject to Article 81 EC Treaty
 - Crisis Cartels?
 - Specialisation Agreements
 - Production JVs
 - Joint Selling
 - Joint Buying
- Conclusions & Practical Tips

Art. 81: Crisis Cartels: Historically Possible

- 1980s and 1990s: EC exempted some restructuring agreements on capacity reduction between competitors from antitrust rules
- Typically used in sectors hit by severe structural overcapacity
- Synthetic Fibres (1984): EC permitted agreement of 3 years which closed 18% of production capacity
- Info exchanges on capacity reductions, consultations on market changes, agreement not to increase capacity and to compensate each other if reductions not implemented

Crisis Cartels: Rationale for Art. 81(3) Exemption

- Market forces by themselves would have failed to achieve the necessary capacity reductions
- Restructuring an industry has a social cost, with loss of employment and harm to fabric of local communities – political component as well as economic aspects
- Exemption (with strict conditions) allows the slim down to happen in a socially acceptable way, and consumers would benefit from a healthier industry later

Crisis Cartel Defence Often Fails

- E.g. *Carbonless Paper Cartel* (Decision 2001) 1992-1995
- Some participants argued (unsuccessfully) that decline of sector and resulting losses were a valid reason for joining the cartel
- Seized documents showed that at one point, cartel members had even considered applying to the EC for a “crisis cartel” exemption
- EC found that the cartel *may have hindered production capacity from adjusting naturally to lower demand by maintaining inefficient competitors in the market longer than they would have stayed under normal conditions of competition.*

Irish Beef Provides no Comfort

- ECJ Preliminary Ruling Decision 20 November 2008
- Late 1990s, Irish government + industry decided 20 processors should be slimmed down to 6 or 8
- Subsequent agreement between 10 Irish beef processors to reduce capacity by 25%, compensate the “goers”
- Agreement was notified to Irish Competition Authority
- Authority found Art. 81(1) infringement, applied to High Court for restraining order
- High Court dismissed restraining order application
- Authority appealed to Supreme Court
- Supreme Court asked ECJ whether, in the circumstances, the agreement was anticompetitive **by object alone** (as opposed to by effects)

Irish Beef Lessons

- Capacity reduction agreements are a restriction of competition by **object**
- Government blessing for the capacity reduction is irrelevant
- Argument by industry that the agreement should be judged by its actual (positive) **effect** on the market in tough times was rejected
- Very difficult to demonstrate that an industry scheme to reduce capacity brings efficiencies likely to benefit consumers
- Regulators believe that in tough times, some firms will and should fail!

Other Structural Options to Reduce Costs

Mergers and Acquisitions

- Divestitures of underperforming or non-strategic parts of the business can reduce costs and raise cash (back to core)
- Mergers for cash or via share swaps or new JVs can also reduce costs and achieve synergies (full-function)
- EC or national merger rules will apply if thresholds met
- Generally need a “change of control”
- Investors taking minority stakes usually don’t get control (c.f. Germany where 25% stake triggers merger control)



Failing Firm Defence under the ECMR

- Available, but not yet used by the Commission in this recession
- Difficult to satisfy the criteria at the best of times:
 - *Inevitable exit of target*
 - *No realistic less anti-competitive outcome*
 - *Assets of the failing firm would inevitably accrue to buyer*

Mergers: Failing Firm is Hard to Prove

- *JCI/FIAMM* Phase II decision of May 07, just published, most recent discussion of failing firm defence
- Confirms that it's an uphill battle to win with this defence
- EC looked in great detail at failing company's financial position & asset sale options + position of creditors and insolvency procedures
- Conclusion: effects of the merger likely to be significantly worse than the effects of letting it go into liquidation
- Failing "division" here, rather than whole failing company
- EC Head of Mergers Nadia Calvino said in April 09 that EC would not "depart from [its] policy" on failing firms, and will remain "healthily sceptical" of such arguments

Mergers: Failing Firm Defence in the UK

- OFT re-issued statement on failing firm defence Dec 08
- To date, only 5 cases where FF has worked in the UK
- Most recently, OFT cleared HMV's purchase of Zavvi on 4/28/09
- The first case during the downturn where "failing firm" defence has been used successfully, no "flood" so far
- Both leading national retailers of entertainment products, with overlapping stores in many areas of the UK
- Zavvi already in liquidation: Overwhelming evidence of failing firm, so OFT didn't get into a detailed market analysis – allowed speedy clearance
- OFT initiated the review – UK is a voluntary filing regime

Specialisation Agreements & Production JVs I

- Specialisation: agreement to stop production and to source from a competitor on a unilateral and even a reciprocal basis
- Permitted where certain conditions are met:
 - Safe harbour where combined market shares do not exceed 20%

AND

- No fixing of onward resale prices, limitation of output or sales (except quantities to be supplied to parties) or allocation of customers and markets

Specialisation Agreements & Production JVs II

- Joint production:
 - 20% safe harbour threshold applies
 - OK to set capacity / production volume of production JV
 - OK to set sales targets / fix prices to customers if JV not only produces but also distributes the output
- Production/specialisation agreements generally OK, even between competitors:
 - Where only commercially viable way to enter a market or do a specific project
 - If low commonality of costs (intermediate product, small proportion of total output)



Joint Selling

- A way of reducing costs
- Generally OK, even between competitors, where parties' combined market share does not exceed 15%, and no price fixing
- Above 15%, joint selling can be justified on efficiencies:
 - Efficiencies must be passed at least in part to customers
 - Pure sales agency without investment: likely to be seen as disguised cartel



Joint Buying

- Generally pro-competitive when competing or non-competing parties bundle volume to get better prices and other terms and conditions of sale
- Challengeable if this creates significant buyer power that shuts out rivals
- Challengeable if an instrument for collusion in a downstream resale market
- Commission “keeping an eye” on buying alliances in European food sector – no intervention so far

Conclusion – Practical Tips

- Competition rules allow lawful restructuring / rationalisation, provided that:
 - Sufficient synergies (economies of scale, better production technologies etc.) can be demonstrated, which benefit (or are at least neutral) for customers (efficiencies)
 - Restrictions must be reasonably necessary and not go beyond what is necessary to achieve economic benefits
 - No less restrictive realistic alternatives, no elimination of competition (e.g. creation of dominant production entity)
- Compliance awareness is key: the higher the market shares and the higher the commonality of costs, the more caution is necessary (spill-over effects!)



Cartel Enforcement: From administrative to civil procedure

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Introduction

- European Union/Cartels - recent developments
 - Commission case selection
 - Commission fining policy
 - Settlements
 - Leniency
- Switzerland
 - First decisions imposing fines and granting leniency
- Private Enforcement

Commission case selection

- Broad range of industries targeted (e.g. removal services, bananas, glass and rubber)
- Willingness to target sector on multiple occasions (*NB*: scope of internal audits):
 - *Rubber Chemicals* (2005)
 - *Synthetic Rubber (BR/ESBR)* (2006)
 - *Chloroprene Rubber* (2007)
 - *Synthetic Rubber (NBR)* (2008)
- Cartels of long (*Paraffin Wax* – 14 years) and short (*Aluminium Fluoride* – 5 months and 18 days) duration
- Cases investigated on “own initiative” (*Car Glass* and *International Removal Services*)



2006 Fines Guidelines

- Intended to provide more transparent fining framework
- Calculation of fine based on:
 - up to 30% of “affected EEA sales” for final year of infringement
 - multiplied by years of violation (periods of less than 6 months count as half year)
 - additional sum of 15-25% of “affected EEA sales” for deterrence
 - increase of up to 100% for prior infringement
 - aggravation/mitigation
- New guidelines and higher fines = reinvigoration of appeals



Fines under 2006 Fines Guidelines

- More structured methodology has resulted in higher fines
- Commission having to carefully consider approach
- *Professional Videotape* and *Flat Glass*: 18% “affected EEA sales” for all participants and additional 17% “affected EEA sales” for deterrence
- *Paraffin Waxes*
 - Total fine for cartel: €676m
 - Sasol fined €318m (despite 50% leniency discount; still 8th highest)



Fines under 2006 Fines Guidelines (cont'd)

- *Car Glass*
 - Highest total fine for cartel: €1.4bn
 - Highest individual fine for cartel participant: Saint Gobain fined €896m
 - Pilkington fined €370m (7th highest)

- *German and French Gas market*
 - Total fine: €1.1bn
 - E.ON (€553m) and GDF Suez (€553m)

Impact of recidivism

- 2006 Fine Guidelines provide for increase of up to 100% for each prior infringement
- Recidivism significantly impacting fines:
 - *Chloroprene Rubber* – Bayer: 50% uplift; ENI: 60% uplift
 - *Synthetic Rubber (NBR)* – Bayer: 50% uplift (3 other rubber cases in parallel)
 - *Paraffin Waxes* – ENI: 60% uplift (reflecting 2 prior infringements)
 - *Car Glass* – Saint Gobain: 60% uplift (reflecting 2 prior infringements)
 - *Sodium Chlorate* – Arkema: 90% uplift (reflecting 3 prior infringements)

Impact of recidivism (cont'd)

- Meaning of prior infringement:
 - No limitation period, but time elapsed between infringements may be taken into account in determining “*propensity to breach*” (CFI in *Choline Chloride* and *Plasterboard*)
 - Prior infringement where company “*continues or repeats the same or a similar infringement*” after decision; therefore decision can be after start of second infringement (CFI in *Plasterboard*; majority of BPB Plc infringement after first decision)



Unlimited jurisdiction of the CFI

- CFI entitled to undertake a full case review; may annul, reduce or increase fine
- *Choline Chloride* (BASF):
 - CFI held two separate cartels (Global and European)
 - Loss of 10% leniency reduction; only related to time-barred Global cartel
 - Resulted in increase in fine

Dawn raids and fines

- Importance of having clear procedures in place enhanced by risk of fine
- *Professional Videotape*:
 - Obstructed Commission's investigation; including shredding of documents
 - Fine increased by 30% on basis that aggravating circumstance (approx €10m)
- *E.ON*:
 - Commission identified that seal had been rendered VOID
 - No requirement to prove that door actually opened
 - Fine of €38m imposed (clearly intended as deterrent)

Settlement

- Although there is a policy and framework, no cases have yet been settled:
 - *Power Transformers, DRAM*
 - Secrecy seems not to be working correctly – function of need to notify investors?
 - Settlement specialist now in cartel unit. Will this improve things?
- Key considerations:
 - Become key considerations as fines start to increase due to 2006 Fines Guidelines
 - “No brainer”? – settlement discount in addition to leniency. If you are a leniency applicant you should try to settle, unless settlement somehow impairs leniency e.g. different periods. But what if leniency might not be granted? Non-lenieny applicants might want to fight after seeing evidence

Settlement (cont'd)

- Key considerations (continued):
 - Formality of process and steps limits ability of Commission and parties to engage constructively
 - Lack of flexibility: (*i.e.* Commission says not strictly a negotiation, and discount capped to 10%)
 - Restricts ability to reach satisfactory settlement
 - But note; can affect level of fine by “negotiating” key parameters (*e.g.* duration, severity, scope of market)

Leniency

- Strategic consideration – what is leniency worth these days?
 - Damages on the rise, and no immunity re civil litigation
 - Commission's policy on 2nd, 3rd in etc. mixed (e.g. *GIS*, *E&E* (but cf *Synthetic Rubber* and *Chloroprene Rubber*))

So:

- Will you get caught?
- Will you get reduced form of leniency?
- Are you a recidivist? (see CFI re *Plasterboard*, you are a recidivist even if no fine imposed)
- Increasing coordination amongst authorities = need for global strategy. Even within the EU things can get complicated (see *E&E*)
- Achieving immunity:
 - Key = documentary evidence (CFI re *Sorbates*). Can't get immunity for corroboration only (see *Flat Glass*)



Swiss ComCo's first decisions imposing fines on horizontal and vertical cartels

- *Felco/Landi*
 - Resale price maintenance
 - Leniency application by Felco as the manufacturer
 - Leniency available but no full immunity
 - Modest fine



Swiss ComCo's first decisions imposing fines on horizontal and vertical cartels (cont'd)

- *Electro Installations Berne*
 - Bid rigging
 - Third party information
 - Dawn raid
 - Leniency application by Gfeller
 - Full immunity granted to Gfeller
 - Aggregate fines CHF 1.24 m



Private Enforcement EU/CH

- White paper of European Commission 2008
- Synthesis Report of Evaluation Group Cartel Act 2009
- Limited relevance of private enforcement in Europe and Switzerland



Private Enforcement EU/CH (cont'd)

- Right to bring claim
 - Small claims
 - Consumers cannot file claim (CH)
 - Assignment of claims
 - Suggestion: representative action (including consumer organizations)



Private Enforcement EU/CH (cont'd)

- Burden of proof and associated problems
 - Access to documents (no fishing expeditions)
 - Binding effect of decision
 - Legal presumptions?



Private Enforcement EU/CH (cont'd)

- Damage to be compensated
 - Proof of damage
 - Expert economic evidence?
 - Estimation formed by judge (CO 42)
 - Passing-on defense?
 - Punitive damages?



Private Enforcement EU/CH (cont'd)

- Cost risks
- Prescription
 - Suggestions: 2 years (EU), 3 years (CH)
 - Effects of administrative proceeding
- Consequences of leniency system
 - Leniency application can be used against applicant
 - Restriction of access to file ?



Evaluation of Swiss Cartel Act

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Goals

The Federal Council has emphasized four primary goals in its mandate addressed to the Federal Department of Economic Affairs:

1. The reinforcement of the Competition Commission as an independent institution
2. The modernization of the control of mergers
3. The differentiated treatment of vertical agreements
4. The shortening of proceedings



Reinforcement of the Competition Commission (ComCo) as an independent institution



Administrative sanctions against companies vs. individual sanctions



Modernisation of the control of mergers

- The hurdles which allow the authorities to prohibit a merger are higher in Switzerland than in other industrial nations.
- Parallel filings (EU/CH) may be inefficient if no effect on Swiss market.



Differentiated treatment of vertical agreements

- “It [sc. the Federal Council] mandated the Federal Department of Economic Affairs to elaborate specific suggestions – namely concerning the rescindment of the current presumption of the harmfulness of vertical agreements.”



International exchange of information between antitrust authorities



Private antitrust litigation

