

A globe made of interlocking puzzle pieces, resting on a dark, reflective surface. The background is a dark green gradient.

Antitrust & Competition REVIEW

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About Our Practice

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Editors' Note



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As 2009 draws to a close, it is an opportune time to begin to reflect on what has been a very active year in the antitrust/competition world. In the United States, for example, we have seen the Obama administration repeal the Bush administration's controversial September 2008 report related to single-firm conduct (monopolies) under Section 2 of the Sherman Act and generally reaffirm its pre-election commitment to antitrust enforcement. In addition, we have seen a marked increase (double-digits) in the number of enforcement actions and second request investigations filed by the FTC as well as private litigants struggling with the new realities of heightened pleading and class certification standards as set forth in the Supreme Court's *Iqbal* and the Third Circuit's *Hydrogen Peroxide* decisions.

In Europe, we have seen the EC forced to address numerous subsidy cases involving prominent financial institutions as a result of the global financial crisis, record-setting fines imposed against Intel and several natural gas manufacturers, and the European Court of Justice endorse the proposition that a parent company may be held liable for anticompetitive behavior of its subsidiaries even when the parent did not participate in, or have control over, those activities.

In China, we have seen a Shanghai court dismiss the first-ever private damages action brought under the country's Anti-Monopoly Law, the National Development and Reform Council issue draft regulations governing dominant companies' pricing practices and the Ministry of Commerce continue to flex its muscles

in merger review cases by imposing strict conditions on several large scale M&A deals.

Indeed, competition authorities and private litigants around the world have been increasingly active. In Canada, for example, 2009 saw the British Columbia Court of Appeal issue the first appellate decision certifying a class action in a contested antitrust case, effectively teeing up the issue for review by the Supreme Court of Canada. And in India, that country's Competition Act dealing with abuse of dominance and cartels finally went into effect in May.

In this edition of the Antitrust and Competition Review, we touch on several of these developments as well as a few others that may not have garnered front-page headlines, but nonetheless are significant events in global antitrust/competition law.

From the United States we offer four articles: a discussion of the Obama administration's increased focus on competition issues affecting US agriculture markets; an analysis of the Ninth Circuit's recent decision in *Doe v. Abbott Labs* and the uncertainty of the law applicable to bundled discounts; an examination of the recent decision in *William O. Gilley Enterprises, Inc. v. Atlantic Richfield, Inc.*, and its current and potential future effect on antitrust claims analyzed under the rule of reason test; and a review of the recent *Feesers, Inc. v. Michael Foods, Inc.*, decision and what it means for the future of price discrimination cases.

From Europe, we bring you three articles: an analysis of the European Court of Justice's June 4 decision regarding the permissibility of information exchanges between competitors and its conclusion that a single meeting

at which one company discloses any information capable of removing uncertainties in the market may be sufficient to establish an infringement under EC competition laws; a commentary upon the European Commission's new draft proposal and regulations on vertical agreements with an analysis of the proposed changes to the regulation concerning selective distribution and online commerce in the European Union; and the notes from an April 2009 Conference, co-sponsored by Mayer Brown, at which leading EC and Member State competition authorities, economists and lawyers discussed the EC's recently issued Guidance paper on its enforce-

ment priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings.

Finally, from Asia, we bring you an article examining the main aspect of the "behavioral prohibitions" (regulations) that will affect future China-related pricing conduct of business operations and providing some high-level compliance tips based on information provided in the relevant draft implementation rules.

As we look forward to what antitrust/competition developments 2010 has to offer, we hope you find these articles interesting and informative and look forward to hearing from you in the future. ♦

One Meeting May Be One Too Many! The European Court of Justice Sets a Strict Antitrust Standard for Information Exchanges Between Competitors

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On June 4, 2009, the European Court of Justice (ECJ) rendered an important judgment on the permissibility of information exchanges between competitors.¹ The ECJ concluded that a single meeting at which one company discloses a single piece of information capable of removing uncertainties in the market may be sufficient to establish an infringement under the Community competition laws.

Background

Representatives of five operators offering mobile telecommunication services in the Netherlands held a meeting at which a participant noted that his company had initiated a reduction of standard dealer remunerations for postpaid subscriptions. The operators discussed this information and agreed that it was desirable to adjust the payments downward.

The Netherlands Competition Authority found that the five companies had concluded an agreement or had entered into a concerted practice. Subsequently, the authority imposed a fine totaling EUR 88 million after determining that the operators' agreement violated a provision of the Dutch Cartel Act.²

The provision in the National Cartel Act is similar to Article 81 EC Treaty. Article 81(1) EC Treaty prohibits all agreements between undertakings,

decisions by associations of undertakings and concerted practices that may affect trade between Member States and that have as their object or effect the prevention, restriction or distortion of competition within the common market.

Issues

The authority's decision was appealed. The Dutch Appellate Court agreed that interpretative points on EU law arose and asked the ECJ to address the following issues:

- Clarification of the notion of “concerted practice”; in particular, the criteria that must be applied when analyzing whether a concerted practice has an anti-competitive object
- Clarification of the presumption of casual connection between concerted practice and market conduct
- Clarification of the extent of such presumption; in particular, whether the presumption applies if the concerted practice is based only on a single meeting between competitors

ECJ Judgment

CONCERTED PRACTICE AND OBJECT

The question of whether a concerted practice is anti-competitive must be analyzed in light of its objective and of the economic and legal context. While the intention itself is not an essential element, it can be taken into account.

The ECJ judgment reiterates the position of law: it is not necessary to consider the actual effects of a concerted practice, where the objectives are apparently anti-competitive. The rationale behind this principle is that certain forms of collusion can be seen, by their very nature, as being injurious to the proper functioning of normal competition.

The ECJ judgment confirms the view that a concerted practice already pursues an anti-competitive object if it has the potential of having a negative effect on competition; i.e., if it is capable of being anti-competitive. It is not necessary to prove an actual prevention, restriction or distortion of competition.

As far as information exchanges between competitors are concerned, the ECJ reiterated that each operator in the market must independently determine the policy that it adopts. The ECJ pointed out that economic operators are expected to adapt themselves intelligently to their competitors' existing or anticipated conduct. However, Article 81 EC Treaty strictly precludes any direct or indirect contact between competitors that might influence them or that might disclose their intentions or decisions about their own conduct on the market where the object or effect of such contact does not correspond to normal market conditions. The ECJ concluded that information exchanges between competitors infringe competition rules if, in the light of the market structure, they reduce or remove the degree of uncertainty relative to the operation of the market in question, with the result that competition between undertakings is restricted.

The fact that the information exchanged did not concern end-consumer prices was found by the ECJ to be irrelevant. The court held that a concerted practice infringes competition rules by object when the exchanged information concerns competitively relevant parameters, even if there is no direct connection between the practice itself and consumer prices. The question of whether the information exchanged in the meeting would, by itself, remove the uncertainty in the market was left by the court to the determination of the appropriate national authority.

CONCERTED PRACTICE AND MARKET CONDUCT

According to the decisional practice of Community courts, there is a presumption of casual connection

between a concerted practice and participating companies' market conduct as long as those companies remain active on the market. This presumption is an integral part of the notion of concerted practice within the meaning of Article 81 (1) EC Treaty.

The ECJ has declared that because the interpretation of Community law by the Community courts is binding on all national courts, the courts are obliged to apply this presumption of casual connection in cases involving concerted practices. Companies taking part in a concerted practice are presumed to take account of the information exchanged with their competitors, unless they are able to prove the contrary with sufficient evidence.

CONCERTED PRACTICE AND SINGLE MEETING

Some of the companies charged with infringement have argued that a casual connection can be presumed only if they have met regularly and with the knowledge that confidential information has been exchanged. It would be "irrational" to assume that a company would base its market conduct on information exchanged during the course of a single meeting, particularly when the meeting had an otherwise legitimate purpose.

The ECJ, however, did not agree with this contention, concluding instead that a single meeting may be sufficient for the participating companies to align their market conduct. According to the ECJ, what matters is not the number of meetings. Rather, the decisive issue is whether one or more meetings afford participants an opportunity to use exchanged information to determine their conduct on the market and knowingly substitute practical cooperation between them for the risks of competition.

Conclusion

The ECJ judgment sets a strict standard for information exchanges and clearly shows that such exchanges are capable of infringing Article 81(1) EC Treaty. It also endorses enforcement activities of Member-State competition authorities when applying national provisions similar to Article 81(1) EC Treaty. The judgment should remind companies to check and monitor their policies regarding contacts with competitors. Specifically, companies should be aware that:

- A concerted practice can infringe competition rules by object; i.e., it is not necessary to consider the actual effects of the practice.
- The intention of the company itself is not an essential element.
- A direct connection between a concerted practice and consumer prices is irrelevant to a determination of infringement.
- An infringement of the competition rules can occur if the subject of the exchanged information concerns competition-relevant parameters and removes or reduces uncertainties in the market.
- It is assumed that companies involved in a concerted practice take account of the information exchanged with their competitors unless they are able to prove the contrary with sufficient evidence.
- A single meeting may be sufficient to establish such presumption. ♦

Endnotes

- 1 Judgment of the Court (Third Chamber) dated June 4, 2009, Case C 8/08. The judgment follows largely the opinion of Advocate General Kokott, delivered on February 19, 2009.
- 2 Decision of the Director-General of the Netherlands Competition Authority, as referred to in Section 62(1) of the Competition Act of December 30, 2002, Case No. 2658-344.

Antitrust Enforcement in US Agriculture Markets: The Obama Administration Plants Seeds for Increased Enforcement

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Introduction

Three recent events indicate that the Obama Administration plans an increased focus on competition issues affecting US agriculture markets. First, on August 5, 2009, the US Department of Justice (DOJ) and the US Department of Agriculture (USDA) announced an unprecedented series of joint public workshops intended “to explore competition issues affecting the agricultural sector in the 21st century and the appropriate role for antitrust and regulatory enforcement in that sector.”¹ Second, speaking before the Organization for Competitive Markets on August 7, 2009, Deputy Assistant Attorney General Philip J. Weiser affirmed that the priorities for DOJ’s Antitrust Division include “competition issues affecting agriculture.”² And finally, on September 19, 2009, Assistant Attorney General Christine A. Varney, in a statement made during a US Senate Judiciary Committee field hearing examining competition in the dairy industry, declared that “[c]ompetition issues affecting agriculture have been a priority...since [she] was confirmed last spring as Assistant Attorney General for the Antitrust Division.”³

Both Varney and Weiser further highlighted the recently announced public workshops and promised a “careful examination” of the level of

competition in US agriculture markets. Taken together, these events represent the first broad brushstrokes of the Obama Administration’s plan for a more robust antitrust enforcement program targeting what it views as potentially anticompetitive forces in agriculture markets.

Brief History of Recent DOJ Enforcement Initiatives in Agriculture Markets

According to Weiser, DOJ’s “interest in competition issues affecting agricultural markets is longstanding.” Recent developments, however, appear to have increased the government’s interest in potential competitive issues in these markets. While technological advances have produced additional “efficiencies” in some areas, Weiser noted that “this technological revolution and accompanying market developments have facilitated the emergence of large firms that produce [agricultural] products, along with challenges for new firms to enter this market.” Indeed, in the last decade, the Antitrust Division has evaluated a number of mergers and acquisitions in the agriculture industry and has intervened, at times, in order to protect against anticompetitive concerns.

Weiser used a recent proposed merger in the beef industry to highlight DOJ interest in, and scrutiny of, transactions in the agriculture markets. In February 2009, the Antitrust Division publicly

welcomed the announcement that JBS and National Beef Packing Company had abandoned their proposed merger.⁴ DOJ opposed the merger on the ground that it “would have combined two of the top four U.S. beef packers resulting in lower prices paid to cattle suppliers and higher beef prices for consumers.” In fact, as Weiser noted, DOJ had actually filed an antitrust lawsuit in US District Court in Chicago on October 20, 2008, to block the proposed acquisition. After months of litigation, and following the announcement that the transaction was being abandoned, DOJ reiterated that it “remains vigilant in protecting competition in [the beef] industry.”

DOJ’s opposition to the JBS/National Beef Packing merger was one of several enforcement actions against agricultural mergers brought during the Bush Administration. In May 2007, for example, DOJ announced that it was requiring Monsanto Company and Delta & Pine Land Company (DPL) to divest a significant seed company, multiple cottonseed lines and other valuable assets in order to proceed with their \$1.5 billion merger.⁵

Explaining that the acquisition of DPL by Monsanto “would have caused higher prices to U.S. farmers for traited cottonseed,” the Antitrust Division filed a civil lawsuit in US District Court in Washington, DC to block the proposed transaction. According to the complaint, the combined company would have “dominated the traited cottonseed market in the United States, with nearly 95 percent of all cottonseed sales in the high-value cotton-growing regions of the MidSouth...and the Southeast.” DOJ also claimed that the merger would probably have deterred “efforts to develop traits that would benefit U.S. cotton farmers.” DOJ concluded that the significant divestitures and licensing changes obtained through this enforcement action would ensure “that cotton farmers benefit from competition to develop and sell high-yielding cottonseed with the most desirable traits.”

In an earlier suit filed in 2002, DOJ challenged the merger of Archer-Daniels-Midland Company (ADM) and Minnesota Corn Producers, LLC (MCP).⁶ DOJ opposed the acquisition as it was initially proposed because it “would have substantially lessened competition by reducing the number of independent competitors in the corn wet milling industry to four

and making coordination among the remaining firms more likely.”

To proceed with the proposed \$634 million transaction, DOJ required ADM and MCP to dissolve a joint venture with a competing corn wet miller. The Antitrust Division explained that the DOJ-required dissolution of the joint venture would “ensure that purchasers of corn syrup and high fructose corn syrup continue to receive the benefits of competition—lower prices.”

Another example of DOJ’s focus on competition in agriculture markets can be found in its eventual approval, in 2000, of Cargill, Inc.’s, acquisition of Continental Grain Company’s worldwide grain trading business.⁷ In opposing the transaction as it was initially proposed, DOJ explained that it “would have eliminated an important competitor for the purchase of crops from U.S. farmers and other suppliers such as independent elevator operators.” DOJ approved the transaction after Cargill agreed to “divestiture of grain elevators held by either Continental or Cargill in each of the nine geographic markets where DOJ believed the consolidation would give grain companies the power to artificially depress prices and to prevent opportunities for manipulation of Chicago Board of Trade corn and soybean futures prices.”

Future Areas of Focus

DOJ’s recent communications give every indication that the Obama Administration intends to build on past enforcement efforts and to expand antitrust enforcement in agriculture markets. In announcing next year’s public workshop series, DOJ and USDA reaffirmed their strong belief that “a competitive agriculture sector is vitally important to producers and consumers alike.”⁸

Assistant AG Varney has noted that the workshops will “address the dynamics of competition in agriculture markets” by determining “whether changes in the marketplace, including increased consolidation and vertical integration, have generated efficiencies, or whether they have led to increases in monopoly or monopsony power.” The DOJ and USDA also hope the workshops will “provide an opportunity for farmers, ranchers, consumer groups, processors, the agribusinesses, and other interested parties to provide examples of potentially anticompetitive conduct” and

to discuss “any concerns about the application of the antitrust laws to the agricultural industry.” The stated goals of the workshops are “to promote dialogue among interested parties and foster learning with respect to the appropriate legal and economic analyses of these issues, as well as to listen to and learn from parties with real-world experience in the agriculture sector.”

During his August 2009 address to the Organization of Competitive Markets, Deputy Assistant AG Weiser reiterated the goals of the DOJ and USDA workshops and observed that “the Antitrust Division is planning to look, in cooperation with the USDA, into the state of competition in agriculture markets.” While making clear that the list was still evolving and non-exclusive, Weiser identified five likely areas of focus during the upcoming workshop series: (i) “particular market segments,” (ii) “vertical integration,” (iii) “buyer power,” (iv) “other legal regimes” and (v) “transparency in the marketplace.”

In suggesting that DOJ would be focused on “particular market segments” during the workshops, Weiser specifically cited three such areas—the seed industry (particularly corn and soybeans), the dairy industry and the livestock markets. With respect to the seed industry, he explained that DOJ will be “evaluat[ing] the emerging industry structure, explor[ing] whether new entrants are able to introduce innovations, and examin[ing] any practices that potentially threaten competition.”

Relative to the dairy and livestock industries, Weiser noted ongoing questions about the state of competition in these markets. Similarly, Assistant AG Varney highlighted DOJ concerns regarding “unprecedented economic upheaval in the dairy industry.”

In discussing DOJ’s interest in “vertical integration,” both Varney and Weiser noted that “agriculture markets, including dairy, have become more vertically integrated over the last 15 to 20 years.” Varney explained that vertical integration occurs “when a manufacturer also participates in other parts of the supply chain, such as distribution of its products or supply of its inputs.” She provided an example in the dairy industry, describing a processor entering into exclusive agreements with a specific cooperative to buy raw milk.

While apparently accepting that such arrangements “can lead to greater efficiencies and savings for consumers,” Varney and Weiser shared a concern that under certain conditions, vertical integration “may alter the incentives of parties” and “can protect or facilitate the exercise of monopoly power.” Presumably, DOJ will use the upcoming workshop series to help identify and evaluate examples of such vertical integration arrangements in the agriculture industry.

Without citing specific examples of “buyer power” or monopsony power, Weiser explained that buyer power is “a form of market power and can disadvantage sellers...” Indicating a concern about markets in which buying power may be concentrated and sellers have limited options with respect to where they can sell, Weiser suggested that DOJ will use the workshop series to examine the competitive impact of buyer power in the agriculture industry.

Varney built upon Weiser’s comments in her remarks when she specifically noted that “[a] number of dairy producers are concerned about the exercise of what economists call monopsony power.” Varney acknowledged that “parts of the dairy industry have experienced extensive consolidation in recent years, with fewer processors and therefore fewer buyers of dairy products.” She noted the potential for an increase in the exercise of buyer power under these circumstances and promised to evaluate such developments in the dairy industry.

Weiser also explained that, in looking into the state of competition in agriculture markets, DOJ will also be examining the underlying regulatory regimes in this area. He identified the Packers and Stockyards Act of 1921—enacted as a result of an FTC investigation into the substantial control exercised by a handful of firms over the meat-packing industry—as one particular piece of legislation worthy of review during the workshops. Weiser suggested that DOJ is “interested in learning whether the controls of the Act are relevant to the way businesses are run today and whether the law is being implemented effectively to promote competition.”

Although he did not offer any other specific examples of laws or “legal regimes” that should be reviewed, Weiser explained that DOJ is generally “interested in evaluating the impact of any regulatory regimes that

may serve to protect particular producers at the expense of consumers.”

While Weiser’s list of five probable areas of workshop focus is not exclusive—and probably will be expanded before the workshops begin in 2010—it is instructive. In his final point, Weiser touched on the nature of transparency in agriculture markets. In that context, it is notable that both Varney and Weiser affirmed their belief that “markets work better and attempted harms to competition are more likely to be thwarted when there is increased transparency to consumers and government about what is going on in an industry.” In the course of the upcoming workshop series, then, DOJ probably will aim to assess whether some parts of the agriculture business lack sufficient transparency.

Conclusion

During his 2008 presidential campaign, Barack Obama pledged to “reinvigorate antitrust enforcement.”⁹ Three recent events provide a first glimpse into the Obama Administration’s plan for a more robust antitrust enforcement program targeting agriculture. These include the announcement of a series of public workshops intended “to explore competition issues affecting the agricultural sector in the 21st century and the appropriate role for antitrust and regulatory enforcement in that sector,” as well as the public statements by two senior DOJ officials reiterating the DOJ Antitrust Division’s sharpened focus on “competition issues affecting agriculture.”

While the schedule for, and the results of, the 2010 public workshop series remain a question, it is clear that under the Obama Administration, the DOJ Antitrust Division plans to build on past enforcement efforts to become even more active in scrutinizing competitive behavior in agriculture markets. Companies in these markets that are considering transactions involving competitors or that would result in greater vertical integration are advised to follow closely both the upcoming workshops and the DOJ’s enforcement efforts. Doing so will enable them to better evaluate how DOJ’s increased enforcement efforts may affect their business plans. ♦

Endnotes

- 1 Press Release, “Justice Department and USDA to Hold Public Workshops to Explore Competition Issues in the Agriculture Industry,” August 5, 2009, available at <http://www.usdoj.gov/opa/pr/2009/August/09-ag-771.html>.
- 2 Philip J. Weiser, Deputy Assistant Attorney General, Antitrust Div., US Dept. of Justice, “Toward a Competition Policy Agenda for Agriculture Markets, Remarks as Prepared for the Organization for Competitive Markets,” August 7, 2009, available at <http://www.usdoj.gov/atr/public/speeches/248858.htm>.
- 3 Christine A. Varney, Assistant Attorney General, Antitrust Div., US Dept. of Justice, “Crisis on the Farm: The State of Cooperation and Prospects for Sustainability in the Northeast Dairy Industry,” Field Hearing Before the Senate Comm. on the Judiciary, 111th Congress, 2009, available at <http://www.usdoj.gov/atr/public/testimony/250178.htm>.
- 4 Press Release, “Department of Justice Statement on the Abandonment of the JBS/Na tional Beef Transaction,” February 20, 2009, available at <http://www.usdoj.gov/opa/pr/2009/February/09-at-146.html>.
- 5 Press Release, “Justice Department Requires Divestitures in \$1.5 Billion Merger of Monsanto and Delta & Pine Land,” May 31, 2007, available at http://www.usdoj.gov/opa/pr/2007/May/07_at_392.html.
- 6 Press Release, “Justice Department Requires ADM to Withdraw from Joint Venture to Proceed With Acquisition of Minnesota Corn Processors,” September 6, 2002, available at http://www.usdoj.gov/opa/pr/2002/September/02_at_511.htm.
- 7 Press Release, “Justice Department Requires Divestiture in Cargill’s Acquisition of Continental Grain,” July 8, 1999, available at <http://www.usdoj.gov/opa/pr/1999/July/293at.htm>.
- 8 Press Release, “Justice Department and USDA to Hold Public Workshops to Explore Competition Issues in the Agriculture Industry,” August 5, 2009, available at <http://www.usdoj.gov/opa/pr/2009/August/09-ag-771.html>.
- 9 Barack Obama, Statement to the American Antitrust Institute, available at <http://www.antitrustinstitute.org/Archives/obama2.ashx>.

The Price of Competition: How China’s Anti-Monopoly Law Impacts Business Pricing¹

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The authorities charged with enforcing prohibitions governing day-to-day trading behaviour—known as “behavioural prohibitions”—in China’s new Anti-Monopoly Law (AML) are still drafting implementation rules. Consequently, a great deal of uncertainty remains regarding when and how the behavioural prohibitions will be more actively enforced, and what compliance steps businesses with operations or sales in China should be taking at this time.

In this article, we examine the main aspects of the behavioural prohibitions that will affect future China-related pricing conduct of business operators, and we provide some high-level compliance tips based on information in the relevant draft implementation rules and international experience.

Role of the NDRC

The AML regulatory regime is unique in how it divides enforcement jurisdiction for the behavioural rules into rules governing price and non-price specific conduct. The former will be handled by the National Development and Reform Commission (NDRC), while the latter will be dealt with by the State Administration of Industry & Commerce (SAIC). Accordingly, it is the NDRC that will set the agenda in terms of enforcement methodology and priorities for review of business pricing under the AML.

The NDRC has rolled out significant competition-related training and education programs for key staff in its Department of Price Supervision in recent months, to prepare these staff for their new AML-related responsibilities. Usefully, the authority has received assistance in these training efforts from key competition agencies in more mature antitrust jurisdictions such as the European Union and the United States.

However, the extent to which the training will translate into sound decision making may largely depend on how appropriately the enforcement work is delegated by the Department of Price Supervision to lower-level agencies.

While the NDRC is reported to employ approximately 40,000 people at its different functional levels across the Mainland, the number of staff in its Department of Price Supervision, which is charged with competition-related responsibilities (let alone those with experience in this area), is very small. This has raised concerns about the prospect of key investigation and enforcement roles being handled by staff at the lower city or county levels.

However, draft procedural measures released by the NDRC in June suggest that these lower level bodies will primarily assist with information gathering. Thus, at least for the time being, it seems that decision-making

and enforcement in cases involving foreign parties will be handled at the national level.

Of course, the extent to which these delegation rules are applied in practice may depend on the volume of cases the NDRC is required to handle going forward. There are also lingering fears that if the agency is overburdened with cases, it may focus on sectors with which it is most familiar via its other price-regulation supervisory roles (in particular, utilities, health care, education and parts of the transport sector), as well as cases involving foreign parties.

Price-fixing

Multinational businesses that operate or sell in China will find that the price-related activities that may raise concerns under the AML are similar to those likely to raise antitrust issues in jurisdictions throughout Europe and in the United States. However, as discussed below, there are signs that the NDRC may apply some unique treatment to particular pricing issues. Business representatives will need to be mindful of this when setting their pricing strategies and engaging in trade negotiations.

Article 13(i) of the AML prohibits a business operator from agreeing with a competitor to fix or change the price of products or services. This is one of several “horizontal” monopoly agreements referenced in the law. Other examples include joint boycotts and market divisions by competitors.

The NDRC’s draft rules in this area elaborate on the basic wording in Article 13 by providing examples of the different forms price-fixing conduct may take. For example, the draft confirms that it will also be a breach of Article 13(i) for competitors to agree on a standard formula to calculate prices or to collectively decide that they will refrain from discounting.

Interestingly, the draft rules also refer to agreements between competitors on production output or sales limits as constituting price-related violations of the AML. This is an example of how the demarcation lines between NDRC and SAIC jurisdiction may become blurred. The impact this kind of conduct has on price may be more properly characterised as “indirect” rather than “direct,” and thus could be seen as falling under the ambit of SAIC.

Many other kinds of conduct that would otherwise seem to fall within the SAIC’s jurisdiction could also be viewed as being indirectly related to price. Consequently, there are concerns that jurisdictional uncertainty could raise the prospect of regulatory forum shopping by complainants and overlapping investigations by SAIC and NDRC.

The draft rules also confirm that competing firms may be regarded as coordinating their pricing, even in the absence of evidence of a clear agreement between them, if:

- There is some “consistency” in their pricing activities (such as if changes to the pricing offered by the various competitors fluctuates by similar levels and at similar times) and
- Those competitors have engaged in some form of prior communication.

This suggests a need to exercise a degree of caution in cases where business operators are active in sectors with regular competitor forums (such as trade association meetings) and where prices fluctuate regularly but with relative consistency between competitors.

According to the NDRC’s draft rules, the NDRC may be allowed to draw a presumption of illegality based merely on prior communications between two or more competing parties in the sector—unless the pricing alignment is readily explained by others factors. Any such presumption may prove difficult to rebut unless a valid alternative subject of those communications is fully and convincingly documented.

Notably, there is a general exemption to the prohibition relating to price-fixing and other “monopoly agreements” under Article 15 of the AML, in addition to specific exemptions for “crisis” and “export” cartels that are likely to have application only to domestic PRC companies. Under this Article, a relevant agreement may qualify for the exemption if it can be shown the agreement has:

- A valid purpose (examples of which are listed in the Article);
- An impact that does not seriously lessen competition; and
- Benefits that consumers can share in.

The general consensus among commentators is that the exemptions are rarely going to have application to traditional price-fixing cartels. It may be very rare that a participant in the cartel can show their conduct was for a legitimate purpose and could benefit consumers.

The exemptions are likely to have more relevance to other forms of competitor collaboration, such as certain competitor joint ventures, which may involve some coordination of pricing at the level of the joint venture or the parents. At this stage, guidance is still pending from the Chinese authorities on such issues. It remains uncertain to what extent detailed guidance in regimes like the European Union and the United States has relevance in China.

Resale Price Maintenance

Article 14 of the AML prohibits stipulating a specific or minimum resale price that downstream distributors or retailers can charge for goods that a business supplies to them for resale. The AML refers to this as a prohibited “vertical” monopoly agreement.

While there is some ongoing uncertainty on this issue, it appears from the text of the AML (and the NDRC’s draft implementation rules) that resale price maintenance will be unlawful per se, unless one of the exemptions in Article 15 applies. That is to say, the NDRC won’t need to demonstrate that the relevant conduct lessens competition. This may effectively be presumed.

However, the list of approved purposes under the Article 15 exemptions includes, usefully, instances where the agreement under review has a purpose such as “reducing costs, enhancing efficiency ...implementing division of specialization ... [or] enhancing competitiveness of SMEs.”

It will be prudent to identify and cite pro-competitive reasons for any resale price restrictions in relevant China-related distribution agreements, as well as provide key internal and external communications that recommend or explain the arrangements.

For example, the agreements might state (where applicable) that the arrangements:

- Maximise the effectiveness and efficiency of the distribution channel and

- Ensure that one retailer that invests time and resources in promoting a relevant product and providing exemplary after-sales service is not “undercut” by another retailer, which does none of these things and simply benefits from the hard work of other retailers.

However, for companies with product ranges that are not subject to significant competition in China, it may be difficult to argue that competition, which in such cases can only occur at the intra-brand level, is not substantially reduced by resale price maintenance arrangements. Under the aforementioned criteria for application of the Article 15 exemption, this would mean the exemption could not apply regardless of whether there were sound pro-competitive justifications for the resale price restriction. In such cases the focus may need to be on “recommended” resale pricing for the time being.

Finally, it is worth noting that in many jurisdictions where similar prohibitions apply, the prohibition is not violated if the relevant downstream party is acting as the agent of the upstream manufacturer or supplier. This is because, at law, title to the supplied goods will not pass, and thus no “resale” occurs. However, it is not yet clear whether the authorities will take a favourable approach to this kind of arrangement in China in the context of the AML.

Relevant Pricing Conduct by Dominant Firms

The AML prohibits businesses that enjoy a dominant market position from abusing that position of dominance. The law contains detailed guidance on when and how dominance may be deemed to exist, discussion of which is beyond the scope of this article. For present purposes, however, it is prudent to note that dominance may be assumed (in the absence of compelling evidence to the contrary) if a business operator has a market share in China exceeding 50 percent.

Once a business is assessed as having a dominant market position, it is subject to a set of single-firm conduct rules that don’t apply to other companies, including smaller competitors. Those rules focus not only on preventing the use of market power by firms to exclude existing or potential competitors from the market, but also on preventing what may be termed as “exploitation” of dominance.

UNFAIRLY HIGH OR LOW PRICING

The main pricing activity that can generate “exploitative conduct” risks for dominant business operators is mentioned in Article 17(i) of the law—selling products at an unfair high price or purchasing products at an unfair low price.

A similar prohibition exists in Europe, but it has rarely been enforced. As the European regulators have openly acknowledged, it can be difficult to apply such a prohibition in a way that does not seem arbitrary and subjective. Perhaps for these reasons, the United States has avoided introducing this kind of prohibition altogether.

Accordingly, there have long been concerns about how the prohibition could be applied in China.

Early versions of the NDRC’s draft implementation rules appeared to justify these concerns, as they stipulated that pricing might be deemed to be unfairly high if it generated, for example, profit margins above 20 percent. A similar formula was provided for determining if pricing was “unfairly low.”

This formulaic approach to the prohibition was roundly criticised, and was seen as indicative of the gap between the instincts of some NDRC officials on these kinds of prohibitions and current best practices. Thankfully, a different approach was adopted in the revised draft published for public consultation in August.

First, this revised draft stated that the prohibition would not be applicable if the relevant customer or supplier of the dominant firm is unable to acquire the same product or a substitute at a reasonable price.

Second, the draft provided for assessment of the fairness of pricing by reference to a range of factors, rather than a set formula. For example, in relation to unfair high pricing, the factors to be considered include whether the sale price is obviously higher than the cost or is substantially higher than the same product sold by other business operators.

DISCRIMINATORY PRICING.

This is a practice that has received attention in recent times due to significant investigations in Europe and Asian jurisdictions such as Japan and Korea, in

particular concerning Intel’s alleged practice of making payments to computer makers in exchange for their boycott of Intel’s rivals.

Article 17(vi) of the AML may also address this type of conduct. It states that a business that enjoys a dominant market position may not give different treatment, in respect of transaction prices, to equivalent transaction counterparts.

The NDRC’s draft implementation rules explain when transaction counterparts will be deemed equivalent. According to the current draft, this will be the case when the transaction terms applicable to transaction counterparts are (other than in relation to price) the same or similar—with particular regard to matters such as the relevant products at issue (and their type, quality and grade), the transaction method, quantities concerned, payment settlement and after-sales service.

This suggests that in circumstances where a business wishes to provide significant discounts or rebates to one customer but not to another, it may be necessary to demonstrate that those discounts or rebates are attributable to genuine cost savings from the arrangements with that customer, for example. Other examples would be where large-volume orders may reduce unit costs, or where a prompt payment discount reduces the supplier’s financing costs.

This is distinct from the provision of more favourable pricing terms in return for “customer loyalty” (fidelity rebates, or up-front payments to secure a long-term exclusive contract, for example), which on the basis of international experience is more likely to be seen as an anti-competitive and unlawful activity because it may facilitate foreclosure of large sections of the market in which the relevant business operator is dominant.

BELOW-COST PRICING

Article 17(ii) of the AML prohibits a business operator from selling products at prices below cost.

Similar prohibitions exist in many competition laws around the world, usually based on concerns that such below-cost pricing (or “predatory pricing,” as it is often called) may have the purpose of shutting out prospective or existing competitors from the market. Competition regulators are generally keen to avoid a situation where the relevant dominant business

operator is able to revert to very high pricing after driving out existing or prospective competitors.

In this context, it is notable that the NDRC does not seem to require a showing that the element of “recoupment of earlier losses” is a likely outcome of a business operator’s “below cost” pricing. This is in contrast to the prevailing approach of the US authorities to this type of prohibition.

One of the key issues that need to be tackled is calculating relevant business costs, in order to determine if a dominant business operator has set prices that fall below these costs. Different regimes have adopted different measures of cost for this purpose. To date, NDRC is yet to provide substantive guidance on this point.

This lack of guidance obviously presents some impediments to compliance efforts. In the interim, it is suggested that a prudent approach, based on comments from NDRC officials and some brief guidance published in relation to broadly similar pre-AML prohibitions in China laws, may be to assume that European cost-calculation methodology will apply.

On this basis, it will be prudent to ensure that pricing for products does not fall below their “average variable cost” (which is basically a matter of adding up all your variable costs like labour, electricity and tangible manufacturing inputs, and dividing by the quantity or units of output).

Where prices of a dominant business operator are set at a level that is higher than this average variable cost, but below what is termed “average total cost” (which you calculate by taking into account both variable costs and fixed costs, like rent and other overheads attributable to the relevant business operation, and dividing that total by units of output), then concerns may only be likely to arise if it can clearly be shown that the business operator had the intent of setting such pricing to eliminate a competitor or deter a potential competitor.

Helpfully, the NDRC’s draft rules do provide a list of situations in which below-cost pricing will be considered to be justified, and this includes cases where the below-cost pricing was instituted to match competitor prices—something that is not always accepted as a valid justification for below-cost pricing in other jurisdictions.

Additionally, it appears that below-cost pricing that is introduced simply as part of a short-term promotion by a new market player (who is, for example, trying to establish a foothold in the market) will generally be deemed not to violate the AML.

CONSTRUCTIVE REFUSAL TO DEAL

For completeness, it is noted that Article 17(ii) of the AML prohibits a dominant business from refusing to trade with trading partners without valid reasons. The NDRC’s draft rules elaborate on this prohibition by providing that an unlawful refusal to deal will arise where a “refusal” is disguised in the form of an offer of an “overly high price” offer (by dominant suppliers) or an “overly low price” offer (by dominant buyers) and without justification.

According to the NDRC’s draft rules, an overly high price is a price that would lead to no profit after the relevant transaction counterpart’s normal production and sale.

This aspect of the draft raises significant concerns, as it does not appear to take into account the level of efficiency of the relevant transaction counterpart, who may suffer a loss as a result of its sale activities due to its own poor business model or operations and not (for example) the price of inputs offered by a dominant supplier.

However, it is possible that this consideration will be taken into account when a determination is made regarding whether the relevant “overly high” or “overly low” price was provided to the customer with “valid reasons.”

Additionally, based on other draft guidance documents published by the SAIC, it appears the prohibition is likely to be of limited application where alternative supply options exist for the relevant customer.

Price of Noncompliance

The NDRC is compelled by procedural regulations to investigate any complaint made in relation to a claimed AML violation if it is accompanied by “sufficient facts and evidence.” The NDRC is also authorised to conduct investigations on its own initiative and has broad powers to conduct dawn raids, question executives and seize evidence.

Where violations of the law are found to have occurred, any illegal gains can be confiscated by the NDRC, and fines of up to 10 percent of total business turnover in the preceding year may be imposed in serious cases. It seems likely this relates to group turnover in the relevant sector, but this is yet to be clarified. Interestingly, it also appears that these fines start at a minimum of 1 percent, except in cases where leniency may be applied.

Private actions are also permitted for recovery of damages suffered as a result of another business operator's violation of the AML. Additionally, the Chinese authorities are contemplating introducing a "double damages" system to encourage litigation in this area and strengthen the impact of the law.

The AML behavioural rules are not being stringently enforced as yet. However, as the public consultation phase has expired in relation to the NDRC's draft implementation rules regarding pricing issues, more active enforcement of these aspects of the law may be imminent. Accordingly, businesses with operations or sales in China should be introducing necessary compliance initiatives.

In particular, it is important that staff who deal with pricing matters receive training on the issues covered in this article. A priority may need to be placed on ensuring that staff involved in regular formal or informal communications with competitors understand how they should conduct themselves in such activities.

Additionally, staff involved in negotiating and drafting terms of trade with suppliers and customers may benefit from the introduction of clear policies specifying the kinds of arrangements that require competition-related review and sign-off before implementation (such as resale price restrictions, and significant price increases or decreases for particular customers or "across-the-board").

Based on the experience of other antitrust regimes, price-setting arrangements may soon become one of the areas of business activity most likely to raise issues under the AML. Implementing appropriate training and other compliance steps now can help business operators to avoid having to pay a potentially high price for noncompliance in the future. ♦

Endnotes

- 1 This article was originally published by GT News, November, 2009.

Bundled Discounts After *Doe v. Abbott Labs*

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For the past several years, US courts have been struggling to articulate the limitations imposed by Section 2 of the Sherman Act on dominant firms seeking to engage in “bundling.” Bundling typically involves providing customers a discount when they purchase products spanning several different product lines. The bundled discounts most frequently challenged under Section 2 are those where the bundle includes both “monopoly products,” over which the dominant firm arguably wields monopoly power, and “competitive products,” relative to which the dominant firm faces competition.

The thrust of the antitrust challenge tends to focus on an allegation that the defendant is using its power in the monopoly market to attempt to monopolize the competitive market. Courts have reached drastically different conclusions on the legal standards applicable to this kind of conduct, which makes counseling in this area particularly difficult.

The Ninth Circuit recently further complicated the analysis of bundled discounts by suggesting that bundled discount cases may be resolved by the legal standards applicable to price squeezing claims. Its decision in *Doe v. Abbott Labs.*, 571 F.3d 930 (9th Cir. 2009), highlights the continued ambiguity surrounding the legal standards

applicable to bundled discounts by a dominant firm.

The Market for Boosted Protease Inhibitors

The plaintiffs in *Doe* alleged that Abbott Labs was attempting to monopolize the market for “boosted” protease inhibitors. Protease inhibitors are considered the most potent class of drugs available to fight the HIV virus. Norvir is the brand name for a patented compound called ritonavir. Abbott originally introduced Norvir in 1996 as a stand-alone protease inhibitor, with a recommended daily dose of 1,200 mg/day, priced at approximately \$18. Later, it was discovered that small doses of Norvir used in conjunction with another protease inhibitor would boost the effectiveness of the other inhibitor. Norvir’s use as a booster also reduced the side effects associated with high doses of protease inhibitors and slowed the rate at which HIV developed resistance to the other protease inhibitors. When used as a “booster,” however, the recommended daily dose of Norvir was only about 100-400 mg/day. By 2003, the average price for a daily dose of Norvir had fallen to \$1.71.

In 2000, Abbott introduced Kaletra, a single pill containing the protease inhibitor lopinavir as well as ritonavir, which is used to boost lopinavir’s effectiveness. Kaletra was effective and

widely used, but it caused some patients to experience significant side effects.

Three years later, two new protease inhibitors were about to be released to the market: Reyataz, by Bristol-Myers Squibb, and Lexiva, by GlaxoSmithKline. Studies showed that when boosted with Norvir, these new drugs were as effective as Kaletra, and were more convenient to some patients. After Reyataz was successfully introduced into the market, Kaletra's market share fell more than Abbott had anticipated. Moreover, the average daily dose of Norvir also fell. While prior protease inhibitors required 200–400 mg of Norvir per day to benefit from its boosting effect, Reyataz was effectively boosted by only 100 mg/day of Norvir.

On December 3, 2003, Abbott raised the price of Norvir from \$1.71 to \$8.57 per 100 mg, but kept the price of Kaletra constant. Abbott claimed that this price increase brought the price of Norvir closer to its considerable clinical value. A group of plaintiffs filed suit, claiming that the price increase violated Section 2 of the Sherman Act. The Section 2 claims centered on the allegation that Abbott was using its patent-conferred monopoly over Norvir to attempt to monopolize the boosted protease inhibitor market, in which Kaletra competed with Reyataz and Lexiva. A central component of the plaintiffs' claims was the understanding that Kaletra, which effectively bundled Norvir with Abbott's inhibitor lopinavir, was "discounted" to the point that competing firms could not offer customers a competitive price for boosted inhibitors.

The Legal Standards Applicable To Bundled Discounts

Much of the modern controversy over the legal standards governing bundled discounts by dominant firms results from the Third Circuit's decision in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc). The plaintiff in *LePage's* was a manufacturer of private label transparent tape. 3M manufactured Scotch tape and had a dominant share of the US transparent tape market. LePage's argued that 3M engaged in a series of related actions, including offering certain types of bundled rebates, that were designed to restrict the availability of lower-priced transparent tape to consumers.

In the challenged bundled rebates, 3M offered discounts to major customers conditioned on purchases spanning six of 3M's diverse product lines. For each product line, 3M fashioned growth targets specific to each customer. The size of the rebate was linked to the number of product lines in which the growth targets were met. Failure to meet the growth target in a single product line would cause the customer to lose the rebate across all of the products it had purchased from 3M.

3M argued that, pursuant to the US Supreme Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), LePage's was required to prove that 3M was selling tape below some measure of its costs. The Third Circuit, however, declined to adopt the per se rule of legality 3M sought. Pointing to its prior precedent in *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978), the Third Circuit noted that a monopolist's decision to link a product on which it faced competition with products on which it faced no competition had long been subject to searching inquiry under Section 2 of the Sherman Act. The court therefore affirmed the jury's Section 2 monopolization verdict despite the absence of evidence that 3M had priced tape below some measure of its costs.

The Ninth Circuit tackled the issue of bundled discounts in *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008). *Cascade* involved allegations of anticompetitive bundled discounts in the markets for primary, secondary and tertiary hospital services in Lane County, Oregon. A jury found in favor of the plaintiff on claims—including Section 2 claims—attacking bundled discounts. On appeal, the Ninth Circuit issued an order inviting *amicus* briefing on the bundled discount issues, then conducted a comprehensive analysis of the applicable antitrust framework.

The court began with the premise that bundled discounts are pervasive and generally procompetitive. It noted, however, that it was possible for a monopolist to use a bundled discount to exclude a competitor of equal or superior efficiency from the market and thus to reduce consumer welfare in the long run. The court determined, moreover, that by relying on a broader range of products, a bundled discounter could achieve competitor exclusion without sacrificing any short-run profits.

Because the jury instructions in *Cascade* had been based upon the Third Circuit’s decision in *LePage’s*, the Ninth Circuit first had to determine if a Section 2 plaintiff could attack bundled discounts qualitatively, by demonstrating market foreclosure, or if a cost-based standard should apply instead. The court surveyed the views of commentators that antitrust claims attacking bundled discounts are similar in certain respects to predatory pricing claims and similar in other respects to tying claims. The Ninth Circuit ultimately concluded that “[a] bundled discount, however else it might be viewed, is a price discount on a collection of goods.” It therefore found particularly relevant a long line of Supreme Court rulings showing that courts evaluating price-cutting behavior must tread with particular care because “mistaken findings of liability would chill the very conduct the antitrust laws are designed to protect.” The Ninth Circuit found “the course safer for consumers and our competitive economy” would be to hold that Section 2 claims “cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of the defendant’s costs.”

Its decision in favor of a cost-based test for liability obliged the court to resolve several thorny questions about how to formulate such a test. Unlike single-product cases, in which courts simply ask whether the defendant priced its product below its incremental cost of producing that product, bundled discount cases present far more challenging scenarios.

As noted above, a monopolist engaging in bundled rebates across several products can exclude equally efficient rivals without sacrificing short-term profits. Simply asking whether the defendant is pricing above its incremental costs therefore fails to capture potentially anticompetitive bundled rebates. With these considerations in mind, the court sought to evaluate the various rules of law proposed by the parties and the *amici*.

The defendant in *Cascade* and some of the *amici* advocated the adoption of an “aggregated discount” rule, under which bundled discounts could violate Section 2 only if the discounted price of the entire bundle was below the bundling firm’s incremental cost to produce the entire bundle. Such a test essentially ignores the multiple-product aspects of bundling and

applies the single-product predatory pricing framework of *Brooke Group*. The court rejected that test, finding that multiple-product cases present different concerns that require a different mode of analysis.

The court then proceeded to consider the legal standard proposed in *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996). The *Ortho* test, designed specifically for multi-product cases, “deems a bundled discount exclusionary if the plaintiff can show that it was an equally efficient producer of the competitive product, but the defendant’s bundled discount made it impossible for the plaintiff to continue to produce profitably the competitive product.” The standard appreciates that a cleverly designed bundled discount can have the effect of excluding an equally efficient competitor from the marketplace. It therefore permits a plaintiff to prove that it was equally efficient in producing the competitive product—and that the challenged bundled discount must therefore necessarily rely on factors other than superior efficiency to foreclose competition.

The Ninth Circuit recognized that the *Ortho* test was better than the aggregated discount rule in identifying bundled discounts that threatened competition. Nevertheless, the court perceived two significant problems in administering the test. Both problems resulted from the fact that the *Ortho* test is subjective because the legality of a challenged bundled rebate depends upon the cost structure of the plaintiff challenging it.

First, the court was sensitive to the fact that the *Ortho* test would not provide particularly helpful guidance to sellers interested in offering procompetitive bundled discounts. Because dominant firms are unlikely to have access to information about their competitors’ costs, they could never be assured that a proposed bundled discount would not violate Section 2.

Second, the court was concerned that the *Ortho* test would necessitate multiple lawsuits challenging the same bundled discount. The court envisioned a scenario in which a monopolist offering a bundled discount faced competition from two firms, one of which was more efficient than the monopolist at producing the competitive product, while the other was less efficient. Under the *Ortho* test, the discount would violate Section 2 relative to the more efficient

competitor but would be perfectly legal relative to the less efficient competitor. Thus, if the less efficient competitor brought an antitrust challenge and failed, the more efficient competitor would be forced to bring a second suit to obtain relief. The Ninth Circuit was skeptical of any rule “that might encourage more antitrust litigation than is reasonably necessary to ferret out anticompetitive practices.”

The court therefore decided to adopt what it termed a “discount attribution” standard amounting to an objective version of the *Ortho* test. Under that standard, which was advocated by several antitrust commentators and *amici*, the full amount of the bundled discounts given by the defendant is allocated to the competitive product. The bundled discount can violate Section 2 only if the resulting price of the competitive product is below the defendant’s incremental cost to produce it. By using the defendant’s own cost structure—rather than the plaintiff’s cost structure—to evaluate the legality of the bundled discount, the “discount attribution” standard will condemn only those bundled discounts that have the potential to exclude an equally efficient producer of the competitive product. The standard also avoids the practical counseling difficulties and multiple lawsuits that troubled the court relative to the *Ortho* test.

Finally, the *Cascade* court turned to the technical question of how to measure the defendant’s incremental cost of producing the competitive product. Relying on its prior precedent in the single-product context, the court determined that the appropriate measure of costs in bundled-discount cases was average variable cost.

Evaluating the Conduct in *Doe* as a Bundled Discount

It was against this background that the district court in *Doe* attempted to evaluate Abbott’s conduct. Abbott filed a motion to dismiss, arguing that plaintiffs’ claims were foreclosed by the Ninth Circuit’s analysis in *Cascade*. The district court denied the motion (see *In re Abbott Labs. Norvir Antitrust Litigation*, 562 F. Supp. 2d 1080, 1091 (N.D. Cal. 2008)), relying on its analysis in the parallel case of *Meijer, Inc. v. Abbott Labs.*, 544 F. Supp. 2d 995 (N.D. Cal. 2008).

The court denied Abbott’s motion for two reasons. First, the court was skeptical that Abbott’s conduct

could properly be analyzed as a bundled discount. The court deemed it “not readily apparent that Kaletra consists of two products at all—ritonavir and lopinavir are combined in a single pill.” Indeed, Abbott did not offer lopinavir as a stand-alone protease inhibitor, and the FDA licensed lopinavir for use only as a component of Kaletra. Because there was no independent price for lopinavir, the court deemed it impossible for Abbott to offer a “discount” on lopinavir when sold as part of Kaletra.

Second, the court held that even if Abbott’s conduct were to be analyzed under the rubric of bundled discounts, the *Cascade* test would not apply. The court found the test inapplicable because the stated goal of the *Cascade* test (making unlawful only those pricing schemes that would exclude equally efficient competitors from the market) would not be met by applying the rule to Abbott’s conduct. The court illustrated its reasoning with numbers from the record. Abbott charged \$17.14 for 200 mg of Norvir. A dose of Kaletra containing the same amount of Norvir was priced at \$18.78. Because the imputed price of lopinavir—the second component of the Kaletra compound—was \$1.64, Abbott’s pricing could fail the *Cascade* test only if its average variable cost of producing lopinavir was greater than \$1.64. But the cost of manufacturing Kaletra was no more than pennies per pill. Thus, Abbott’s pricing of Kaletra could virtually never be subject to liability under the *Cascade* test.

As the court observed, no newly developed protease inhibitor could ever be profitably sold at a price reflecting Abbott’s average variable cost of production, “because the manufacturer would never be able to recoup its huge research and development costs.” In other words, the court found that “unique structural characteristics of the pharmaceutical industry, where fixed costs in the form of investment in research and development dwarf variable costs,” rendered the *Cascade* test inapplicable.

The court briefly considered modifying the *Cascade* test to utilize a measure of cost that better addressed the realities of the pharmaceutical industry, but it found such an approach “difficult to implement in practice.” It therefore found the *Cascade* test an inappropriate measure of Abbott’s conduct because application of the test would immunize conduct that

could drive an equally efficient competitor from the protease inhibitor market.

Following the district court's decision, the parties entered into a high/low settlement. They agreed to base the ultimate settlement amount on how the Ninth Circuit resolved several questions on interlocutory appeal, including whether the *Cascade* test applied to Abbott's conduct.

Evaluating the Conduct in *Doe* as a Price Squeeze

The Ninth Circuit defied the parties' expectations by resolving the case on a different ground. According to the Ninth Circuit, the Supreme Court's recent decision in *Pacific Bell Telephone Co. v. Linkline Communications, Inc.*, 129 S. Ct. 1109 (2009), immunized Abbott's conduct from antitrust liability.

Linkline involved allegations of a "price squeeze" in the wholesale and retail markets for the provision of DSL service. Internet service providers sued AT&T, alleging that the company's high wholesale prices for DSL transport services, combined with its low prices for retail DSL service, had unlawfully squeezed their profit margins. The Court analyzed each aspect of the alleged squeeze separately.

First, relying on its recent decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), the Supreme Court found that AT&T's wholesale prices were immune from antitrust scrutiny. FCC regulations required AT&T to provide DSL transmission services to the plaintiffs. But the Court determined that AT&T had no obligation under the antitrust laws to provide services to its rivals. Given that AT&T could, consistent with Section 2, refuse to provide DSL transmission services to the plaintiffs under any terms, it necessarily followed that Section 2 could not condemn providing those services at prices higher than the plaintiffs would have preferred.

Second, the Court evaluated plaintiffs' claims that AT&T's retail prices were too low. Noting the strong antitrust policies in favor of low prices to consumers, the Court found that low prices could violate Section 2 only if they were predatory under the *Brooke Group* analysis—a theory the plaintiffs had not adequately alleged. Finding that plaintiffs' price squeezing claim

was "nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level," the Court found AT&T immune from antitrust liability.

The *Doe* court found its case to be indistinguishable from *Linkline*. Conceiving of plaintiffs' claims as amounting to an allegation that Abbott's prices for Kaletra were too low and its prices for Norvir were too high, the Ninth Circuit evaluated each claim separately. Because plaintiffs had alleged no refusal to deal at the booster level and no below-cost pricing at the boosted protease inhibitor level, the Ninth Circuit found Abbott's conduct to be beyond the range of Section 2.

Evaluating the Conduct in *Doe* as Monopoly Leveraging

The plaintiffs in *Doe* resisted application of *Linkline* by arguing that they had alleged neither price squeezing nor bundled rebates, but rather had alleged a free-standing claim for monopoly leveraging. The Ninth Circuit had previously approved such a theory of Section 2 liability in *Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997). That case involved an allegation that Kodak had refused to sell its parts to independent service organizations and that the company "used its monopoly power over Kodak photocopier and micrographic parts to attempt to create and actually create a second monopoly over the service markets."

The *Doe* plaintiffs maintained that their theory was indistinguishable; that is, they alleged that Abbott was using its monopoly power over the booster market to attempt to create a second monopoly over the boosted protease inhibitor market. The Ninth Circuit was unconvinced, pointing out that "*Image Technical* involved a refusal to deal." Under those circumstances, the court found that *Linkline's* logic compelled the conclusion that the *Doe* plaintiffs had not stated a claim under Section 2.

Conclusion

Unfortunately, bundled discounts continue to defy categorization into easily applicable antitrust standards. Even within the Ninth Circuit, the extent to which the *Cascade* test was modified by *Linkline* and *Doe* remains unclear. The facts in *Doe* closely resemble

neither the traditional multiple product offerings of bundled rebate analysis nor the wholesale/retail market distinction in price squeeze analysis. The *Doe* court's logic suggests that Section 2 defendants within the Ninth Circuit could now enjoy even broader protection than was available under *Cascade*. Nevertheless, particularly given the Third Circuit's decision in *LePage's*, offering bundles that include both competitive products and products over which the bundler may have monopoly power remains subject to unclear antitrust standards. ♦

The Review of the EC Regulation on Vertical Restraints: Selective Distribution and Online Commerce

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Introduction

The European Commission (Commission) is reviewing the Block Exemption Regulation for Vertical Agreements (VBER), which expires on 31 May 2010.¹ The VBER provides the legal framework regulating vertical relationships. Under certain conditions, the VBER provides for a safe harbor or an automatic exemption for agreements between suppliers and distributors. The VBER also lists a number of so-called “black clauses” that, if included in a vertical agreement, can cause the loss of the automatic exemption benefit.

On 28 July 2009, the Commission launched a public consultation on a draft proposal for a new regulation (Draft Regulation) and its interpretive guidelines (Draft Guidelines) on vertical agreements.²

According to the Commission, the proposed regime does not intend to significantly alter the current regulation; rather, the Commission intends to update the legislation to reflect the most recent market developments. In particular, the draft amendments intend to address the evolution of Internet-based sales.

Of particular interest are the changes proposed in relation to the interaction between selective distribution and online commerce. This article summarizes the proposals made in this regard and comments briefly on their implications.

What is New: Critical Review

TERRITORIALITY AND SELECTIVE DISTRIBUTION

Article 1(d) of the current VBER defines selective distribution system as “a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors.” Article 1(1)(c) of the Draft Regulation does not change the definition.

Further, as it currently stands, Article 4(b) third indent allows suppliers to restrict an appointed distributor in a selective distribution system from selling (actively or passively) at any level of trade to unauthorised distributors. However, the Draft Regulation adds that the exemption would apply if and when applied to selective distributors “in markets where such system is operated.”

The novelty resides precisely in this last phrase. The questions are inevitable. What does it mean? What type of situations is it meant to regulate? The answers are unclear.

First, the precise meaning of the phrase is quite obscure and could give rise to a number of different interpretations. On the one hand, the amendment could be

interpreted as applying to situations where suppliers apply different distribution systems in various markets (presumably in antitrust markets). On the other hand, a literal reading of the amendment could suggest a different situation, whereby any sales made by authorized dealers to non-authorized distributors outside the markets where the selective distribution is operated would be presumed to be legitimate. Clearly, both interpretations could not be reconciled.

Second, read literally, the amendment would contradict the definition of selective distribution of Article 1(d) (Article 1(1)(c) of the Draft Regulation) as a network where sales can only take place among authorized dealers and between those dealers and end-consumers, which remains unchanged.

Finally, the amendment adds complexity, by requiring suppliers to define antitrust markets, and legal uncertainty. Both complexity and uncertainty are unwelcomed guests in the days of self-evaluation and online commerce. The Commission has thus generated a new grey area, which fertilizes the ground for more litigation.

Thus, it is clear that this amendment is a clear example of the Commission's having missed the opportunity to introduce a clearer and more simple regulation of vertical agreements.

Favouring Online Commerce?

While maintaining the distinction between active and passive sales,³ arguably of obsolete and difficult application in the online world, in the Draft Guidelines the Commission proposes to consider hardcore restrictions and, therefore, to presume illegal as an infringement of Article 81(1) EC Treaty the following:

Paragraph (52) [...]

- » requiring a (exclusive) distributor to prevent customers located in another (exclusive) territory from viewing its website or requiring the distributor to put on its website automatic re-routing of customers to the manufacturer's or other (exclusive) distributors' websites;
- » requiring a (exclusive) distributor to terminate consumers' transactions over the internet once their credit card reveals

an address that is not within the distributor's (exclusive) territory;

- » requiring a distributor to limit the proportion of overall sales made over the Internet;²⁹
- » requiring a distributor to pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line.³⁰

29 This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products off-line to ensure an efficient operation of its brick-and-mortar shop, nor does it preclude the supplier from making sure that the online activity of the distributor remains consistent with the supplier's distribution model (see paragraphs 54 and 57). This absolute amount of required off-line sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location.

30 This does not exclude the supplier offering the buyer a fixed fee to support its off-line or online sales efforts.

The debate on Internet commerce and certain distribution means was first opened by eBay's *Call for Action*,⁴ where certain restrictions to Internet commerce were considered to amount to barriers to the common market. To steer up the debate, Commissioner for Competition, Ms. Neelie Kroes, organized a roundtable on online commerce⁵ and published a consultation under the title "Opportunities in Online Goods and Services: Issue Paper."⁶

The various contributions submitted to the Issue Paper demonstrate that the heart of the debate is enterprise freedom and consumer choice.⁷ In simple terms, the online champions (and the supporting platforms) argue that the Internet promotes consumer choice in terms of wider product range, lower prices and 24/7 service, and that online window shopping exists as a matter of fact. Those advocating for selective distribution and the right to decide who can be a member of the network claim that their products necessitate selective distribution and that online shops cannot always be right for all products, and that online retailing of such products necessitate

that online shops guarantee compliance with a number of qualitative conditions for the sake of brand protection and customer care.

The preliminary result of the debate, as reproduced in paragraph 52 of the Draft Guidelines, suggest that online commerce may be being treated more favourably than traditional means of trade. The reason being that a number of practices are prohibited and, therefore presumed illegal, without explicit reasoning and without the support of empirical evidence. For a critical review, we analyse some of those provisions:

Web Rerouting

The first of the new presumptions of illegality affects restrictions to web rerouting. The prohibition of web rerouting prompts some questions. One of the main issues is that the Commission does not allow to exempt the practice under objective justifications. While objective justifications are not considered, there are a number of technical, commercial and even legal justifications for web rerouting practices. In particular, from a legal perspective, web re-routing may serve to address issues concerning disparate legislative systems (consumer protection, product liability, data protection, etc.) and trading conditions, as well as to minimize free-riding risks and to provide for adequate liability structures.

Limiting the Proportion of Offline and Online Sales

Under the new Draft Guidelines, any requirement imposed on a distributor to limit the proportion of overall sales made over the Internet would be presumed illegal. Simply put, suppliers would be banned from imposing resale restrictions over the Internet. Traditionally, the ability for suppliers to impose resale restrictions has been one of the major tools used to prevent free-riding issues.⁸ Hence, the new regime would prevent suppliers to regulate the risk of Internet free riding.

Dual Pricing

Moreover, the Commission also would presume illegal any suppliers' requirement obliging online distributors to pay a higher price for the products than those distributors with physical outlets.

This restriction steps directly into the unresolved

issue of price discrimination. Price discrimination can be the result of multiple variables and in particular simply reflect different national market conditions (e.g., different cost structures, tax regimes, divergent national rules on consumer protection and product liability, specific responses to customer service, culture, taste and preferences, etc.). Arguably, restriction of competition is not the objective of the practice.

The new amendments would thus ban, as hardcore restrictions restraints, to Internet commerce, even in the context of selective distribution, and would reverse the burden of proof under Article 81(3) EC Treaty to suppliers.⁹

Conclusion

The Commission has indicated that the review of the VBER was an exercise of simplification, and that no major changes were to be expected.¹⁰

However, the development of online commerce is at the heart of a series of amendments proposed by the Commission as soft law, which has created much controversy. For some, the proposed regulation shifts the balance toward a more favoured treatment of Internet retailers (and intermediary auction platforms) and prevents suppliers from protecting their brick and mortar selective distributors from free-riding behaviours. Online traders claim that in the name of consumer choice no restrictions can be imposed to online commerce. Their positions seem difficult to reconcile.

A critical review of the proposed amendments poses a number of questions. First, although the Commission may have well-founded reasons and empirical evidence to support such new presumptions of illegal practices, the proposed drafts do not provide any reasoning.

Second, the consideration of certain practices (as per paragraph 52 of the Draft Guidelines) as hardcore restrictions of passive sales without at least room for objective justification have stern legal consequences. As stated in paragraph 47 of the Draft Guidelines: "Including such a hardcore restriction in an agreement gives rise to the presumption that the agreement falls within Article 81(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 81(3), for which reason the block exemption does not apply."

Finally, far from the touted objectives of better regulation and simplification,¹¹ some of the amendments are purported to boost legal uncertainty and as a result, increase the risk of litigation in a market where a large proportion of the players are small businesses.

The public consultation closed on 28 September 2009. If adopted in December 2009,¹² the new rules should be in force for a period of 10 years, beginning 30 June 2010. No transition period is foreseen. ♦

Endnotes

- 1 Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L336721, of 29.12.1999.
- 2 Available at http://ec.europa.eu/competition/consultations/2009_vertical_agreements/index.html
- 3 See paragraph 50 of the Guidelines and paragraph 51 of the Draft Guidelines. Note that under the VBER, passive sales can not be restricted under any circumstances.
- 4 Available at <http://ebayinkblog.com/2008/06/25/ebay-launches-call-for-action-campaign-in-europe/>
- 5 Available at http://ec.europa.eu/competition/sectors/media/online_commerce.html
- 6 Available at http://ec.europa.eu/competition/consultations/2008_online_commerce/online_issues_paper_annex.pdf
- 7 See public contributions at http://ec.europa.eu/competition/consultations/2008_online_commerce/index.html
- 8 See, for instance, judgment of the German Federal High Court of 4 November 2003 *Depotksmotik im Internet* where the court on the basis of the VBER and its interpretative Guidelines concludes that (i) it is neither discriminatory not unjustified within a selective distribution system to condition the supply of the goods to the condition that at least 50% of total sales are made through the brick-and-mortar store (and thus 50% online at the most) and (ii) there is no obligation to supply or even authorize a mere e-trader.
- 9 See paragraph 47 of the Draft Guidelines. “However, this is a rebuttable presumption which leaves open the possibility for undertakings to plead an efficiency defence under Article 81(3) EC in an individual case. In case the undertakings substantiate that likely efficiencies result from including the hardcore restriction in the agreement and that in general all the conditions of Article 81(3) are fulfilled. This will require the Commission to effectively assess—and not just presume. The likely negative effects on competition before making the ultimate assessment of whether the conditions of Article 81(3) are fulfilled.”
- 10 Proclaiming the limited scope of the changes, the Commission has published the draft proposal for public comments without undertaking an impact assessment of the amendments. However, some stakeholders claim that, in fact, the changes proposed by the Commission are not insignificant and will have a major impact on their core business. In this regards, it is worth noting that under Recital 4 of Regulation No. 19/65/EEC of the Council of 2 March 1965 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices (OJ P 36, 6.3.1965, p. 533), the Commission’s powers to block exempt certain categories of agreements and concerted practices should only be exercised “after sufficient experience has been gained in the light of individual decisions.”
- 11 The most important elements of the Commission’s better-regulation strategy are simplification, the reduction of administrative burden and impact assessments. See http://ec.europa.eu/governance/better_regulation/index_en.htm
- 12 Recent information suggests that the European Commission could postpone the adoption of the VBER until the new Commission is in place. Such a decision would mean that the VBER would be adopted in 2010.

Rescuing a Rule of Reason Claim by Aggregating the Effects of Noncollusive, Noncoercive Agreements—A New Litigation Threat For Industry Standard Contracting Practices?

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United States antitrust law condemns very few types of agreements between businesses outright. That *per se* status is generally confined to agreements to restrain price or output that are made between participants at the same level of a market—i.e., conspiracies among competitors. Most other claims asserting that a business agreement unlawfully restrains trade under Section 1 of the Sherman Act are evaluated under the rule of reason.

Rule of reason analysis requires an assessment of the actual or likely anticompetitive effects of the challenged practice. For practical purposes, a showing of anticompetitive effects requires a showing of market power. That is because few arrangements that do not involve collusion among competitors can affect the competitive process in the absence of market power. Consequently, if a party with only a small market share engages in a contracting practice, rule of reason analysis ends at the threshold.

In practice, rule of reason litigation often founders on the plaintiff's inability to prove market power. A recent decision by the US Court of Appeals for the Ninth Circuit, however, may make such rule of reason claims substantially easier to maintain.

On April 3, 2009, a divided panel of the Ninth Circuit revived a decade-long lawsuit brought on behalf of a putative

class of wholesale gasoline purchasers who had sued nine petroleum companies over their hedging practices involving a special blend of gasoline required by the California Air Resources Board (CARB gasoline). See *William O. Gilley Enterprises, Inc. v. Atlantic Richfield, Inc.*, 561 F.3d 1004 (9th Cir. 2009). The defendants had won summary judgment in an almost identical lawsuit in California state court. That action had alleged that the refiners had conspired to limit supply and raise prices by entering into a series of bilateral exchange agreements that effectively kept CARB gasoline off the spot market.

For once, however, federal court—and federal antitrust law—proved more plaintiff-friendly than California state court. The Ninth Circuit held that market power analysis can aggregate the market share of all counterparties to a single party's contracts, even in the absence of a broader conspiracy to restrain prices or output. Thus, the plaintiffs were entitled to pursue their theory that the refiners' bilateral exchange agreements, while made without collusion, had the aggregated effect of raising prices above competitive levels and therefore violated Section 1 of the Sherman Act under the rule of reason.

The Ninth Circuit recognized that a rule of reason claim usually requires

proof of market power in order to show that the agreement has anticompetitive effects. Breaking new ground, however, the panel majority held that the effects of each defendant's multiple exchange agreements could be aggregated. This ruling, in turn, allowed market power to be shown by aggregating the market share of the other defendants who were counterparties to a single defendant's series of hedging agreements. That is, even though each defendant lacked market power individually, the claim could go forward, even in the absence of collusive action, so long as the defendants' collective market power was sufficient to threaten anticompetitive effects that might violate Section 1 under the rule of reason.

The effect of the Ninth Circuit's decision could be limited to its unusual factual setting, which involved a concentrated market in which each of the participants entered into hedging agreements with some or all of the others. All of the producers had large sales commitments to their respective distribution networks. Because the market was subject to artificial regulatory limitations, there were no independent producers. Consequently, individual producers had no alternative source of supply except one another. Thus, producers' options for hedging their own sales requirements were largely limited to purchases from their competitors.

But the aggregation principle recognized in this decision instead could have much broader consequences for antitrust litigation. The Ninth Circuit's decision may provide a new basis on which to bring common industry contracting practices under closer antitrust scrutiny. This is because its reasoning seems but one step away from allowing the independent parallel action of a variety of noncolluding market participants to be treated together for purposes of market power analysis.

Background

In 1991, the California Air Resources Board (CARB) adopted regulations limiting the sale of gasoline in California to a new, cleaner burning, but more expensive formulation of gasoline—CARB gasoline—beginning in 1996. That same year, a putative class of retail CARB gasoline purchasers sued nine petroleum companies in California state court (the *Aguilar* action), asserting violations of

California's Cartwright Act.¹ The suit alleged that the defendants had conspired to restrict output and raise prices of CARB gasoline by entering into a series of bilateral exchange agreements to ensure that each refiner had an outlet for any surplus and a source of supply to make up any shortfall. Plaintiffs argued that the agreement had effectively prevented most CARB gasoline from reaching the spot market. Two years later, in 1998, Gilley Enterprises filed a Sherman Act complaint in federal court, mirroring the allegations in *Aguilar* against the same defendants. The federal action was stayed pending resolution of the state court lawsuit.

In 2001, the California Supreme Court upheld a grant of summary judgment to the defendants in *Aguilar* on the ground that there was no evidence of a conspiracy or collusive action.² The defendants subsequently moved for summary judgment in *Gilley* on the ground of issue preclusion (collateral estoppel). The district court agreed, but granted Gilley leave to amend its complaint.

Gilley's amended complaint alleged that 44 CARB gasoline exchange agreements had the effect of unreasonably restraining trade even in the absence of a conspiracy. The district court dismissed the complaint because Gilley could not articulate how any *individual* exchange agreement could have anticompetitive effects, as each agreement accounted for only a small percentage of the relevant market.

After the Ninth Circuit remanded for a further opportunity to replead, Gilley filed another amended complaint, relying for its theory of anticompetitive effects on the *aggregate* market power of each individual refiner-defendant and all other refiners who entered into exchange agreements with it: "[t]hrough the use of [the defendant's] exchange agreements, coupled with its own refining capacity and that of its contracting partners, [defendant] has obtained sufficient market power to limit the supply of CARB gas to unbranded marketers and to raise the price."³

The district court again dismissed the complaint, holding that Gilley's allegation of the existence of a network of exchange agreements that allowed defendants to coordinate their production and output to limit the amount of CARB gasoline on the spot market "is, at its core, a conspiracy claim."^{4, 5} In the district court's view, even if the exchange agreements

could be aggregated, there still was no causal connection between the exchange agreements and anticompetitive effect in the absence of a conspiracy.

The court provided a hypothetical: producer A enters into separate exchange agreements with producers B, C, D, E and F. If producer B overproduces gasoline, A may be able to take the excess amount and adjust its own production accordingly. But in the absence of coordinated action among the defendants, one producer cannot have enough control over the refining capacity in its geographic area to keep gasoline out of the spot market and away from unbranded sellers. This is because producers C, D, E and F may also produce excess gasoline that cannot be absorbed by A because A has already taken the overproduction from B. Without further agreement among the producers, the alleged market distortion could not occur.

The Ninth Circuit's Decision

The Ninth Circuit reversed. The court of appeals agreed with the district court that *Aguilar* precluded a claim that depended upon proof of collusion by the defendant oil companies to control supply and prices.⁶ But the majority held that Gilley had stated a valid antitrust claim by pleading that, “without a conspiracy,” the exchange agreements, “when aggregated together,” had “an anti-competitive effect on competition in the relevant market.”⁷

The Ninth Circuit majority held that the district court should have permitted Gilley to allege the cumulative effects of a single defendant's exchange agreements to show that defendant's market power and anti-competitive effect. Drawing on the analogy of a single party's array of tying agreements with different consumers, the Ninth Circuit held that antitrust law generally permits “the aggregation of multiple contracts when evaluating the legality of an individual contract.”⁸ The majority declined to limit that principle to exclusive dealing and tying contracts that could be aggregated to show the market power of the single party that imposed those contracts upon its customers. Rather, the court recognized “no general rule [that] requires that only the easiest cases may be aggregated.”⁹

The court also held that it was improper on a motion to dismiss for the district court to “probe the soundness of Gilley's economic theory” to find that the claim

was, at its core, a conspiracy claim.¹⁰ According to the panel, “[t]he district court may be correct in its understanding of how the economy or the oil business works, but that is a factual assessment not left to the court, even a savvy judge, to decide on a Rule 12 motion.” Moreover, the court of appeals disapproved of the district court's reliance on hypothetical reasoning that applied common sense to the allegations in the complaint. In the panel's view, the courts must accept at face value the complaint's conclusory allegations: i.e., that anticompetitive effects have resulted from the exchange agreements in the absence of collusion, even if the conclusion made no sense in light of the facts pleaded.

The panel was not disturbed by the US Supreme Court's recent requirement in *Bell Atlantic Corp. v. Twombly* that pleaded antitrust theories be plausible, not merely possible.¹¹ Instead, the panel viewed *Twombly* as simply reaffirming the principle that “[e]ven if ... a savvy court[] view[s] actual proof of the facts pleaded in the [complaint] as improbable and conclude[s] that a recovery is remote and unlikely, the complaint should still proceed.”¹²

Judge Callahan dissented. She believed that *Aguilar* precluded the *Gilley* complaint because, to make sense, the new complaint necessarily relied on collusion. More broadly, she believed that *Twombly* precluded the majority's indulgence of the complaint's counterintuitive theory of noncollusive anticompetitive effects.¹³ And most important, she rejected the use of aggregation to rescue the complaint.

Judge Callahan agreed that Gilley could aggregate each defendant's contracts to determine that defendant's market power. But she rejected the notion that Gilley could aggregate all of the bilateral agreements by all of the defendants. Judge Callahan viewed the complaint's theory as necessarily reliant on market-wide aggregation. It is not clear that the majority's reasoning would permit market-wide aggregation in every setting. In the specific circumstances of CARB gasoline production, however, market-wide aggregation results from the panel majority's holding that Gilley could aggregate the market shares of all participants in each defendant's agreements.

Judge Callahan did not believe that aggregation would salvage Gilley's claim, no matter what market share resulted from the aggregation of each defen-

dant's exchange agreements. In her view, individual exchange agreements, unlike exclusive dealing contacts, do not inherently restrain trade. The use of exchange agreements to avoid selling excess gasoline on the spot market is consistent with each defendant's economic self-interest because spot markets produce lower returns than do sales to branded dealers. As a result, aggregation at most would produce a complaint that pleaded market power without pleading any unlawful conduct. In Judge Callahan's view, a "narrow focus" on the effect of the various bilateral agreements "would convert self-interest parallel action, similar to that found to be legal in *Twombly*, into an antitrust violation."¹⁴

Implications of the Decision

The *Gilley* decision raises many more questions than it answers. The Ninth Circuit revived allegations that had failed in the accommodating California state courts because there was no evidence of any agreements among suppliers to use the hedging agreements to reduce competition.

The decision might have the relatively narrow effect of permitting aggregation only of a single market participant's contracts in the market power analysis. In that interpretation, the *Gilley* claims survived only because each defendant contracted with most of the other suppliers in these reciprocal hedging agreements. That is, contracts with parties who were not also competing suppliers might not have had the effect of inflating a single defendant's market power.

On the other hand, the breadth of the panel majority's reasoning could sustain broad new antitrust theories that have little apparent economic basis. Such interpretations could support Section 1 violations based on industry-standard contracting practices, regardless of how indistinct or unsubstantiated their threat to competition. It is easy to imagine at least some trial courts giving the Ninth Circuit's decision this broader reading.

The *Gilley* decision has two significant implications.

First, in rejecting the district court's role in screening a pleaded theory for economic common sense, the Ninth Circuit undermines the requirement of plausible antitrust pleading in *Twombly*—a requirement of plausibility that the US Supreme Court has since

extended to all civil actions.¹⁵ The majority gave a strikingly narrow construction to the *Twombly* directive to dismiss antitrust claims that are not plausible in light of basic economic principles. *Twombly* emphasized that a complaint fails if "it stops short of the line between possibility and plausibility of 'entitle[ment] to relief.'"¹⁶ Yet the panel treated any analysis of plausibility as purely factual and thus inappropriate at the pleading stage.

In contrast, many other courts of appeals have recognized that *Twombly* requires a determination of plausibility on a motion to dismiss.¹⁷ The *Gilley* majority reiterated older precedent holding that dismissals are "disfavored in antitrust actions."¹⁸ But *Twombly* appeared to have put that disfavor to rest. In finding that a complaint alleging merely parallel conduct did not sufficiently plead a conspiracy, the Supreme Court explained, "it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potential enormous expense of discovery in cases with no 'reasonably founded hope that the [discovery] process will reveal relevant evidence' to support a § 1 claim."¹⁹

The Ninth Circuit's majority also departed from the spirit, if not the text, of *Twombly* in chiding the district court for considering whether the asserted anticompetitive effects could occur without a conspiracy. Such a common-sense analysis would seem necessary to ensure that a claim has crossed "the line from conceivable to plausible." Indeed, the Supreme Court explained that the sufficiency of a complaint "turns on the suggestions raised by [the alleged] conduct when viewed in the light of common economic experience."²⁰ Yet the *Gilley* majority found that the district court had exceeded the appropriate judicial role when it attempted "to determine the soundness of Plaintiffs' economic theory."²¹ Common sense, it seems, has no place at the pleading stage.

While courts must take as true any allegations of historic fact, it is unclear how a court could determine whether a pleaded entitlement to relief is plausible, rather than merely possible, without probing the soundness of the plaintiff's economic theory. More specifically, the theory adopted by the Ninth Circuit appears in substantial part to provide an end-run around *Twombly*. One of the central holdings of that

decision was that parallel conduct “is just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market” as with a conspiracy.²² And such “unilaterally prompted” conduct is usually analyzed on the basis of each individual actor’s market power, if any.

In line with this analysis, the *Gilley* district court considered whether the pleaded agreements actually reflected anticompetitive control of the market. With neither allegations of coordinated action nor allegations that the exchange agreements required a contracting partner to produce or purchase a pre-established amount of CARB gasoline, it concluded that no defendant could control the output of any of its contracting partners. Moreover, as the Ninth Circuit dissent noted, there are sound economic reasons why, even without collusion, an oil refiner is strongly motivated to avoid having to sell gasoline on the spot markets. Spot markets exist only when a refiner produces more gasoline than can be sold by its branded dealers. They result from refiner inefficiencies and they produce lower returns than the refiner can obtain through its branded dealers.²³ Given these economic realities, then, the theory of noncollusive anticompetitive effects, as opposed to individual interest-seeking, does not make economic sense. The *Gilley* majority’s refusal to recognize any meaningful judicial role in assessing the economic plausibility of the allegations in an antitrust complaint will cause further confusion for litigants and trial courts while prolonging the litigation of meritless claims.

Second, the Ninth Circuit’s decision is troubling in that it apparently permits the aggregation of contracts among different parties not acting in concert to determine market power. The decision suggests that the effects of a single market participant’s agreements may be aggregated not only to determine *that* defendant’s market power, but also to attribute to it the market power of all entities with which it contracts. If horizontal competitors buy and sell from each other, for example, then their market shares may be aggregated for purposes of antitrust analysis, even in the absence of any collusion between them at either the buyer level or the seller level.

As the dissent pointed out, the complaint appears to

allege the aggregation of the contracts of all the defendants, and the majority opinion did not clearly distinguish between aggregating the contracts of one defendant and aggregating the contracts of all defendants (perhaps because each defendant contracted with most or all of the others). Aggregating the contracts of all defendants would include the entire market whenever an entire industry follows a standard contracting practice—here, a hedging strategy. Yet no real “power” would result from the standard practice, since no individual defendant—and no coordinated group—would control output and pricing.

Aggregation is commonly used to determine the probable competitive effects of a merger by considering the impact on the competitive landscape of two firms acting in a coordinated manner. And it makes sense to aggregate a single defendant’s contracts to evaluate that defendant’s ability to affect competition through restrictive practices. Thus, a single defendant’s series of tying agreements or unreasonably long exclusive dealing arrangements might be treated together. But that aggregation would reflect the market power of a single market participant able to impose anticompetitive terms on its customers.

In *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, for example, the Ninth Circuit aggregated the market share encompassed in all of a defendant’s unreasonably long concession franchise agreements with follow-the-franchise clauses that, taken together, created barriers to entry and precluded competition within the franchise market.²⁴ That type of aggregation treated a single defendant’s pattern and practice of using exclusive deals to lock up the market incrementally, on the ground that a defendant should not be allowed to do piecemeal what it would be prohibited from doing simultaneously.

Similarly, the market effects of a single defendant’s tying arrangements are generally treated as a whole, precluding the need to examine each tied sale independently. But even though tying and exclusive dealing must be evaluated under the rule of reason, their *potential* for anticompetitive effects is well recognized (if somewhat controversial) where they foreclose sufficient proportions of a market. This is true, in part, because of the seeming coercion exercised to demand agreement to the tie or exclusive deal.

It is difficult, in contrast, even to articulate how the bilateral exchange agreements seen in *Gilley* might have actual anticompetitive effects. This is especially the case because the agreements did not *require* a contracting partner to purchase gasoline under the contract, nor did they limit a partner from selling its own gasoline on the spot market.²⁵

In the context of *Gilley*, all aggregation could show is one defendant's potential market power if it purchased all of its contracting partners' gasoline production. But that is neither the probable, nor even the possible, effect of those agreements, much less a plausible outcome. Rather, the hedging agreements provided refiners with definite prices for any excess production, along with definite access to supply any excess needs if their own production was inadequate.

Although rule of reason analysis is necessarily fact-specific, aggregation alone—that is, market power alone—shows only that a challenged practice, if anticompetitive, could have sufficiently widespread effects to harm the integrity of the market as a whole. Even at the pleading stage, however, a plaintiff should be required to articulate a plausible basis for believing that the challenged agreements restrained competition. It should not be sufficient merely to demonstrate that agreements of similar structure covered a substantial share of the market.

Other courts have applied this more-stringent analysis. For example, in evaluating whether certain resale limitations in Anheuser-Busch's agreements with its distributors violated Section 1, the Eleventh Circuit took a very different approach to the proper role of aggregation in Section 1 allegations. The court of appeals in that case declined to aggregate Anheuser-Busch's individual distributor agreements for the purpose of showing market power and anticompetitive effect.²⁶ The court cautioned that, if aggregation were permitted in the absence of a conspiracy among the distributors, "aggregation of market share would always be required when reviewing vertical restraints."²⁷ That practice, in turn, could threaten "arrangements traditionally reviewed under the rule of reason, by making market power seem to appear where it does not really exist."²⁸ As the Eleventh Circuit recognized, weakening the market power screen in this way could subject a much wider variety

of neutral agreements and business practices to a fact-specific analysis of their competitive effects.

The Ninth Circuit's decision, however, does exactly that. In reality, each refiner's agreements give it power only over its own production and whatever additional purchases it may need to make. In the absence of collusion, an individual oil refiner has no control over the production, supply or pricing of its contracting partners. An analysis that aggregates the market shares of its exchange agreement partners, however, makes it appear that the single refiner has market power to affect prices merely because it can purchase gasoline from other refiners.

The *Gilley* decision may be short-lived. After the defendants petitioned for rehearing, the court swiftly called for a response and has since considered the petition for nearly six months. But if *Gilley* remains in place—or if other courts adopt its reasoning—companies facing rule of reason claims may find that a complaint's economic implausibility will not necessarily result in early dismissal. And unless the reciprocal nature of the exchange agreements in *Gilley* provides a strict limiting principle, a more advanced rule of reason inquiry may result whenever many companies within an industry use similar contracts. ♦

As we were going to press, the Ninth Circuit panel withdrew its opinion and issued a new decision affirming the dismissal. The new opinion rests largely on gaps in the pleading, while offering dicta that echoed many of the ideas in the withdrawn opinion. We will explore the new opinion in the next edition of the Antitrust Review.

Endnotes

- 1 See *Aguilar v. Atlantic Richfield Co.*, 25 Cal.4th 826 (2001)
- 2 *Id.*
- 3 See *Gilley*, 561 F.3d at 1008-09
- 4 *Id.* at 8.
- 5 *William O. Gilley Enters., Inc. v. Atlantic Richfield Co.*, No. 98cv132BTM, at 6 (S.D. Cal. July 18, 2006) (slip op.).
- 6 See *Gilley*, 561 F.3d at 1008-09.
- 7 *Id.* at 1009.
- 8 See *Gilley*, 561 F.3d at 1010-11.
- 9 *Id.* at 1011.

- 10 *Id.* at 1013 (“That the district court believes that the allegedly anticompetitive effects would not actually occur without a conspiracy does not justify dismissal of the [complaint] for failure to state a claim.”).
- 11 550 U.S. 544 (2007).
- 12 *See Gilley*, 561 F.3d at 1011.
- 13 *Id.* at 1019-21.
- 14 *Id.* at 1021-22.
- 15 *See Ashcroft v. Iqbal*. 129 S. Ct. 1937, 1949-51 (2009).
- 16 *Twombly*, 550 U.S. at 557; *see id.* at 570 (“Because the plaintiffs have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.”).
- 17 *See, e.g., Christy Sports, LLC v. Deer Valley Resort Co.*, 555 F.3d 1188, 1191-92 (10th Cir. 2009); *Wilkerson v. New Media Tech. Charter Sch. Inc.*, 522 F.3d 315, 321-22 (3d Cir. 2008); *Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 434 & n.2 (6th Cir. 2008); *Limestone Dev. Corp. v. Village of Lemont.*, 520 F.3d 797, 802-04 (7th Cir. 2008); *In re Elevator Antitrust Litig.*, 502 F.3d 47, 50-52 (2d Cir. 2007).
- 18 561 F.3d at 1009 (citing *Hosp. Bldg. Co. v. Trs. of Rex Hosp.*, 425 U.S. 738, 746, 96 S.Ct. 1848, 48 L.Ed.2d 338 (1976)).
- 19 *Twombly*, 550 U.S. at 559 (quotation marks and citations omitted).
- 20 *Id.* at 565.
- 21 *Gilley*, 561 F.3d at 1011.
- 22 *Twombly*, 550 U.S. at 554.
- 23 *Gilley*, 561 F.3d at 1022.
- 24 *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1301 (9th Cir. 1982).
- 25 The *Aguilar* court described the contracts as “exchange agreements—under which, for example, two companies *may* trade, with or without a price differential, products of the same type in different geographic areas and/or at different times *or* products of different types in the same geographic area and/or at the same time.” 25 Cal. 4th at 839 (first emphasis added).
- 26 *Maris Distributing Co. v. Anheuser-Busch, Inc.*, 302 F.3d 1207, 1218-19 (11th Cir. 2002).
- 27 *Id.* at 1218.
- 28 *Id.*

Uncertainty Makes a Comeback under the Robinson-Patman Act

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Just when it looked as though the US Supreme Court's 2006 Volvo¹ decision would discourage more price discrimination cases, along comes a court that not only finds a violation but holds a seller in contempt for ceasing sales to a disfavored purchaser.

In *Feesers, Inc. v. Michael Foods, Inc.*, a food manufacturer charged lower prices to a foodservice operator—which served meals at schools, hospitals and other institutions—than it charged to a food distributor—which resold pre-packed food products to customers that ran their own dining operations. The manufacturer did not view these two customers as competitors but the US District Court for the Middle District of Pennsylvania disagreed, finding that institutional customers chose either to hire a foodservice operator or to buy food and operate dining services themselves, but not both. The court also did not believe that customers never considered switching between the two options. On this basis, the court found that the foodservice operator and the food distributor were in competition after all. Accordingly, a sustained difference in the prices they were charged proved a violation against both the manufacturer for discriminating, and against the foodservice operator for inducing discrimination.

The manufacturer argued that, in any event, it had satisfied the requirements of the meeting competition defense.

The court disagreed again. Applying some interesting reasoning, the court found that because the manufacturer never learned the details of competitive offers, it was more likely to be beating those offers than just meeting them.

The court enjoined the manufacturer from discriminating between the foodservice operator and the food distributor, and enjoined the food-service operator from inducing or receiving a discriminatory price. Faced with the choice of lowering its price to the distributor or raising its price to the foodservice operator (and risking the loss of a much larger volume of business), the manufacturer halted sales to the food distributor altogether. The court promptly found the manufacturer in contempt.²

Strikingly, the court gave little weight to the testimony of 10 witnesses from various institutions who insisted that they did not perceive the distributor to be a competitor of the foodservice operator. The court discounted the testimony of these witnesses by pointing out that the defendants did not call any witnesses who were considering switching from one model to the other, and only presented witnesses who substantiated the defendants' position. The court refused to infer from the testimony of these 10 witnesses that no customer ever considers making a switch, and consequently gave "no weight" to their testimony at all.

The court also rejected the manufacturer's argument that it had satisfied the requirements of the meeting competition defense. While sympathetic to the lengths to which the manufacturer's representative had gone to obtain information from the foodservice operator about competing bids it had received, the court held that the representative had not done enough.

The record showed that in negotiations with the foodservice operator, the manufacturer's representative was told that she had to charge less in order to meet the price offered by a major competitor. The representative knew that this competitor routinely charged lower prices and knew of instances in which she previously had lost business to that competitor; she therefore considered the foodservice operator's representations to be credible and asked how close she needed to be to meet competition. However, the fact that she never obtained the details of the competitor's offer, including the precise prices and the duration, did not satisfy the court. Instead, the court held that the manufacturer was not entitled to the protection of the meeting competition defense because the foodservice operator could be expected to be seeking an even lower price than the competitor was offering, the manufacturer did not demand enough verification, and the manufacturer never told the foodservice operator that it was meeting competition when it quoted its own price.

The court's holding stands in contrast to earlier cases. It had been settled by the Supreme Court in the *Gypsum* case that the meeting competition defense only "requires the seller, who has knowingly discriminated in price, to show the existence of facts which would lead a reasonable and prudent person to believe that the granting of a lower price would in fact meet the equally low price of a competitor."³ Most courts have taken a "pragmatic" approach to this test, requiring a seller to demonstrate that its price was a good-faith response to a competitor's lower price.⁴ "The good-faith standard" was "the benchmark against which the seller's conduct is to be evaluated."⁵ The factors considered to determine good faith have been: "whether the seller made efforts to corroborate the reported discount by seeking documentary evidence or by appraising its reasonableness in terms of available market data"; "whether the seller had received reports of similar discounts from other

customers"; "whether the seller had past experience with the buyer"; and "whether the seller was threatened with a termination of purchases if the discount were not met."⁶

In *Beatrice Foods Co.*,⁷ for example, the Federal Trade Commission held, 3-2, that the competition defense is applicable in competitive bidding contests where the seller exercises good faith to calculate a bid that would approximately meet bids that competitors are expected to submit. The Commission stated, "Precisely meeting the exact prices of competitive bids can have no realistic meaning" in this context. The Commission continued, "To require that Beatrice adhere to a precise 'Meet but not beat' criterion under these circumstances, where the Beatrice representatives otherwise exhibited every element of good faith, is not reasonable. To hold otherwise would be effectively to outlaw such bidding situations by insisting upon an artificial and rigid test."⁸

Beatrice won the bidding to supply the customer, Kroger, by predicting who the low bidder would be among its competitors, approximating what that bidder's bid would be based on Beatrice's knowledge of that bidder's habits and its pricing to other accounts, and coming up with a bid that would undercut the other bidder by a small amount. Beatrice was able to demonstrate that it was trying to meet competition, albeit with a slightly better bid that would win the business. Kroger browbeat Beatrice somewhat by insisting that Beatrice had to do even better in order to win, and Beatrice was permitted to lower its bid further as long as it believed in good faith that it was meeting a competitive bid. (It turned out that Kroger was misleading Beatrice, but that was not Beatrice's problem as long as it acted in good faith.)

Other cases similarly have applied a flexible and pragmatic approach to evaluate meeting competition in the context of competitive bidding.⁹ This approach has recognized the fact that if a bidder could only meet, but not beat, competing offers, every bidding contest among sellers would end in a tie, or else the winning bid would have to become the seller's price to all of its customers. While some might favor applying the Robinson-Patman Act in this way, the "flexible and pragmatic" approach announced by the Supreme Court in *Gypsum*¹⁰ provides a more practical defense.

But not for the defendants in *Feesers*. In contrast to the approach adopted in *Gypsum* and *Beatrice*, the *Feesers* court seems to be demanding a degree of certainty that, if followed by other courts in the future, would depart from the prevailing approach.

There are many other wrinkles in the court's opinion—too many to recount them all—and there reportedly will be an appeal which might bring some clarification. Meanwhile, the chief takeaways are: (i) customers that may not appear to be competitors nevertheless may be considered competitors if they ever lose business to one another, and (ii) sellers should not be shy about asking customers to “show me the offer” if they are being asked to meet competition.

Ironically, the district court in *Feesers* had earlier granted summary judgment in favor of the defendants but was reversed by the Third Circuit Court of Appeals. (This litigation has been going on for more than five years.) Apparently, *Volvo* may not take sellers very far in the Third Circuit today, and unhappy customers across the country may begin taking encouragement from the *Feesers* odyssey. Although the government has not brought a price discrimination case in years, it is clear that the appetite of private plaintiffs for cases of this kind persists, and at least some courts may be rolling out the welcome mat. ♦

Endnotes

- 1 *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, 126 S.Ct. 860 (2006).
- 2 No. 1: CV-04-0576, 2009 U.S. Dist. LEXIS 44094 (M.D. Pa. May 26, 2009).
- 3 *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 438 (1983) (quoting *United States v. U.S. Gypsum Co.*, 438 US 422, 451 (1978)).

- 4 *Falls City*, 460 U.S. at 451.
- 5 *United States Gypsum*, at 454.
- 6 *Reserve Supply Corp. v. Owens-Corning Fiberglas Corp.*, 971 F.2d 37, 42 (7th Cir. 1992) (citing *U.S. Gypsum*, 438 U.S. at 454–55).
- 7 76 F.T.C. 719, 811 (1969).
- 8 A dissent by Commissioner Dixon summed up the decision as follows: “The opinion, as I read it, stands for the proposition that a large buyer can use his purchasing power to induce a supplier to discriminate in price regardless of the anticompetitive consequences of such discrimination, and that the supplier can with impunity succumb to such inducement under the protection of the Section 2(b) proviso without regard to whether the lower price he is meeting may be unlawful.” Commissioner Dixon asserted: “It is... clear that Congress did not intend that Section 2(b) should be used to permit a large buyer to negotiate lower prices by having suppliers bid against one another for his business without regard to the legality of such discriminatory offers.” Commissioner MacIntyre also filed a dissent, opining that *Beatrice* failed to “display [] the diligence of inquiry into alleged competitors’ offers required by the precedents...”
- 9 *See, e.g. Water Craft Mgmt., LLC v. Mercury Marine*, 361 F. Supp. 2d 518 (M.D. La. 2004) (meeting competition established through common, though speculative, knowledge of other seller’s offer); *Reserve Supply*, 971 F.2d at 45–46 (“necessarily attendant with [the customer]’s report of the [competitor’s discount] is the message that if the discount is not met, business will shift to the competitor”); *Walker v. Hallmark Cards, Inc.*, 992 F. Supp. 1335, 1341 (M.D. Fla. 1997) (meeting competition defense based on defendant tracking and verifying reports of competing offers). A seller need not know the details of the competing offers. *See Great Atlantic & Pacific Tea Co. v. F.T.C.*, 440 U.S. 69, 82–84 (1979) (“Since good faith, rather than absolute certainty, is the touchstone of the meeting competition defense, a seller can assert the defense even if it has unknowingly made a bid that in fact not only met but beat his competition.”).
- 10 438 U.S. at 454.

Pricing Abuses in the New EC Guidance on Article 82

*Notes of a Conference Co-hosted by Mayer Brown
April 2009, Brussels*

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Panel 1 – Some Comments on the Article 82 Guidance’s Treatment of Predation

After a short introduction by the moderator, the panelists were asked to individually present their views on the treatment of predation by the Art. 82 Guidance.¹

As a starting point, the moderator referred to the *France Télécom*² judgment of the European Court of Justice (ECJ) in which it was made clear that recoupment was not a necessary condition to prove predation. The moderator further stated that it was unfortunate that the ECJ did not take the opportunity to answer a couple of important questions, namely:

- What happens in the event that the incumbent can prove that recoupment is not possible?
- What happens if the incumbent aligns its prices to those of his competitors?

From an economist’s perspective, three conditions need to be fulfilled for a finding of predation. First, the firm must be dominant. Paragraph 14 of the Guidance paper adopts a market share threshold of at least 40 percent for a finding of dominance. The speaker underlined the fact that this deviation from the 25 percent threshold proposed in the Discussion Paper constitutes a significant improvement in the position of the Commission, which should be welcomed.

Although there might be some cases where market power already arises in the case of low market share levels, the total number of such cases can be said to be small. Therefore, a higher threshold considerably reduces the danger of legal uncertainty. This is particularly true given the problems of market definition in dominance cases.

Second, the predating firm must have engaged in profit sacrifice. The panel member briefly explained that average avoidable cost (AAC) is the cost benchmark used to determine whether or not conduct leads to profit sacrifice, and long run average incremental cost (LRAIC) is used to assess whether an as efficient competitor could be foreclosed. Although AAC is a suitable cost benchmark and is to be preferred to average variable cost (AVC) (because AVC does not distinguish between common costs and variable/fixed costs), in order to avoid risks of prosecution it would seem that dominant firms are required to price above LRAIC.

According to the panel member, the new LRAIC average total cost (ATC) test should be welcomed because it does not include common costs. All other foreseeable solutions would have been arbitrary.

The third and final criterion is that the conduct must be likely to result in consumer harm. The panelist noted that paragraph 6 of the Guidance introduces a very interesting distinction between foreclosure and anticompetitive foreclosure. The “as efficient competitor test” in paragraph 22 deserves full support as this is a good benchmark to distinguish between harm to competitors that arises from competition on the merits and from anti-competitive foreclosure. Therefore, this test reduces uncertainty for dominant firms, because the test is based on its own costs and prices.

Unfortunately, however, it seems that the “as efficient competitor test” in paragraph 22 of the Guidance is undermined in the paragraph that follows it. This is problematic, as it decreases the level of legal certainty.

Although the affirmation that the key objective of the Guidance is to “protect competition, not competitors” should be appreciated, it should nonetheless be noted that the Guidance leaves too many caveats and too much discretion to the European Commission. It should additionally be recognized that the Guidance

moves away from *form-based rules*, signaling a departure from legal precedents.

In support of his point of view, another panel member referred to some concrete examples:

- Dominance can also be found under a 40 percent market share threshold.
- Footnote 18 in the Guidance states that, contrary to the principle set out in paragraph 26, there might be certain cases where common costs may nevertheless be taken into account. By opening the door to this possibility, advising in this field becomes a very complicated task for legal and economic professionals, creating further legal uncertainty.
- The Guidance raises considerable questions when in paragraph 23 it states that inefficient competitors may have to be protected.
- In paragraph 64, the Commission reserves the possibility that even if pricing is above AAC, there may be profit sacrifice.

The economist concluded by stating that the Guidance paper does not significantly reduce uncertainty in the assessment of predation and other abusive practices. Underlined by a virtual/notional example, another panel member demonstrated that the Guidance does not eliminate the risk that legitimate pricing policies could be deemed anti-competitive. There is enough room for the Commission to capture conduct which in principle should be permissible.

Another panel member felt that while the Guidance paper was carefully written, in order to understand it fully one must read between the lines. He noted that there are no rules concerning the burden of proof in the Guidance, making it very difficult for companies and their advisors to defend a case.

He then turned the attention of the audience to the recent *Glaxo* case brought by the French competition authority.³ He underlined that these cases concerning predation are very rare. An important question that arises in connection with predation cases is whether they should be assessed *ex ante*, because there is always the possibility that predation fails; for example, because a competition authority has intervened. In his view, there were three lessons to be learned from the outcome of the French *Glaxo* case: first, recoupment can, in principle, happen in a market other than the

one where the practices took place; second, it may prove difficult to counter the defendants' claim that recoupment was unlikely; and third, in this respect, there is no good substitute for hard evidence.

An EU Member State competition authority official expressed the view that there is a link between market power and predation, but stressed that this link is not an automatic one. He added that, in his view, proving that no recoupment is possible is both more important and harder to do than proving market power.

On the question of consumer harm, an economist noted that the issue with the Guidance is that although it sets out many principles, it invariably leaves room for interpretation and exceptions.

From the perspective of a national competition authority, reference was made to the fact that, on the one hand, by fighting against predation, competition authorities are often accused of depriving consumers of lower prices. On the other hand, one of the main concerns of competition authorities is the creation of "false negatives." Additionally, in this panelist's view, an authority loses predictability if it does not fight against predation. From this perspective the Guidance did a good job by striking an appropriate balance to reach both goals.

Concerning the cost benchmarks proposed by the Guidance paper, it was stated that some national competition authorities agree with these benchmarks because of how they define "sacrifice." Nevertheless, it should be questioned if competition authorities have the duty, in finding the appropriate counterfactual, to examine every possible alternative. There are national competition authorities that clearly take the view that they are not obliged to examine every possible alternative.

Concerning margin squeeze, one of the panelists noted that there are considerable differences between the approach to margin squeeze in the European Union and the United States. The US Supreme Court has taken the view that margin squeeze has no basis in competition law, suggesting that it is a question of regulation. Therefore, the United States is one of the rare jurisdictions without margin squeeze. A possible explanation for this fundamental divergence might be the fact that in the European Union, a significant

number of markets are still in the process of becoming deregulated. Therefore, if margin squeeze is not found to be anticompetitive, the goals of deregulation would be frustrated.

As a conclusion, each of the panel members presented their personal impressions on the debate, focusing particularly on how the Guidance helps advisers and companies deal with predation.

One panel member concluded that a certain number of trade-offs are inevitable in the drafting of such a document, and that the Guidance can be seen as a consistent and reasonable paper overall. Another panel member underlined again that although it is necessary to read between the lines in order to understand all the principles in the Guidance, in general it offers a positive and reasonable assessment. A third member of the panel agreed with the main principles, but criticized the fact that there are many caveats and exceptions to the rules.

Panel 2 – Some Comments on the Article 82 Guidance's Treatment of Single-Product Conditional Rebates

The moderator opened this panel by addressing the following question to a panel member with an economic background:

"Does the quantitative test in the Guidance document for retro-active rebates match the test identified in previous Commission decisions and court cases?"

The economist responded by saying that while the Guidance paper departs from the traditional form-based view on rebates, it nevertheless fails to propose a sound economic approach. This panelist also noted as an advantage that the Guidance treats single-product conditional rebates under exclusive dealing, and that the Guidance's focus on price-cost comparison and anticompetitive foreclosure, as opposed to the suction effect, was welcomed.

However, the panel member also noted negative aspects, such as the lack of guidance on how to compute the contestable share for the price-cost comparison of retroactive rebates. This is due to the fact that the effective price varies within the relevant range. He felt that, given the uncertainty regarding how to calculate the relevant range,

it would be desirable for the Commission to improve this test in the future.

The panel member felt that the Guidance should be seen as incomplete. There is no clear reference to economic theories of exclusive dealing, with price-cost comparisons seemingly insufficient to prove consumer harm. Further, he felt that to say that prices below AAC are always bad is an oversimplification and that the Guidance was too brief and unclear on this point. Thus, the Commission should have introduced criteria indicating the direction it plans to take in the future. He did feel, though, that the Commission did a commendable job on the vertical and horizontal Guidelines in this respect. It should be encouraged to replicate its efforts with regard to the application of Article 82 EC.

A further point, which another panel member identified, is that a rational customer will not want to lock itself into inefficient exclusive dealing. In general, customers understand any downsides of being locked in and therefore will try to protect themselves against such an occurrence.

The second question was addressed to an official from DG Competition: “Noting that the subject of intermediation was present in the *BA*⁴ and *Michelin*⁵ cases, is intermediation important for the qualitative and quantitative assessment of conditional rebates?”

The panel member replied that the reason why intermediation is not mentioned in the Guidance is because the Guidance applies mainly to single-product rebate schemes, while in *BA* and *Michelin* the rebates in question were part of very complex schemes. Furthermore, the main aim of the rebate schemes in *BA* and *Michelin* was to attain a certain level of supply, an issue which is not addressed in the Guidance at all.

BA and *Michelin* were each in strong dominant positions, offering rebates over a long period of time that were far greater than those of their competitors. Intermediaries were selling at a loss but were able to re-establish their profit margin as soon as the dominant suppliers repaid the rebates. In these two cases, the fact that intermediation was present was key to the findings that the rebate schemes were unlawful: with intermediation, competitors were not able to offer the same rebates *BA* and *Michelin* were offering.

The moderator then asked the following question: “What particular challenges do you see in the Guidance’s consideration of multi-product rebates?”

From the perspective of an in-house competition counsel, it was first mentioned that multi-product rebates are a very common practice, which can, as a matter of principle, be pro- and anti-competitive. In most cases, offering only some of these products could never be competitive. It follows that for multi-product rebates to be illegal, four conditions must be fulfilled: first, dominance on a market; second, different products must be concerned; third, a foreclosure effect must be present; and fourth, no efficiencies should be present.

In order to find mixed bundling unlawful, the Guidance proposes two main tests. The first test can be found in Paragraph 60. However, this test raises some difficulties because it addresses neither the question of the reasonable payback period, nor the complexity of applying the test to multi-product rebates.

The second test proposed by the Guidance can be found in Paragraph 61, read in conjunction with Paragraph 54. In the panel member’s view, this test is preferable to the first one. There are nonetheless difficulties regarding this test’s interpretation of terms such as “identical.”

Products and bundles are never identical in practice in the purest sense of the word. Unfortunately, however, the Guidance does not address the important question of how to deal with situations in which the price of the bundle is above the price of competitors’ bundles. In this case, there is simply no foreclosure.

In addition, it is very difficult to prove efficiencies. The test in the Guidance is taken directly from Article 81(3) EC and is very difficult to apply. The panel member added that the evidential burden should fall on the European Commission as opposed to the dominant undertaking.

The next question sought the US perspective on the following question: “Do you consider the EU approach diverging or converging with the US approach?” In response, it was mentioned that although there are still some differences, the two approaches are converging. One key divergence concerning rebates is on cost benchmarks: while the European Commission

uses AVC, the trend in the United States favours use of AAC. Furthermore, the US case law is still developing in certain fields. For example, concerning single product loyalty discounts: the state of the law is still unclear, with little case law to serve as guidance.

The next question was addressed to an in-house competition counsel: “Per the Guidance, identification of the contestable market share is key to rebates analysis. What practical use is such a concept for a corporation?”

In the opinion of the panel member, this concept does not have a useful practical meaning. It is even hard to explain where the concept comes from, and it can only be applied poorly and/or very rarely.

A further question was addressed to a panel member with an economic background: “The efficiencies defence is stated in the Guidance. Is this a realistic or a theoretical defence?”

The economist responded by stating that in general, the efficiency defence is a realistic one although it is not easy to reverse the burden of proof in practice. While the efficiency defence is mentioned, the Guidance’s silence on intermediation is problematic. This problem should not be underestimated as intermediation almost always produces efficiencies.

The penultimate question related to the last paragraph of Damien Geradin’s December 2008 paper entitled “A proposed test for separating pro-competitive conditional rebates from anti-competitive ones.” Quoting the author, the moderator stated that “[t]he application of such effects-based tests, which are now applied by most of the world’s leading competition authorities, require complex assessments and thus the investment of significant resources both for the competition authority which decides to investigate a given rebate scheme and for the dominant firm which is investigated. Because resources are generally scarce, competition authorities should not initiate investigations into conditional rebates lightly”.

The moderator then asked whether it is feasible for a corporation that is not being investigated to devote the resources necessary to determine with sufficient comfort that the corporation’s rebates scheme is not abusive, addressing the question to the two in-house competition counsel present on the panel. The panel members stated that devoting such resources is not possible and often does not lead to concrete determinations. Companies price all the time, and it is impossible to check all the rebates all of the time as they simply lack the resources to do so. Not only is it expensive, but also time consuming and not realistic. Only few price offers require deeper analysis.

The final question of the conference was: “In the US there seem to be safe harbours for rebates, although this is not the case for every area of US antitrust law. Why do the authorities consider safe harbours appropriate or necessary for rebates?”

A panel member with significant US experience responded that safe harbours have been viewed as particularly important where the type of conduct at issue is likely to have pro-competitive benefits that could be chilled by the threat of antitrust condemnation. He also noted that for many firms the definition of dominance may offer more promise of providing certainty than the creation of safe harbours. ♦

Endnotes

- 1 Guidance of the Commission’s Enforcement Priorities in applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, C(2009) 864 final, 9 February 2009.
- 2 Case C-202/07 P, *France Telecom v Commission*, 2 April 2009.
- 3 Décision no 07-D-09 du 14 mars 2007 relative à des pratiques mises en oeuvre par le laboratoire GlaxoSmithKline France.
- 4 Case C-95/04 P, *British Airways v Commission*, 15 March 2007.
- 5 Case T-203/01 P, *Michelin v Commission*, 30 September 2003.

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