

Northwestern Law

Fourth Annual

Chicago Forum on International Antitrust Issues

Presented by: Northwestern Law Searle Center on Law, Regulation, and Economic Growth

Thursday, June 13–Friday, June 14, 2013

Northwestern University School of Law
Chicago, Illinois

In an ever changing legal landscape, this program again promises to provide a timely and practical update on antitrust developments around the world. Our speakers are leading private and in-house lawyers, economists and antitrust enforcers from the US, EU, Brazil and India. Among them are Bruno Lasserre, President, Autorite de la Concurrence, Paris; Maureen K. Ohlhausen, FTC Commissioner; and Professor William Kovacic, now at George Washington University Law School and formerly an FTC Chairman.

- Update on International Cooperation and Convergence
- Year in Review – US, EU and Brazil
- Venturing Outside the US – Antitrust Issues in Competitor Collaborations, Joint Ventures, Strategic Alliances, Teaming Agreements
- Antitrust Litigation, Arbitration and Use of Economists Outside the US
- Lessons Learned – From Compliance to Global Cartel Investigations
- Update on Antitrust Enforcement in India
- Antitrust Perspective on Innovation, New Product Development, Standard Setting and Licensing
- Antitrust Issues in Doing Business in China
- Evaluating the Effects of Merger Policy
- Basic Economic Concepts Arising in Antitrust Matters
- Tying, Bundling, Exclusivity, MFNs and Other Distribution Issues
- Identifying and Resolving Conflicts Outside the US

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- Memorandum of Understanding on Antitrust Cooperation between the United States Department of Justice and the United States Federal Trade Commission and the Ministry of Corporate Affairs (Government of India) and the Competition Commission of India

- The Never-ending yet Vital Pursuit of Greater Cooperation, Convergence, and Transparency—Remarks of Maureen K. Ohlhausen, Commissioner, Federal Trade Commission at the First Annual Symposium. China Institute of International Antitrust and Investment, China University of Political Science and Law, Beijing, China (March 22, 2013)

- Memorandum of Understanding on Antitrust and Antimonopoly Cooperation between the United States Department of Justice and Federal Trade Commission, on the One Hand, and the People's Republic of China National Development and Reform Commission, Ministry of Commerce, and State Administration for Industry and Commerce, on the Other Hand

- Taking Notes: Observations On the First Five Years of the Chinese Anti-Monopoly Law, Remarks of Maureen K. Ohlhausen, Commissioner, Federal Trade Commission at the

Competition Committee Meeting, U.S. Council for International Business, Washington, DC (May 9, 2013).

YEAR IN REVIEW—US, EU, and Brazil

- "2013: What to expect on the European competition policy front," by Tom Jenkins and Bill Batchelor (Baker & McKenzie, European & Competition Law Practice, Brussels)

- "FA Premier League: The Broader Implications for Copyright Licensing," by Tom Jenkins and Bill Batchelor (Baker & McKenzie, European & Competition Law Practice, Brussels)

- "CJEU AstraZeneca Judgment: Groping Towards a Test for Patent Office Dealings," by Bill Batchelor and Melissa Healy in European Competition Law Review

- History of Competition Policy in Brazil: 1930–2010

- Competition Policy in Brazil (Presentation—Francisco Todorov)

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- EC Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements

- EC Guidelines on Vertical Restraints

- FTC/DOJ Antitrust Guidelines for Collaborations Among Competitors

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- 2012 Global Guide to Competition Litigation—England and Wales (Baker & McKenzie)

- "Arbitrating Competition Law Disputes: A Matter of Policy?" by Francesca Richmond in the Kluwer Arbitration Blog

- Global Guide to Competition Litigation

- Draft Guidance Paper: Quantifying Harm in Actions for Damages Based on Breaches of Article 101 or 102 of the Treaty on the Functioning of the European Union

- The Use of Experts in International Litigation (Presentation—Kristin Terris)

- Antitrust Litigation Outside of the U.S (Presentation—Francesca Richmond)

LESSONS LEARNED FROM COMPLIANCE TO GLOBAL CARTEL INVESTIGATIONS (ETHICS CREDIT)

- 2012 Guidelines Manual, Chapter Eight: Sentencing of Organizations
- *United States of America v. AU Optronics Corporation*
- Statement of Assistant Attorney General Bill Baer on Changes to Antitrust Division's Carve-Out Practice Regarding Corporate Plea Agreements
- Sentencing Memo: United States of America v. AU Optronics Corporation
- Guiding Principles of Enforcement
- Compliance Matters: What companies can do better to respect EU competition rules
- Framework-Document of 10 February 2012 on Antitrust Compliance Programmes
- "Competition Law Compliance Programs and Government Support or Indifference" by Theodore Banks and Nathalie Jalabert-Doury
- "Enforcers' Consideration of Compliance Programs in Europe: Are 2011 Initiatives Raising Their Profile or Reducing It to the Lowest Common Denominator?" by Nathalie Jalabert-Doury & Gillian Sproul
- Lessons Learned From Compliance to Global Cartels Translating Theory Into Practice (Presentation—Karine Faden)

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- Update on Antitrust Enforcement in India (Presentation—Nicholas J. Franczyk)

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- Antitrust, Innovation, and Standard-Setting (Presentation—John D. Harkrider)

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- Antitrust Issues in Doing Business in China (Presentation—H. Stephen Harris, Jr.)

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- "Assessing the Quality of Competition Policy: The Case of Horizontal Merger Enforcement" by William E. Kovacic

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- "Market Definition and Unilateral Competitive Effects in Online Retail Markets," by Michael R. Baye

- "Unilateral Competitive Effects of Mergers Between Firms with High Profit Margins," by Elizabeth M. Bailey, Gregory K. Leonard, and Lawrence Wu

- "Horizontal Mergers of Online Firms: Structural Estimation and Competitive Effects," by Yonghong An, Michael R. Baye, Yingyao Hu and John Morgan

- "Hypotheticals and Counterfactuals: the Economics of Competition Policy," by Mark Williams and A. Jorge Padilla

- Horizontal Merger Guidelines

TYING, BUNDLING, EXCLUSIVITY, MFNS AND OTHER DISTRIBUTION ISSUES

- Tying, Bundling , Exclusive Dealing, & Loyalty Discounts: Basics of the Analysis Under US Antitrust Law (Presentation—Mark McLaughlin)

IDENTIFYING AND RESOLVING CONFLICTS OUTSIDE THE US

- Identifying and Resolving Conflicts Outside the US (Presentation—Jason H. Staples and Charles F. Regan, Jr.)

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Fourth Annual Chicago Forum on International Antitrust Issues

Thursday, June 13-Friday, June 14, 2013

Northwestern University School of Law
Wieboldt Hall #147
340 E. Superior Street, Chicago, IL 60611

Thursday, June 13th

Morning Session Chair: Roxane C. Busey, Partner, Baker & McKenzie LLP, Chicago, IL

8:00 a.m. **Registration and Continental Breakfast** (WB 150)

8:40-8:45 **Welcome and Introduction** (WB 147)
Dean Daniel B. Rodriguez, Dean and Harold Washington Professor, Northwestern University School of Law
Max Schanzenbach, Professor of Law and Director of Searle Center on Law, Regulation, and Economic Growth at Northwestern University School of Law
Matthew L. Spitzer, Incoming Director, Searle Center on Law, Regulation, and Economic Growth at Northwestern University School of Law

8:45-9:15 **Keynote Address: Update on International Cooperation and Convergence**
Maureen K. Ohlhausen, Commissioner, Federal Trade Commission

9:15-10:15 **Year in Review—US, EU, and Brazil**
Roxane C. Busey, Partner, Baker & McKenzie LLP, Chicago, IL *(moderator)*
Bill Batchelor, Baker & McKenzie LLP, Brussels, Belgium
Britt M. Miller, Partner, Mayer Brown LLP, Chicago, IL
Francisco Todorov, Partner, Trench, Rossi e Watanabe Advogados, Brasilia, Brazil

10:15-10:30 **Networking Break** (WB 150)

10:30-11:15 **Venturing Outside the US—Antitrust Issues in Competitor Collaborations, Joint Ventures, Strategic Alliances, Teaming Agreements**

Nick Koberstein, Division Counsel, Corporate Transactions, Abbott Laboratories *(moderator)*
Jean-Yves Art, Associate General Counsel, Microsoft Corporation, Brussels, Belgium
Mildred L. Calhoun, formerly of BP America, Chicago, IL
Anne Gron, Vice President, NERA Economic Consulting

11:15-12:15 **Antitrust Litigation, Arbitration and Use of Economists Outside the US**

Robert McLeod, Editor in Chief, MLEX Market Intelligence *(moderator)*
Patrick Ahern, Partner, Baker & McKenzie LLP, Chicago, IL
Francesca Richmond, Associate, Baker & McKenzie LLP, London, United Kingdom
Kristin Terris, Vice President, NERA Economic Consulting

12:15-12:45 **Lunch** (WB 540)

12:45-1:15 **Lunch Address**

Bruno Lasserre, President, Autorité de la Concurrence, Paris, France

Afternoon Session Chair: Thomas Campbell, Partner, Baker & McKenzie LLP, Chicago

1:30-2:30 **Lessons Learned From Compliance to Global Cartel Investigations** *(ethics credit)*

Thomas Campbell, Partner, Baker & McKenzie LLP, Chicago, IL *(moderator)*
Karine R. Faden*,* Managing Counsel, Regulatory, Antitrust & Competition, United Airlines
Neville S. Hedley, Director, Internal Investigations, Abbott Laboratories
Nathalie Jalabert Doury, Partner, Mayer Brown International, Paris, France

2:30-3:15 **Update on Antitrust Enforcement in India**

H. Stephen Harris, Jr., Partner, Baker & McKenzie LLP, Washington D.C. *(moderator)*
Nicholas R. Franczyk, Counsel for International Technical Assistance, Federal Trade Commission
Samir R. Gandhi, AZB & Partners, New Delhi, India

3:15-3:30 **Networking Break** (WB 150)

3:30-4:30 **Antitrust Perspective on Innovation, New Product Development, Standard Setting and Licensing**

Alice W. Detwiler, Senior Attorney, Microsoft Corporation *(moderator)*
John D. Harkrider, Axinn Veltrop & Harkrider LLP
Roy Hoffinger, Vice President, Legal Counsel, Qualcomm Inc.
Jay Jurata, Partner, Antitrust & Competition, Orrick, Herrington & Sutcliffe LLP

4:30-5:15 **Antitrust Issues in Doing Business in China**

Russell W. Damtoft, Associate Director, Office of International Affairs, Federal Trade Commission *(moderator)*
H. Stephen Harris, Jr., Partner, Baker & McKenzie LLP, Washington, DC

5:15 **Cocktail Reception** (WB 540)

Friday, June 14th

Morning Session Chair: Chris Kelly, Partner, Mayer Brown LLP, Chicago, IL

8:00 a.m. **Continental Breakfast** (WB 150)

8:45-9:15 **Evaluating the Effects of Merger Policy**
William E. Kovacic, Global Competition Professor of Law and Policy, George Washington University Law School and former Chairman, Federal Trade Commission

9:15-10:15 **Basic Economic Concepts Arising in Antitrust Matters**
Anne Gron, Vice President, NERA Economic Consulting (moderator)
Michael R. Baye, Bert Elwert Professor of Business Economics and Public Policy, Department of Business Economics, Kelley School of Business, Indiana University
Thomas S. Respess, Principal Economist, Baker & McKenzie LLP, Washington, D.C.

10:15-10:30 **Networking Break** (WB 150)

10:30-11:30 **Tying, Bundling, Exclusivity, MFNs and Other Distribution Issues**
Jean-Yves Art, Associate General Counsel, Microsoft Corporation, Brussels, Belgium
Paul Frontczak, Jr., Senior Antitrust Counsel, Shell Oil Company
Nelson Jung, Director, Competition Enforcement, Office of Fair Trading, London, United Kingdom

11:30-12:30 **Identifying and Resolving Conflicts Outside the US** (professional responsibility(ethics) credit)
Charles F. Regan, Partner, Mayer Brown LLP, Chicago, IL
Jason H. Staples, Senior Counsel, International Legal Operations, Abbott Laboratories

12:30 pm **Adjourn**

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SPEAKER BIOS

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Fourth Annual Chicago Forum on International Antitrust Issues

Participant Biographies

PATRICK J. AHERN practices in the areas of antitrust and litigation. His experience includes representing some of the world's largest oil companies across various US courts. Among other publications, Mr. Ahern co-authored sections on the Noerr-Pennington Doctrine and Premerger Notification as an update on the chapter of "Antitrust Considerations" of the *Illinois Institute of Continuing Legal Education Health Care Handbook* (1990 update). He also served as assistant editor of *The Antitrust Law Journal* from 1994-1996, and editorial board member of the *ABA Antitrust Law Development Treatise* from 1997 to 1998.

Mr. Ahern focuses on antitrust litigation and counseling, as well as commercial litigation and class actions. He has also led numerous presentations at meetings of the ABA Antitrust Section

Mr. Ahern received his BA from Georgetown University in 1981 and his JD from the University of Illinois College of Law in (1984).

JEAN-YVES ART is Associate General Counsel at Microsoft. He leads a team of lawyers who counsel business executives on all antitrust aspects of Microsoft's activities in the EMEA region (including merger review, interoperability and standards policy). In close coordination with the Company's headquarters in Redmond, Jean-Yves also manages the antitrust proceedings in which the Company is involved in the region.

Before joining Microsoft in 2002, Jean-Yves had practiced European competition law for ten years with Coudert Brothers, a firm that he joined after having worked for three years as a legal secretary at the Court of Justice of the European Communities.

Jean-Yves is also visiting professor at the College of Europe, Bruges, where he teaches EU merger control, and at the University of Liège where he co-chairs a seminar on advanced topics in EU antitrust law. He has written extensively and is a regular speaker at conferences on EU competition law.

BILL BATCHELOR advises on merger control, antitrust litigation and regulatory investigations. He has worked in the Washington DC, London and Brussels offices of Baker & McKenzie, as well as spending time at both the EU Commission and UK competition authorities. Bill's focus is on high tech IT and lifescience companies.

Bill advises on EC and multi-jurisdictional merger control laws in relation to mergers and joint ventures. Recent projects include Cisco/WebEx, Cisco/Ironport, Cisco/Navini, Cisco/Linksys/Belkin (for Cisco), ADM/Pura, ADM/Elstar, ADM/Wilmar (for ADM), Amex/Fortis/Alphacard (for Alphacard); OTPP/Camelot (for OTPP), Canal+/TVN/n (for Canal+), Biogen Idec/Elan (for Biogen).

Bill regularly counsels clients on collaboration and distribution strategies, including co-promotion/co-branding, B2B platforms, media distribution arrangements and go-to-market channel programmes, including the 3G mobile, data networking, telecoms, lifescience and software sectors.

Bill is acting for complainants and defendants in cartel and market power investigations. Recent projects include: reversing a Commission cartel decision in the *Synthetic Rubber* cartel; successfully securing one of the lowest negotiated settlements in the seven year long *DRAM* investigation; securing significant reductions in fine for Archer Daniels Midland in respect of the *Citric Acid*, *Amino Acids* and *Sodium Gluconate* investigations before the UK and EU authorities as well as before the EU courts; successfully representing KirchMedia (now Infront) before the EU courts reversing approval of a UK law mandating free-to-air coverage of the FIFA World Cup; defending a large multinational bank in the Belgian Banks cartel investigation of the European Commission into the fixing of currency conversion rates leading to a successful settlement; successfully defending a global software company in antitrust litigation before the Greek courts; securing access to interface information for a complainant from the UK competition authorities in respect of a dominant software vendor; successfully defending abuse of dominance investigations by the EU and German authorities in relation to a well known global IT company.

Bill graduated from Bristol University and has also studied at the University of Hanover. Bill qualified as a solicitor (England & Wales) in 1998.

In addition to in-house and client briefs on competition law, commercial and gambling issues, Bill's external publications include contributing to Butterworths Competition Law, Cartels Chapter, Sweet & Maxwell's IT Encyclopaedia, Competition Law Chapter, authoring "B2B Marketplaces and EC Competition Law" (Antitrust Bulletin), "Application of the Technology Transfer Block Exemption to Software Licensing Agreements" (CTLR); "The Fallout from Microsoft: The Court of First Instance Leaves Critical IT Industry Issues Unanswered" (CTLR); Premier League: the Implications for Copyright (ECLR); Antitrust in the IT Industry: Recent Merger Control Issues (e-Concurrences)

MICHAEL BAYE is the Bert Elwert Professor of Business at Indiana University's Kelley School of Business. He served as the Director of the Bureau of Economics at the US Federal Trade Commission during 2007 and 2008. Michael is also a Special Consultant for NERA Economic Consulting, and has provided expert testimony in matters ranging from advertising and pricing to mergers and monopolization. He has provided written and oral expert testimony for the Canadian Competition Bureau, the US Department of Justice, and numerous private parties.

Professor Baye has won numerous awards for his outstanding teaching and research, and has published several textbooks. His research focuses mainly on pricing strategies and their impact on consumer welfare and firm profits in both online and traditional markets. His academic work on mergers, auctions, patents, advertising, online markets and other areas related to antitrust and consumer protection has been published in leading economics and marketing journals. Additionally, his academic research on pricing strategies in online markets has been featured in *The Wall Street Journal*, *Forbes*, and *The New York Times.*

Michael has lectured and spoken at conferences and academic institutions throughout North America and Europe, and has held visiting appointments at Cambridge, Oxford, Erasmus University, Tilburg University, and the New Economic School in Moscow. In addition to his extensive academic publications and practical antitrust experience, he has also served on numerous editorial boards in economics as well as marketing.

Professor Baye received his B.S. from Texas A&M University in 1980 and his Ph.D. in economics from Purdue University in 1983.

ROXANE C. BUSEY, a partner in the Chicago office of Baker & McKenzie, is a nationally recognized antitrust attorney. She served as Chair of the ABA Section of Antitrust Law in 2001-02 and as Chair of the Section's Task Force on the Antitrust Modernization Commission from 2003-2007. She is also featured in the ABA Antitrust Section's Oral History, which is available on the Section's website.

Ms. Busey's practice includes both antitrust counseling and litigation. She has practiced before the Federal Trade Commission, the Department of Justice, and various state antitrust enforcement agencies. A significant portion of Ms. Busey's practice relates to mergers, joint ventures and strategic alliances. She has obtained merger clearance from the FTC or the DOJ for numerous transactions in various industries, including a recent transaction for $1.3 billion involving IFCO Systems NV where the FTC issued a Second Request but closed the investigation and terminated the waiting period prior to IFCO certifying substantial compliance. She also works in conjunction with the firm's global competition network of over 250 competition lawyers to provide multijurisdictional merger control and other antitrust advice.

Ms. Busey's litigation experience includes both civil and criminal matters. She was one of the lead counsel successfully defending the National Resident Matching Program in *Jung v. AAMC,* an antitrust class action lawsuit filed by three medical residents alleging a wage fixing conspiracy among the nation's leading teaching hospitals. She served as a Special Master in an antitrust health care case pending in federal district court. She recently represented clients in criminal cartel cases before the DOJ and has represented clients in class action price fixing cases in federal court.

Ms. Busey has developed global antitrust compliance programs, given antitrust training, and conducted compliance audits in many industries for many companies and

associations. She has counseled companies with large or dominant market shares on a variety of practices, including exclusionary conduct, essential facility, refusals to deal, tying arrangements, bundled discounts, and resale pricing. She also has addressed antitrust intellectual property issues in licensing and pooling agreements, and she was involved in an FTC investigation involving standard setting and related intellectual property issues.

Ms. Busey has been recognized for at least a decade as a leading antitrust authority by Chambers USA *America's Leading Business Lawyers; The Best Lawyers in America; Who's Who in America; Competition & Antitrust Expert Guide;* Global Counsel*, Competition Law Handbook; Guide to the World's Leading Competition and Antitrust Lawyers;* Illinois Leading Lawyers Network*; Illinois Top 50 Business Lawyers; Illinois Top 10 Women Lawyers;* and *Illinois Top 10 Women Litigators.*

Ms. Busey is a frequent lecturer and author on antitrust issues. She has been co-chair of the Practicing Lawyers Institute's antitrust program in Chicago for over a decade, where she regularly speaks on *Relationships Among Competitors*. She also regularly speaks on *Antitrust Counseling* for the Antitrust Section's biannual Master's Program. She has testified before the FTC on Mergers, Joint Ventures; Efficiencies and Global Competition; Intellectual Property; and Health Care. She is also one of the founders of the annual Chicago Forum on International Antitrust Issues sponsored by the Searle Foundation and Northwestern Law School.

Ms. Busey received her law degree from Northwestern Law School.

MILDRED L. CALHOUN retired in June 2011 after 12 years as the Senior Antitrust and Trade Regulation lawyer at BP America Inc., the US affiliate of BP plc, one of the world's largest integrated oil companies. Her practice included counseling on antitrust issues in all of BP's businesses, including exploration and production of oil and gas, refining and retail gasoline sales, chemicals and commodities trading. She was responsible for BP's US antitrust compliance programs and conducted many hours of training programs worldwide every year. She supported BP's Mergers & Acquisition Group in providing market analysis and merger counseling. This includes responsibility for Hart Scott Rodino filings and advice.

Prior to joining BP in 1999, Ms. Calhoun was employed by the Antitrust Division of the United States Department of Justice for seventeen years.

Ms. Calhoun has written and lectured on topics relating to antitrust. She has been a member of the faculty of the Practicing Law Institute's Annual Antitrust Law Institute since 2002 and was an adjunct member of the faculty of the Indiana University School of Law at Indianapolis.

She was Chair of the Antitrust & Unfair Competition Law Section Council of the Illinois State Bar Association from 2008-2009. She is a member of the American Bar

Association and was a member of the Advisory Board of the Corporate Counseling Committee (Antitrust Section).

Ms. Calhoun earned her J.D., in 1978 from Indiana University School of Law and her B.A. in 1975 from Northwestern University. She is admitted to the bars in Indiana, Illinois and Washington, D.C.

THOMAS CAMPBELL is senior counsel with Baker & McKenzie LLP in Chicago and has more than 30 years of experience trying cases in a wide variety of industries, including defending a pipeline company accused of monopolizing the transportation of natural gas, a maker of grand pianos accused of monopolization, and a baking company accused of predatory pricing. He has been on the winning side in seven of eight antitrust cases tried to verdict or decision.

Mr. Campbell focuses on the trial of antitrust actions and business disputes. He is particularly recognized for having tried a series of prominent cases in the healthcare field that have contributed to the development of antitrust law application in the healthcare industry.

Mr. Campbell is a graduate of Cornell Law School (J.D.) (1968) and Dartmouth College (B.A.) (1965).

RUSSELL DAMTOFT is the Associate Director of the Federal Trade Commission's Office of International Affairs. He is part of the teams that are responsible for building relationships between the FTC and antitrust agencies in China and India, as well as maintaining ongoing relationships with Canada, Latin America, and Russia. He also manages portions of the FTC's technical assistance program for developing competition agencies. He has provided technical assistance to newer competition agencies in numerous countries, in Latin America, Central and Eastern Europe, the former Soviet Union, India, Pakistan, and China, which included stints as a long-term advisor in Lithuania and Romania.

Mr. Damtoft has been with the Federal Trade Commission since 1985. Before the Office of International Affairs was established, he performed similar duties in the Bureau of Competition, served as Assistant Regional Director of the FTC's Chicago Regional Office, as Assistant to the Director of the Bureau of Consumer Protection, Attorney-Advisor to a Commissioner, and as a staff attorney in the Bureau of Consumer Protection.

He graduated from the University of Iowa College of Law in 1981 and from Grinnell College in 1976. He is a member of the American Bar Association, where he serves on the Editorial Board of *Competition Laws Outside of the United States.*

ALICE W. DETWILER is a senior attorney, antitrust with Microsoft Corporation where she has been since 2007. Prior to this she was an association with DLA Piper and a member, Bureau of Competition, Office of Policy and Evaluation, Federal Trade Commission, 2001-2003.

Ms. Detwiler is a graduation of Princeton University, A.B., cum laude, 1991 and Harvard Law School, J.D. magna cum laude, 1994.

KARINE R. FADEN is Managing Counsel – Regulatory, Antitrust & Competition for United Airlines, based in its Washington, DC office.

At United, Ms. Faden is in charge of regulatory legal matters with the DOT, FAA, TSA, CBP and other U.S. regulatory agencies, as well as antitrust and competition law worldwide. Her antitrust responsibilities range from ensuring global antitrust compliance to providing the full range of strategic and agency counseling. Prior to joining United, Ms. Faden practiced in the Washington, DC antitrust group of Freshfields Bruckhaus Deringer, where she focused on aviation and represented various Star Alliance carriers.

Ms. Faden received her JD from the Georgetown University Law Center, together with an MPH from the Johns Hopkins University School of Public Health. She is admitted to the bars of New York and Washington, DC, and lives in Washington, D.C. with her husband and two children.

NICHOLAS J. FRANCZYK is Counsel for International Technical Assistance in the Federal Trade Commission's Office of International Affairs. He has been an attorney with the Federal Trade Commission since 1987, where he has worked on various antitrust and consumer protection matters. As Counsel for International Technical Assistance, Nick is responsible for providing various assistance and training to foreign agencies in the areas of competition and consumer protection law and policy, including training of personnel in substantive legal principles, analytical framework, and investigative techniques. He has served as long-term resident advisor to the South African Competition Commission (July– November 2004 and April–September 2008) and to the Indonesian Business Competition Supervisory Commission (January–April 2004). He has participated in more than forty training programs for competition and consumer protection authorities throughout the world, including bilateral programs in India, Indonesia, Kenya, Mozambique, the Philippines, Russia, South Africa, Tanzania, Vietnam, and Zambia, and regional workshops in Colombia, Ghana, Hungary, Kenya, Korea, Slovakia, South Africa, Vietnam, and Zambia. He has prepared written comments on numerous draft competition laws, rules and regulations. In addition, he has conducted commercial law assessments in Indonesia (2007), Kenya (2009) and Tanzania (2007 and 2010) for the United States Agency for International Development.

PAUL FRONTCZAK is Senior Americas Antitrust Counsel at Shell Oil Company where he advises management regarding antitrust and other legal issues associated with

general commercial activities and strategic business initiatives, including mergers and acquisitions, joint ventures and alliances. Prior to joining Shell, Paul was Counsel in the Washington D.C. office of Clifford Chance where he represented merging parties, third-party complainants, potential divestiture candidates and targets of government investigations in their dealings with the Federal Trade Commission, the Department of Justice, State Attorneys General, Department of Defense, CFIUS and foreign regulators. Paul was also a Lead Attorney in the Mergers I division of the United States Federal Trade Commission where he led merger investigations and secured a number of multi-billion dollar enforcement actions.

Late this year Paul is taking a new position at Shell as Senior Counsel, Anti-bribery and Corruption and Antitrust for Asia. He will be based in Singapore.

Paul has an MBA from Rice University, a J.D. from Albany Law School and a B.A from Muhlenberg College.

SAMIR R. GANDHI heads the Competition practice at AZB & Partners and deals with a broad range of competition law and policy issues.

Samir has represented the Competition Commission of India (CCI) as its counsel in its early litigation soon after it was made operational, including in its first appeal at the Supreme Court of India. He has also advised clients-both as complainants and as defendants, in several cartel and abuse of dominance cases, including in sectors such as cement, pharmaceuticals, internet search & advertising, automobiles and others.

Samir has worked on numerous merger filings since the enforcement of the merger control provisions in India and was part of the advisory team to the Commission that helped give shape to the 2011 merger regulations. He has advised Pfizer in the acquisition of its nutrition business by Nestle, Google in the acquisition of assets by Intel from Motorola Mobility, Qualcomm in its merger of Indian entities with Bharti Airtel amongst others.

Samir also routinely advises on competition compliance programmes and has also been involved in framing competition policy for the Competition Commission of India as well as the Islamic Republic of Afghanistan. He is a member of the International Bar Association working group on merger regulation and frequently publishes and speaks on competition law.

Samir is a graduate of the National Law School of India University, Bangalore and the London School of Economics and Political Science, where he was a Commonwealth Scholar and Mahindra Trust Fellow. He was a visiting fellow at Columbia Law School and is admitted to practise in India.

ANNE GRON is a vice president at NERA Economic Consulting specializing in economic research and analyses in the areas of securities and finance, intellectual

property and antitrust. Dr. Gron has worked on competition-related matters involving companies in insurance distribution, automobile insurance, and financial institutions. She has also worked on matters involving companies in a number of markets and industries including life insurance, annuities, reinsurance, mortgage financing, retail deposits, marketing databases, artificial joints, computer peripherals, beverage distribution, airlines, automotive repair, mutual funds, and discount retailing.

Dr. Gron's work has been published in a number of the top economic journals including the *Rand Journal of Economics*, the *Journal of Industrial Economics*, the *Journal of Law and Economics*, the *Review of Economics and Statistics*, and the *American Economic Review*.

Prior to joining NERA, Dr. Gron taught Competitive Strategy, Microeconomics and Risk Management and Insurance to MBA students at Kellogg School of Management and at the Graduate School of Business (now Booth) at the University of Chicago. Dr. Gron received her PhD in economics from the Massachusetts Institute of Technology, with concentrations in industrial organization and regulation, and public finance. She received her BA, magna cum laude, in economics and computer science from Williams College.

JOHN HARKRIDER is co-chair of Axinn, Veltrop & Harkrider's antitrust practice. His practice concentrates on mergers, counseling and litigation. In the merger context, he advised Google in connection with its acquisitions of Motorola Mobility and hA Software. He represented Cingular in its $41 billion acquisition by BellSouth and BellSouth in its $86 billion acquisition by AT&T and is currently representing Thermo Fisher in its $13 billion acquisition of Life. In litigation, he has represented Tyson Foods in litigation against the DOJ, and represented United Technologies Corporation in Walker Process and Sham Litigation Section 2 claims. He also represented the U.S. Department of Justice in its investigation and suit to enjoin WorldCom's attempted acquisition of Sprint, which was the largest merger ever challenged by the DOJ.

Recently, he represented Google and Motorola Mobility in connection with the FTC's standard-essential patent investigation. He also represents Red Hat on patent/antitrust issues.

H. STEPHEN HARRIS, JR. is a partner in Baker & McKenzie's Global Antitrust & Competition Group. Mr. Harris is widely published and globally recognized as a leading antitrust lawyer and commercial litigator by publications including *Chambers USA* (2004-2011), *International Who's Who of Competition Lawyers* (2000-2011), and *PLC Which Lawyer?* (2001-2011).

Mr. Harris practices antitrust law, including class actions and cartel and merger investigations, before US and international courts and agencies. He also represents financial institutions in complex regulatory and commercial litigation.

Mr. Harris handles civil and criminal antitrust litigation and cartel investigations in a broad range of industries, including financial institutions, pharmaceuticals, information technology, electronics, health care, consumer products, retail, and software. He also has represented major money-center banks in numerous cases against US financial regulatory agencies

Mr. Harris attended Columbia Law School (J.D. Honors, Harlan Fiske Stone Scholar) (1982) and Cornell University (A.B. magna cum laude, College Scholar) (1977).

NEVILLE (NED) HEDLEY is the Director of Internal Investigations at Abbott Laboratories. Prior to that Mr. Hedley was a Trial Attorney at the U.S. Department of Justice, Antitrust Division, Midwest Field Office from 2009 – 2012 where he worked primarily on nationwide bid-rigging and market manipulation investigation and related prosecutions concerning the municipal finance and municipal derivatives market. Mr. Hedley was also Senior Trial Attorney, U.S. Commodity Futures Trading Commission, Enforcement Division, Chicago Office from 2007 – 2009 and Assistant U.S. Attorney, Southern District of California, San Diego, CA, Criminal Division from 2004 – 2007 and Associate, Mayer Brown, Tax Controversy Group, Chicago Office from 1997 – 2004.

He received his B.A. from Wake Forest University, his J.D. from New England School of Law, his LL.M. from New York University School of Law and his M.B.A. Northwestern University Graduate School of Business.

ROY HOFFINGER is Vice President, Legal Counsel, for Qualcomm, Inc, a position he has held since October 2006. At Qualcomm, Mr. Hoffinger is responsible for antitrust and competition law matters. Prior to joining Qualcomm, Mr. Hoffinger was a member of Perkins, Coie LLP and Holme, Roberts & Owen in Denver, Colorado, where he practiced antitrust and regulatory law. Prior to returning to private practice, Mr. Hoffinger spent 14 years as in-house counsel for Qwest and AT&T, as Vice President, Chief Counsel for Federal and State Regulation, and Chief Counsel, Antitrust & Federal Regulation, respectively. Mr. Hoffinger currently serves on the Advisory Board of the Silicon Flatirons Telecommunications Program sponsored by the University of Colorado. He received his J.D. from the University of Chicago Law School in 1982.

NATHALIE JALABERT DOURY is the head of Mayer Brown's Antitrust and Competition in the Paris office.

Nathalie has developed an extensive practice in all aspects of competition law at both a national and European level, including: cartels, concerted practices and abuse of dominance, mergers, horizontal and vertical agreements as well as State aids.

She regularly advises companies on compliance issues and has recently coordinated with Theodore Banks (Compliance and Competition Consultants) an international survey on competition law compliance programs covering 17 antitrust regimes around

the world. The study was published in the Concurrences Review N°2/2012. She is a member of the Antitrust & Competition Law Compliance Forum.

Nathalie earned a Master's Degree in English and North American Business Law (DEA) from the Université Paris I Panthéon-Sorbonne, and a Master's Degree in International Business Law (DESS) from the Université Paris X Nanterre.

JOHN "JAY" JURATA, a partner in Orrick's Washington, D.C., office, is a member of the Antitrust and Competition Group. His practice covers all areas of U.S. and EU competition law, with an emphasis on antitrust and intellectual property issues involving technology markets.

Mr. Jurata has wide experience representing clients in government investigations relating to monopolization and abuse of dominance, mergers and acquisitions, and high-stakes antitrust and intellectual property litigation. He also provides counseling advice regarding the strategic use of patents, intellectual property licensing, interoperability, tying/bundling, pricing, distribution, and competitor collaborations. Mr. Jurata has participated in six trials in federal/state courts and appears regularly before the U.S. Department of Justice Antitrust Division, the U.S. Federal Trade Commission, the European Commission Directorate General for Competition, the U.S. International Trade Commission, and various State Attorneys General offices.

Prior to entering the legal profession, Mr. Jurata served as an officer in the United States Navy.

NELSON JUNG is the Director of Mergers at the Office of Fair Trading where, until recently, he was a Director of Competition Enforcement. He is a qualified lawyer in Germany as well as a Solicitor in England and Wales. Having qualified as a lawyer in Germany in 2002, Nelson completed an LLM at University College London, specialising in European Law. He then joined the Antitrust practice group at Clifford Chance LLP in London before, as a Senior Associate, he moved to the Office of Fair Trading in 2010.

Nelson is the author of the chapter on "Air Transport and EC competition law" in Competition Law of the European Community (LexisNexis) and has written several articles on developments on EU and competition law in publications such as Competition Policy International and Competition Law Insight. His experience includes advising on mergers and acquisitions under the EU Merger Regulation, joint ventures, cartels, abuses of dominance as well as vertical and horizontal agreements across a wide range of sectors.

CHRISTOPHER KELLY has an antitrust litigation practice that focuses on the application of antitrust law to the acquisition and use of intellectual property rights. He counsels and represents clients regarding antitrust implications of patent infringement litigation and settlement, patent pools, licensing, and standard-setting. He also

frequently advises and represents clients on distribution-related antitrust issues. Chris co-authored the Supreme Court briefs in *Illinois Tool Works Inc. v. Independent Ink, Inc.*, which led to an important antitrust victory for intellectual property owners. He has advised and represented several major innovator pharmaceutical firms in connection with the initiation and settlement of Hatch-Waxman patent infringement litigation. He speaks frequently at CLE programs on mitigating antitrust risk in settling Hatch-Waxman infringement litigation. Prior to entering private practice, Chris served in several significant positions over 16 years at the United States Department of Justice, Antitrust Division. From 1996 until 2001, he was the Division's Senior Counsel for Intellectual Property, advising Justice Department officials on infringement settlements, patent pools, competitor collaborations, the future of the Internet Domain Name System, database protection, and other important IP-related legal and policy issues. He also was a Special Assistant US Attorney in the Eastern District of Virginia, and following law school served a judicial clerkship with Judge John A. Terry of the District of Columbia Court of Appeals.

NICK KOBERSTEIN Based at the company's headquarters near Chicago, Illinois, Nick serves as Abbott's in-house antitrust specialist. His responsibilities include leading the company's preparation for antitrust agency reviews of proposed transactions and managing merger control submissions before competition authorities on a global basis. He has successfully obtained merge control clearances for Abbott transactions in numerous jurisdictions, including the US, EU, Russia, Korea, Colombia, Ukraine and Vietnam.

Among Nick's accomplishments at Abbott is obtaining merger control clearances for the company's $6.2 billion acquisition of Solvay Pharmaceuticals in 2010. For this transaction, Nick oversaw the submissions of over a dozen merger control notifications around the World and led the company's negotiations with the European Commission that resulted in the Commission approving the transaction during the Phase I review period, conditioned on the company divesting Solvay's cystic fibrosis testing business.

Prior to joining Abbott, Nick was an antitrust partner in the Washington, D.C., office of McDermott Will & Emery, where he defended mergers, acquisitions and joint ventures before the Federal Trade Commission, Department of Justice, Department of Defense, CFIUS and state antitrust agencies. Representative transactions include:

> Mars Incorporated's (the owner of Pedigree branded pet nutrition products) acquisitions of Nutro Products, a leading producer of nutritional pet food products, the North American operations of Doane Pet Care, a leading manufacturer of private label pet food products, and Greenies, a leading manufacturer of pet snacks and treats;
>
> Jarden Corporation's acquisition of K2 Inc., which combined two leading sporting goods suppliers;

The acquisition of ADVO, Inc., by Valassis Communications, Inc., which combined two large marketing services providers; and

H.I.G. Capital's acquisition of Severn Trent Laboratories, which was merged with TestAmerica Inc. to create the largest environmental testing company in the US.

Nick began his legal career as an attorney in the Mergers III and I Divisions of the Federal Trade Commission's Bureau of Competition. During his eight years with the FTC, Nick led merger investigations in a wide variety of industries, four of which resulted in asset divestitures pursuant to consent agreements and three of which resulted in the parties abandoning their proposed transactions.

Nick earned his J.D. in 1994 from Georgetown University and his B.A. in 1990 from Michigan State University. He is admitted to the bars in Illinois and Washington, D.C.

WILLIAM E. KOVACIC is the Global Competition Professor of Law and Policy and the Director of the Competition Law Center at the George Washington University Law School. Kovacic joined the George Washington faculty in 1999.

From January 2006 to October 2011, Professor Kovacic was a member of the Federal Trade Commission, He chaired the agency from March 2008 until March 2009. From January 2009 to September 2011, he served as Vice Chair for Outreach of the International Competition Network. Professor Kovacic was the FTC's General Counsel from 2001 through 2004, and also worked for the Commission from 1979 until 1983, initially in the Bureau of Competition's Planning Office and later as an attorney advisor to former Commissioner George W. Douglas.

Kovacic was a member of the faculty at the George Mason University School of Law from 1986 to 1999. From 1983 to 1986, he practiced antitrust and government contracts law with Bryan Cave's Washington, DC, office. Earlier in his career, Kovacic spent one year on the majority staff of the U.S. Senate Judiciary Committee's Antitrust and Monopoly Subcommittee.

Beginning in 1992, Kovacic was an adviser on antitrust and consumer protection issues to the governments of Armenia, Benin, Egypt, El Salvador, Georgia, Guyana, Indonesia, Kazakhstan, Mongolia, Morocco, Nepal, Panama, Russia, Ukraine, Vietnam, and Zimbabwe.

BRUNO LASSERRE is a member of the *Conseil d'État*, the French supreme administrative court, which he joined in 1978 after graduating from *École Nationale d'Administration* (ENA), the French national school for civil service.

Between 1989 and 1997, he served as Director for Regulatory Affairs, and then Director General for Posts and Telecommunications at the French Ministry of Posts and Telecommunications. In this position, he developed and implemented a comprehensive

overhaul of the telecommunications sector, culminating in its full opening to competition as well as in the creation of an independent regulator.

He returned to the *Conseil d'État* in 1998, where he chaired the 1st Chamber for three years, before becoming Deputy Chairman for all litigation activities, between 2002 and 2004.

After serving as Member of the board of the *Conseil de la concurrence* (1998-2004), he was appointed President in July 2004, and in this capacity pushed through a major reform that transformed it into the *Autorité de la concurrence*, responsible for merger review and competition advocacy in addition to antitrust enforcement. He has chaired the *Autorité* since then.

He is also an Officer of the French *Légion d'honneur* and a Commander of the French *Ordre national du Mérite*.

MARK MCLAUGHLIN is a partner with Mayer Brown LLP in Chicago, and has concentrated his practice on antitrust, securities class actions and related litigation, and franchising and distribution matters. He has litigated substantial antitrust cases involving a variety of industries and issues, including monopolization claims, challenges to acquisitions, price fixing, exclusive dealing, sham litigation and price discrimination claims, and claims involving practices in foreign commerce. He also regularly provides counseling in antitrust matters.

Mark is a graduate of the University of Notre Dame Law School, JD magna cum laude and the University of Notre Dame, BA, summa cum laude.

ROBERT MCLEOD is Chief Executive of MLex Ltd, Editor-in-Chief of MLex market intelligence and publisher of MLex magazine. He founded MLex, a service focused on antitrust, trade and financial services regulation and enforcement, in 2005 and has overseen the expansion of the subscription based news service to cover energy and climate change regulation, financial services and telecommunications and media. MLex has operations in the US, Europe, China and Brazil.

Robert McLeod writes extensively on antitrust and competition policy and is a frequent conference speaker on issues relating to policy implementation in Brussels. As well as MLex, he is a frequent contributor to other publications including The Banker, IP Law and Business, e-Concurrences and the Competition Policy International Antitrust Journal.

Prior to launching MLex, Mr McLeod worked for Bloomberg News in London, Paris and Brussels covering financial services, mergers and acquisitions, and antitrust.

BRITT M. MILLER is a partner in the Chicago office, where she practices in the areas of antitrust litigation and complex commercial litigation. She is co-leader of the Chicago Litigation Practice and a group leader of Mayer Brown's Antitrust & Competition practice. Britt focuses on representing domestic and international corporations in price-fixing, market allocation, monopolization, and conspiracy cases, and has also counseled clients on general antitrust issues. Since joining Mayer Brown in 1998, Britt has been involved in numerous antitrust cases including *In re Vitamins Antitrust Litigation*, one of the largest antitrust cases ever filed in the US. Her antitrust work has involved a variety of products and industries including synthetic rubber, aspartame, resins, household moving services, consumer health products, industrial chemicals, nursing services, fertilizers and vitamins.

Britt's general litigation experience spans both the federal and state court systems and includes client representations relating to contract disputes, constitutional rights, securities fraud, banking practices, airline deregulation, products liability and trust interpretation. Britt co-authored the "United States" chapter for the 2007-2012 editions of *Global Competition Review's* "Private Antitrust Litigation" treatise, is a contributing author to West's *Illinois Civil Discovery Practice*, and has given numerous presentations on international antitrust issues. She is a member of the American Bar Association's Section of Antitrust Law and the Section of Litigation and has been named a "Rising Star" in the Antitrust Litigation sections of the Illinois Super Lawyers list published by *Law & Politics* since 2008. Britt was named also "Future Star" by Benchmark Litigation in 2010, 2011, 2012 and 2013. In addition, she was recently named one of Law 360's "10 competition lawyers under 40 to watch." Prior to joining Mayer Brown, Britt served as a Judicial Extern to the Honorable George M. Marovich, US District Court for the Northern District of Illinois (1997).

Britt earned her BA from Auburn University and her JD from Northwestern University.

MAUREEN K. OHLHAUSEN was sworn in as a Commissioner of the Federal Trade Commission on April 4, 2012, to a term that expires in September 2018. Prior to joining the Commission, Ohlhausen was a partner at Wilkinson Barker Knauer, LLP, where she focused on FTC issues, including privacy, data protection, and cybersecurity. Ohlhausen previously served at the Commission for 11 years, most recently as Director of the Office of Policy Planning from 2004 to 2008, where she led the FTC's Internet Access Task Force. She was also Deputy Director of that office. From 1998 to 2001, Ohlhausen was an attorney advisor for former FTC Commissioner Orson Swindle, advising him on competition and consumer protection matters. She started at the FTC General Counsel's Office in 1997.

Before coming to the FTC, Ohlhausen spent five years at the U.S. Court of Appeals for the D.C. Circuit, serving as a law clerk for Judge David B. Sentelle and as a staff attorney. Ohlhausen also clerked for Judge Robert Yock of the U.S. Court of Federal Claims from 1991 to 1992. Ohlhausen graduated with distinction from George Mason University School of Law in 1991 and graduated with honors from the University of Virginia in 1984.

Ohlhausen was on the adjunct faculty at George Mason University School of Law, where she taught privacy law and unfair trade practices. She served as a Senior Editor of the Antitrust Law Journal and a member of the American Bar Association Task Force on Competition and Public Policy. She has authored a variety of articles on competition law, privacy, and technology matters.

CHARLES F. REGAN, JR., a partner in Mayer Brown's Chicago office, currently serves as the Firm's lead conflicts attorney. He advises on legal and business conflict issues, as well as other professional responsibility matters, that arise in Mayer Brown's offices worldwide. Before taking on his conflicts responsibilities, Chuck was a litigator who focused on benefits and ERISA litigation, and has extensive experience in pension class actions and commercial litigation. He earned an AB from the University of Chicago and a JD from Northwestern University School of Law, where he was Managing Editor of the *Northwestern University Law Review*. Before joining Mayer Brown, Chuck clerked for the Honorable Marvin E. Aspen of the United States District Court for the Northern District of Illinois.

THOMAS S. RESPESS, III has experience in all areas of antitrust, including the competitive analysis of mergers and acquisitions, price fixing and volume of commerce, and monopolistic practices. In prior positions at the Federal Trade Commission, Tom developed expertise in the financial analysis of merger efficiency claims and failing firm defenses. He teams with other economists in Baker & McKenzie Consulting LLC to provides econometric and other quantitative analyses of competition issues. Tom works regularly with outside economic experts and Firm attorneys to advise clients in transaction, investigation, and litigation matters. With his background and experience as attorney, economist and accountant, Tom provides multidimensional service to Baker & McKenzie's antitrust practice and clients.

Professional experience

- Assistant Director, Accounting and Financial Analysis, Federal Trade Commission
- Attorney Advisor to Commissioner, Federal Trade Commission
- Senior Economist, Bureau of Economics, Federal Trade Commission
- Antitrust Associate Attorney, Crowell & Moring LLP
- Antitrust Associate Attorney, Vinson & Elkins LLP

Professional affiliations

- American Economic Association
- American Bar Association
- American Institute of Certified Public Accountants

Education and admission

Education

- B.S., Management Science, Georgia Institute of Technology (1975)

- Ph.D., Economics, Rice University (1982)
- J.D., George Mason University School of Law (1991)

Bar Admittance

- District of Columbia
- Virginia

CPA Certification

- Virginia

FRANCESCA RICHMOND is an English qualified commercial litigator whose practice has an emphasis on public law and antitrust litigation. She provides strategic advice on contentious matters across a range of industries including media and advertising, telecoms, gambling, alcohol, food, tobacco and health and safety regulation.

Francesca recently completed a twelve month secondment with Baker & McKenzie's Antitrust Litigation team in Chicago and has acted on a number of antitrust litigation matters in England and Wales. She led the successful defence of Trade Stomil,one of five defendants to an English High Court follow-on action for damages by tire manufacturers in respect of the Butadienne Rubber cartel. She also advised a major European medical devices manufacturer on contentious competition litigation strategy around securing supply from a dominant upstream manufacturer.

Francesca is an editor of the Baker & McKenzie Global Guide to Competition Litigation and writes regularly on antitrust litigation (most recently for the Competition Law Journal on *Pursuing Effective Remedies in Private Competition Actions*). She founded the Competition Litigation Network, which hosts quarterly networking events for antitrust litigators, in 2009. Francesca is also a member of the Law Society for England and Wales and the Constitutional and Administrative Law Bar Association. She is committed to pro bono work and has appeared before the Supreme Court on behalf of the United Nations High Commissioner for Refugees on two occasions.

JASON STAPLES is Senior Counsel with Abbott's Legal Regulatory and Compliance division. Mr. Staples joined Abbott in 2010 to assume leadership of the international practice group supporting global clinical development. He was instrumental in expanding the scope of the team's expertise beyond proprietary pharmaceuticals to all of Abbott's medical device, diagnostics, and nutrition businesses. Prior to joining Abbott, he served for several years as legal counsel for a CRO (now INC Research) providing management and consulting services for the global biopharmaceutical industry. He specializes in areas of international law and regulatory compliance associated with all aspects of clinical research including related intellectual property, anti-corruption and privacy law concerns. Mr. Staples is a graduate of Boston University and the Case Western Reserve University School of Law.

KRISTIN TERRIS is a Vice President in NERA's Antitrust and Labor Practices. She contributes to projects involving the study of relevant markets, mergers and acquisitions, predatory pricing, tying and bundling, exclusive dealing and essential facilities, as well as antitrust and commercial damages. Her work is incorporated into expert testimonies and presentations to regulatory agencies. Her main areas of specialization include econometric analysis, applied industrial organization, labor, construction, and energy.

Before joining NERA, Dr. Terris was a faculty member at Wellesley College, where she taught undergraduate level courses in microeconomic theory and econometrics. While completing her PhD in economics at Georgetown University, she also taught graduate and undergraduate level courses in mathematics, economic theory, and labor. Prior to graduate school, Dr. Terris worked as a Program Manager at USWest Wireless on a project to design and build their wireless network. Before that, she worked for more than a decade at Bechtel, where she contributed to project management and consulting engagements for clients worldwide, including projects in power generation, petroleum processing, environmental cleanup, telecommunications, nuclear weapons demilitarization, and security.

Dr. Terris has presented several research papers on labor economics issues at seminars and conferences throughout the US. Her dissertation was an applied study of the effects of unemployment on individuals' subsequent employment opportunities. She received her PhD and MA in economics from Georgetown University and earned a BS in electrical engineering and a second BS in finance from the University of Colorado in Boulder.

FRANCISCO TODOROV is recognized as a leading practitioner in antitrust and trade regulation by various publications such as *Chambers, GCR, Who´s Who*. and *PLC*. He has authored and co-authored several publications and articles on his areas of practice. In addition, Mr. Todorov is a lecturer of competition law at the University of Brasilia and a director at the Brazilian Association for Research into Competition, Consumer and International Trade Law of IBRAC. Mr. Todorov has worked at Baker & McKenzie London office.

Mr. Todorov focuses on competition law, merger filings and cartel investigations. He handles abuse of dominance cases, antitrust litigation and advises on leniency agreements and settlements with the competition authority. He is also active in trade remedy cases, especially dumping investigations. Mr. Todorov advises clients on Brazilian telecommunications regulations and represents them in related regulatory and competition proceedings.

Represented clients from different industries before competition and trade remedy authorities, including the pharmaceutical, consumer goods, food, packaging, infra-structure, oil & gas, energy and telecommunications industries.

Columbia University (LL.M.) (1999) and University of Brasília (LL.B.) (1995).



KEYNOTE ADDRESS BY MAUREEN K. OHLHAUSEN: UPDATE ON INTERNATIONAL COOPERATION AND CONVERGENCE

MEMORANDUM OF UNDERSTANDING ON ANTITRUST COOPERATION BETWEEN THE UNITED STATES DEPARTMENT OF JUSTICE AND THE UNITED STATES FEDERAL TRADE COMMISSION, AND THE MINISTRY OF CORPORATE AFFAIRS (GOVERNMENT OF INDIA) AND THE COMPETITION COMMISSION OF INDIA

The United States Federal Trade Commission and the United States Department of Justice, on the one hand, and the Ministry of Corporate Affairs (Government of India) and the Competition Commission of India, on the other hand (collectively referred to as the "U.S. and Indian competition authorities"),

Desiring to enhance the effective enforcement of their competition laws by creating a framework that provides for enforcement cooperation between the U.S. and Indian competition authorities,

Recognizing the benefit of technical cooperation between the U.S. and Indian competition authorities in order to enhance an environment in which the sound and effective enforcement of competition law and policy supports the efficient operation of markets and economic welfare of the citizens of their respective nations,

Recognizing that the development of a well-functioning system for effectively implementing competition law and policy involves the U.S. and Indian competition authorities, and also other government agencies, and the legal, business, and academic sectors, and

Recognizing that establishing good communications between the U.S. and Indian competition authorities on competition law and policy will contribute to improving and strengthening the relationship between the United States and India, have reached the following understanding:

I. COOPERATION

1. The U.S. and Indian competition authorities intend to share and to keep each other informed of significant competition policy and enforcement developments in their respective jurisdictions, with an opportunity to comment on these developments.

2. The U.S. and Indian competition authorities recognize that it is in their common interest to work together in technical cooperation activities related to competition law enforcement and policy. Subject to reasonably available resources, they may jointly engage in appropriate activities in furtherance of that interest, such as, ***inter alia:*** (a) participating in training courses on competition law and policy organized or sponsored by one another; and (b) providing assistance, where appropriate, in promoting understanding of sound competition policy among important supporting institutions, government agencies, the business community, bar associations, academic institutions, etc.

3. The U.S. and Indian competition authorities recognize that, when they are investigating related competition matters, it may be in their common interest to cooperate in appropriate cases, consistent with their respective enforcement interests, legal constraints, and available resources.

4. The U.S. and Indian competition authorities plan to evaluate the effectiveness of the cooperation under this Memorandum on a regular basis to ensure that their expectations and needs are being met.

II. WORKPLAN

1. The U.S. and Indian competition authorities intend to develop a work plan of cooperative activities, which may be revised by mutual consent.

III. COMMUNICATIONS

1. The U.S. and Indian competition authorities may request advice and communications from one another regarding matters of competition law enforcement and policy; provided, however, communications relating to case investigations shall be limited to the relevant U.S. and Indian competition authorities investigating the matter.

2. The U.S. and Indian competition authorities plan to appoint a liaison officer for the purpose of facilitating contact in furtherance of this Memorandum. Communications may be carried out by telephone, electronic mail, videoconference, or in person, as appropriate.

3. Officials of the U.S. and Indian competition authorities may meet, as appropriate, to exchange information on their current and contemplated policy and enforcement efforts and priorities.

IV. CONFIDENTIALITY

1. It is understood that the U.S. and Indian competition authorities do not intend to communicate information to the other if such communication is prohibited by the laws governing the agency possessing the information or would be incompatible with that agency's interest.

2. In so far as information is communicated, the recipient should, to the extent consistent with its laws, maintain the confidentiality of any such information communicated to it in confidence.

EFFECTIVE DATE

The present Memorandum of Understanding comes into effect from the date of its signature and cooperation under this Memorandum is intended to continue until either the U.S. or Indian competition authorities wish to discontinue such cooperation in which case the U.S. or Indian competition authorities should endeavor to provide three months notice of its intention to discontinue cooperation to the other participant. Discontinuation of the present Memorandum of Understanding is not intended to affect the implementation of the projects that are already in process under the present Memorandum.

This Memorandum is intended to set forth an advisory framework for cooperation. The U.S. and Indian competition authorities reserve their full discretion in implementing the Memorandum, and nothing in it is intended to change existing law, agreements, or treaties, or create legally binding or enforceable rights or obligations.

Dated at Washington, D.C., on September 27, 2012, in four originals, each in the English and Hindi languages, both texts being official.

United States Federal Trade Commission	United States Department of Justice
Ambassador of India to the United States of America for the Ministry of Corporate Affairs Government of India	Competition Commission of India

United States of America

Federal Trade Commission

The Never-ending yet Vital Pursuit of Greater Cooperation, Convergence, and Transparency

Remarks of Maureen K. Ohlhausen
Commissioner, Federal Trade Commission

First Annual Symposium
China Institute of International Antitrust and Investment
China University of Political Science and Law
Beijing, China

March 22, 2013

Good morning. It is my great pleasure to be here at the First Annual Symposium held by the China Institute of International Antitrust and Investment (CIIAI). I would like to thank Frank Fine, the Executive Director of the CIIAI, for graciously inviting me to speak at this inaugural symposium. Frank and his colleagues at the Institute should be commended for establishing the first globally-oriented antitrust think tank in Asia. Along with other observers of competition law and policy developments, I look forward to the great work and programs the Institute will produce in the future.

This morning, I would like to address three goals that competition agencies have pursued for many years: cooperation, convergence, and transparency. Much has been accomplished in these areas by agencies around the world. Much like the goal of perfection, however, the pursuit of greater cooperation, convergence, and transparency is a never-ending one. We can always seek greater cooperation among competition authorities, particularly those that have arrived on the scene more recently. We can always work toward closer harmonization of the process and substance of our competition analyses. And, we can always provide greater transparency and

guidance to those following and affected by our enforcement and policy decisions. Nonetheless, each of these goals is essential to a well-functioning system of global competition authorities.

In my remarks, I will discuss my expectations for the Federal Trade Commission's (FTC or Commission) priorities in the areas of cooperation and convergence, as well as my own thoughts on the importance of transparency. I will also touch on some recent developments – in both the United States and China – in each of these three areas.

Before I proceed any further, let me take the opportunity to clarify that I am speaking only for myself in presenting these remarks; I am not speaking for the entire Federal Trade Commission. Nonetheless, I can say without hesitation that there is a high degree of continuity in the FTC's international antitrust agenda. The FTC is institutionally structured to ensure continuity, with Commissioners from both of the two major U.S. political parties and staggered seven-year terms for the Commissioners that transcend the election cycle. Also, the priorities of Democratic and Republican Commissioners and administrations in the international area have been remarkably consistent, emphasizing bilateral and multilateral cooperation and seeking convergence toward sound competition policy.

This commitment to fostering international cooperation – stretching back over many administrations and several FTC Chairmanships – has enabled the FTC to strengthen its ties with our international partners, play a lead role in multilateral fora, such as the International Competition Network (ICN), and expand our program of international technical assistance. Whatever policy differences sometimes divide us domestically, Republicans and Democrats have largely shared an international vision and a strong commitment to the role of the FTC in building stronger international antitrust relationships.

I. Cooperation

A. Benefits of Cooperation among Competition Authorities

With that introduction, let me start with the important goal of increased cooperation among competition agencies. To make what I think is by now a fairly well established point, inter-agency cooperation on competition cases is critical given the global nature of many businesses and transactions and the inter-connected nature of the global economy. There are now well over 100 jurisdictions enforcing competition laws. Cooperation among those agencies can mean many different things, including discussions of substantive competition law, economic analysis, and procedural issues; the sharing of general knowledge about a particular industry; and, of course, coordinating on a specific investigation. To be clear, however, cooperation does not necessarily mean consistent results in every case; that is simply not a realistic goal.

Cooperation among competition authorities benefits the agencies involved in the cooperative efforts, the businesses and other parties subject to competition laws, and the economies of the countries involved in the cooperation. Cooperation allows agencies to identify issues of common interest, to improve their analyses, and to avoid inconsistent outcomes. The more cooperation there is across agencies, the more those agencies can deepen relationships with their counterparts – at both the staff and supervisory levels. Even in situations where detailed specifics of an investigation cannot be shared, it is useful for competition authorities to be able to share their experiences – both good and bad. Further, cooperation on cases helps businesses around the globe by providing more consistent outcomes on a particular case, as well as enhanced certainty, which in turn facilitates greater investment and innovation by all businesses. Finally, cooperation facilitates the effective and efficient enforcement of competition laws, which helps to maintain competitive markets and thus a more attractive investment climate.

The most commonly cited example of inconsistent outcomes in the competition area involves merger remedies, or restrictive conditions, as they are often called here in China. Cooperation can help avoid situations in which remedies imposed or accepted by one agency are inconsistent with those imposed by an agency in another jurisdiction. Cooperation can also be beneficial when agencies are coordinating the announcement of their respective merger remedies.

B. FTC Developments and Priorities in the Area of Cooperation

The FTC works bilaterally with a large and growing number of jurisdictions on case cooperation and assistance. The United States government has bilateral cooperation agreements with eight jurisdictions: Australia, Brazil, Canada, the EU, Germany, Israel, Japan, and Mexico. In addition, the U.S. antitrust agencies – the FTC and the U.S. Department of Justice Antitrust Division (Antitrust Division) – have entered into Memoranda of Understanding (MOUs) with the competition agencies in Chile, Russia, India, and of course China.[1]

Pursuant to these agreements, or often without an agreement in place, the staff of the FTC cooperates with foreign competition agencies on individual cases and on developing competition policy. The agencies frequently exchange investigative information, for example, when the FTC and a foreign agency review a case that raises competition concerns in one or both jurisdictions. The agencies may exchange both public information and what we often refer to as "agency confidential" information – that is, information that the agency does not routinely disclose to outside parties, but may disclose under federal law. Examples of agency confidential information include staff views on market definition, competitive effects, and remedies, as well as the fact that the FTC is investigating a particular party.

[1] Fed. Trade Comm'n, International Antitrust and Consumer Protection Cooperation Agreements, http://www.ftc.gov/oia/agreements.shtm.

To mention a few of our ongoing cooperation efforts, we continue to have frequent opportunities to work with our colleagues in the Canadian Competition Bureau and the Directorate General for Competition at the European Commission (DG Comp). Following the enactment of Canadian rules aligning their merger review procedures more closely with the U.S. system, the FTC has worked closely with Canadian officials to ensure maximum interactivity between our systems. We hold regular in-person roundtables between case handlers. We also have had a series of staff exchanges, made possible by the US SAFE WEB Act,[2] a statute that enables the FTC to host foreign competition (and consumer protection) agency officials and, in appropriate circumstances, provide them with access to non-public materials, allowing them to gain valuable experience by working with case teams at the FTC.

We have worked closely with DG Comp on merger investigations for many years. More recently, the FTC and DG Comp have cooperated on numerous unilateral conduct investigations, including the recent *Google* search bias and standard-essential patent matters. Although cooperation in conduct cases is more challenging – given that they are not subject to the same time constraints as mergers and parties may not have the incentive to facilitate cooperation – coordination on these matters is important and we are committed to making that happen with the EC and other agencies whenever possible and appropriate.

In recent years, we have seen the emergence of many new competition laws and merger control regimes across Asia, Latin America, and Africa. This presents opportunities to spread the benefits of sound competition policy, but also raises challenges to both cooperation and convergence. New laws and MOUs, combined with increased cross-border business activity, are laying the foundation for broader cooperation, and we have had opportunities to cooperate

[2] Undertaking Spam, Spyware, and Fraud Enforcement with Enforcers beyond Borders Act, Pub. L. No. 109-455, 120 Stat. 3372 (2006).

productively with jurisdictions such as Mexico. The FTC has worked closely with the Mexican Federal Competition Commission to strengthen its capacity to evaluate and address anticompetitive practices. This has included coordinating a series of judicial education programs featuring prominent U.S. jurists, as well as tightening our coordination in merger reviews. Our relationship with the Mexican competition agency is strong and has provided a bridge to other agencies in Latin America. Brazil, for example, has made major institutional reforms and adopted major legislative changes, including to its merger review system.

From experience, we know that bilateral case cooperation, while distinct from convergence, also facilitates greater understanding and can create a foundation of legal convergence as well. As our cooperation extends to newer agencies and additional types of cases, we hope that we will build a better foundation for deeper substantive and procedural convergence. I expect that finding solutions to practical problems agencies face will build stronger relationships as we learn from each other and assist each other in improving our performance and effectiveness.

Nonetheless, there are certain challenges that we are likely to encounter in our coordination efforts in the future. For example, new rules governing data privacy could make bilateral cooperation more difficult. We have encountered instances in which firms raised concerns that providing requested information to the FTC could violate another country's data privacy laws. As you may know, Europe is currently considering a new privacy regulation. While we share the goal of ensuring adequate privacy protections, we want to make sure privacy rules do not make it more difficult to obtain and share data for law enforcement purposes. We are working with our U.S. government and EC colleagues on these issues.

C. China's Recent Efforts in the Area of Cooperation

Turning to recent coordination efforts by China, as many of you know, in July 2011, the FTC and the Antitrust Division signed a Memorandum of Understanding with the Chinese Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), and the State Administration for Industry and Commerce (SAIC).[3] The MOU establishes a framework for cooperation between the two U.S. antitrust agencies and the three Chinese Anti-Monopoly enforcement agencies. The MOU anticipates cooperation at two levels: first, a joint dialogue among the senior competition officials at all five agencies, and second, communication and cooperation between individual agencies at the senior or working level. The MOU identifies several specific avenues for cooperation, including: (1) exchanges of information and advice about competition law enforcement and policy developments; (2) training programs, workshops, and other means to enhance agency effectiveness; (3) exchanges of comments on proposed laws, regulations, and guidelines; and (4) cooperation on specific cases or investigations, when it is in the investigating agencies' common interest.

Even before the signing of the MOU with the Chinese agencies, the FTC, along with the Antitrust Division, had devoted considerable resources to working with Chinese officials on developing the Anti-Monopoly Law (AML). The two U.S. agencies engaged in frequent meetings and training workshops, in both China and the United States, with all three Chinese competition agencies. We discussed substantive competition analysis and effective investigative techniques with the Chinese agencies. In addition to many informal exchanges, we submitted numerous written comments on draft implementing rules and guidelines. The Chinese

[3] *See* Press Release, Fed. Trade Comm'n, Federal Trade Commission and Department of Justice Sign Antitrust Memorandum of Understanding with Chinese Antitrust Agencies (July 27, 2011), *available at* http://www.ftc.gov/opa/2011/07/chinamou.shtm. The text of the MOU is available at http://www.ftc.gov/os/2011/07/110726mou-english.pdf.

government welcomed our views on the Anti-Monopoly Law as it proceeded through several rounds of drafting. We, in turn, very much appreciated the opportunity to provide our views.

In addition to the MOU, the U.S. agencies and MOFCOM have a *Guidance for Case Cooperation*,[4] which establishes a framework for cooperation in merger cases. Under that document, which was issued in November 2011, the agencies can – but are not required to – exchange information and engage in other useful cooperative efforts when they are investigating the same transaction.

We will hold another joint dialogue with China and the Antitrust Division under our MOU later this year, having held our initial joint dialogue last September. We have already had the opportunity, in the hard disk drive mergers,[5] to cooperate with MOFCOM, and look forward to future opportunities. We hosted a MOFCOM official at the FTC for six months through our International Fellows program and will continue our technical assistance program for the three Chinese agencies. Looking forward, I am confident that the FTC will continue to place great importance on building a strong, cooperative relationship with China and its competition agencies. We look forward to expanding and deepening our relationships with all three agencies, to the benefit of U.S. and Chinese businesses and consumers.

Beyond their relationship with the FTC and Antitrust Division, the Chinese agencies now have MOUs or similar arrangements with the EU, the U.K. Office of Fair Trading, and the Korean and Japanese Fair Trade Commissions, among others. Officials from MOFCOM, NDRC, SAIC, and other Chinese government entities are devoting substantial resources to studying foreign competition enforcement through formal technical assistance and exchange

[4] Guidance for Case Cooperation between the Ministry of Commerce and the Department of Justice and Federal Trade Commission on Concentration of Undertakings (Merger) Cases (Nov. 29, 2011), *available at* http://www.ftc.gov/os/2011/11/111129mofcom.pdf.

[5] *See* Fed. Trade Comm'n, Statement of the Federal Trade Commission Concerning Western Digital Corporation/Viviti Technologies Ltd. and Seagate Technology LLC/Hard Disk Drive Assets of Samsung Electronics Co. Ltd, at 2 (Mar. 5, 2012), *available at* http://www.ftc.gov/os/caselist/1110122/120305westerndigitalstmt.pdf.

programs, secondment of personnel to foreign agencies, and direct exchanges with foreign practitioners, scholars, and industry groups.

Finally, in addition to the international coordination efforts I just discussed, I would like to raise a point about domestic coordination efforts. As the AML is developed further, case coordination and cooperation between NDRC and SAIC, as well as between each of those agencies and their respective provincial authorities, will be important. Such coordination will allow those agencies to avoid inconsistencies, overlaps, and gaps in enforcement of the AML. While it is easy to point out certain (and sometimes high-profile) disagreements between the FTC and the Antitrust Division, overall my experience supports the conclusion that the relationship serves as an example of successful coordination between domestic competition agencies.

II. Convergence

A. Benefits of Convergence by Competition Authorities

A second important goal for competition authorities to pursue is greater convergence upon substantive competition norms, procedural standards, and operational techniques. Convergence does not mean the establishment of identical policies and enforcement mechanisms around the world. As with coordination, total convergence is not a realistic or necessarily proper goal. Nonetheless, as with coordination, convergence can benefit the agencies involved in such efforts, businesses subject to those agencies' laws, and competition law and policy more generally.

From the U.S. perspective, sound competition analysis, consistent outcomes, and convergence toward best practices benefits U.S. consumers and ensures that U.S. businesses receive fair and equal treatment from competition regimes around the world. Standardization also can reduce unnecessary costs associated with competition enforcement by, for example,

simplifying the regulatory review process faced by merging parties. Moreover, the same benefits accrue to any country that seeks increased harmonization of its competition regime with its foreign counterparts. Convergence efforts can also yield benefits of increased cooperation. To that end, one should not underestimate the importance of frequent contacts and networking among agency personnel in day-to-day operations and case work. Finally, increased convergence in procedure and substantive policy encourages competitive markets, investment, a greater understanding and respect for competition laws, and thus greater compliance with those laws by businesses.

B. FTC Developments and Priorities in the Area of Convergence

As many of you know, the FTC and the Antitrust Division have played a leading role in promoting convergence toward best practices in competition policy and enforcement. Given differences in histories, cultures, legal systems, and levels of economic development, it is inevitable that differences in the working and application of competition laws and policies will persist. The FTC believes, however, that learning from the experience of others in handling similar issues – including those involving institutional arrangements, procedures, and the substance of antitrust enforcement – can promote convergence toward better practices.

The FTC works in several multilateral fora on competition law and policy issues. Prominent among these are the ICN and the Organization for Economic Cooperation and Development (OECD). The ICN was founded in 2001 by the FTC, the Antitrust Division, and 14 other competition agencies. Its membership now includes 127 competition authorities. Despite that diverse membership, the ICN has succeeded in achieving consensus on recommended practices in several areas, including merger review procedures, substantive merger analysis, and the criteria for assessing abuse of dominance. Work product by the ICN has

included recommended practices, case-handling and enforcement manuals, reports, legislation and rule templates, and workshops.[6]

The FTC's work in the ICN is a top priority of our international program. We serve on its Steering Group and as Co-Chair of its Agency Effectiveness Working Group, and are active across the wide range of its work. With our partners at DG-Comp, we co-lead a project on "investigative process" that examines aspects of procedural fairness in the context of agency investigations, including topics such as transparency, confidentiality, and internal checks and balances. This multiyear project entails conducting a broad overview of agencies' practices, which we expect to culminate in agreement on best practices or other forms of guidance for agencies. As it addresses fundamental principles for all agencies and is important to our business community stakeholders who face investigations around the world, I expect this to be a banner project, and one worth following.

We also lead the ICN's "Curriculum Project," which develops online video training modules designed principally for younger agencies, as well as new staff at all competition agencies. The first set of modules covers basic concepts of antitrust enforcement, such as market definition, market power, and abuse of dominance. We expect eventually to develop a virtual university of materials for use by agencies at all levels of development.

Turning to the OECD, where we join agencies from countries with developed economies to discuss competition topics of mutual interest, we see some similar new themes. Historically, the multilateral competition organizations have focused on substantive and procedural convergence. Recently, however, we have seen a growing interest in questions of "agency infrastructure," which provides a foundation for effective enforcement. This is reflected in the current work of the ICN I just mentioned and in the current work program of the OECD.

[6] The ICN's work product is available on the ICN website at http://www.internationalcompetitionnetwork.org/.

In addition to its periodic consideration of discrete antitrust topics, the OECD Competition Committee is conducting an ongoing exploration of two strategic themes – (1) international enforcement cooperation, and (2) evaluation of competition enforcement and advocacy. Along with the ICN, the OECD's International Cooperation Project is reviewing coordinated efforts among competition authorities in investigations to identify examples of effective cooperation and possible areas for improvement.

The ICN and OECD recently conducted a joint survey of competition authorities, the results of which will serve as a basis for ongoing work, which may include model agreements on information exchange and enforcement cooperation. According to the ICN/OECD survey results, international cooperation is a policy priority for a vast majority of competition agencies, with most agencies finding such cooperation to be useful to their enforcement strategies. Further, participants in the survey reported that the benefits from cooperation outweigh the costs. The survey also found that effective cooperation of enforcement action is enhanced by the ability of enforcers to exchange information (both confidential and non-confidential) about the cases they are investigating.[7]

In addition to the ICN and OECD, the United States is a founding member of the Asia-Pacific Economic Cooperation (APEC), a 21-member regional economic forum founded in 1989. APEC is addressing issues of transparency and due process in competition investigations, a consistent priority for both the business community and the United States.

Looking forward, we envision a continuing process of "soft convergence," by which I mean dialogue among agencies, identifying superior practices, and voluntary acceptance of such practices. Our goal is to convince other competition authorities to embrace sound competition

[7] *See* Philip Collins, *The OECD/ICN Joint Survey on International Enforcement Cooperation: A Ground-Breaking Initiative*, COMPETITION POLICY INT'L (2013), *available at* https://www.competitionpolicyinternational.com/assets/Uploads/ICN2-26-2013.pdf.

policies, which are grounded in economic analysis, respectful of intellectual property rights, and fair and transparent to affected persons and businesses. Yet, for the foreseeable future, substantive convergence will remain a challenge. Differences in laws, their interpretation, and legal and economic analysis will remain. This creates a challenge for us to reach consistent outcomes. We will have more work to do just to minimize disruption and costs to firms and agencies.

C. China's Recent Efforts in the Area of Convergence

Moving now to China's efforts in the area of convergence, as I mentioned earlier, in the relatively few years since the AML was adopted, the Chinese government and competition agencies have demonstrated a significant and growing interest in engaging with foreign competition authorities, multilateral competition organizations, and other stakeholders. The Chinese agencies should be commended for their interest in benefitting from the experience of the U.S. and other competition agencies and international competition organizations. With a longer history of enforcing competition laws, we have learned from the many mistakes that we have made during the development of our own laws. China has the advantage of studying the latest competition policy theories and law enforcement methods developed by other countries. So far, it is clear that China and its competition agencies are willing to take advantage of this opportunity.

As just one example, MOFCOM is currently drafting its *Regulation on the Imposition of Restrictive Conditions in Concentrations between Business Operators*.[8] In doing so, MOFCOM held a series of seminars over the past couple years to obtain feedback on drafts of the regulation. In the process, MOFCOM also discussed its plans for the remedies regulation with competition

[8] *See* Press Release, MOFCOM, MOFCOM Held Special Press Conference on "Anti-monopoly Work Progress in 2012" (Jan. 5, 2013) [hereinafter MOFCOM Press Release], *available at* http://english.mofcom.gov.cn/article/newsrelease/press/201301/20130108513014.shtml.

officials from the United States and European Union, reflecting a willingness to seek input from many stakeholders.

It is my hope that China remains an active participant in the many convergence-related discussions taking place across the globe and on a seemingly daily basis. China participates in the work of the OECD Competition Committee as an observer and is a member of UNCTAD. Participation in the ICN by the Chinese competition agencies would be welcome and certainly would be a significant factor in the future success of that organization.

Finally, I fully expect CIIAI, under Frank Fine's strong leadership, to play a significant role in persuading China to continue to converge toward sound competition policy. CIIAI's mandate is to promote due process and transparency in antitrust investigations, and to promote policy convergence where it is practical and advisable to do so. CIIAI thus can – and no doubt will – serve as a catalyst for convergence in China and throughout Asia.

III. Transparency

A. Benefits of Transparency by Competition Authorities

A final and important goal that I would like to discuss this morning is transparency about how and why competition agencies enforce their laws. Such transparency can benefit the agency, parties subject to that agency's laws, and the state of the law more generally. Transparency in our enforcement efforts, of course, offers guidance to market participants on how to comply with the antitrust laws. In that respect, it offers predictability and fairness to persons and businesses subject to an agency's jurisdiction. It allows them to better understand and predict the likely outcome of particular cases and, in the merger review area, the time and costs that a review is likely to entail. Transparency can foster increased compliance with the law. Transparency also may allow the agency to gain broader support among its various stakeholders for its core mission. In other words, increased transparency can improve the

credibility of the competition agency. Further, the discipline of explaining an agency's decision-making is likely to improve the quality and the end results of that decision-making. Finally, increased transparency by agency heads regarding the substantive norms driving competition policy and law enforcement can be of significant help to agency staff actually doing the case work and trying to implement the agency's competition program.

There are of course many opportunities for an agency to be transparent. These include guidelines on how laws will be implemented, statements explaining actions or non-actions that signify a change in enforcement policy, statements issued in connection with the closing of investigations, releases of merger information and data, and speeches by agency officials.

Certainly, it is understandable why an agency would have reservations about increased transparency. First, there is additional work involved in preparing information for public disclosure. Further, the agency may be concerned about being locked into a publicly disclosed policy or losing some discretion in future matters based on its public statements. Being transparent also opens up an agency to potential criticism for its stated policies or its enforcement decisions. It also may provide a roadmap for competitors to use in complaining to an agency about a proposed merger or a competitor's course of conduct. Even taking into account these considerations, it is crucial that competition agencies strive for as much transparency as possible and practical.

B. FTC Developments Implicating Transparency

Generally speaking, I believe the FTC has been appropriately transparent in our antitrust enforcement. Over the years, we have issued several enforcement guidelines, policy statements, statements in connection with the closing of significant investigations, and (jointly with the Antitrust Division) certain data stemming from our merger review process. I applaud these

efforts and hope the Commission will maintain, if not increase, its level of transparency in the future.

Nonetheless, the FTC has reached some decisions recently with which I disagreed. A significant part of my concern with these decisions is the lack of transparency and guidance that they provide. Before I address those decisions, some background on the FTC may be useful. As many of you know, the FTC is comprised of five Commissioners. When the agency takes a particular action, such as filing a lawsuit or settling with the target of an investigation, individual Commissioners sometimes issue separate statements explaining their views, including why they voted for or against the action.

There are two recent decisions by the FTC that I voted against and in which I issued a dissenting statement.[9] Each of these actions involved standard-essential patents – that is, patents that are essential to the implementation of a technical standard – and the use of Section 5 of the FTC Act, which prohibits, among other things, "unfair methods of competition." In the first matter, *Robert Bosch GmbH (Bosch)*,[10] the agency investigated a proposed acquisition by Bosch that raised competitive concerns in the market for certain automotive air conditioning repair equipment. During the course of the investigation, FTC staff uncovered evidence indicating that the acquired company, SPX Service Solutions (SPX), had sought injunctive relief against competitor firms that were interested in licensing certain SPX patents that may have been standard-essential and that SPX allegedly had offered to license on reasonable and non-

[9] In addition to the two decisions discussed herein, I voted against the FTC's July 2012 withdrawal of its policy statement regarding the seeking of disgorgement in competition cases because of my concern that such withdrawal would reduce agency transparency and leave those subject to our jurisdiction without sufficient guidance as to the circumstances in which the FTC will pursue the remedy of disgorgement in antitrust matters. *See* Statement of Commissioner Maureen K. Ohlhausen Dissenting from the Commission's Decision to Withdraw its Policy Statement on Monetary Equitable Remedies in Competition Cases (July 31, 2012), *available at* http://www.ftc.gov/os/2012/07/120731ohlhausenstatement.pdf.

[10] *In re* Robert Bosch GmbH, FTC File No. 121-0081.

discriminatory (RAND) terms.[11] The FTC settled this matter with Bosch, requiring Bosch to divest certain assets to address the proposed merger.[12] To address the alleged patent-related conduct, the FTC required Bosch, first, to agree not to seek injunctions on its standard-essential patents against parties that are willing to license such patents, and, second, to license those patents on a royalty-free basis.[13]

In the second matter, the FTC investigated and ultimately entered a settlement with Google and its recently acquired subsidiary, Motorola Mobility.[14] As in *Bosch*, the FTC alleged that Google and Motorola violated Section 5 of the FTC Act – but not the antitrust laws – by seeking injunctive relief against competitors that were willing to license certain standard-essential patents that Motorola had agreed to license on RAND terms through its participation in several standard-setting organizations.[15] In *Google*, the remedy imposed by the FTC was more complex than the flat prohibition on seeking injunctive relief imposed in *Bosch*. Rather, the FTC's consent order established a multi-step process that Google must wade through before it is permitted to seek injunctive relief on its standard-essential patents.[16]

In my dissents in the *Bosch* and *Google* matters, I took issue with, among other things, the lack of transparency and guidance that the FTC's decisions provided to patent holders and others subject to our jurisdiction.[17] In particular, I raised concerns about the FTC enforcing

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[11] *Id.*, Analysis of Agreement Containing Consent Orders to Aid Public Comment, at 4 (Nov. 26, 2012), *available at* http://www.ftc.gov/os/caselist/1210081/121126boschanalysis.pdf.
[12] *See id.* at 3-4.
[13] *See id.* at 4-5.
[14] *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120.
[15] *See id.*, Analysis of Proposed Consent Order to Aid Public Comment, at 3-6 (Jan. 3, 2013), *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolaanalysis.pdf.
[16] *See id.* at 6-8.
[17] *See In re* Robert Bosch GmbH, FTC File No. 121-0081, Statement of Commissioner Maureen K. Ohlhausen, at 3-4 (Nov. 26, 2012) [hereinafter Ohlhausen *Bosch* Statement], *available at* http://www.ftc.gov/os/caselist/1210081/121126boschohlhausenstatement.pdf; *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120, Dissenting Statement of Commissioner Maureen K. Ohlhausen, at 1-3 (Jan. 3, 2013) [hereinafter Ohlhausen *Google* Dissent], *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolaohlhausenstmt.pdf.

Section 5 without providing sufficient information about the relationship between that statutory provision and the antitrust laws, including the Sherman and Clayton Acts. Without such information, it is unclear what the term "unfair method of competition" means or how the Commission will use its enforcement discretion under Section 5. The inherent ambiguity in the FTC Act makes it all the more important that the agency provide meaningful limiting principles to application of Section 5.

A related point I raised in my *Bosch* and *Google* dissents is that one of the effects of those decisions was to create conflict between the FTC and other U.S. government institutions.[18] The first such conflict arises between the FTC on the one hand and the International Trade Commission (ITC) and the federal courts on the other as a result of our prohibiting holders of standard-essential patents from seeking injunctive relief in the ITC and the courts. Our decisions effectively tell holders of standard-essential patents that they cannot go to ITC, where the only available relief is an exclusion order. I would note that I am not saying that competition policy should take a secondary position to other industrial policy concerns. Quite the contrary, the FTC has correctly advocated for a greater role for competition in U.S. industrial policy decisions. However, as I have noted, I believe we need to exhibit a certain amount of regulatory humility and recognize that we may not be the best-positioned governmental entity to act in a particular area if other government institutions have the authority and expertise to address the relevant issues.[19]

The second institutional conflict created by these two decisions is between the FTC and the Antitrust Division, with whom we share antitrust jurisdiction. When we rely on Section 5 of the FTC Act, which only the FTC can enforce, rather than the antitrust laws, which both agencies

[18] *See* Ohlhausen *Bosch* Statement, *supra* note 17, at 1-2; Ohlhausen *Google* Dissent, *supra* note 17, at 5-6.
[19] *See* Ohlhausen *Bosch* Statement, *supra* note 17, at 2.

enforce, we potentially create two different standards for patent holders, depending on which agency happens to review any alleged misconduct. One wonders how this institutional conflict is viewed by foreign competition authorities.

Another concern raised by these cases is what may be perceived as insufficient recognition of intellectual property rights. In both *Bosch* and *Google*, the FTC placed significant restrictions on the ability of holders of standard-essential patents to seek injunctions, which is a critical intellectual property right.[20] In my view, the FTC did this in each case with very little, if any, evidence that the patent holder agreed to waive this right when it participated in the standard-setting process. Further, in *Bosch*, the FTC required Bosch to grant royalty-free licenses on its patents as a remedy for seeking injunctions on its potentially standard-essential patents.[21] No matter how good the intentions may have been in these cases, my concern is that they may send a message to our foreign counterparts that we do not place a very high value on intellectual property rights. Any such perception is clearly inconsistent with the appreciation for IP rights that we typically hold in the United States. Thus, I would recommend that any agency or party interested in relying on these decisions proceed with caution and to consider all of the Commissioner statements that were issued in connection with those decisions.

C. Chinese Developments Implicating Transparency

Finally, let me turn to recent Chinese developments that implicate the goal of transparency. Both inside and outside of China, companies, competition lawyers, and the press are paying increasing attention to China's competition regime – particularly in the area of merger control. This attention reflects the greater role that China has in the world economy and in the

[20] *See In re* Robert Bosch GmbH, FTC File No. 121-0081, Decision and Order, at 13-14 (Nov. 26, 2012) [hereinafter *Bosch* D&O], *available at* http://www.ftc.gov/os/caselist/1210081/121126boschdo.pdf; *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120, Decision and Order, at 6-12 (Jan. 3, 2013), *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolado.pdf.

[21] *See Bosch* D&O, *supra* note 20, at 13.

merger control area. The attention also makes the level of transparency of Chinese merger review more important than ever. Fortunately, it appears that MOFCOM has welcomed comments from interested outside parties on how to improve its merger analysis and the transparency of its merger review process. I would note that, although I am focusing on MOFCOM in this discussion of transparency in the merger review process, both NDRC and SAIC have demonstrated a willingness to increase the transparency of their enforcement efforts in the non-merger space. For example, SAIC has released a draft of its *Guidelines on Anti-Monopoly Enforcement in the Field of Intellectual Property Rights*[22] and generally has released more information regarding its enforcement efforts over the past year or so.

Speaking of guidelines, MOFCOM has published or is in the process of publishing several of these to provide more guidance on both substantive and procedural issues in the area of merger control. In 2011, MOFCOM promulgated the *Interim Provisions on Assessment of Competitive Impact of Concentrations of Business Operators*, which laid out the framework MOFCOM uses to review mergers.[23] There is also significant interest in several forthcoming guidelines. As I mentioned earlier, MOFCOM has been drafting its *Regulation on Restrictive Conditions*, which will provide a framework for the implementation of merger remedies. MOFCOM is also preparing the *Interim Provisions on Simplified Procedures for Reviewing Cases of Concentrations between Business Operators*, which is expected to create a "fast-track" procedure for reviewing transactions that are unlikely to create competitive concerns.[24]

As mentioned earlier, another form of transparency is the publication of merger decisions. As required by the AML, the Anti-Monopoly Bureau of MOFCOM has issued an

[22] *See* Alexander Wang, *Latest Developments in China's Antitrust Enforcement: 2012 and Beyond*, 4 INT'L ANTITRUST BULL. 20, 21 (Dec. 2012).
[23] *See* MOFCOM Press Release, *supra* note 8.
[24] *See id.*

official decision for each of the roughly 16 transactions in which it has imposed restrictive conditions, as well as the single transaction that is has blocked.[25] MOFCOM's decisions have summarized the agency's findings and competitive concerns. Increasingly, these decisions speak in the same language used by more experienced agencies, focusing on relevant market definition, unilateral and coordinated effects, and entry conditions. The amount of information in those public decisions also has increased over time. These developments are welcome. MOFCOM may also consider issuing decisions in matters that it closes without any restrictive conditions. Often it is as useful for practitioners to know why an agency has closed a merger investigation as it is to know why an agency has challenged a merger. For that reason, I have encouraged my own agency to publish as many closing statements as possible and practical.

MOFCOM went beyond what is required in the AML in late 2012, publishing for the first time a list of the parties to, and the nature of, every transaction that it had unconditionally cleared since the implementation of the AML. MOFCOM updated this information in January 2013 and will provide updates on a quarterly basis.[26] The information MOFCOM is now disclosing will improve the ability of companies and their counsel to predict the outcome of the merger review process for their own transactions. MOFCOM's recent increases in transparency are all the more impressive when you take into account the relatively small staff that they have for merger review.

There are two areas of merger control in which additional efforts at increased transparency would be extremely useful. The first is merger remedies or restrictive conditions. Here, there is significant value in merging parties understanding the agency's competitive concerns as early as possible to allow the parties to propose remedies, if possible. Merging

[25] *See* Wang, *supra* note 22, at 20.
[26] *See* MOFCOM Press Release, *supra* note 8.

parties also would benefit from increased transparency on how they should submit remedy proposals and how such proposals are evaluated. Further, in issuing agency decisions, explaining the relationship between the theory of competitive harm and the restrictive conditions imposed would provide additional transparency and guidance. These types of information will help companies better prepare merger filings, address competitive concerns raised by a transaction, propose remedies, if necessary, and more generally navigate the review process.

The second area in which increased transparency would be beneficial involves the role of industrial and other non-competition policies in competition matters. The AML does explicitly allow the competition authorities to consider non-competition factors in formulating and enforcing competition policy. For example, Article 27 of the AML,[27] which covers merger control, identifies the effect on the development of the national economy as a factor that MOFCOM can consider in deciding whether to approve a merger. China is of course not the only jurisdiction in which competition law must coexist with industrial policy. Nonetheless, competition authorities, including those in China, should be as transparent as possible when such non-competition policies dictate the result in a competition matter. Without sufficient information to discern the rationale underlying an agency's decision – particularly one that results in the blocking of, or imposition of restrictive conditions on, a merger – businesses and their advisors may be left wondering how the decision was made and what to expect in future matters.

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To conclude, my hope and expectation is that the Federal Trade Commission's cooperation and convergence efforts will continue even in this time of austere government budgets. As I have hopefully convinced you this morning, the benefits greatly outweigh the

[27] Anti-Monopoly Law of the People's Republic of China, art. 27(5).

costs in these areas. It is also my expectation that the FTC will continue its cooperation and convergence efforts in a spirit of leadership and all due humility. We recognize that we are making policy and enforcement suggestions to sovereign countries on how they ought to implement their competition regimes. We do this with the firm conviction of our beliefs, but also with great respect for the foreign agencies with which we engage.

In concluding, let me also commend China and its three competition agencies for their quick and meaningful entry onto the global competition stage. The AML has only been in effect for four-and-a-half years, and the competition missions at MOFCOM, NDRC, and SAIC comprise a relatively small number of people. Yet, it is clear that China and these three agencies will play a significant role in global competition law and policy for years to come.

Thank you very much for your attention this morning.

MEMORANDUM OF UNDERSTANDING ON ANTITRUST AND ANTIMONOPOLY COOPERATION BETWEEN THE UNITED STATES DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, ON THE ONE HAND, AND THE PEOPLE'S REPUBLIC OF CHINA NATIONAL DEVELOPMENT AND REFORM COMMISSION, MINISTRY OF COMMERCE, AND STATE ADMINISTRATION FOR INDUSTRY AND COMMERCE, ON THE OTHER HAND

OBJECTIVES

The United States Federal Trade Commission, the United States Department of Justice (together the "U.S. antitrust agencies"); and the People's Republic of China National Development and Reform Commission, Ministry of Commerce, and State Administration for Industry and Commerce (together the "PRC antimonopoly agencies"),

Desiring to enhance the effective enforcement of their competition laws and policies by creating a framework for long-term cooperation between the U.S. antitrust agencies and the PRC antimonopoly agencies,

Recognizing the benefit of technical cooperation between the U.S. antitrust agencies and the PRC antimonopoly agencies in order to enhance an environment in which the sound and effective enforcement of competition law and policy supports the efficient operation of markets and economic welfare of the citizens of their respective nations,

Recognizing that the development of a well-functioning system for effectively implementing competition law and policy involves the respective antitrust or antimonopoly agencies, and also other government agencies, the judiciary, and the legal, business, and academic sectors, and

Recognizing that establishing good communications between U.S. and PRC government agencies on competition law and policy, including establishing this framework for cooperation between the U.S. antitrust agencies and the PRC antimonopoly agencies, will contribute to improving and strengthening the relationship between the United States and China,

intend to cooperate as follows:

STRUCTURE

The U.S. antitrust agencies and the PRC antimonopoly agencies are the counterparts of this Memorandum of Understanding ("Memorandum"), which sets out a framework for cooperation.

The framework for cooperation between the U.S. antitrust agencies and the PRC antimonopoly agencies is composed of two parts: the first is the joint dialogue among all parties to this Memorandum on competition policy at the senior official level (the "joint dialogue") and the second is communication and cooperation on competition law enforcement and policy between individual U.S. antitrust agencies and PRC antimonopoly agencies.

With regard to the first part, unless otherwise agreed, the location of the joint dialogue should alternate between China and the United States, and the host should alternate among the relevant antitrust or antimonopoly agencies. The U.S. antitrust agencies and the PRC antimonopoly agencies intend to convene the joint dialogue periodically, in principle once a year. Based upon the initiative of either side, the parties to this Memorandum may establish ad hoc working groups under the joint dialogue to facilitate discussions on particular issues regarding competition policy and laws. The ad hoc working groups could be conducted in tandem with the joint dialogue or separately as agreed by the individual antitrust or antimonopoly agencies to satisfy their particular needs.

With regard to the second part, the U.S. antitrust agencies and each of the PRC antimonopoly agencies, individually, may also engage in communication and cooperation, separate from the joint dialogue, at the senior or working level.

No agency leads the cooperation under this Memorandum on behalf of each side. Each agency plans to appoint a liaison for the purpose of facilitating contact in furtherance of this Memorandum.

Communications between the agencies may be carried out by telephone, electronic mail, videoconference, meeting, or other means, as appropriate.

The U.S. antitrust agencies and the PRC antimonopoly agencies intend to notify the other promptly of significant changes regarding their authorities responsible for competition policy and law enforcement.

CONTENT

The U.S. antitrust agencies and the PRC antimonopoly agencies recognize that it is in their common interest to work together, including in the following areas, subject to reasonably available resources: (a) keeping each other informed of significant competition policy and enforcement developments in their respective jurisdictions; (b) enhancing each agency's capabilities with appropriate activities related to competition policy and law such as training programs, workshops, study missions and internships; (c) exchanging experiences on competition law enforcement, when appropriate; (d) seeking information or advice from one another regarding matters of competition law enforcement and policy; (e) providing comments on proposed changes to competition laws, regulations, rules and guidelines; (f) exchanging views with respect to multilateral competition law and policy; and (g) exchanging experiences in raising companies', other government agencies' and the public's awareness of competition policy and law.

Each agency recognizes that, when a U.S. antitrust and a PRC antimonopoly agency are investigating related matters, it may be in those agencies' common interest to cooperate in

appropriate cases, consistent with those agencies' enforcement interests, legal constraints, and available resources.

The U.S. antitrust agencies and the PRC antimonopoly agencies plan to evaluate the effectiveness of the above-mentioned activities under this Memorandum on a regular basis to ensure that their expectations and needs are being met.

WORK PLANS

The U.S. antitrust agencies and each individual PRC antimonopoly agency intend to develop detailed work plans of cooperative activities under this Memorandum, which may include law enforcement capacity building and other activities, and to revise and update such work plans as necessary.

CONFIDENTIALITY

It is understood that the U.S. antitrust agencies and the PRC antimonopoly agencies do not intend to communicate information to the other if such communication is prohibited by the laws governing the agency possessing the information or would be incompatible with that agency's interests. Insofar as information is communicated, the recipient should, to the extent consistent with its laws, maintain the confidentiality of any such information communicated to it in confidence.

EFFECTIVE DATE

Cooperation under this Memorandum is effective as of the date of signature.

This Memorandum is intended to set forth an advisory framework. Nothing in this Memorandum is intended to create legally binding rights or obligations, to change existing law, contracts or treaties, to prevent the parties to this Memorandum from seeking or providing assistance to one another pursuant to other bilateral or multilateral agreements or arrangements, or to exclude other technical cooperation projects.

The parties to this Memorandum intend to consult regarding any questions concerning the understanding or implementation of this Memorandum.

Signed in Beijing on July 27, 2011, in five copies, in the Chinese and English languages, with both versions being equally official.

/s/ Jon Leibowitz	/s/ Christine A. Varney
United States Federal Trade Commission	United States Department of Justice

/s/ Peng Sen	/s/ Gao Hucheng	/s/ Zhong Youping
PRC National Development and Reform Commission	PRC Ministry of Commerce	PRC State Administration for Industry and Commerce

United States of America

Federal Trade Commission

Taking Notes:
Observations On the First Five Years of the Chinese Anti-Monopoly Law

Remarks of Maureen K. Ohlhausen
Commissioner, Federal Trade Commission

Competition Committee Meeting
U.S. Council for International Business
Washington, DC

May 9, 2013

Good morning. It is a pleasure to be with you at this meeting of the Competition Committee of the US Council for International Business. I would like to thank Michael Blechman, Jim Rill, and Justine Badimon for inviting me to speak with you. Your Committee plays an important role in multilateral institutions like the Organization for Economic Development (OECD) and the International Competition Network (ICN) in advocating for better predictability in the design and implementation of competition laws and authorities across the world. One of my goals as a Commissioner is to pursue transparent, predictable, and economically sound policies at the FTC and to advocate for similar policies around the world.

With that in mind, I want to discuss with you today competition enforcement in China. Most of the discussion about China in my circles has focused on the purpose of its antitrust regime and how best for American business and government to engage it. I was in China just a few weeks ago and spoke on this topic, extolling the benefits that can come from increased cooperation, convergence, and transparency among the world's competition authorities. And, indeed, I will touch on some of those same themes today.

But the question I want to focus on is whether China, which has a history vastly different from ours, is following a similar trajectory of development as some of the more established competition regimes around the world. Many of the people advocating for increased international cooperation (including me) tend to work from the assumption that most competition authorities are either at a similar place analytically and philosophically or are heading along generally similar trajectories or making efforts to do so – some are simply a bit further along than others. And, this assumption appears largely to hold for most of the modern competition enforcement regimes. I am not saying that, for instance, the EC and American competition regimes are the same. My point is that they have grown from comparable legal and economic cultures and are therefore linked at a normative level or, where there are differences, they have made conscious efforts to converge on particular norms. China, of course, has developed from a different tradition. So, I think it is fair to ask whether it can and should sustain a modern competition regime in the form we understand?

These issues have been debated since before the Chinese even adopted the Anti-Monopoly Law, with most of those discussions remaining unresolved for lack of sufficient data. But with the five-year anniversary of the AML coming up this August, I think we may have just enough of a track record of enforcement actions, international cooperation, and legal and regulatory evolution by the Chinese to get a decent sense of the approaches favored by the Chinese regime and the direction it may be headed. Before I go any further, let me clarify that I am speaking only for myself today; I am not speaking for the Federal Trade Commission or any other Commissioner.

I. China and the Need for Cooperation and Convergence

A. Introduction

So why do we care about the direction the Chinese authorities, MOFCOM [Chinese Ministry of Commerce], NDRC [the National Development and Reform Commission], and SAIC [the State Administration for Industry and Commerce] are heading? Well, there are of course some very obvious reasons. The first, and I assume one of particular importance to this audience, is commerce. The Chinese economy continues to be among the fastest growing national economies in the world. It is already the third-largest export market for the United States, with more than $109 billion worth of American goods and services sold to China last year. And, of course, with its growing economic clout China will likely continue to expand its influence outside its borders. As happened with the United States and Europe, competition regimes in emerging economies will begin to look at China as a model. In addition, if China evolves into a new type of model that does not follow existing modern competition norms, it could challenge the sense of comity that has developed among nations with advanced enforcement agencies and their application of antitrust law. For instance, with some exceptions, thankfully it is becoming less the norm to see non-competition goals pursued under the guise of antitrust enforcement among most modern regimes. It is in everyone's interest that we continue to engage China and advocate for a modern competition model or at least one that operates in relative harmony with other competition authorities, as the potential benefits are manifold. But it will take some patient cooperation on both sides for us to continue moving in the right direction. Let me take a few minutes here to highlight some of the potential upsides of international cooperation and convergence across the world's agencies, including those in China.

B. Cooperation

Business deals today more and more frequently cross national boundaries, a trend that amplifies the need for more consistent and predictable enforcement by the world's more than 100 competition authorities. Cooperation does not necessarily mean consistent results in every matter; that is simply not realistic. But it can create more consistent outcomes on specific cases, enhance efficiency, and provide predictability to businesses, which in turn facilitates investment and innovation. I agree with my colleagues at the Antitrust Division, who have noted seven guiding principles to foster cooperation: (1) agency transparency and accountability, (2) mindfulness of other jurisdictions' interests, (3) broader and deeper engagement by agencies across jurisdictions, (4) dialogue on all aspects of international competition and enforcement, (5) respect for different legal, cultural, and political paradigms, (6) trust in different agencies' actions, and (7) greater convergence of competition regimes.[1]

C. Convergence

In particular, the move to convergence on substantive norms, procedural standards, and operational techniques will help competition agencies remain in step with the globalization of markets. I do not think it is realistic, at least not within our lifetimes, to expect "hard" convergence. There are too many legal and cultural approaches to business around the world for us to arrive at a global consensus on the details of competition enforcement. Nonetheless, I think it is possible to move over time to "soft" convergence in procedural standards and operational techniques and, where they exist, to better identify and highlight cultural and legal differences for businesses and consumers. Ultimately, increased convergence in procedure and substantive policy across borders lowers transaction costs for businesses and makes it easier for them to self-

[1] Rachel Brandenberger, *International Cooperation: Taking a Broader View* at 9 (Dec. 6, 2012), *available at* www.justice.gov/atr/public/speeches/289760.pdf

regulate and comply with the laws on an *ex ante* basis, leading to more competitive markets and expanded investment. This is precisely why it is so important for us to identify the trajectory of the Chinese authorities today and determine how best to engage them in cooperation and manage convergence with them over time.

II. The Characteristics of Modern Competition Regimes

Ideally, we would like China and other emerging markets' competition regimes to converge on a modern enforcement paradigm. So what are some of the characteristics we should be looking for? I see at least five key elements necessary for such a competition authority.

First, competition-based factors should guide antitrust policy and enforcement decisions. This means industrial policy, national security, employment, and other non-competition issues ideally should not play a role in decisions by competition agencies about mergers, acquisitions, or other conduct. Those concerns should be addressed by another part of government. And, to the extent non-competition issues do play a role, it should be transparent to the parties.

Second, competition enforcement decisions should focus on achieving welfare goals informed by industrial organization economics. In the United States, most agencies' effects analysis focuses on consumer welfare, others argue for a total welfare standard. Either way, the remedies sought should be reasonably related to achieving an I/O-based welfare goal. This at a minimum requires policymakers and agency staff to be properly trained lawyers and economists.

Third, the competition regime must abide by commonly-accepted timing requirements, merger reporting thresholds, and other best practices in merger notification and review. Ideally, but not necessarily, these standards would follow norms based on work like the ICN Merger Working Group's Recommended Practices for Merger Notification and Review Procedures.

Fourth, the agency must be transparent in its analysis of mergers, acquisitions, and conduct cases, as well as in the dissemination of data for cleared and abandoned transactions and

other enforcement decisions. Again, the agency's transparency efforts could follow best practices like the ICN's Recommended Practices for Merger Analysis. Giving businesses and consumers a clear window into agency approaches through analytical guidelines, statements explaining decisions, and speeches enhances agency credibility and offers market participants a way to comply more easily with the laws. Transparency offers predictability and fairness to those subject to an agency's oversight, preserving due process for the parties, reducing the cost of merger reviews, and promoting increased compliance with the law. In addition, the practice of publicly explaining decisions can prompt agency self-evaluation, better understanding and implementation of decisions down the management chain, and, ultimately, enhanced decision-making quality.

Fifth, and finally, the model modern competition agency should aspire to international cooperation in both multilateral and bilateral settings, ideally following the guiding principles on cooperation that I noted earlier. The FTC works with numerous agencies around the world through both multilateral and bilateral engagements. We serve on the ICN's Steering Group and as Co-Chair of its Agency Effectiveness Working Group, and are active across the wide range of its initiatives to help develop best practices and international norms. At the OECD, we are participating in a dialogue on "agency infrastructure" as a foundation for effective enforcement. The FTC also maintains bilateral relationships to promote agency information sharing and case cooperation with agencies across many jurisdictions, both informally and under the auspices of a growing number of formal agreements.[2]

[2] Fed. Trade Comm'n, International Antitrust and Consumer Protection Cooperation Agreements, http://www.ftc.gov/oia/agreements.shtm.

III. Where China Stands After Five Years of the AML

So, how do the Chinese enforcement agencies measure up along these five dimensions? Better than you might expect, all things considered – but there is still room for improvement.

A. The Role of Non-Competition Factors In Chinese Antitrust Enforcement

Article 27 of the Anti-Monopoly Law, which covers merger control, sets out the factors for MOFCOM to consider when deciding whether or not to approve a merger. Three factors are consistent with what we see here in the United States – market concentration, share and power; effects on entry and technological innovation; and effects on consumers. But the last two factors expressly allow for broader considerations: the effect of the proposed deal on the development of the national economy, and any other factors determined by the State Council Anti-Monopoly Enforcement Authority. Article I of the AML also sets out the goal of the law to "safeguard the … social public interest and promote the healthy development of the socialist market economy."

Some practitioners and impacted parties have asserted that the Chinese competition agencies have relied on non-competition factors in some of their analyses.[3] Although reliance on non-competition factors is not ideal, if it is the case that Chinese authorities are evaluating transactions and conduct on broader measures, I think the critical question is what we can do over time to help narrow the scope of analysis to focus on competition. In other words, what can we do to promote greater harmony or convergence on this point? Here are some suggestions that I hope will promote greater convergence over time: (1) continue to broaden and deepen our engagement with the Chinese, offering them as much guidance and commentary as is helpful; (2) encourage their increased involvement in multilateral organizations like the ICN, which would benefit from China's involvement and vice versa; (3) engage the Chinese with an understanding

[3] *See, e.g.*, D. Daniel Sokol, *Merger Control Under China's Anti-Monopoly Law*, at 7-15 (Jan. 27, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2207690.

that they are approaching the competition laws from a different legal and cultural perspective; and (4) be transparent in how we in the US agencies handle matters and analyze the competition issues influencing our own actions, to set an example and to minimize misunderstanding with the Chinese agencies.

Ultimately, I think the key here is patient cooperation and diligent work on both sides, as the most fruitful way forward is to engage the Chinese agencies, offer them advice and support, and advocate for greater convergence toward a competition-based analysis.

B. The Slow, but Heartening, Adoption of I/O Economic Analysis

Another hallmark of a modern competition regime is a reliance on I/O economics. Here, China appears to be moving in what I would characterize as the right direction. Some foreign practitioners initially criticized MOFCOM's economic analysis as relatively weak, citing for example the lack of a relevant market finding in the agency's early decisions in *Coca-Cola/Huiyan* and *InBev/Anheuser-Busch.*[4]

However, more recent MOFCOM decisions include relevant market definitions, as well as analytical forays beyond structural presumptions to the more sophisticated terrain of unilateral and coordinated effects. For instance, MOFCOM's approval of the United Technology/ Goodrich acquisition in June 2012, required a structural remedy but preceded similar decisions by the US and EU. In addition, China's courts appear to have increased the sophistication of their analyses. For example, in the recent *Qihoo v. Tencent* case, the Guangdong High People's Court in a careful March decision rejected bundling and exclusionary practices claims because the plaintiff had failed to identify a relevant market in which the defendant was dominant. And, in March 2012, the Shanghai No. 1 Intermediate court rejected a resale price maintenance case against Johnson & Johnson for lack of an adverse effect on competition. These types of

[4] *See id.*

decisions are encouraging, particularly in their sophisticated application of the economic concepts that are fundamental to modern antitrust enforcement.

C. A Potential Turning Point in Merger Review Procedures

MOFCOM also is making strides to improve its merger review and notification procedures. Although many practitioners find the notification requirements ambiguous, the reviews slow, and the process difficult to predict, particularly MOFCOM's handling of Chinese state-owned entities, including in acquisitions with foreign parties, the Chinese are moving quickly to strengthen the merger notification regime.[5] For example, last summer MOFCOM revised its merger notification form to include more details about notification requirements that had been unclear, like calling for submission of internal studies and reports about the proposed transaction. More recently, MOFCOM sought comments (the comment period ended two weeks ago) on its new *Regulation on the Imposition of Restrictive Conditions in Concentrations between Business Operators*.[6] MOFCOM also just requested comments on a streamlined simple transactions regulation modeled after the EC's *Notice on a Simplified Procedure*, the *Interim Regulations on Standards for Simple Cases of Concentrations of Business Operators*.[7] Although some key differences exist, these regulations appear to be moving more to the U.S. and EU approaches and could be an improvement, offering businesses greater procedural certainty on remedies procedures.

D. Transparency

MOFCOM also is working hard to increase transparency, a welcome improvement as China still is considered a "black box" by many practitioners, in terms of the visibility into its

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[5] *See id.* at 16-19.
[6] *See* Press Release, MOFCOM, MOFCOM Held Special Press Conference on "Anti-monopoly Work Progress in 2012" (Jan. 5, 2013) [hereinafter MOFCOM Press Release], *available at* http://english.mofcom.gov.cn/article/newsrelease/press/201301/20130108513014.shtml.
[7] *See* David Tring, *MOFCOM Speeds Up Simple Mergers* (May/June 2013), *available at* http://www.chinalawandpractice.com/Article/3201576/MOFCOM-speeds-up-simple-mergers.html

process and substantive analysis.[8] In 2012, MOFCOM exceeded the disclosure requirements under the AML, which mandate publication of prohibited transactions and conditional approvals. In September, MOFCOM released information on all cases cleared without conditions since 2008 (458 in total) and will be updating the data on a quarterly basis. In addition, Director General Shang Ming, the head of the Anti-monopoly Bureau at MOFCOM, held a press conference on the bureau's progress in 2012, running through the cases MOFCOM examined and explaining the rationales behind its big decisions.[9] I think these efforts are impressive, as I can attest to the fact that such disclosures require significant work and the Chinese agencies already are understaffed and have a large workload of reviews.

E. Openness to International Cooperation

Although I do not think the Chinese agencies would quite meet each of the seven guidelines for enhancing international cooperation just yet – for instance, they do not yet have the same level of transparency or international involvement of an FTC or DG Comp – they are changing quickly and appear to be genuinely intent on cooperating with other nation's enforcement agencies, both on a bilateral and multilateral basis. China's agencies have entered many international cooperation agreements, with new formal relationships started in 2012 between MOFCOM and the UK's Office of Fair Trade, all three Chinese agencies (MOFCOM, NRDC, and SAIC) and the Korean Fair Trade Commission, and NRDC, SAIC and the EU, which complements MOFCOM's existing 2004 agreement with the EU.

The FTC and the Antitrust Division have maintained an MOU with all three Chinese agencies since July 2011.[10] This MOU provides for a joint dialogue among the senior

[8] *See* Sokol, *Merger Control*, *supra* note 3, at 16-18.
[9] *See* MOFCOM Press Release, *supra* note 6.
[10] *See* Press Release, Fed. Trade Comm'n, Federal Trade Commission and Department of Justice Sign Antitrust Memorandum of Understanding with Chinese Antitrust Agencies (July 27, 2011), *available at*

competition officials at all five agencies, as well as communication and cooperation between individual agencies at the senior or working level. It also identifies specific avenues for cooperation, including: (1) exchanges of information and advice about competition law enforcement and policy developments; (2) training programs, workshops, and other means to enhance agency effectiveness; (3) exchanges of comments on proposed laws, regulations, and guidelines; and (4) cooperation on specific cases or investigations, when it is in the investigating agencies' common interest. Pursuant to the MOU, we held our first joint dialogue with China this past September and will hold our next dialogue later this year.

The FTC, DOJ, and MOFCOM also have issued a framework for cooperation in merger cases, the *Guidance for Case Cooperation.*[11] This framework allows us to exchange information and engage in other cooperative efforts when investigating the same transaction. Under these auspices, MOFCOM cooperated with the FTC in the hard disk drive mergers.[12]

On a multilateral basis, China participates in the OECD Competition Committee as an observer and is a member of UNCTAD. The Chinese agencies also consistently ask for and implement comments from third parties on proposed changes in Chinese laws and regulations. We spent substantial resources working with Chinese officials to aid in their development of the Anti-Monopoly Law a few years ago. We participated in workshops with their agencies, discussed substantive competition analysis and effective investigative techniques, and submitted numerous written comments on drafts of their laws and regulations. I believe that such efforts were worthwhile, and I hope that we continue to cooperate with the Chinese agencies. In

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http://www.ftc.gov/opa/2011/07/chinamou.shtm. The text of the MOU is available at http://www.ftc.gov/os/2011/07/110726mou-english.pdf.

[11] Guidance for Case Cooperation between the Ministry of Commerce and the Department of Justice and Federal Trade Commission on Concentration of Undertakings (Merger) Cases (Nov. 29, 2011), *available at* http://www.ftc.gov/os/2011/11/111129mofcom.pdf.

[12] *See* Fed. Trade Comm'n, Statement of the Federal Trade Commission Concerning Western Digital Corporation/Viviti Technologies Ltd. and Seagate Technology LLC/Hard Disk Drive Assets of Samsung Electronics Co. Ltd, at 2 (Mar. 5, 2012), *available at* http://www.ftc.gov/os/caselist/1110122/120305westerndigitalstmt.pdf.

addition, we have found the ICN a productive forum and think it would benefit from Chinese participation going forward.

IV. Lessons For U.S. Enforcers

A. Introduction

I have traveled to China and met with many of their officials both there and in the U.S. My takeaway on a personal level is that they are genuinely interested in modernizing their competition authorities and being woven into the fabric of international enforcement. They want to be perceived as sophisticated enforcers in keeping with the size and sophistication of their economy. I think on four of the five factors I discussed today, the Chinese agencies are still relatively young but moving ambitiously along the trajectory of other, now well-established international enforcement bureaus. They have a stronger interest in behavioral remedies, which means we may see more of a hybrid model, even putting aside the use of non-competition factors. I think the most valuable lesson here is that we can and should continue to engage the Chinese authorities through outreach, cooperation efforts, and technical assistance. Our efforts appear to be paying off. As I mentioned today, the FTC has been reaching out across a range of initiatives – from formal high-level cooperation, to technical assistance abroad, and hosting MOFCOM officials here.

Also, in the near term, leading competition agencies in some respects should be even more cautious, transparent, and analytically meticulous in their own work because emerging market authorities are watching and could misunderstand our actions or potentially use sloppy decisions on our part as "competition fig leaves" to address other domestic issues or concerns. Before we move to questions and answers, let me close with a story about how this issue recently became very real to me.

B. Creating Doctrinal Confusion

As many of you likely know, I recently dissented in two FTC decisions involving standard-essential patents.[13] In the first matter, *Robert Bosch GmbH (Bosch)*,[14] while investigating a proposed acquisition, the FTC staff uncovered evidence that the acquired company, SPX Service Solutions (SPX), had sought injunctive relief against competitors for patents that may have been standard-essential and allegedly subject to reasonable and non-discriminatory (RAND) licensing terms.[15] The FTC alleged Bosch violated Section 5 of the FTC Act – but not the Sherman Act – and ordered Bosch to refrain from seeking injunctions on these patents against willing licensees and to license the patents on a royalty-free basis.[16]

Similarly, the FTC settled with Google and its subsidiary, Motorola Mobility.[17] As in *Bosch*, the FTC alleged that Google and Motorola violated Section 5 of the FTC Act by seeking injunctive relief on standard-essential patents subject to RAND commitments.[18] In *Google*, the FTC imposed a more complex remedy than in *Bosch*, establishing a multi-step process for Google to follow before seeking injunctive relief on its standard-essential patents.[19]

In my dissents, I took issue with, among other things, the lack of transparency and guidance the FTC's decisions provided to patent holders and others subject to our jurisdiction.[20]

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[13] In addition to the two decisions discussed herein, I voted against the FTC's July 2012 withdrawal of its policy statement regarding the seeking of disgorgement in competition cases because of my concern that such withdrawal would reduce agency transparency and leave those subject to our jurisdiction without sufficient guidance as to the circumstances in which the FTC will pursue the remedy of disgorgement in antitrust matters. *See* Statement of Commissioner Maureen K. Ohlhausen Dissenting from the Commission's Decision to Withdraw its Policy Statement on Monetary Equitable Remedies in Competition Cases (July 31, 2012), *available at* http://www.ftc.gov/os/2012/07/120731ohlhausenstatement.pdf.

[14] *In re* Robert Bosch GmbH, FTC File No. 121-0081.

[15] *Id.*, Analysis of Agreement Containing Consent Orders to Aid Public Comment, at 4 (Nov. 26, 2012), *available at* http://www.ftc.gov/os/caselist/1210081/121126boschanalysis.pdf.

[16] *See id.* at 4-5.

[17] *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120.

[18] *See id.*, Analysis of Proposed Consent Order to Aid Public Comment, at 3-6 (Jan. 3, 2013), *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolaanalysis.pdf.

[19] *See id.* at 6-8.

[20] *See In re* Robert Bosch GmbH, FTC File No. 121-0081, Statement of Commissioner Maureen K. Ohlhausen, at 3-4 (Nov. 26, 2012) [hereinafter Ohlhausen *Bosch* Statement], *available at*

In particular, I raised concerns about the FTC enforcing Section 5 without providing sufficient information about the relationship between that statutory provision and the antitrust laws, including the Sherman and Clayton Acts. Without such information, it is unclear what the term "unfair methods of competition" means or how the Commission will use its enforcement discretion under Section 5. I also was concerned our decisions would create conflict with other federal institutions since a *de facto* effect of our orders is to prohibit standard-essential patent holders from pursuing injunctive relief in federal courts and the ITC.[21] Moreover, when we rely on Section 5 of the FTC Act, which only the FTC can enforce, rather than the antitrust laws, which both the DOJ and FTC can enforce, we potentially create two different standards for patent holders, depending on which agency happens to review any alleged misconduct.

I am also concerned that the settlements created potentially confusing precedent for foreign enforcers. The FTC placed serious restrictions on the ability of holders of standard-essential patents to seek injunctions, which is a critical intellectual property right.[22] In my view, the FTC did this in each case with very little, if any, evidence that the patent holder agreed to waive this right when it participated in the standard-setting process. Further, in *Bosch*, the FTC required Bosch to grant royalty-free licenses on its patents as a remedy for seeking injunctions on its potentially standard-essential patents.[23] No matter how good our intentions, my worry is that they may send the wrong message to our foreign counterparts that we do not place a very

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http://www.ftc.gov/os/caselist/1210081/121126boschohlhausenstatement.pdf; *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120, Dissenting Statement of Commissioner Maureen K. Ohlhausen, at 1-3 (Jan. 3, 2013) [hereinafter Ohlhausen *Google* Dissent], *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolaohlhausenstmt.pdf.

[21] *See* Ohlhausen *Bosch* Statement, *supra* note 20, at 1-2; Ohlhausen *Google* Dissent, *supra* note 20, at 5-6.

[22] *See In re* Robert Bosch GmbH, FTC File No. 121-0081, Decision and Order, at 13-14 (Nov. 26, 2012) [hereinafter *Bosch* D&O], *available at* http://www.ftc.gov/os/caselist/1210081/121126boschdo.pdf; *In re* Motorola Mobility LLC and Google Inc., FTC File No. 121-0120, Decision and Order, at 6-12 (Jan. 3, 2013), *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolado.pdf.

[23] *See Bosch* D&O, *supra* note 22, at 13.

high value on intellectual property rights and that we have not explained adequately why these cases are the exception rather than the norm.

Unfortunately, it turns out my concerns may not be merely theoretical. As I mentioned, I was in China recently for a conference and series of meetings with government officials and industry leaders. During the last day of the conference, as I was listening to a presentation on the U.S. and Chinese antitrust laws, the FTC's decision in Google SEPs came up. The lecturer argued that we in the U.S. have a strong essential facilities doctrine. He then drew a line from this supposed precedent (with no mention of *Trinko*) and similar European decisions to the Chinese Anti-Monopoly Law and other Chinese laws that prohibit unreasonable refusals to deal as to essential facilities.

Then, and this is where I really became concerned, turning to a slide that said "inspiration from *Google case*" the presenter reasoned that the FTC's decision in the Google SEPs matter meant that an "unreasonable" refusal to grant a license for a standard essential patent to a competitor should constitute monopolization under the essential facilities doctrine. The remedy, he implied, should be compulsory licensing (presumably on favorable terms) because that would be the best way to facilitate competition among the licensees. Again, he may have missed the U.S. appellate court decisions and agency statements that largely defer to the rights of patent holders in licensing matters. Or misunderstood other existing precedent. Either way, I saw far too many heads nodding in agreement in the crowd, which confirmed for me how very careful I and other enforcers in more mature regimes need to be when making pronouncements about competition law – the Chinese and other agencies in emerging economies are watching. And they are taking notes on their favorite parts.

Thank you very much for your attention. I look forward to your questions.



YEAR IN REVIEW—US, EU, and Brazil

2013: What to expect on the European competition policy front

Authors: Tom Jenkins and Bill Batchelor Baker & McKenzie, European & Competition Law Practice, Brussels[1]

Efficient enforcement with a tough edge

At the outset of 2012, many commentators described the first two years of EU Competition Commissioner Joaquin Almunia's mandate as an era of "quiet but efficient" enforcement. Settlements designed to achieve pragmatic market outcomes, as opposed to big fines designed to attract front page headlines, were symbolic of this approach. As the year progressed, we saw signs of the Commissioner becoming increasingly comfortable with his role and willing to tackle some difficult and sometimes highly political issues.

The Commission is also poised to take a stand on a number of issues that also are a focus of the U.S. antitrust authorities. In many instances, there is broad trans-Atlantic agreement on the way forward, but Commissioner Almunia has made it clear that he will not hesitate to take a different path from his U.S. counterparts if market circumstances in Europe require him to do so.

On both sides of the Atlantic, the agencies are acting against patent settlement agreements in the pharma sector and "hold up" issues in relation to standard essential patents in the high tech sector. Likewise, they are both maintaining that they will be tough on cartels. However, Commissioner Almunia is taking a tougher approach in seeking a remedies package to allay concerns about Google's search results, despite the FTC closing its file on the matter on the basis of "light" commitments not to misappropriate third party content.

The Commission is also increasingly willing to take a tough line in markets that are important for Europe's competitiveness, energy being one of those. The 2012 decision to open proceedings against Gazprom for alleged abuse of dominance (restricting cross-border gas supplies, restricting diversification of supply and imposing unfair prices) has triggered a considerable political backlash and was a courageous move in geopolitical terms. The Commission has also stood its ground in a number of controversial mergers and has not hesitated to impose far-reaching remedies, or to prohibit deals outright where no suitable remedies were forthcoming.

For the remainder of 2013, we are likely to see the same commitment to efficient enforcement, but equally a Commission, and a Commissioner, prepared to tackle the tough cases.

Enforcement Priorities

Cartel Enforcement - Business as Usual

In 2012, the Commission handed out a total of nearly €1.9 billion in cartel fines against 37 undertakings (an average fine of more than €51 million per undertaking fined): this represents more than a 200% increase on fines imposed in the previous year. The €1.4 billion imposed on seven TV and monitor tube manufacturers should be sufficient to dispel any latent suspicion that Commissioner Almunia would not be tough in sanctioning cartels.

Over a dozen separate investigations in the automotive parts sector, as well as probes into alleged collusion over the setting of various interbank lending rate benchmarks (*Libor*, *Euribor* and *Tibor*) continue into 2013, and we can expect some (but not all) of these cases to reach the decision stage in 2013. Even though only one out of the five cartel decisions adopted in 2012 was the result of a settlement, the Commissioner has indicated that he expects half of the decisions taken in 2013 to be under the settlement procedure. This is in no small part due to the need to allocate the Commission's limited resources to clear a significant backlog.

[1] With thanks to Hua Jing-Legrand for her assistance in preparing this article.

Protecting Innovation in the High Tech Sector

The high tech sector will inevitably continue to be the subject of intense scrutiny during 2013 as the Commission seeks to intervene in fast moving markets to protect competition without harming innovation. The Commission's on-going investigation into whether Google is abusing a dominant position in relation to the way it presents search results continues, and is expected to result in a commitments decision in 2013.[2]

Almunia has already stated publicly that he fears Google has acted unlawfully and that he will not be swayed by the 4 January decision of the US Federal Trade Commission ("FTC") that essentially found no antitrust violation in the way in which Google had presented its search results. Devising an appropriate remedy that satisfies both the Commission and the plethora of complainants[3], whilst proving commercially and technically palatable to Google, may continue to prove difficult in practice.

Another area of focus has been the manner in which holders of standard essential patents ("SEPs") exercise these rights as against potential licensees. The Commission's main concern is that the right to seek an injunction leads to the possibility of a holder of an SEP (a patent necessary to implement a standard with which all manufacturers must comply, such as GSM or EDGE for mobile phones) either using the threat of an injunction to "hold up" the industry, or to demand unfair terms from potential licensees. In December 2012, the Commission sent a Statement of Objections to *Samsung*, which is believed to express these concerns, and in May 2013 a Statement of Objections to *Motorola Mobility* (now owned by Google). A German court has sent the same legal point to the EU Court in *Huawei v. ZTE*[4], so we may see the EU Court leapfrog the Commission's procedure. In the US, the FTC has already accepted commitments from Google/Motorola Mobility not to seek injunctions in respect of SEPs without going through a mandatory period of negotiation and arbitration. Whilst the Commission may consider this to be a useful template for a settlement decision in its investigation, a similar settlement looks unlikely in relation to Samsung which has pledged to firmly defend itself. This means that, in all likelihood, any attempt by the Commission to develop a new category of "abusive conduct" in this area will face early judicial scrutiny.

In March, the Commission issued its first fine for failure to comply with commitments previously given to the Commission under Article 9 of Regulation 1/2003. Microsoft was handed a €561 million for failing to implement the promised "browser ballot" screen in one version of its Windows 7 operating system. This remedy was agreed in 2009 to allay concerns that Microsoft had unlawfully tied supplies of Windows with its internet browser, Internet Explorer.

E-Commerce in the Spotlight

2012 saw increased scrutiny of suppliers' online distribution arrangements, particularly from national competition authorities. There is a risk that this trend may lead to additional layers of complexity, if not divergence, in terms of how the EU competition guidelines on internet sales in the vertical restraints guidelines are to be interpreted. In France, the *Autorité de la concurrence* concluded a sector inquiry into internet shopping, as well as a separate investigation (and a fine of almost €1 million) against Bang & Olufsen[5] for prohibiting its distributors from selling via the internet. A similar fine, imposed on cosmetics firm *Pierre Fabre*, was upheld by the Paris Court of Appeals on 1

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2 On 25 April 2013, Google offered certain commitments to close the Commission investigation. These includes an offer to label its own services more clearly in its search results and a commitment to display links to rival search engines for some services (full text of commitments offered available here: *http://ec.europa.eu/competition/antitrust/cases/dec_docs/39740/39740_8608_5.pdf*).

3 The strategic importance of this investigation to Google's competitors was highlighted by the recent meeting between Commissioner Almunia and Microsoft CEO, Steve Ballmer.

4 Case C-170/13 *Huawei Technologies* (pending);

5 Decision 12-D-23 of 12 December 2012

February 2013 following a reference to the Court of Justice[6]. Competition authorities in the UK, Germany and Switzerland continued to investigate alleged resale price maintenance in relation to online hotel room bookings. At EU level, the Commission concluded a settlement in the e-books case, whereby publishers were forced to terminate allegedly problematic "agency" agreements so as to permit the discounting of e-books by their resellers. Since January, Google has been involved in a complaint at the Commission for abusive conduct toward its rival shopping sites. The French authority is also probing into app stores of companies including Apple, Google and Microsoft for service restrictions.

The message across Europe is that regulators will continue to vigorously apply competition law to ensure that consumers receive the best deal online. Compliance with EU law in this area should remain at the top of businesses' agenda.

Copyright under Attack

Since the early days of the common market, EU competition and free movement law has had to grapple with the conflict between cross border trade and national IP rights; historically, a distinction has been drawn between the distribution of tangible copies of IP-protected works (such as books, CDs and DVDs) and communications via intangible means (such as broadcasts). In 2012, we have seen an activist Court of Justice further restrict the scope of performance copyright on competition/free movement grounds. In *FA Premier League*[7], the Court distinguished twenty years of prior case law to find that absolute territorial protection in relation to the cross border supply of satellite decoder cards contravened Article 101 TFEU. In *Usedsoft*[8], the same court considered that an online download of software, which involved the transfer of ownership of a copy, triggered exhaustion, with the effect that the copyright holder could not prohibit resale. We see courts in the US also struggling to square rights holder protection with free commerce in *Kirtsaeng*[9]**,** upholding "international exhaustion" preventing US rightsholders objecting to the resale in the US of books purchased abroad at far cheaper prices, and *Redigi*[10]**,** finding infringement in the transfer of "second hand" digital files via a cloud locker service.

In the *CISAC* cases before the General Court[11], we see a damaging defeat for the European Commission's decade long efforts to bring collecting societies to heel. The cases address the patchwork of collecting societies in Europe that - according to the Commission - have acted anti-competitively in not allowing a one-stop-shop licensing service for pan-European online music services. The Commission alleged that the observed parallel conduct of the collecting societies in granting only national licences was proof of a conspiracy to share the market. The globalising nature of the digital music industry would dictate that societies should compete to offer cross-border licences. Yet the observed practice of every society was to demarcate nationally. That could only occur - per the Commission - if there were a concerted practice between societies to preserve each others' local monopolies. The Court confirmed that parallel conduct alone could be proof of collusion. But it is a high standard. The Commission must show that there is no other plausible explanation for the observed parallelism. The Commission failed to shift this burden in *CISAC*. The collecting societies plausibly pointed to their historic roots in setting up national monitoring and enforcement networks to police their authors' rights, and the challenges of operating cross-border, rather than outsourcing that cross-border policing to the local collecting society.[12]

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6 Case C-439/09 *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la Concurrence e.a.*

7 Cases C-403/08 and C-429/08 *FA Premier League* [2011] All E.R. (EC) 629

8 Case C-128/11, *UsedSoft GmbH v Oracle International Corp* [2012] All E.R. (EC) 1220

9 *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013)

10 *Capitol Records, LLC v. ReDigi Inc.*, No. 12 CV 95 (RJS) (S.D.N.Y., March 30, 2013)

11 Case T–392-456/08 *CISAC et al. v Commission* (12 April 2013, not yet reported).

12 Case T–442/08 *CISAC v Commission*, judgment delivered 12 April 2013 (not yet reported), paras 149-150 ("the Commission did not explain how such cooperation could work once competition between the collecting societies has been experienced. In particular, in the contested decision, it did not analyse what financial and commercial interests

These developments can be expected to have significant ramifications for the way content is licensed in Europe in the coming years, and in particular could force radical changes to the business model of collecting societies. Right to legal recourse will also be under debate as Samsung fights against EU charges[13] over unfair seeking of patent injunctions against Apple, as for whether the high legal benchmark on vexatious litigation confirmed in last September's *Protégé* judgement[14] will be applied to Samsung.

The Pharmaceutical Industry Remains under Scrutiny

Pay-for-Delay Agreements between Originators and Generics

Since the sector inquiry in 2009, the Commission has been monitoring patent settlement agreements in the pharmaceutical sector, born out of concerns that such agreements are being used to delay generic entry and artificially prolong the patent holder's monopoly (so-called "pay for delay" or "reverse payment agreements"). 2013 can be expected to see the Commission formally sanction such agreements in cases opened against Servier (perindopril)[15] and Lundbeck (citalopram)[16]. Statements of Objections in both cases were issued in July 2012. The Commission is also investigating agreements between Cephalon and Teva (modafinil)[17]. The FTC is vociferously opposed to these types of agreements but, after losing a series of cases in the US courts, it has finally used a recent circuit split to petition the U.S. Supreme Court to adjudicate on the matter. The European Commission will scoop the Supreme Court on the same point (*FTC v Watson Pharmaceuticals*[18]) since it must take a decision in *Lundbeck* by June 2013 when the statute of limitations expires. So there is a clear risk of divergent approaches. Cooperation between pharmaceutical companies other than via patent settlements has also come under scrutiny. On 31 January 2013, the Commission sent a Statement of Objections to Johnson & Johnson and Novartis (in relation to the drug fentanyl): the Commission's complaint is understood to relate to a co-promotion/joint marketing agreement. In the mean time, as we describe below, the Commission has set out its stall on the law on pay-for-delay in its draft guidelines on technology transfer, rather premature one might think before issuing a decision in any of the pending cases, or waiting for judicial pronouncements**.**

Regulatory Abuse

On 6 December 2012, the Court of Justice handed down its long awaited ruling in *AstraZeneca*[19]. The Commission had previously found AstraZeneca to have abused its dominant position by making misleading statements to a number of national European patent offices in order to prolong the protection it received via supplementary protection certificates. The Court of Justice has gone some way towards resolving the uncertainties created by the General Court's decision by giving explicit comfort in relation to day-to-day patenting activities. No company will face antitrust liability for ordinary fallibility or because the subject matter of a patent is later found not to meet the patentability criteria. The standard established is a high one - needing a persistent course of misleading conduct. That said, the lack of a bright line test for what is "misleading" in the Court's reasoning means that companies in this sector should remain vigilant in their dealings with patent authorities and other regulators. The judgment clears the way for the Commission to continue to prosecute cases of alleged misleading conduct before the patent office. A reprise of *AstraZeneca* is expected to feature in the

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would induce the local collecting society to cooperate with another collecting society competing with it in its territory. Furthermore, it must be pointed out that the Commission did not answer the question of who would manage the general monitoring of the market in order to require users to request licences – not merely the monitoring of licences which have already been granted – if the collecting societies were not involved in the execution of that task.")

13 Case COMP/39939, *Samsung - Enforcement of UMTS standards essential patents*

14 Case T-119/09, *Protégé International Ltd v European Commission* [2012]

15 Case COMP/39612, *Servier (perindopril)*

16 Case COMP/39226, *Lundbeck*

17 Case COMP/39686, *Cephalon*

18 10-12729-DD, *FTC v Watson Pharmaceuticals,Inc.*

19 Case C-457/10 P, *Astrazeneca v Commission* [2013] 4 C.M.L.R. 7

Servier case, both in the Commission's proceedings and in the on-going UK civil litigation in which multiple UK health authorities are suing Servier for damages.

An Economic Approach to Article 102: Will the Courts Join In?

2012 saw the first signs of willingness on the part of the EU Courts to embrace economics in abuse of dominance cases, two years on from the Commission's publication of its enforcement guidelines. The old case law of the Court has been criticised for its tendency to indulge in broad brush condemnations of common businesses practices (such as loyalty rebates), and in so doing generating considerable legal uncertainty for firms with strong market shares.

Whilst the April 2012 judgment of the Court of Justice in *Tomra*[20] was unpromising (the Court finds a rebate scheme *per se* abusive without applying the Commission's guidelines as to whether the level of rebate, applied to the contestable portion of the market, was sufficient to foreclose as efficient rivals). However, later cases provide more hope that the Court will follow a more economics-based approach. In *Post Danmark*[21], the Court found that selective price cutting by a dominant undertaking that targeted customers of rivals, but which fell short of predation (pricing below cost), did not automatically infringe Article 102. Some commentators, including prominent EU officials, predict Post Danmark is the death knell of discrimination as a standalone abuse in EU law. Others take a more cautious line, noting that the Court addressed only exclusionary conduct (whether price cutting evicts rivals) not secondary line injury (whether a disfavoured customer is effectively prevented from competing with the favoured one). The latter may remain a separate abuse even for above cost price discrimination. It is possible that 2013 will see further strides by the Court in this area: there is an outside chance that the General Court may hand down its judgment in the *Intel* rebates case[22] in which the Commission imposed a breathtaking €1.06 billion fine in 2009. Although it seems likely that the Commission's findings will be broadly upheld, the Court's treatment of the Commission's economic analysis will be a useful pointer for the future.

Policy Developments

Technology Transfer: on 20 February, the Commission published its proposed draft revisions to the technology transfer block exemption and guidelines governing patent and know-how licenses. The Commission is proposing to make the block exemption more restrictive in a number of areas, including: (i) termination on challenge clauses (which entitle the licensor to terminate an IP licence if the licensee challenges the validity of the underlying IP), which will - under the proposals - cease to be covered by the block exemption; (ii) the ability of the licensor to restrict passive sakes to a territory/customer group exclusively reserved to a single licensee; (iii) exclusive grant backs of non-severable improvements; and (iv) the treatment of the licensing of software copyright for distribution. The Commission has also sought to tackle patent settlement agreements (suggesting that a "reverse payment" may indicate that such an agreement is anti-competitive) and technology pools (building on its experience in the field of standard setting). New versions of the block exemption and guidelines must be adopted by 1 May 2014.

Collective Redress and Access to Evidence: After years of delay, Commission is expected to publish legislative proposals on both collective redress and access to evidence (in particular leniency statements) in follow-on damages cases. This is in part to resolve the uncertainty left in the wake of the Court's judgment in *Pfleiderer*[23], which effectively left it to national courts to balance the interests of private damages claimants on the one hand and protection of leniency programmes on the other in determining the extent to which evidence should be disclosed. Unsurprisingly, this has led to differing approaches across the EU, and in particular in France, Germany and the UK. It will be

[20] Case C-549/10 P, *Tomra Systems ASA v European Commission* [2012] 4 C.M.L.R. 27
[21] Case C-209/10, *Post Danmark A/S v Konkurrencerådet* [2012] 4 C.M.L.R. 23
[22] Case T-286/09, *Intel v Commission* (pending)
[23] Case C-360/09, *Pfleiderer AG v Bundeskartellamt* [2011] 5 C.M.L.R. 7

interesting to see how the Commission approaches this balancing exercise. Even if draft legislation is introduced, it will take around two years to take effect. Meanwhile, access to the Commission's file remains a thorny issue, with a number of pending appeals currently before the Luxembourg Courts which can be expected to reach judgment in 2013.

State Aid Modernisation: in 2013 we expect to see further progress in streamlining State aid decision making, a focus on high impact cases, and support of State aid measures designed to support sustainable, smart growth in Europe. The Commission plans to progress modernisation of a number of State aid instruments through the end of 2013 including the Guidelines Aid for Industrial Rescue and Restructuring; Aviation Aid; and a new Framework for Research, Development and Innovation Aid. The proposed modernisation of the procedural State aid rules has met with opposition from certain Member States, particularly regarding increased access to information from market players, comparable to that in antitrust investigations. The proposal would also enable the Commission to carry out State aid sector inquiries and cooperate with national courts. Finally, we are expecting judgments in several key cases testing the Commission's far reaching definition of State aid, including in *France Télécom*[24]. In this case the Commission found the French minister's unspecified declarations of support for France Télécom, which restored investor confidence at the time, and a subsequent binding offer by the French state of a shareholder loan that was never accepted by France Télécom, to be sufficiently linked to constitute State aid. The question of when separate state actions can be viewed as a single State aid measure is critical in terms of legal certainty for economic operators in their dealings with public authorities.

Merger Control

A tougher approach: The Commission received 283 notifications in 2012, down from 309 in 2011. Of these, 254 were cleared in phase 1 (9 with commitments, 170 under the Simplified Procedure). Of the eight phase II in-depth investigations concluded in 2012, one was cleared unconditionally (*Telefónica/Vodafone/Everything Everywhere/JV*[25]), six with commitments, and one prohibited (*Deutsche Börse/NYSE*[26]). 2013 has already seen two prohibition decisions, *UPS/TNT* and *Ryanair / Aer Lingus III* (the latter case being a repeat of the deal which the Commission previously prohibited in 2007). Almunia has shown himself willing to hold out for remedies to ensure the maintenance of competitive markets. As is illustrated by *UPS/TNT*[27], prohibited on 30 January 2013, he is willing to block a transaction where the remedies offered fail to clearly resolve the competition concerns. The message is very much that merging parties in concentrated industries should place as much attention upfront on remedy-design and strategy as on their substantive arguments and efficiency claims.

Procedural Reform: On 27 March 2013, the Commission published proposals to streamline procedural aspects of its merger review process, and in particular to expand the scope of the simplified procedure. The simplified procedure substantially reduces the data burden on parties since in requires only an overview of the parties' horizontal and vertical overlap markets, without the deep dive information which makes notification so burdensome before the EU. The Commission is proposing to increase the market share thresholds in the simplified procedure notice to 20% for horizontal overlaps and 30% for vertical relationships, as well as those involving higher market shares but minimal increments (where the Herfindahl-Hirschman Index[28] increment is smaller than 150 and combined market share below 50%). This is welcome since the *average* pre-notification period runs 10 weeks, taking into account the vast majority of notified deals that have no impact on competition. Neither of these proposed consultations is likely to result in a sea-change in EU merger control, but

[24] Case C-399/10 P, *Bouygues SA et Bouygues Télécom SA v European Commission*
[25] Case COMP/M.6314, *Telefónica/Vodafone/Everything Everywhere/JV*
[26] Case COMP/M.6166, *Deutsche Börse/NYSE Euronext*
[27] Case COMP/ M.6570, *UPS/TNT Express*
[28] Index of market concentration, calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers.

they represent useful opportunities for stakeholders to push for a more efficient approach, (hopefully) resulting in faster clearance decisions, greater legal certainty and lower legal bills.

Mind the Gap: The Commission is exploring whether its inability to assess minority shareholdings under the Merger Regulation represents a material enforcement gap. These concerns stem from the early salvos in the *Ryanair/Aer Lingus* saga, where the General Court found, in 2009[29], that the Commission lacked the competence to review Ryanair's acquisition of a 29% stake in Aer Lingus. We can expect to see draft proposals in this area for consultation in 2013. Since the overwhelming majority of minority acquisitions do not raise issues, introducing some appropriate "filter" is likely. Issues include whether any minority notification regime will be mandatory or voluntary and the nature of the threshold (e.g. a hard percentage of voting rights, or a more qualitative threshold, such as the UK's "material influence"). Any remedial action taken to address this perceived enforcement gap will be proportionate to the economic harm potentially caused by such shareholdings and may follow national authorities' trends where enforcement action tends to be limited in number but targeted at economically significant transactions. The Commission is also examining the possibility of *ex-post* control, giving it the power to power to examine, on an *ad hoc* basis, acquisitions of such shareholdings. Equally mooted is the possibility of guidance on their treatment of such shareholdings under EU competition law similar to those in the U.S.

[29] Case T-411/07, *Aer Lingus Group Plc v European Commission* [2011] 4 C.M.L.R. 5;

FA Premier League: The Broader Implications for Copyright Licensing

Bill Batchelor
Baker & McKenzie

Tom Jenkins
Baker & McKenzie

Broadcasting right; Competition law; Copyright; Decoders; EU law; Football; Freedom to provide services; Infringement; Internet; Licensing agreements; Satellite television

In *Football Association Premier League*[1] the EU Court of Justice (ECJ) concluded that a licensor of copyright could not lawfully impose territorial restrictions on its licensees (in this case a broadcaster). Laws preventing users from receiving ex-territory broadcasts were unenforceable under EU free-movement principles. Contractual restrictions were unenforceable under EU competition law.

The result effectively reverses or at least heavily distinguishes the *Coditel I* and *II* line of cases which held that territorial limits to content licensing were entirely legal. Those cases—until now—have underpinned the legality of territorial licensing, an essential part of the business model for licensing audiovisual works in Europe's fragmented national markets.

For content owners the key question is whether the *FAPL* judgment requires: (i) one-stop-shop licensing across all 27 EU Member States only in relation to satellite broadcasting; or (ii) all audiovisual content. They need to conform licensing agreements to the current law: (i) identifying whether they have pro-competitive grounds for exempting territorial protection completely from the application of EU competition law (an art.101(3) TFEU justification) notwithstanding the Court's conclusion that no justification could be claimed by FAPL; (ii) relying on alternative restrictions compliant with competition law, such as active marketing restrictions, quotas (limiting the number of subscribers a broadcaster may reach) or relying on language/audio-track differences to discourage cross-border content broadcasts. They will also need to anticipate the next steps of the European Union and national competition authorities, as the EU Commission (the Internal Market, but as yet not the Competition Directorate General) has announced a sectoral study.[2]

For broadcasters/distributors of content, they will need to ascertain whether *FAPL* is an opportunity to seek pan-European licences (or to challenge territorial restrictions on national licences). *FAPL* also provides a means to challenge royalty rates which differ based on the territory in which the end user is located.

Whether for content owners or distributors of content, *FAPL* is likely to reinvigorate the political debate. It provides new urgency to the political/legislative debate around collective rights management and copyright reform.

The judgment

Buying a TV sports subscription to watch UK Premier League football is far more expensive in the United Kingdom (where UK football is essential viewing)[3] than Greece (where UK football has niche appeal). Rather than buy an expensive licence from Sky, the UK licensee of the rights, UK pub owners would illicitly install cheap Greek decoder cards in their set-top boxes. This permitted decryption of the Greek satellite broadcaster's signal and displayed Premier League matches to the pub's customers. FAPL alleged that this cross-border trade was illegal. It infringed copyright, it was contrary to the territorial restrictions in the Greek broadcaster's licence and pub owners committed criminal offences relating to unlawful decryption/misuse of decoder cards. On referral from the UK High Court, the ECJ concluded as follows:

UK decoder misuse laws contrary to EU free-movement principles

It was contrary to EU movement principles for national laws to prohibit use of decoder cards in this way. TFEU art.56 prohibits state measures restricting the provision of services between EU states. It was uncontested that such a restriction existed.

No art.56 defence

It is a defence to art.56 to show that any such restriction is justified by a public interest objective, necessary and proportionate. Although the Court found a relevant public interest objective in this case (intellectual property (IP) protection), the restriction went beyond what was necessary to achieve this objective. Drawing on established precedent, the Court found that—reduced to its essentials (termed "specific subject matter" in EU doctrine)—IP protection conferred the right "to exploit commercially the marketing or making available of the protected subject matter, by the grant of licences in return

[1] *Football Association Premier League Ltd v QC Leisure (FAPL)* (C-403/08 & C-429/08) [2012] F.S.R. 1. Virtually identical issues were raised in proceedings brought by the European Union of Football Associations (UEFA) in a separate case also referred to the Court of Justice by the High Court of England and Wales (*European Union of Football Associations (UEFA) v Euroview Sport Ltd* (228/10) [2010] EWHC 1066 (Ch)). This reference has now been withdrawn and it is likely that the Court will decide this case in line with the judgment of the Court of Justice in FAPL.

[2] "EC studies potential for pay-TV cross border market" (Mlex, December 8, 2011).

[3] The rights cost the UK's incumbent satellite broadcaster, Sky, £1.6 billion, or £4.3 million per match, for three seasons of Premier League football.

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for payment".[4] But a licensor could be adequately remunerated based on the number of actual or potential subscribers to its licensee's broadcast (tracked via the number of decoder cards). It was disproportionate to go further to create territorial monopolies for its licensees so as to extract maximum profit in each territory.[5] As the Court stated:

> "[S]uch partitioning and such an artificial price difference to which it gives rise are irreconcilable with the fundamental aim of the Treaty, which is the completion of the internal market."[6]

Coditel I distinguished

The *Coditel I* case—the key EU authority on which licensors have relied for decades to police national broadcasting territories using copyright—was confined to its facts and the 1970s era to which it belonged.[7] There, the alleged infringers had neither a licence in the originating state nor had they paid royalties to the rights holder. Here, by contrast, the Greek broadcaster had paid FAPL royalties—albeit far less that FAPL would have earned in the United Kingdom—and was duly licensed in the originating state (Greece). *Coditel I* therefore did not apply.[8] Further, the result in *Coditel I* ignored the developments in the EU legislative framework that sought to create a pan-European broadcasting market.[9]

Reception of Greek broadcast by UK pub not copyright infringement

Though the logical extension of the Court's reasoning would be to prevent an IP holder from relying on national copyright in a manner which would have similarly frustrated a cross border broadcast, the Court found that it did not need to go so far. It concluded that none of the acts involved in the Greek broadcaster's service being received in the United Kingdom involved copyright infringement:

Communication to the public: Greek broadcast into the United Kingdom:

Satellite broadcasting is subject to a very specific copyright regime that states that "communication to the public" occurs only in the state of origin (since otherwise the breadth of a satellite footprint would require copyright clearances in all 27 EU states). So the act of communication by the Greek broadcaster—who was duly licensed in the originating state—to the UK pub did not infringe copyright.[10]

Reproduction: images in the pub's set top box and television:

Reproduction of the images in the pub's set top box and television did not infringe copyright. It fell within the temporary copying exception to copyright infringement.[11]

Communication to the public by the pub owner infringed copyright

Had the pub owner merely watched the matches privately, with family or friends, the Court considered that no infringement would have arisen. But the pub owner had instead taken the additional step of showing the matches publicly, to entertain and attract customers. That act, the Court found, constituted a further act of "communication to the public" of protected works—in other words letting consumers watch matches on television. The pub owner needed a licence to do so and, absent consent, infringed FAPL's copyright.[12]

Territory restrictions in FAPL licence agreements infringe competition law

The territorial restrictions agreed with the Greek licensee/broadcaster were contrary to EU competition law, which prohibits absolute restrictions on the cross border provision of services within the European Union. The *Coditel II*[13] line of cases—the sister case to *Coditel I* which had been the key authority on which licensors of

[4] *FAPL* [2012] F.S.R. 1 at [107].
[5] *FAPL* [2012] F.S.R. 1 at [109]–[113].
[6] *FAPL* [2012] F.S.R. 1 at [115].
[7] *Procureur du Roi v Mare Debauve and Others S.A Campagnie Generale pour la Diffusion de la Television Coditel and Others v S.A. Cine Vog Films and Others* [1981] 2 C.H.L.R. 361 at [15] (EU free trade law did not prevent exclusive assignee of Belgian copyright from suing Belgian TV stations for unlicensed rebroadcasting of German TV channels containing protected works).
[8] *FAPL* [2012] F.S.R. 1 at [118]–[121].
[9] *FAPL* [2012] F.S.R. 1 at [121].
[10] Directive 93/83 on the co-ordination of certain rules concerning copyright and rights related to copyright applicable to satellite broadcasting andcable retransmission [1993] OJ L248/15 art.1(2)(b).
[11] Directive 2001/29 on the harmonisation of certain aspects of copyright and related rights in the information society [2001] OJ L6/22 art.5(1); *FAPL* [2012] F.S.R. 1 at [182]. The Court stated without further comment that it was undisputed that the acts of reproduction concerned were: (i) temporary; (ii) transient or incidental; and (iii) an integral and essential part of a technological process. It found that the sole purpose of the reproduction, being the mere reception of satellite broadcasts, was lawful use with no independent economic significance. This approach does not appear to be consistent with that taken by the UK Court of Appeal in *Newspaper Licensing Agency Ltd v Meltwater Holding BV* [2011] EWCA Civ 890; [2012] Bus. L.R. 53, where copies incidentally made whilst internet browsing were found to fall outside the temporary copies exception set out in art.28ACDPA 1988; on this issue, the *Meltwater* decision has been appealed to the UK Supreme Court.
[12] Although note that UK domestic copyright law (s.72(1)) of the Copyright, Designs and Patents Act 1985) provides for a defence to infringement where a broadcast (and the film and sound recording contained in that broadcast) are played in a public venue, provided that the audience has paid for admission. This is prima facie inconsistent with the interpretation of "communication to the public" under EU Directive 2001/29.
[13] Coditel S.A. and Others ve Cine Vog Films S.A. and Others (No.2) (Case 262/181) [1983] 1 C.M.L.R. 49

audiovisual content had relied for decades to impose national broadcasting territories—was again distinguished. The Court essentially took the view that, whilst the fact of a licensor granting an exclusive licence did not infringe TFEU art.101 (relying on *Coditel II*),[14] absolute territorial restrictions aimed at enforcing this exclusivity (such as a contractual obligation not to supply Greek decoder cards to customers in other EU Member States) constitute "by object" restrictions of competition and are thus unlawful under art.101.[15] No exemption was possible based on any putative pro-competitive benefits. The mere fact that a rights holder could obtain a higher licence fee in the United Kingdom than in Greece was not a countervailing efficiency justifying exemption.[16]

Analysis

Is FAPL confined to satellite broadcasting?

Narrow or broad FAPL?

In addition to the satellite broadcasting at issue in FAPL, the most obvious application of a single EU market in content distribution is in relation to internet-based services, which—unlike cable or terrestrial broadcasting—are most suited to international distribution of content.

Proponents of a narrow view of *FAPL*[17] have argued the judgment is confined to satellite broadcasting and laws on misuse of decoder cards. They point out, correctly, that the copyright regime and use of decoder cards is wholly different in a download or online streaming model. The Satellite Directive[18] clears the "communication to the public" copyright in the originating state, so no licence is required in receiving states.[19]

In contrast, for a download or streaming service, the Copyright and Related Rights Directive[20] has no similar provision. Therefore, to make copyright protected work available for download by customers in the United Kingdom via the internet from a server in Germany, a business arguably requires a licence of both German and UK copyright (though there is a pending reference to the Court which raises this question at the moment.)[21] The Court is careful not to rule that any copyright law is exhausted by EU free trade rules. Hence, proponents of "narrow *FAPL*" argue that content owners remain free to rely on copyright to block cross border services unless cleared in the destination country.

Other commentators[22] read the judgment far more broadly. The Court's approach applies with equal force to any national law restricting cross-border services that purports to protect intellectual property:

- Though directed at decoder misuse laws, the Court's reasoning turns on whether the protection afforded to IP under EU free movement and competition law justified the restrictions.[23] Of necessity, therefore, the same reasoning applies to national copyright laws. It is well established law that restrictions on free trade emanating from IP rights must be objectively necessary to protect the specific subject matter of these IP rights to comply with EU free trade laws.[24]
- The Court's reasoning effectively emasculates *Coditel I*[25] *and II*.[26] These cases are the key authorities upholding the legality of copyright restrictions. Without them, all national copyright laws are potentially vulnerable to challenge.
- The Court did not need to reach a view on the issue of copyright because, on the facts, no infringement arose in the broadcast from Greece to the UK pub. This is in contrast to the Court's Advocate General (who reached a different conclusion on copyright). Thus, it was necessary for her

[14] *FAPL* [2012] F.S.R. 1 at [137]: "As regards licence agreements in respect of intellectual property rights, it is apparent from the Court's case-law that the mere fact that the right holder has granted to a sole licensee the exclusive right to broadcast protected subject-matter from a Member State, and consequently to prohibit its transmission by others, during a specified period is not sufficient to justify the finding that such an agreement has an anti-competitive object."

[15] *FAPL* [2012] F.S.R. 1 at [141] to [144]. Though long relied upon by the content industry to justify territorial restrictions in licences, in fact a close reading of *Coditel II* shows the Court was far more circumspect. It required inquiry into whether "the exercise of the exclusive right to exhibit a cinematographic film creates barriers which are artificial and unjustifiable in terms of the needs of the cinematographic industry, or the possibility of charging fees which exceed a fair return on investment, or an exclusivity the duration of which is disproportionate to those requirements, and whether or not, from a general point of view, such exercise within a given geographic area is such as to prevent , restrict or distort competition within the common market." (*Coditel II* at [19].) *FAPL* can be seen as consistent with *Coditel II* to the extent that the Court justifies its judgement by these additional economic factors.

[16] *FAPL* [2012] F.S.R. 1 at [145].

[17] Graf, "Competition Law Blog", available at *http://kluwercompetitionlawblog.com/* [Accessed January 30, 2012].

[18] Directive 93/83.

[19] [2012] EWHC 108 (Ch) (Not yet reported). Directive 93/83 art.1(2)(b). ("The act of communication to the public by satellite occurs solely in the Member State where, under the control and responsibility of the broadcasting organization, the programme-carrying signals are introduced into an uninterrupted chain of communication leading to the satellite and down towards the earth." This means that, in respect of satellite broadcasting, there will be no "act of communication to the public" in any Member State other than the Member State of origin, and therefore no relevant act requiring authorisation).

[20] Directive 2001/29.

[21] *Football Dataco Ltd v Sportradar GmbH (C-173/11)*.

[22] See, e.g. Edwards Angell (*http://www.edwardswildman.com/files/upload/IPM.pdf* [Accessed January 30, 2012]), Harbottle (*http://blog.harbottle.com/dm/?p=42* [Accessed January 30, 2012]) (both in relation to the Advocate General's Opinion); Taylor Wessing (*http://reaction.taylorwessing.com/reaction/e-updates/BGC_PubLady_061011_01.html* [Accessed January 30, 2012), in relation to the judgment.

[23] *FAPL* [2012] F.S.R. 1 at [90].

[24] See, for example, *Deutsche Grammophon Gesellschaft GmbH v Metro SB Grossmarkte GmbH & Co KG* (C-78/70) [1971] E.C.R. 487; [1971] C.M.L.R. 631 at [11]. (Case C-173/11). The judgment of the Court of Justice has not yet been handed down. The judgment of the Court of Appeal of England and Wales can be found at [2011] 1 W.L.R. 3044.

[25] *FAPL* [2012] F.S.R. 1 at [118]–[121].

[26] *FAPL* [2012] F.S.R. 1 at [137]–[139].

(but not for the Court) to consider further whether the doctrine of exhaustion of rights applied to the copyright in question.[27]

Towards an "exhaustion" doctrine for cross-border services?

Indeed, the Court in *FAPL* may be seeking to develop a defence akin to "exhaustion" of IP rights, common to other forms of protected work, such as patented goods, books, records or CDs.[28] Once sold in any EEA state, such goods may freely circulate across borders. The right of the IP holder to claim infringement is "exhausted" after first sale. The development of the exhaustion doctrine by the Court in the 1970s and 80s was a conscious attempt to reconcile fragmentation of national IP rights (still enforced at national level) with the creation of a single European free trade area. Thus, the doctrine of exhaustion was found to apply to the mechanical rights in physical manifestations of copyrighted works, such as books and records.[29] However, with regard to performance rights (e.g. the right to make a work available to the public via a TV broadcast), the court took the opposite view, accepting that the rightsholder's interest in receiving adequate remuneration for each performance justified a different approach.[30] In the age of analogue cable television, there was no means of assessing the audience (and therefore the appropriate level of remuneration).

In the context of pay-per-view satellite broadcasts and internet distribution, it may be argued this logic is less convincing. As the Court in *FAPL* pointed out,[31] it is possible *precisely* to calculate the audience for broadcasts of the Premier League (in Greece and outside Greece) based on the number of decoder cards sold: in other words there is no need to rely on territorial restrictions to guarantee adequate remuneration to the rightsholder. A similar logic would seem to apply to distribution of content via the internet, with detailed records kept of content accessed via streaming or downloaded. In the context of the downloading of eBooks and MP3 files, it is more logical to see these as being analogous to physical books and CDs (governed, since the 1970s, by the principles of exhaustion) than to a free-to-air TV broadcast, and this was certainly the view of A.G. Kokott.[32] The Advocate General and Court may be tending towards a conclusion that the distinction between performance and mechanical rights as regards exhaustion has outlived its usefulness, at least in circumstances where effective remuneration on a pan European basis can be guaranteed.

In *FAPL*, the Court appears to be seeking to develop a doctrine equivalent to "exhaustion" applicable to cross-border service provision, namely that there can be no IP infringement where:

- the service provider is duly licensed in the originating state (even if the licence is a national one only);
- the service provider has agreed to remunerate the rights holder for use of the rights[33]; and
- the number of actual or potential viewers/users can be reliably tracked (e.g. number of decoder cards), so as to properly calculate royalties. Where tracking is impossible (e.g. number of customers in a pub), the defence does not apply.

Proponents of the narrow view are likely to counter that exhaustion of the author's right to control communication to the public is excluded by the Copyright and Related Rights Directive art.3(3). But partial harmonisation of copyright in the Copyright and Related Rights Directive cannot oust the application of EU free trade rules enshrined in primary legislation (art.56 of the Treaty overrides secondary legislation, such as Directives).[34] There is nothing in EU law to prevent the court from using art.56 to extend the protection afforded to free trade in services. The Advocate General's Opinion, indeed, expressly challenges any assumption that principles of exhaustion can apply only to expressions of copyright in tangible works.[35] She concludes:

> "[T]here is no need for a restriction of freedom to provide services in the case of a simple communication [of works to an end user] in order to protect the specific subject matter of the right to such communication to the public."

She goes on to identify music, video and software distribution as key business models that would otherwise be frustrated by national fragmentation of IP rights.[36]

A key uncertainty though arises from the fact that the Court did not address the fact that copyright remains a *national* right in Europe. That is, when a French user

[27] *Football Association Premier League Ltd v QC Leisure (C-403/08 & C-429/08)* Opinion of A.G. Kokott February 4, 2011 (hereafter *FAPL* Opinion) para.188.
[28] See, for example, *Deutsche Grammophon v Metro* [1971] E.C.R. 487; [1971] C.M.L.R. 631.
[29] *Deutsche Grammophon v Metro* [1971] E.C.R. 487; [1971] C.M.L.R. 631 at [12]. ("If a right related to copyright is relied upon to prevent the marketing in a Member State of products distributed by the holder of the right or with his consent on the territory of another Member State on the sole ground that such distribution did not take place on the national territory, such a prohibition, which would legitimize the isolation of national markets, would be repugnant to the essential purpose of the Treaty, which is to unite national markets into a single market").
[30] *Coditel I* [1980] E.C.R. 881 at [13]. ("In these circumstances the owner of the copyright in a film and his assigns have a legitimate interest in calculating the fees due in respect of the authorization to exhibit the film on the basis of the actual or probable number of performances and in authorizing a television broadcast of the film only after it has been exhibited in cinemas for a certain period of time").
[31] *FAPL* [2012] F.S.R. 1 at [113].
[32] *FAPL* Opinion para.185. ("Other services, by contrast, do not differ significantly from goods. Computer software, musical works, e-books, films etc. which are downloaded from the internet can easily be passed on in electronic form. This is also illustrated by the fact that additional digital rights management measures are needed to prevent them being passed on. In these areas such a strict delimitation of the two fundamental freedoms would be arbitrary").
[33] *FAPL* [2012] F.S.R. 1 at [107].
[34] *R. v Ministry of Agriculture, Fisheries and Food Ex p. Hedley Lomas (Ireland) Ltd* (C-5/94) [1996] E.C.R. 1-2553; [1996] 2 C.M.L.R. 391.
[35] *FAPL* Opinion paras 180–200.
[36] *FAPL* Opinion paras 185 and 186.

downloads a track in France, it is an exercise of the *French* copyright, whereas when a *German* user downloads the very same track, created from the same master file in Germany, it is an exercise of the German copyright. This is the main challenge that faces a broad interpretation of the case. Precisely this debate was had in relation to other IP rights (such as design rights[37] and trade marks[38]) in the 1970–80s, where the Court was similarly concerned that the national nature of these rights might carve up the internal market. It developed the doctrine of exhaustion to prevent the same trade mark owner[39] relying on its national trade marks to restrict parallel trade.[40] Once the trade mark owner had placed its goods on the market, then it could not prevent resale across borders within the European Union. Just as in *FAPL*, the Court found that any agreement with a similar effect—which assigned or licensed national IP rights so as to partition the market[41]—would be contrary to competition law. So there is plenty of precedent for the Court taking the view that the national nature of IP rights does not prevent the Court concluding that there is a violation of EU free trade rules which needs to be remedied via "exhaustion" type defences.

That is not to say that delimitation of IP rights territorially is necessarily contrary to free movement principles. For example, one can imagine situations where there is rights segmentation for historical reasons, for example, through disposals of national business units with associated IP, or other legitimate reasons without any intent to delimit national markets.

International exhaustion?

The EU Court's case law has consistently limited the doctrine of exhaustion to the EEA.[42] So even following the logic in *FAPL*—to the extent that a rights holder licences content in respect of a territory outside of the EEA, this will not create a right to communicate that work in the EEA, and the rights holder will be free to set different royalties in the European Union to, for example, those in the United States. A more interesting situation is the case of a rights holder outside of the European Union which licenses the communication of its content in a single EU Member State. Following the logic of a wide reading of *FAPL*, that rights holder could not object to its licensee communicating this work across all 27 EU Member States, and could not impose differential royalties in different EU Member States.

FAPL and online distribution

To operate a download or streaming service requires copyright licences (at minimum): (i) to communicate content to the public (the "making available right"); and (ii) to create copies of the content, both on the content provider's servers and on the end users' computer. In some countries, authorisation for the end user copy is unnecessary because there is an exception for private copying.

"Communication to the public"

Unlike the Greek broadcaster in *FAPL*, an online content provider cannot rely on the origination state copyright clearance provision in the Satellite Directive. Subject to the pending reference to the Court in *Football Dataco*,[43] the Copyright and Related Rights Directive requires that the content provider has copyright clearance in the originating and receiving countries (say Germany and the United Kingdom) when it makes available content to the public in the United Kingdom from a German server. This will commonly involve obtaining licences from collecting societies in both states.

FAPL states that national laws restricting cross border communications services are contrary to EU free-movement principles, provided that:

- the service provider is licensed in the originating country (even if that licence is limited only to the originating country);
- the service provider remunerates the rights holder; and
- effective tracking of the actual/potential audience is possible.

On a broad reading of *FAPL*, once a content provider pays, and receives a German "making available" licence from GEMA, it has a *FAPL* defence to any copyright claim from sister societies in other EEA states if it makes the content available outside of Germany. That assumes that downloads are tracked efficiently and the content provider makes available this information so that royalties can be calculated.

A wrinkle arises in relation to the breadth of GEMA's repertoire. The easiest position to defend is if GEMA holds the worldwide (or at least EEA wide rights), because, for example, the IP owner has assigned its worldwide rights to collect royalties to GEMA. Then it

[37] *Keurkoop BV v Nancy Keen Gifts BV* (C-144/81) [1982] E.C.R. 2853; [1983] 2 C.M.L.R. 47.
[38] *Sirena Srl v Eda Srl* (C-40/70) [1971] E.C.R. 69; [1971] C.M.L.R. 260.
[39] The Court limited exhaustion to those cases where there were "economic links" between the proprietors of the national rights. See *Cnl-Sucal NV SA v Hag GF AG* (C-10/89) [1990] E.C.R. 1-3711; [1990] 3 C.M.L.R. 571; *IHT Internationale Heiztechnik GmbH v Ideal Standard GmbH* (C-9/93).
[40] *Centrafarm BV v Sterling Drug Inc* (C-15/74) [1974] E.C.R. 1183; [1974] E.C.R. 1147; [1974] 2 C.M.L.R. 480.
[41] *Keurkoop BV v Nancy Kean Gifts BV (C-144/81)* [1982] E.C.R. 2853; [1983] 2 C.M.L.R. 47 at [28]: "[I]t is therefore for the national court to ascertain in each case whether the exercise of the exclusive right in question leads to one of the situations which fall under the prohibitions contained in Article [101] and which may, in the context of the exercise of exclusive rights to designs take very different forms, such as, for example, the situation where persons simultaneously or successively file the same design in various member states in order to divide up the markets within the community among themselves."
[42] See *Silhouette International Schmied GmbH & Co KG v Hartlauer Handelsgesellschaft mbH* (C-355/96) [1998] E.C.R. 4799; [1998] 2 C.M.L.R. 953; *Micro Leader Business v Commission of the European Communities* (T-198/98) [1999] E.C.R. II-3989; [2000] 4 C.M.L.R. 886.
[43] *Football Dataco Ltd v Sportradar GmbH. Football Dataco Ltd, Scottish Premier League Ltd, Scottish Football League, PA Sport UK Ltd v Sportradar GmbH* (Case C-173/11). The judgment of the Court of Justice is not yet handed down. The judgment of the Court of Appeal of England and Wales can be found at [2011] 1 W.L.R. 3044.

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seems clear that since the IP owner will be adequately remunerated even if the content provider sells a download in (say) the United Kingdom.

But commonly GEMA will not hold the worldwide (or EEA) rights, but will benefit from cross licensing from sister societies only of the German rights. Sister societies have split the rights and given GEMA no more than it can exploit domestically. On this fact pattern it is arguable that a *FAPL* defence should still apply if a content provider sells a download to (say) the United Kingdom. The content provider still has a domestic licence from GEMA, so the IP owner is still adequately remunerated by paying GEMA royalties which GEMA then pays to the in-licensing sister society. This stretches *FAPL* still further, but remains reasonably within the bounds of the judgment and EU precedent.

Reproduction

Reproduction on a content provider's servers will pose few difficulties. That will be covered by the provider's domestic licence.

Reproduction on the end user's PC will not require a copyright licence in those countries where private copying exceptions exist. These are primarily the countries which impose levies on hard drives and MP3 players (and other digital copying devices/media), such as Germany, France and Spain. Hence, there is no need to assert a *FAPL* defence.

Reproduction in non-levy countries such as the United Kingdom is not subject to private copying exceptions. Nor is the temporary reproduction exception applicable (unlike *FAPL*) since the copy is more than ephemeral.[44]

Here, a further extension of *FAPL* is required, but the logic of doing so remains sound. The Court's dicta on when restrictive IP protection laws do not comply with EU law are of general application, also to reproduction rights. The argument would be that:

- the content provider is licensed in the originating state to allow end users to make private copies;
- it pays adequate remuneration to the domestic collecting society for this right (and even if the domestic society does not directly pay the IP owner, it will remit payment to the relevant sister society); and
- the number of downloads/personal copies can be efficiently tracked, so as to ensure royalties are efficiently calculated.[45]

Content licence restrictions

Whilst some commentators have welcomed the court's statement that—of itself—exclusive territorial licensing does not infringe art.101, this offers little comfort. A licensor can legitimately appoint one licensee broadcaster physically present in the territory, but cannot protect that licensee from competition by neighbouring licensees. [46]

In both cases, any absolute territorial licence restrictions contained in agreements with collecting societies (or other content licensors) with a similar effect would be, according to *FAPL*, invalid as being contrary to EU competition law, and would be unlikely to benefit from an exemption under art.101(3). At most, consistent with the rules on distribution of tangible goods, licensors would be able to restrict a content provider from engaging in active marketing of downloads in other countries. But they would not—crucially—be able to prevent use of the internet to market downloads.[47]

Licensors will need to consider whether there are grounds justifying an exemption from the application of art.101(1) for a territorial restriction on cross border broadcasting/distribution.

The Court does not consider with sufficient detail the possibility of countervailing efficiencies under art.101(3), referring only to its conclusions on free movement without a separate consideration of the distinct requirements of art.101(3).[48] The better view is that the Court's conclusion is limited to the facts presented to it (namely that FAPL sought to justify its restrictions by claiming the need to maximise local revenues through a series of territorial monopolies).

Innovation: to finance audiovisual works with niche or uncertain appeal it may be necessary to grant the contributors to the work an (absolutely protected) territorial franchise in which to exploit the work. The contributors will not take the risk that only active sales restrictions will sufficiently protect their investment. Absent the territorially delimited licences, the work would not have existed.[49] If, to the contrary, the Court prohibits this method of financing new works, it is likely to substantially disadvantage smaller production companies or new entrants to the sector.

[44] The position is likely to be different in relation to streaming, where there are better grounds for arguing that the private copying exception applies.

[45] Collecting societies may claim that they lose visibility of the number of personal copies that the end user makes. But that is not fatal to a *FAPL* [2012] F.S.R. 1 defence. The same problem arose in *FAPL* in that FAPL complained it could not distinguish between commercial and private users of decoder cards (i.e. that a commercial user, who is charged a higher subscription would lie and say the subscription was a private one only). The Court said this was no defence to restrictions on cross border services, since the same problem arose both domestically and in a cross border context. In the same way, lack of visibility of end user copies is not a problem inherent in cross border services. It happens in any event. So it cannot be used as a justification for restricting cross border services: *FAPL* at [128]–[131].

[46] Michel Barnier, Commissioner for the Internal Market made at the ACT annual conference (Brussels: November 9, 2011): "[W]e are waiting to see the concrete commercial implications of this decision on the market… it doesn't mean that rights-holders are obliged to grant licences for the whole of Europe, nor that broadcasters are obliged to buy a pan-European licence".

[47] Guidelines on Vertical Restraints [2010] OJ C130/1 para.52; *Pierre Fabre Dermo-Cosmétique SAS v Président de l'Autorité de la Concurrence* (C-439/09) [2011] 5 C.M.L.R. 31.

[48] *FAPL* [2012] F.S.R. 1 at [140].

[49] Commission's Horizontal Guidelines [2011] OJ C11/1 para.237 (in the context of commercialisation agreements "a commercialisation agreement is normally not likely to give rise to competition concerns if it is objectively necessary to allow one party to enter a market it could not have entered individually or with a more limited number of parties than are effectively taking part in the co-operation, for example, because of the costs involved").

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Protection against free riding: the most common justification for territorial licensing is that of the need to protect against "free riding". For example, FAPL might legitimately claim that Sky spends millions (indeed billions over the lifetime of the Premiership) in enhancing the quality of the sport (through licence fees that flow through to player salaries attracting top talent), engaging in marketing and offering additional services (HD, 3D). It is therefore entitled to protection from foreign broadcasters who have made no such investment, but rather "free ride" on Sky's efforts.

To date, EU cases have only afforded limited protection from free riding via active marketing restrictions. Licensors might consider whether a more robust approach can be warranted in the case of broadcast licensing. As some commentators have noted, given the disparity in value of rights between the home nation (where the national football league is essential viewing) and foreign countries (where foreign football has far less appeal) a perverse outcome of the case might be to discourage any licensing of the rights outside of the home nation, for fear of jeopardising the rights domestic value, where foreign rights sales would not compensate for the loss.

A period of absolute exclusivity might also be merited to ensure the success of the launch of a new product or service. For example, Sky's launch of its satellite service back in the 1980s involved an enormous amount of investment risk, which it might not have made without protection from broadcasts derived from other states. Absolute protection might be exempted under art.101(3) in such cases.

The attraction to UK pubs of Greek decoder cards is mainly the price difference between a commercial subscription to Sky's services (around £2,000) and the cost of a residential subscription to Nova's Greek pay TV service. But the Court ruled that FAPL could legitimately prevent commercial use of the subscription. The difference between Greek residential and UK residential subscription fees will also be high. But to buy access to Premier League content, a UK consumer would be required to pay for subscription to the Greek service in its entirety. This may be an unattractive proposition if the consumer also wishes to watch other UK pay-TV programming. It will have to buy both a UK and Greek subscription. A standalone Greek Premier League channel "add on" package might be more attractive. But it is generally lawful for a licensor to require a broadcaster to adhere to a "field of use" restriction (a "technical field of application or… product market"),[50] such that a licensor requiring a broadcaster to make available content only within a pay-TV subscription service (if this is a separate market to a standalone sports offering) may use a field of use to make purchasing a Greek service less attractive. In addition, and as suggested by A.G. Kokott,[51] FAPL could restrict a broadcaster in a particular Member State to making the FA Premier League available with the commentary in the home Member State language.

Finally, it is submitted that the judgement in FAPL should not be seen as undermining the existence of different "windows" (theatrical release, DVD purchase, DVD rental, pay-per-view, subscription pay-TV, free to air TV) for distribution of audiovisual content.[52] The progressive time windows in which the industry makes works available has been held a necessary feature of efficient exploitation of audiovisual works by competition authorities and in some countries the windowing system is underpinned by national legislation. Reading FAPL to allow broadcasters in one country (in the TV window) to undermine the value of the theatrical exhibition rights in a neighbouring country (in which the same film has been just launched in cinemas) would fundamentally undermine the windowing system and the economics of the industry.[53] *Coditel I* and *II* must therefore remain good law in respect of the underpinnings of the windowing system.

Differential pricing

Applying the logic of the FAPL judgment (the right to maximise revenues by charging different royalties in different Member States falls outside of the specific subject matter of copyright),[54] content licensors would also not be permitted to charge differential pricing depending on the country of download. It is old law that differential pricing depending on the destination country is an illegal restriction on exports (because it discourages sales to high priced countries).[55] Content licensors would therefore be required to charge a uniform tariff regardless of the destination state.

Postscript

Kitchin L.J. gave his judgment in the UK proceedings in one of the co-joined FAPL cases on February 3, 2012[56]. He found that:the publicans had a valid defence under UK domestic copyright law, and therefore did not infringe copyright in the broadcast itself, or related sound recordings, by virtue of the Copyright, Designs and Patents Act 1988 s.72(1)(c). However, this defence did

[50] This definition comes from the Commission's Guidelines on the application of Article 101 of the EU Treaty to technology transfer agreements [2004] OJ C101/2 para.179.
[51] *FAPL* Opinion para.202.
[52] *Coditel I* [1980] E.C.R. 881 at [13].
[53] There can be many legitimate reasons for a film's windows to be different in neighbouring countries. For example, where commercial success is uncertain outside of the movie's core market, the studio may opt for a "slow build" strategy, seeing whether critical reception and word of mouth generate sufficient demand for wider or international theatrical release.
[54] *FAPL* [2012] F.S.R. 1 at [108].
[55] *GlaxoSmithKline Services Unlimited v Commission of the European Communities* (C-501/06 P, C-513/06 P, C-515/06 P & C-519/06 P) [2009] E.C.R. I-9291; [2010] 4 C.M.L.R. 2 at [46], upholding the General Court judgment in the same case (*GlaxoSmithKline Services v Commission of the European Communities* (T-168/01) [2006] E.C.R. II-2969; [2006] 5 C.M.L.R. 29 at [147]). This case chiefly concerned a clause in a pharmaceutical distribution agreement which establishes a system of differentiated prices according to whether each of the 82 medicines concerned was intended to be resold and reimbursed in Spain or in any other Member State. This was found by both the General Court and the Court of Justice to constitute a restriction of art.101 TFEU by object.
[56] [2012] EWHC 108 (Ch) (Unreported February 3, 2012).

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not extend to the underlying artistic and musical works contained in the broadcast (e.g. the Premier League anthem and graphics). The Premier League's claim for infringement of copyright in these works has been referred to the Patents County Court. Although the issue of whether FAPL could obtain an injunction to restrain further use remains to be determined, there is more than a hint in Kitchin's judgment that such a remedy may not be warranted. Kitchin L.J. also a declaration, in line with the judgment of the Court of Justice, that the absolute territorial protections imposed by FAPL infringed art.101(1).

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EUROPEAN COMPETITION LAW REVIEW

Volume 34: Issue 4 2013

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Editor
Julian Maitland-Walker
Solicitor
22 The Parks
Minehead
Somerset TA24 8BT
Telephone: 44 1643 707777
Fax: 44 1643 700020

News Section Editor
Professor Mark Furse
University of Glasgow
Glasgow G12 8QQ
(m.furse@law.gla.ac.uk)

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http://www.wz.uw.edu.pl

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CJEU AstraZeneca Judgment: Groping Towards a Test for Patent Office Dealings

Bill Batchelor
partner, Baker & McKenzie, Brussels

Melissa Healy
associate, Baker & McKenzie, Brussels

Abuse of dominant position; EU law; Fines; Generic medicines; Market definition; Misleading statements; Patents

Background

In 2005 the EU Commission fined AstraZeneca €60 million for abusing its dominance in relation to proton pump inhibitors (PPIs) by: (i) using misleading statements to obtain supplementary protection certificates ("SPCs") that extended its exclusivity in relation to Losec; and (ii) using regulatory procedures (namely the deregistration of Losec's capsule form) to delay the authorisation of competing generic products. This decision was first upheld by the General Court and again reconfirmed by the Court of Justice in its December 2012 judgment.[1] The specifics of the allegations are now largely of historic interest since the transitional teething troubles of the SPC regulation have long since been resolved.[2] However, the EU Courts judgments establish principles that are far wider than just these historical footnotes. These principles will apply to all dealings with a patent office and with regulators by companies with a "dominant" market position.

Narrow Market Definition

Rejecting pleas that PPIs gradually replaced H2 blockers, thus suggesting competitive constraints of substitutable products, the court declined to overrule the Commission's wide margin of discretion when making complex appraisals of this kind. It found the General Court did not err in law by concluding that the gradual nature of the increase in sales for PPIs was not due to the competitive constraint exercised by H2 blockers. It also agreed that the General Court's treatment of doctors' prescribing inertia in the context of market definition and the substantive examination of dominance was justifiable. Similarly it was unmoved by submissions that "dominant" market power was impossible where member states exercise powers to set price and terms of supply. That the General Court had failed to consider all the relevant factors—for example ignoring that the price of shorter duration PPI treatment was comparable to a longer course on H2 blockers—was of no avail. The Commission had done enough to prove its case, and was within its margin of discretion even with these errors.

This approach to market definition suggests a very narrow market (and hence dominance over that market) can be established and defended by the Commission, particularly in relation to companies coming to market with innovative products commanding higher prices. This approach fails to take due account of other external factors such as the regulatory environment within which pharmaceutical medicines operate, the ability of others players to enter the market and the competitive role played by existing therapies.

Misleading Statements to a Patent Office

For practitioners, the most important part of the judgment is the treatment of the legal test established by the General Court for determining when a misleading statement to a patent office can constitute an abuse of dominance.

The General Court's test has been criticised as setting the bar too low. Any objectively misleading statement to a patent office can amount to abusive conduct. The test is an objective one—whether the statement is in fact erroneous—and takes no account of the state of mind of the person making the representation. Even a genuine and honest error made by a dominant company in the context of the patent process, if not promptly self-corrected, could amount to an abuse. Regardless of whether that error is ultimately corrected as part of the appropriate checks and balances systems internal to the patent office.

Had this been upheld, it would have been highly damaging. The patent examination process takes years, and more than 50 per cent of the hundreds of thousands of applications made each year do not result in a patent being issued.[3] Could the General Court seriously be saying that each unsuccessful inventor is also potentially liable to huge fines for an antitrust violation?

The Court of Justice goes some way towards tempering this extreme test. It examines at length the scale, deliberateness and prolonged nature of the alleged misrepresentations. It finds that this "consistent and linear conduct … characterised by … highly misleading representations and by a manifest lack of transparency" clearly engages antitrust liability ([93]). Conversely, it explicitly gives comfort to day-to-day patenting practices. No company faces liability merely for ordinary fallibility

[1] *AstraZeneca v Commission* (T-321/05) [2010] E.C.R. II-2805 (although, the fine was ultimately reduced to €52.5 million). See also *AstraZeneca v Commission* (C-457/10 P) [2013] 4 C.M.L.R. 7.
[2] The law has also been changed so that the withdrawal of a marketing authorisation (MA) does not (generally) prevent generics relying on the MA, even post withdrawal, as a short cut to regulatory approval under the abridged authorisation procedure.
[3] In 2011, a total of 142, 810 patent applications were filed at the European Patent Office and approximately 47 per cent of all such applications resulted in a successful patent grant. See *EPO Annual Report* 2011 available online at *http://www.epo.org/about-us/office/annual-report/2011/statistics-trends.html* [Accessed February 18, 2013].

or because the subject-matter of a patent application is ultimately found not to have met the patentability criteria ([99]).

> "[T]he General Court did not hold that undertakings in a dominant position had to be infallible in their dealings with regulatory authorities and that each objectively wrong representation made by such an undertaking constituted an abuse of that position … that example is radically different from [AstraZeneca's] conduct in the present case."

> "[T]he assessment of whether representations made to public authorities for the purposes of improperly obtaining exclusive rights are misleading must be made *in concreto* and may vary according to the specific circumstances of each case. It thus cannot be inferred from that judgment that any patent application made by such an undertaking which is rejected on the ground that it does not satisfy the patentability criteria automatically gives rise to liability under Article [102] EC."

So where does it ultimately set the bar for antitrust liability? A simple mistake in communication with a patent office is not enough. Large scale deception plainly suffices. The court abstains from setting a specific test between these two ends of the spectrum. This seems to leave open whether the applicant knew or perhaps should have known that there was an argument of invalidity and may therefore make "sailing close to the wind" in filing patents with slender claims to validity dangerous in the case of undertakings with dominant positions.

While this may need to be settled at a future date, companies at least have comfort that the Commission cannot cite unchallenged the extremes of the General Court's test.

Effect on Competition

In contrast, the Court of Justice sets a low bar for the requirement to find an effect on competition in abuse of dominance case. It easily concludes AstraZeneca's allegedly misleading representations to the patent office had an effect on competition—notwithstanding that: (i) the company was not dominant at the time the exclusive rights were to take effect; (ii) the misleading statement was in some cases detected and corrected by the patent offices before any competitors learnt of the possible grant of an SPC; and (iii) the SPC rights were in some cases not subsequently relied upon to restrict generic entry. The Court of Justice overcomes these objections with the semantic device that even "potential" anticompetitive effects give rise to the requisite effect on competition under TFEU art.102:

> "although the practice of an undertaking in a dominant position cannot be characterised as abusive in the absence of any anti-competitive effect on the market, such an effect does not necessarily have to be concrete, and it is sufficient to demonstrate that there is a potential anti-competitive effect." ([149])

Practitioners may be forgiven for asking where the boundary lies between "no effect" and an undetectable "potential effect."

Misuse of regulatory procedures

The Court of Justice upholds the General Court's finding that use of regulatory procedures to exclude competitors engages art.102 liability, unless there is a legitimate reason or objective justification for that regulatory conduct.[4] It is irrelevant that as a regulatory matter, the company is entirely within its rights. Article 102 acts as an unseen overlay to all regulatory procedures, outlawing conduct that the regulation may on its face permit, if an ill-defined boundary into dominance and anti-competitive exclusion is crossed. Though unsatisfactory in terms of legal certainty, the confirmation that a legitimate reason for the regulatory conduct will be sufficient to excuse exclusionary effects means the second *AstraZeneca* abuse is not as potentially far reaching as the first. It will be a rare fact pattern where a company uses regulation solely to block a competitor and can show no other motive. For example, the court was prepared to accept that avoiding phamacovigilance obligations might in principle be grounds for deregistration (an act which—under the then prevailing legal view—also impeded generic entry).[5] Note that the theme of abusively "gaming" the regulatory system does not appear to be confined to the European Union:

- In 2011, the UK OFT found that Reckitt Benckiser had abused its dominant position by withdrawing and de-listing a branded product, following expiry of its patent but before the publication of the generic name for it. This meant that National Health Service prescriptions were issued for the patent protected product, rather than for generic alternatives.
- In September this year, an Italian Administrative Court reversed a decision of the Italian Antitrust Authority which had fined Pfizer for taking various steps to obtain a supplementary protection certificate for a drug that would otherwise have lost its exclusivity protection in Italy before the rest of the European Union. The

[4] The court confirmed that a dominant company "cannot … use regulatory procedures in such a way as to prevent or make more difficult the entry of competitors on the market, in the absence of grounds relating to the defence of the legitimate interests of an undertaking engaged in competition on the merits or in the absence of objective justification" (judgment at [134]).

[5] However, on the facts before the court, there was no evidence that this was *AstraZeneca*'s motive. On the file, there was only evidence of anti-competitive intent.

court found that the Italian Antitrust Authority had failed to prove a clear exclusionary intent.

- The US FTC recently accused Warner Chilcott of gaming the regulatory system by "product hopping"—making minor changes to its antibiotic drug to keep generics off the market (since generic drugs could not be sold if they were not the same as the brand-name drug they reference). The FTC's view is that making minor changes to drugs and pulling the previous formulation off the market to prevent the sale of the generic version is anti-competitive.

Conclusion

The judgment is firmly rooted in the specific facts of the *AstraZeneca* case. It could well be that this case proves to be an outlier on the fringes of competition and IP law. The court's efforts to temper the General Court's judgment on what constitutes an "objectively misleading" statement is to be welcomed, for all that it offers no clear standard to replace it. At minimum, the statement that simple mistakes during the patenting process are not impugned gives companies comfort, and starts to give some boundaries to an otherwise untenably broad precedent. Regulators know that any form of miscommunication cannot be seized upon as abusive. Rather they must have in mind that absent strong evidence of sustained, near-fraud type conduct, they risk failing to meet the—as yet unidentified—Court of Justice standard of abuse.

Disclosure of leniency materials in follow-on damages actions: striking "the right balance" between the interests of leniency applicants and private claimants?

Michael Sanders

Elizabeth Jordan

Charalampos Dimoulis

Kirstin Schwedt

Brenda DiLuigi

Maikel van Wissen
Linklaters LLP

Cartels; Disclosure; Germany; Leniency programmes; Netherlands; Private enforcement; United States

Introduction

The detection and penalisation of cartels has always been a priority policy for the European Commission. The Commission regards its leniency programme as "the most effective tool at [its] disposal for the detection of cartels".[1] The large number of cartels that have been detected and dismantled as a direct consequence of leniency applications is testimony to the success of this programme.

The right to redress for victims of anti-competitive behaviour is also well-established under EU law. The Court of Justice of the European Union (the CJEU) has highlighted the importance of private follow-on damages actions as an important deterrent that can make "a significant contribution to the maintenance of effective competition in the Community."[2] The Commission actively encourages the private enforcement of EU competition law, as complementary to its public enforcement procedures.

The rapid development of follow-on damages regimes in the EU Member States—particularly in the United Kingdom, Germany and the Netherlands—poses a growing threat to conventional leniency incentives. A cartelist's potential exposure to liability for civil damages in these jurisdictions and others, such as the United States, where treble damages are available, could well exceed the Commission's fine. A rational leniency applicant will therefore reflect carefully on whether and how co-operation with the Commission could prejudice its position in relation to private damages actions, and will assess whether this could outweigh any potential fine savings. If the benefits of the leniency programme are no longer obvious or cannot be assessed with certainty, there is a very real risk that cartelists will be discouraged from stepping forward.

Recently, the interests of potential leniency applicants and private damages claimants have increasingly been brought into direct conflict. Courts and regulators have been forced to grapple with the difficult issue of striking an appropriate balance between these interests, which both safeguards the effectiveness of EU and national leniency regimes and supports the effective exercise of rights of redress.

The numerous attempts made by proactive and resourceful private claimants to gain access to leniency materials have been a key battleground over the past 18 months. The Commission has fought to protect the confidentiality of such materials, concerned by the prospect of leniency applicants being "discouraged by discovery orders issued in civil litigation."[3] However, much to the concern of the Commission and the potential leniency applicant, the European courts have tipped the balance in favour of the private claimant in their recent judgments in this area. In its June 2011 *Pfleiderer*[4] judgment, the CJEU encouraged such attempts by ruling that leniency materials were not protected from disclosure as a matter of EU law. Furthermore, the European courts have also curtailed the Commission's ability to resist applications for access to leniency materials under the Transparency Regulation.[5]

The onus is now on the Commission and national regulators to restore a stable and certain balance between the conflicting interests that exist. Various initiatives are currently under consideration at EU and national level, but the final legislative outcome of these is hard to predict. In the meantime, it is increasingly difficult for a potential leniency applicant to evaluate the risks of making an application.

[1] *National Grid Electricity Transmission Plc v ABB Ltd* [2012] EWHC 869 (Ch): Observations of the European Commission pursuant to art.15(3) of Regulation 1/2003, para.12.
[2] *Courage Ltd v Crehan* (C-453/99) E.C.R. I-6297; [2001] 5 C.M.L.R. 28 at [27].
[3] Commission Notice on Immunity from fines and reduction of fines in cartel cases, para.6.
[4] *Pfleiderer AG v Bundeskartellamt* (C-360/09) [2011] 5 C.M.L.R. 7.
[5] Regulation 1049/2001.

1 An uncertain balancing of interests by the European and national courts

1.1 Pfleiderer: the CJEU declines to strike a balance at Community level

Leniency documents frequently contain highly-sensitive information in the form of detailed accounts of the cartel arrangements and the participation by the applicant in those arrangements. In the hands of a private claimant, such documents could not only strengthen the claim against the leniency applicant, but also risk making the leniency applicant an easier target as a defendant than other participants in the cartel.

As noted above, private claimants seeking access to leniency materials have received strong encouragement from the CJEU's judgment in *Pfleiderer*. In an alarming decision for regulators and potential leniency applicants, the CJEU held that, as a matter of EU law, private claimants were not prevented from gaining access to documents submitted to the Commission by a leniency applicant. The Commission and national regulators themselves guarantee that leniency materials will be treated on a strictly confidential basis precisely because they recognise that the risk of disclosure is likely to deter a leniency applicant from coming forward. Until *Pfleiderer*, the Commission, national regulators and leniency applicants had shared the common assumption that documents prepared for the purposes of a leniency application would likewise receive protection from disclosure in a civil damages context.

In *Pfleiderer* the CJEU acknowledged the difficult balance to be struck between the conflicting interests of securing effective enforcement of competition law through the leniency regime and the interests of claimants in obtaining evidence to facilitate damages claims. Crucially, however, the CJEU refused to strike that balance at EU level, or indeed to give any clear guidance on how that balance ought to be struck. Instead, it issued the national courts of the 27 Member States a rather imprecise instruction to "weigh the respective interests in favour of disclosure on a case-by-case basis, according to national law, taking into account all the relevant factors in the case."

As matters currently stand, it has been accepted as a matter of EU law that it may be appropriate for leniency materials to be disclosed in certain circumstances. However, the *Pfleiderer* test does not provide the basis for a harmonised approach. This leaves the potential leniency applicant unable to assess the risk of disclosure of its leniency *documents with any accuracy*.

1.2 Application of Pfleiderer: a case-by-case balancing exercise by Member State courts

The courts of Germany and the United Kingdom—two of the European jurisdictions currently preferred by claimants in follow-on damages actions—have already faced the challenge of applying the *Pfleiderer* test. The inconsistent approaches taken in these early decisions confirm that the probability of disclosure of leniency material is likely to vary between national jurisdictions within the European Union. This factor is increasingly likely to influence a private claimant's choice of jurisdiction when bringing a follow-on damages claim.

1.2.1 Application of the Pfleiderer test in Germany

In Germany, both the national regulator (the *Bundeskartellamt*) and the German courts have taken a robust stance in defence of the leniency regime. The private interests of potential claimants in securing access to leniency information are generally considered to be outweighed by the public interest in an effective leniency regime. Like the Commission, the *Bundeskartellamt* emphasises to leniency applicants that it will use its discretionary powers to protect leniency materials by refusing applications by third parties for file inspection or the supply of information.[6] This is also reflected in the practice of the courts.

On January 18, 2012, the District Court of Bonn[7] refused access to leniency materials after conducting the *Pfleiderer* balancing exercise. In so doing, the court weighed the parties' interests in accordance with German law and concluded that the effectiveness of the leniency programme should not be jeopardised by granting disclosure. The court noted that, according to German criminal procedure rules, access to documents can be refused if the purpose of an investigation (including different investigations) appears to be put at risk. It observed that the attractiveness of leniency programmes would suffer considerably if potential leniency applicants had to fear disclosure of documents submitted voluntarily. As part of its balancing exercise, the court also highlighted that there are only very limited means for competition authorities to detect cartels and that, by contrast, it is not excessively difficult for a claimant to obtain a damages award as the *Bundeskartellamt*'s (or the Commission's) finding of infringement cannot be contested in a follow-on damages claim and the German courts may estimate the amount of damages if the precise amount cannot be established with certainty.

Similarly, on August 22, 2012, the Düsseldorf Higher Regional Court[8] prevented claimants from obtaining access to the court file for a pending appeal against a fine by the *Bundeskartellamt*, which contained the leniency

[6] Paragraph 22 of the Notice no. 9/2006 of the Bundeskartellamt on the immunity from and reduction of fines in cartel cases of March 7, 2006, *http://www.bundeskartellamt.de/wEnglisch/download/pdf/Merkblaetter/06_Bonusregelung_e_Logo.pdf* [Accessed February 20, 2013].
[7] Case 51 Gs 53/09, *Pfleiderer v Bundeskartellamt*, GRUR-RR 2012, 178.
[8] Case V-4 Kart 5+6/M (OWi), *Roasted Coffee*, BB 2012, 2459.

documents. According to the Düsseldorf court, access to leniency documents has relatively little value for the claimant as compared to the cartel authority's finding of infringement, which constitutes binding proof in a follow-on damages claim. The court did not consider that leniency documents would necessarily assist a court's assessment of causation and damages. Therefore, the claimant's interest in accessing the leniency material did not outweigh the leniency applicant's interest in maintaining confidentiality. As a result, some commentators have argued that leniency applicants would be well-advised to provide as little information as possible relevant to the calculation of damages in their application, so that potential claimants have no interest in seeking access.[9]

Leniency applicants will be reassured by the hard line taken by the German courts to date, which have so far shown an appreciation of the need for certainty.

1.2.2 Application of the Pfleiderer test in the United Kingdom

The position in Germany is quite different from the rather more nuanced approach taken by the English High Court on April 4, 2012 in the *National Grid*[10] case. In that case, the English court undertook the *Pfleiderer* balancing exercise for the first time in the context of an application for disclosure for various leniency materials.

The court had the benefit of a detailed submission from the Commission, highlighting the potentially harmful implications of disclosure of leniency materials to private litigants for the leniency regime. In conducting the balancing exercise, the court reached the following main conclusions:

(i) Leniency applicants do not have a legitimate expectation that their leniency statements would be protected from disclosure: the grant of leniency does not confer protection from the civil law consequences of an infringement.

(ii) Although it is relevant to consider whether disclosure would increase the leniency applicant's exposure to liability compared to addressees that did not seek leniency, this concern did not arise on the facts.

(iii) The risk of deterring leniency applications is a relevant consideration, but participants in serious cartels will still continue to be incentivised to apply for leniency regardless of disclosure, due to the scale of the fines and the risk of leniency applications by other participants with potential civil damages consequences for all.

(iv) Proportionality is a relevant factor governing disclosure decisions, with the availability of information from other sources and the relevance of the leniency materials to the dispute being the key considerations.

Having reviewed the relevant leniency materials and conducted this balancing exercise, the court ordered some limited disclosure of leniency material contained in the non-confidential version of the Commission decision and in certain responses to Commission requests for information.

The *National Grid* judgment highlights the uncertainty that surrounds access to leniency material: the English court appears to have taken a completely different view from the German courts of both, the likely utility of leniency materials to the private claimant and the potential threat that disclosure poses to the leniency regime.

The judgment demonstrates that the English courts are prepared to order disclosure of leniency materials to private claimants in certain circumstances. It also indicates that the types of factors that the English courts will take into consideration when making this assessment are simply not matters which can be assessed at the time when a potential leniency application is weighing up the merits of an application. Faced with such uncertainty, a potential leniency applicant may well be deterred. It is therefore not at all clear that the English court's confidence in the continuing effectiveness of leniency incentives in the face of the disclosure risk is well-founded.

1.2.3 Pfleiderer test not yet applied in the Netherlands

The other main European jurisdiction favoured by follow-on damages claimants is the Netherlands.

The Dutch regulator (the NMa) has indicated that it will refuse any requests for disclosure of leniency material in order to maintain the effectiveness of its investigations. However, the Dutch courts have not yet been called upon to conduct the *Pfleiderer* balancing exercise. It will be interesting to see how their approach differs from that taken by the German and English courts.

1.3 Donau Chemie: A further opportunity for the CJEU to weigh in

In what has been described as "*Pfleiderer* reloaded",[11] a preliminary reference by the Regional Court of Vienna in the case of *Donau Chemie*[12] has provided the CJEU with a further opportunity to clarify this issue. According to Austrian legislation, disclosure of documents may not be granted unless all parties agree for such disclosure to be ordered. Since a leniency applicant is likely always to

[9] *Murach*, GWR 2012, 419.
[10] *National Grid v ABB* [2012] EWHC 869 (Ch).
[11] Law Blog beck-online: Dr. Rolf Hempel, *Akteneinsicht in Kronzeugenantraege*, October 5, 2012 (language of entry: German).
[12] *Bundeswettbewerbsbehorde v Donau Chemie AG* (C-536/11), judgment of February 7, 2013, not yet reported.

refuse disclosure, it has been argued that the Austrian law effectively creates a bar on disclosure. The preliminary reference asks the CJEU to clarify whether this is compatible with EU law, as the Austrian judge is not in a position to conduct the *Pfleiderer* balancing exercise.

This case shows just how contentious this issue currently is. In the hearing before the CJEU on October 4, 2012, five Member States (Germany, France, Spain, Italy and Belgium) and all of the cartel participants intervened in support of the argument that the Austrian disclosure rules are compatible with the balancing exercise required under *Pfleiderer*.

In his opinion of February 7, 2013, Advocate General Jääskinen concluded that the Austrian disclosure regime was incompatible with the EU principle of effectiveness. He accepted that a national legislator could regulate the factors which could be taken into account in conducting the *Pfleiderer* balancing exercise, but found that the Austrian regime went too far in precluding such an exercise from taking place. A.G. Jääskinen also suggested that a national rule which gave absolute protection to leniency applicants, but required the interests of other participants in the anti-competitive conduct to be balanced against the interests of the alleged victims, would be more proportionate.

The judgment of the CJEU is highly-anticipated, and it remains to be seen to what extent it will follow A.G. Jääskinen's opinion.[13]

1.4 The Transparency Regulation: protection by the General Court of rights of access

Private claimants have also been actively exploring other avenues to obtain disclosure of leniency materials. One of these is the Transparency Regulation, which provides that all documents of EU institutions must be open to public access. In the past, the Commission has relied on exceptions to this general disclosure obligation, such as the protection of commercial interests and the protection of the purpose of investigations,[14] to resist disclosure of documents held in its cartel investigation files. This was reassuring for leniency applicants, who could rely on the Commission blocking this route of access to leniency materials. However, in a series of recent judgments, the European courts have curtailed the Commission's entitlement to rely on these exceptions and opened up the possibility of disclosure of leniency materials via this route:

1.4.1

On December 15, 2011, in the *CDC* case,[15] the General Court annulled the Commission's decision to refuse CDC's request for access to the index to the file for the hydrogen peroxide cartel investigation. CDC was a claimant in follow-on damages proceedings before the German courts, and had made the request to identify documents in a defendant's possession likely to assist its claim. In annulling the decision, the General Court held that the Commission was not entitled to refuse requests based on the general nature of the documents requested, but must instead assess each document separately to determine whether it falls within the Transparency Regulation exceptions in full or in part.

Worryingly for leniency applicants, the General Court concluded that the interest of a cartelist in avoiding actions for damages is not a "commercial interest" and "does not constitute an interest deserving of protection" under the Transparency Regulation. The General Court also chose to emphasise the important role played by private damages actions in maintaining effective competition throughout the European Union, and remarked that such mechanisms "ought to be equally protected" along with leniency programmes.

1.4.2

On May 22, 2012, in the case of *Energie Baden-Wuerttemberg AG* (EnBW),[16] the General Court annulled the Commission's decision to refuse a request by EnBW, an alleged victim of the gas insulated switchgear cartel, for access to leniency materials from the Commission's file. The General Court found that the Commission had, again, misapplied the Transparency Regulation exceptions and that it had erred in its restrictive interpretation of the scope of EnBW's request for access. The General Court reiterated that to justify refusal of access to a document, the Commission must explain how access to that document could *specifically and actually* undermine the interest protected by each exception. This decision has been appealed to the CJEU by the Commission.[17]

It seems likely that private claimants will be encouraged by the General Court rulings in *CDC* and *EnBW* to seek increasingly to use the Transparency Regulation to secure access to leniency materials. Indeed, the judgment of the General Court is pending in relation to appeals made by German insurers WGV, VHV, LVM, and Huk-Coburg on similar grounds against the Commission's refusal to grant them access to the files on its car glass cartel investigation.[18]

[13] According to the CJEU registry, judgment can be expected during the second or third quarter of 2013.
[14] Regulation 1049/2001, art.4(2).
[15] *CDC Hydrogene Peroxide Cartel Damage Claims v European Commission* (T-437/08) [2012] 4 C.M.L.R. 14.
[16] *EnBW Energie Baden-Wurttemberg AG v European Commission* (T-344/08) [2012] 5 C.M.L.R. 4 .
[17] According to the ECJ registry, judgment can be expected in the second or third quarter 2013.
[18] *Wuerttembergische Gemeinde-Versicherung v European Commission* (T-421/12); *VHV v European Commission* (T-420/12); *LVM v European Commission* (T-419/12).

1.5 Intervention by private claimants: ruled out by the European courts

Yet another route to access to leniency materials that has recently been explored by private claimants is direct intervention in appeals against the Commission's decision in cartel cases. Fortunately for leniency applicants and other addressees of Commission decisions, the European courts have so far barred this option.

On October 10, 2011, Schenker AG attempted to use this route to gain access to documentation in support of its follow-on damages action against certain airlines found by the Commission to have participated in the air cargo cartel. However, the General Court refused to allow Schenker to intervene in support of the Commission in various appeals brought by addressees of the Commission's decision on the grounds that it had failed to establish a direct, existing link in the results of the case.[19] The General Court expressly held that it was not the role of appeals against cartel decisions "to make possible or facilitate the bringing of civil actions in the national legal system, such as claims for damages". On June 20, 2012, the CJEU dismissed Schenker's appeal against this decision on the basis that the fact that Schenker was a customer of the cartelists, and intended to bring a damages action to recover losses suffered as a result of the cartel, was not sufficient to give it a direct and existing interest in the outcome of the appeal proceedings.[20]

This shows that, despite the indications to the contrary in the *Pfleiderer*, *CDC*, and *EnBW* judgments, there are limits to the extent to which the European courts are prepared to facilitate follow-on damages actions in cartel cases.

1.6 Tipping the balance in favour of disclosure in the United States

In recent years, US courts have demonstrated increased sensitivity to the risks to the European Commission's enforcement efforts posed by private antitrust plaintiffs' discovery demands. As described below, while US courts have not reached consistent conclusions on the ultimate issue of disclosure in all cases, the Commission, through submission of letters and intervention in US proceedings, has successfully argued for the confidentiality of Commission investigatory materials pursuant to the US legal doctrine of international comity.

International comity is:

> "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws."[21]

The US Supreme Court has "long recognized the demands of comity in suits involving foreign states, either as parties or as sovereigns with a coordinate interest in the litigation" and has emphasized that "American Courts should therefore take care to demonstrate due respect for any special problem confronted by […] any sovereign interest expressed by a foreign state."[22] In conducting comity analyses, US courts consider the following factors:

(a) the importance to the […] litigation of the documents or other information requested;
(b) the degree of specificity of the request;
(c) whether the information originated in the United States;
(d) the availability of alternative means of securing the information; and
(e) the extent to which noncompliance with the request would undermine important interests of the United States, or compliance with the request would undermine important interest of the state where the information is located.[23]

The final factor—which requires a balancing of the interests of the United States against the interests of the foreign jurisdiction—is generally considered by US courts to be the "most important" factor, "as it directly addresses the relations between sovereign nations."[24]

In recent cases, the Commission has successfully asserted that the effective enforcement of EU competition laws outweighs the interests of private plaintiffs in obtaining discovery material. In 2010, a federal district court in New York issued an order denying access by the plaintiffs to a Statement of Objections issued by the Commission and a transcript of an oral hearing from the Commission's investigation.[25] Following an initial ruling ordering disclosure of the material, the Commission submitted a briefing on appeal asserting its interest in protecting the confidentiality of its enforcement proceedings. In reviewing the decision on appeal, the court concluded that disclosure of the material would be contrary to the law of international comity, and in doing so, stated that "the Commission has strong and legitimate reason to protect the confidentiality of Statements of Objections and Oral Hearings as a general matter."[26] Further, the court recognized that the confidentiality of the proceedings is "particularly important", as it "encourages free and open participation by the parties under investigation, which in turn serves the Commission's interest in detecting and punishing

[19] *Deutsche Lufthansa and Others v Commission* (T-46/11).
[20] *Schenker AG v European Commission* (C-602/11 P(I)) [2012] 5 C.M.L.R. 19.
[21] *Société Nationale Industrielle Aérospatiale v United States District Court*, 482 U.S. 522, 544 n.27 (1987) (quoting *Hilton v. Guyot*, 159 U.S. 113, 163–164 (1895)).
[22] *Société Nationale Industrielle Aérospatiale v United States District Court*, 482 U.S. 546.
[23] *Société Nationale Industrielle Aérospatiale v United States District Court*, 482 U.S. 544, n.28.
[24] *Madanes v Madanes*, 186 F.R.D. 279, 286 (S.D.N.Y. 1999).
[25] *Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 05-md-1720 (JG)(JO), 2010 WL 3420517 (S.D.N.Y. August 27, 2010).
[26] *Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 05-md-1720 (JG)(JO), 2010 WL 3420517 (S.D.N.Y. August 27, 2010) at 9.

violations of its laws" and that "[t]he Commission's interests would be significantly undermined if its confidentiality rules were disregarded by American courts in this case and others like it."[27]

Similarly, in *In re Rubber Chemicals Antitrust Litigation*, the plaintiff sought production of documents related to the Commission's investigations in connection with the rubber chemicals industry.[28] The defendant objected to producing the documents, and the Commission argued in a letter submitted to the court that the production of the materials:

> "would undermine its ability to initiate and prosecute future investigations by creating disincentives to co-operate with the Commission and would prejudice future investigations."[29]

In that case, the defendant had already produced to plaintiffs the underlying documents that were provided to the Commission. The court denied the plaintiffs' request, finding the "marginal benefit" of the material sought to be:

> "outweighed by the impact that disclosure will have on the Commission's interests in the effective enforcement of its competition laws and its co-operation with the US to enforce those laws internationally."[30]

Likewise, in *In re Methionine Antitrust Litigation*, plaintiffs sought confidential submissions made by the defendants to the Commission.[31] The Commission submitted a letter to the court opposing the production of the documents. Following a comity analysis, the court concluded that "the balance tips strongly in favour of the interests of the [C]ommission" in light of its strong arguments as to why the production of the documents would harm its interests and that nondisclosure would cause minimal harm to plaintiffs, who were already in possession of underlying source documents as well as redacted copies of the submissions in question.[32]

The foregoing cases reflect a willingness of US courts to defer to the legitimate interests of the Commission in protecting its leniency programme and in the effective enforcement of EU competition laws. However, the decisions also make clear that the US courts' comity analyses are highly subjective and case specific, and that the Commission will need to continue to be vigilant in intervening in US court proceedings to protect confidentiality as issues of potential disclosure arise.

It remains to be seen how, if at all, *Pfleiderer*, *National Grid* and other decisions that may follow will affect future discovery rulings in the United States. However, US courts are unlikely to afford greater deference to requests by the Commission (or other EU governing bodies) than such requests receive within the European Union, and thus it is possible that those decisions could tip the balance and pave the way for private litigants in the United States to obtain discovery of such material. Accordingly, potential applicants will need to assess whether the benefits of participating in the EU leniency programme are outweighed by the risks of treble damages in the United States, should investigatory materials be used against them in US proceedings.

2 Restoring the balance: a challenge for the European Union and national legislator

2.1 The Commission promises "the right balance"

The Commission is acutely aware of the heightened tension between the interests of private claimants and the effectiveness of leniency programmes, and of the undesirable uncertainty arising from the recent decisions of the European courts described above. It has recognised for some time that "the interaction between the measures improving the conditions for antitrust damages actions and various aspects of public enforcement of competition rules"[33] needs to be addressed. It also accepts its own responsibility to remedy the situation by introducing legislative proposals at EU level because "individual action by Member States does not seem capable of achieving this in any consistent manner."[34]

Joaquín Almunia, the EU Commissioner for Competition, has announced his intention to propose legislation before the end of the year that ambitiously promises to "strike the right balance" between the protection of leniency programmes and the victims' rights to obtain compensation. According to the Commission's work programme for 2012 a legislative proposal for "a directive on rules governing actions for damages for infringements of the competition law provisions" is currently under development. The stated aim of the proposed Directive is:

> "to ensure effective damages actions before national courts […] and to clarify the interrelation of such private actions with public enforcement by the Commission and the national competition authorities, notably as regards the protection of leniency programmes, in order to preserve the central role of public enforcement in the EU."

[27] *Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 05-md-1720 (JG)(JO), 2010 WL 3420517 (S.D.N.Y. August 27, 2010) at 9.
[28] 486 F. Supp. 2d 1078 (N.D. Cal. 2007) .
[29] 486 F. Supp. 2d 1078 (N.D. Cal. 2007) at 1084.
[30] 486 F. Supp. 2d 1078 (N.D. Cal. 2007) at 1084.
[31] No. 00-MD-1311 (CRB) (N.D. Cal. June 17, 2002).
[32] No. 00-MD-1311 (CRB) (N.D. Cal. June 17, 2002) at 13.
[33] European Commission Roadmap: *Legislative proposal on antitrust damages actions*, version No.1.
[34] European Commission Roadmap: *Legislative proposal on antitrust damages actions*, version No.1.

In December 2012, the deadline for the legislative proposal was deferred once more with Joaquín Almunia stating that the Commission will propose legislation "in the coming months."[35] In the meantime it still remains unclear from the various high level policy statements made by Commission officials precisely what the Commission considers "the right balance" to be, and how this lofty aim will be translated into detailed legislative proposals.

It is worth remembering that the Commission has been proposing EU legislation to improve redress mechanisms for breaches of competition law for a number of years. In 2005, the Commission started a consultation with its Green Paper on how to remove the main national law obstacles to damages actions for breach of competition law. The Green Paper, which identified access to evidence as one of the main obstacles at the time, was succeeded by the 2008 White Paper on the same topic, which suggested specific policy measures to improve access to private redress mechanisms. The legislative proposal described in the Commission's 2012 work programme above is the successor to the White Paper. Potential leniency applicants and private claimants alike will be interested to see how the Commission will seek to strike the balance and tie the threads of its previous proposals together.

In the meantime, Member States—perhaps in part because they have grown tired of waiting for the Commission to seize the initiative—have also been active in pursuing initiatives which seek to strike a balance between the competing aims at national level. Although the national competition authorities appear to share the view that "leniency materials should be protected against disclosure to the extent necessary to ensure effectiveness of leniency programmes",[36] it is inevitable that this common high level aim will be translated into the national procedural rules of the 27 Member States in different and potentially inconsistent ways.

2.2 The UK Government seeks views on "the right balance"

2.2.1 Consultation by the OFT on its leniency application guidance

Like the Commission, the UK regulator (the Office of Fair Trading or OFT) has been finding it increasingly challenging to protect leniency materials from disclosure to private claimants. As a matter of policy, the OFT normally seeks to resist requests for disclosure of leniency materials in connection with private proceedings on public interest grounds. However, the ability of the OFT to prevent the disclosure of leniency materials to private claimants is limited, because it is subject to the jurisdiction of the courts. Accordingly, if, having conducted the *Pfleiderer* balancing exercise, a court ordered the OFT to disclose leniency documents to a private claimant, the OFT would be bound to comply.

The OFT launched a consultation in October 2011[37] seeking the views of interested parties on draft revisions to its current guidance on the handling of applications for leniency in cartel cases. In its draft revised guidance (the final version is still awaited), the OFT renewed its pledge to refuse to disclose leniency material. In support of this position, it refers to the strong public interest in encouraging full and frank disclosure by leniency applicants, and notes that non-disclosure of such material may be in the public interest to protect the efficacy of the leniency regime.

One controversial aspect of the OFT's original draft guidance was its proposal to require waivers of legal professional privilege as a condition of leniency, in order to facilitate criminal prosecution of cartel conduct. This was concerning, not only because of the status of privilege as a fundamental right under English law, but also because of the serious risk of such waivers jeopardising the leniency applicant's entitlement to withhold privileged material from disclosure in other proceedings in other jurisdictions. The furore provoked caused the OFT to rethink this aspect of its proposal and to commence a supplementary consultation[38] on an alternative option in October 2012, which closed on November 14, 2012.

2.2.2 BIS consultation on reform of private actions in competition law

In parallel, the Department for Business, Innovation and Skills (BIS) has conducted a wide-ranging consultation on how best to complement the public enforcement regime by promoting more private challenges to anti-competitive behaviour.[39]

In its consultation document, BIS acknowledged the challenge of finding an acceptable balance between effective private actions and sufficient incentives to come forward. BIS emphasised its desire to "ensure private actions complement the public enforcement regime" and that "private actions do not discourage companies from whistle-blowing on cartels, which is a vital part of the OFT's enforcement activity." In relation to leniency documents, BIS indicated that it was minded to protect documents "directly involved in the leniency application and which would not have been created if the company had not been seeking leniency." BIS also invited views on a controversial proposal to shield leniency applicants from joint and several liability in a civil damages context as a further incentive to come forward.

[35] AmCham 29th Competition Conference, Brussels, December 6, 2012.
[36] Resolution of the Meeting of Heads of the European Competition Authorities of May 23, 2012.
[37] Office of Fair Trading: *Applications for leniency and no-action in cartel cases—OFT's detailed guidance on the principles and process: A Consultation on OFT guidance*, October 2011.
[38] Office of Fair Trading: *Applications for leniency and non-action in cartel cases—OFT's detailed guidance on the principles and process: A supplementary consultation on OFT guidance*, October 2012.
[39] BIS: *Private actions in competition law: A consultation on options for reform*, April 2012.

The UK Government published its proposals in response to the consultation on January 29, 2013.[40] In this response, the UK Government concluded that it would be preferable for legislative action to protect the leniency regime to be taken at European level, both for reasons of consistency and effectiveness, as well as in terms of providing certainty for potential leniency applicants. The UK Government has, accordingly, chosen to defer to the European Commission in this area for the time being. However, the response makes it clear that if the European Commission does not bring forward such legislation sufficiently quickly, or if such legislation does not contain adequate protections, the UK Government will consider further whether it should legislate at national level to protect the leniency regime.

2.3 The German Government wastes an opportunity to strike a balance

In the course of the year 2013, the 8th Amendment to the German Act Against Restraints of Competition shall come into force. It was hoped that this Amendment would clarify the rules on disclosure of leniency material under German law in light of the *Pfleiderer* judgment, and thereby introduce welcome certainty for leniency applicants.

The first draft of the Amendment included a section on the confidentiality of leniency applications, which provided that leniency material would not be disclosed to private claimants under German law.[41] The explanatory notes to this provision of the amendment explicitly referred to the *Pfleiderer* judgment and the need for EC law to be effectively applied.[42]

Disappointingly, the provisions concerning confidentiality of leniency applications were dropped from the final version of the Government bill and will therefore not pass into German law.[43] Despite the views to the contrary expressed by the German Federal Council (*Bundesrat*) in May 2012,[44] the German Government ultimately considered that legislative intervention was not needed. Rather than enacting a clear and predictable rule, the German Government instead chose to continue to entrust the *Pfleiderer* balancing exercise to the German courts.[45]

2.4 The Dutch Government appears minded to protect leniency materials

On January 1, 2013, the Dutch competition authority will be merged with the Netherlands Consumer Authority and the Independent Post and Telecommunications Authority of the Netherlands. On May 31, 2012, the Dutch Government launched a public consultation on a draft bill to align the legal powers of the respective authorities.[46] Although this draft bill does not refer to the *Pfleiderer* judgment, the explanatory notes provide some insight into the Dutch Government's views on disclosure of leniency materials.

Article 12s of the draft bill sets out proposed rules for disclosure of decisions and other documents provided to the new merged authority, which are based on the general disclosure rules for Dutch governmental bodies. The explanatory notes explicitly state that requests for disclosure of documents should be rejected as a matter of course if such disclosure would interfere with the objectives of the new authority's legal functions. According to the explanatory notes, "this would (for example) be the case when it is requested to disclose information provided by leniency applicants in the context of competition law cases". In this draft bill, the Dutch government is therefore taking a clear position in favour of the protection of leniency materials.

However, whether the final bill will include any guidance on the disclosure of leniency materials remains to be seen. The consultation closed on July 20, 2012 and, at the time of writing, the Dutch Government had still not sent the draft bill to parliament. It is difficult to predict what the final outcome of the legislative process will be.

3 An increasingly complex balancing exercise for the leniency applicant

As has been highlighted throughout this article, striking a satisfactory balance between the interests of private claimants and those of potential leniency applicants is fraught with difficulty. The recent decisions of the European courts in *Pfleiderer*, *CDC* and *EnBW* have threatened conventional leniency incentives by favouring the private claimant's interest in disclosure of leniency materials. The delicate balancing exercise surrounding the disclosure of leniency materials has been deferred to the Member State courts, creating an unsettling lack of predictability.

The European Commission has undertaken to resolve this uncertainty by introducing legislative proposals at EU level that will "strike the right balance" between these conflicting interests. However, the detailed legislative proposals and the timing of implementation of resulting legislation are very difficult to predict. Parallel initiatives at Member State level further complicate the picture.

As follow-on damages regimes continue to develop in the competition sphere, there is increasing scope for the cartel participant's potential exposure to civil damages to exceed the administrative fine that it may avoid by co-operating with the Commission or national competition authority. The risk of disclosure of leniency materials in

[40] BIS: *Private actions in competition law: A consultation on options for reform — government response*, January 2013.
[41] BMWi-Referentenentwurf, available at *http://www.bmwi.de/BMWi/Redaktion/PDF/G/gwb-8-aenderung-referentenentwurf* [Accessed February 13, 2013].
[42] BMWi-Referentenentwurf, available at *http://www.bmwi.de/BMWi/Redaktion/PDF/G/gwb-8-aenderung-referentenentwurf* [Accessed February 13, 2013], p.51.
[43] BR-Drs. 176/12.
[44] BR-Drs. 176/12 (B), p.3.
[45] BT-Drs. 17/9852, p.80 et seq.
[46] *http://www.internetconsultatie.nl/materielewetacm* [Accessed February 18, 2013].

civil damages actions —both within the European Union and elsewhere—is therefore a factor that a well-advised potential leniency applicant will wish to assess and take into consideration when considering the merits of applying for leniency. In the current fast-moving and unstable environment within the European Union, that exercise is both complex and uncertain. While this remains the case, there is a risk that some potential leniency applicants may well take the view that silence is the safer course.

Vertical price fixing in the United States — Who's in charge?

Douglas F. Broder

Anthony P. Badaracco

Daniel A. Pincus*

California; Kansas; Maryland; New York; Price fixing; Resale price maintenance; United States; Vertical agreements

A manufacturer that takes steps to control the price at which retailers sell its products to consumers is engaged in what is known in the United States as resale price maintenance. For almost a hundred years, the US courts treated resale price maintenance accomplished by "agreement" as per se illegal vertical price fixing.1 This meant an antitrust plaintiff could establish a claim that a defendant had violated s.1 of the Sherman Antitrust Act simply by proving the existence of such an agreement. The courts would not allow the defendant to present evidence and argue that the agreement did not harm competition or was actually pro-competitive. But in *Leegin Creative Leather Products v PSKS, Inc.,2* the US Supreme Court declared that agreements between manufacturers and retailers on minimum prices charged to consumers would no longer be treated as automatically illegal. Instead, like all other vertical agreements (such as an agreement to limit the geographic boundaries in which a retailer may sell that manufacturer's products), such agreements would be subject to review under the Rule of Reason. Under a Rule of Reason analysis, defendants may introduce evidence aimed at proving that their conduct did not harm competition or that the conduct's pro-competitive benefits outweighed any harm to competition. Because such evidence may be introduced, Rule of Reason claims are much costlier to prosecute, harder to win, and therefore—despite the attraction of the treble damages and attorney fee awards that automatically go to a successful antitrust plaintiff—much less likely to be brought in the first place. Many observers believed *Leegin* would usher in a dramatic change in how manufacturers, no longer threatened with easily-proved antitrust claims, would approach vertical pricing issues. But the result has not been so simple for at least two reasons. First, the Supreme Court provided little guidance on how lower courts should analyse such agreements under the Rule of Reason. Secondly, something striking has happened: a number of states have simply disagreed, taking the position that resale price maintenance agreements remain illegal per se under their respective state laws. This article traces the history of vertical price fixing under US federal and state law, highlights the Supreme Court's landmark 2007 decision abandoning per se treatment under federal law, and then analyses recent efforts in some states to retain a broad proscription of such agreements. The result, for today at least, is a legal patchwork in which a manufacturer's agreements with retailers on price, while subject to more forgiving Rule of Reason treatment under federal law and the laws of some states, are still illegal per se under some states' laws.

I. Background and History

The primary source of American antitrust law is the federal Sherman Act and decisions of the US Supreme Court interpreting it. Most states have their own antitrust laws, and, while most of those follow federal precedents, they are not required under the US Constitution to do so. In fact, a few states have drafted their own laws specifically because of disagreements with federal antitrust standards. For example, the California's Cartwright Act, drafted in 1907, shortly after the passage of the Sherman Act, imposed tougher standards in some areas. Resale price maintenance has become one area of federal and state divergence.

Vertical agreements are those reached by entities at different levels of the distribution chain for the same product, whereas horizontal agreements are those between rivals that operate in the same markets. In a minimum vertical price fixing agreement, manufacturers require retailers to agree in writing not to sell below a certain price. In this sort of arrangement, a manufacturer (operating "upstream" in the distribution chain) limits the ability of retailers (operating "downstream") to compete on price or charge different prices to different customers.

There may be good reasons for a manufacturer *not* to reach this sort of agreement. A manufacturer often has a strong disincentive to drive up the retail prices charged for its products. After all, economics teaches that lower retail prices of a given product generally yield increased retail sales for that product. So, higher prices typically mean fewer sales—and weaker returns for the manufacturer.

But sometimes manufacturers have strong incentives to set a price floor for their products. A manufacturer may want to protect its reputation as a luxury brand. It may also want to prevent customers from first visiting retail stores that expend significant resources on customer services and then buying at lower prices from online or discount retailers that free-ride on those services.

* Mr. Broder is a partner and leader of the antitrust group in the New York office of K&L Gates LLP. He is the author of, among others, *U.S. Antitrust Law and Enforcement: A Practice Introduction* 2nd edn (Oxford: Oxford University Press, 2012). Messrs. Badaracco and Pincus are associate attorneys at K&L Gates LLP. The authors wish to thank Paul F. Donahue of K&L Gates LLP for his valuable assistance in preparing this article.

The Supreme Court has only recently drawn back from per se condemnation of agreements on minimum resale prices. The court has recognized that certain market realities should allay some fears surrounding such agreements, pointing out, among other things, that these agreements can foster competition at the manufacturer level while limiting it at the retail level. Moreover, legal questions on vertical agreements are almost entirely concerned with *intra*brand competition (i.e., competition on products within the same brand). Yet, historically the main thrust of the antitrust laws has been to protect *inter*brand competition (i.e., competition for similar products made by different manufacturers).

Perhaps inevitably, given this tension, the Supreme Court's precedents over the last century have drifted back and forth between prohibition and relative leniency toward resale price maintenance agreements.

A. Per Se or Rule of Reason Analysis

Section 1 of the Sherman Antitrust Act ("s.1") prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States."[1] Read literally, this language would prohibit *all* contracts. The Supreme Court has never taken a literal approach to s.1. Instead, the court condemns as illegal only "unreasonable" restraints of trade by employing a "Rule of Reason," whereby "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[2] Those circumstances generally include the specifics of the relevant business, the nature and effect of the restraint in question, and the business's market power.

But the Rule of Reason does not govern all restraints. The court has found that some conduct, such as horizontal agreements among competitors to fix prices or divide markets, is so "manifestly anticompetitive" that it "lack[s] … any redeeming virtue."[3] It has declared such conduct "unlawful per se."[4] Because per se agreements are automatically illegal, proving the existence of such agreements ends the inquiry, and a defendant may not attempt to justify its conduct, as it may in a Rule of Reason case. Accordingly, the Supreme Court has "expressed reluctance to adopt per se rules with regard to restraints where the economic impact of certain practices is not immediately obvious."[5]

B. Federal History

The Supreme Court first held minimum resale price maintenance agreements illegal per se in 1911 in *Dr. Miles Medical Co. v John D. Park & Sons Co*.[6] That decision faced criticism from the beginning. Just eight years later, in *United States v Colgate & Co.*,[7] the Supreme Court carved out a crucial exception, holding that so long as a manufacturer does not enter into any agreement with its retailers on retail prices, the manufacturer can refuse to deal with any retailer who fails to adhere with the manufacturer's suggested prices. Without a formal agreement on price, the court stated there could be no violation of the Sherman Act, which requires a "contract, combination … or conspiracy."[8]

Nonetheless, in 1967, the Supreme Court extended the *Dr. Miles* rule, holding that customer and territorial restraints—agreements on factors other than price—were illegal per se as well.[9] And in its very next term, in *Albrecht v Herald Co.*,[10] the court declared *maximum* resale price maintenance agreements illegal per se as well. The *Dr. Miles* rule held strong—with all resale price maintenance agreements being treated as illegal per se—for nearly 100 years.

Eventually, the Supreme Court began to pull back from a blanket rule of per se illegality for vertical agreements. In 1977, the court held in *Continental T.V., Inc. v GTE Sylvania Inc.*[11] that vertical *non*-price agreements would no longer be treated as illegal per se but instead would be subject to the Rule of Reason.[12] The court noted that while such restraints might limit *intra*brand competition, that concern deflected attention away from protecting *inter*brand competition, which it stated was the core concern of the antitrust laws.[13]

In 1997, the Supreme Court reversed its nearly thirty-year-old *Albrecht* decision, declaring in *State Oil Co. v Khan*[14] that maximum resale price agreements were not illegal per se and should instead be judged under the Rule of Reason. In so doing, the court re-evaluated the key assumptions underlying the *Albrecht* rule of per se prohibition of maximum vertical price agreements.

[1] 15 U.S.C. § 1.
[2] *Continental T.V., Inc. v GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977).
[3] 433 U.S. at 50 (internal citations omitted).
[4] *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997).
[5] *Khan*, 522 U.S. at 10.
[6] 220 U.S. 373 (1911).
[7] 250 U.S. 300 (1919).
[8] 15 U.S.C. § 1.
[9] *United States v Arnold Schwinn & Co.*, 388 U.S. 365 (1967).
[10] 390 U.S. 145 (1968).
[11] 433 U.S. 36 (1977) (overruling *Schwinn*).
[12] 433 U.S. 36 (1977) at 49.
[13] 433 U.S. 36 (1977) at 52 & n.19.
[14] 522 U.S. 3 (1997).

First, "[t]he *Albrecht* decision was grounded in the fear that maximum price fixing by suppliers could interfere with dealer freedom."[15] However, the court found that after *Albrecht*, manufacturers had integrated distribution function into their business model, bypassing the very retailers *Albrecht* was intended to protect.[16]

Secondly, the "*Albrecht* Court also expressed the concern that maximum prices may be set too low for dealers to offer consumers essential or desired services."[17] However, "such conduct, by driving away customers, would seem likely to harm manufacturers as well as dealers and consumers, making it unlikely that a supplier would set such a price as a matter of business judgment."[18]

Thirdly, "*Albrecht* noted that vertical maximum price fixing could effectively channel distribution through large or specially advantaged dealers."[19] Yet by *Khan*, the court acknowledged the difficulty faced by a manufacturer in profiting by excluding potential retailers.[20]

Finally, "*Albrecht* reflected the court's fear that maximum price fixing could be used to disguise [*per se* illegal] arrangements to fix minimum prices."[21] The *Khan* court found the Rule of Reason sufficient to punish such unlawful arrangements without imposing the potential ills affiliated with per se treatment.[22] Moreover, the court noted commentators' concerns that "*Albrecht*'s *per se* rule has even more potential for deleterious effect on competition after … *GTE Sylvania*, because, now that vertical non-price restrictions are not unlawful per se, the likelihood of dealer monopoly power is increased."[23]

C. The Leegin Decision

In this historical context, the Supreme Court's 2007 *Leegin Creative Leather Products v PSKS, Inc.* decision represents both a landmark turning point and the culmination of a long-developing trend. In *Leegin*, a leather goods manufacturer refused to sell to retailers that resold the manufacturer's products below its suggested prices.[24] The manufacturer alleged that it had adopted this policy "to give its retailers sufficient margins to provide customers the service central to its distribution strategy" and to maintain the luxury brand image and reputation it sought to build for its goods.[25] When one retailer continued to sell at lower prices, the manufacturer terminated its supply relationship with the retailer. The retailer sued, alleging that it had been required to enter into vertical minimum resale price agreements that were illegal per se under *Dr. Miles*. A jury agreed, awarding treble damages to the retailer. The intermediate appellate court affirmed.

But the Supreme Court reversed. It held that minimum resale price agreements between manufacturers and their distributors would no longer be viewed as illegal per se and would instead be evaluated under the Rule of Reason.[26] The court formally overruled *Dr. Miles*, reasoning that the economic and competitive effects of resale price maintenance agreements simply did not justify per se prohibition. Citing "economics literature [that …] is replete with procompetitive justifications" for such agreements, the court found that:

> "[m]inimum resale price maintenance can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand."[27]

The court's decision also pointed to other economic benefits, such as the fact that eliminating price competition among retailers, and alleviating the threat of bare-bones discounters, leads retailers to "compete among themselves over services" that consumers value.[28]

Leegin did not come as much of a surprise to antitrust lawyers. One lower court decision described it as the latest in "the general trend in antitrust law away from per se condemnation."[29] And the *Leegin* court itself noted that in "more recent cases" it has "continued to temper, limit, or overrule once strict prohibitions on vertical restraints."[30] In any event, following *Leegin*, all s.1 challenges to vertical agreements between manufacturers and their retailers are tested under the Rule of Reason.

Leegin, on its face, seemed to offer a new opportunity for manufacturers to enter into resale price maintenance agreements with retailers. When, shortly afterward, the Supreme Court set tougher pleading standards for *all* federal cases (including antitrust), it became even more difficult to bring a claim based on a manufacturer's resale price practices.[31] And the court has done nothing to cast doubt on *Colgate*, meaning that a manufacturer can still suggest retail prices and refuse to deal with any retailer that does not go along, so long as retailers "independently decide" to adhere to the manufacturer's suggested prices.[32]

[15] *Khan*, 522 U.S. at 16.
[16] *Khan*, 522 U.S. at 16–17.
[17] *Khan*, 522 U.S. at 17.
[18] *Khan*, 522 U.S. at 17.
[19] *Khan*, 522 U.S. at 17.
[20] *Khan*, 522 U.S. at 17.
[21] *Khan*, 522 U.S. at 17.
[22] *Khan*, 522 U.S. at 17–18.
[23] *Khan*, 522 U.S. at 18.
[24] 551 U.S. 877.
[25] 551 U.S. at 883.
[26] 551 U.S. at 907.
[27] 551 U.S. at 889.
[28] 551 U.S. at 891.
[29] *BookLocker.com, Inc. v Amazon.com, Inc.*, 650 F. Supp. 2d 89, 100 (D. Me. 2009).
[30] *Leegin*, 551 U.S. at 901.
[31] See *Bell Atlantic Corp. v Twombly*, 550 U.S. 544 (2007); *Ashcroft v Iqbal*, 556 U.S. 662 (2009).
[32] See *United States v Parke, Davis & Co.*, 362 U.S. 29, 44 (1960).

But the line between permissible encouragement for retailers to adhere to a manufacturer's suggested pricing and a formal agreement between a manufacturer and a retailer has always been difficult to draw. The *Leegin* court did not say that minimum resale price maintenance is a good thing, or that it is always permissible, but rather simply that courts should look at the reasons behind such agreements and the likely competitive effects. The Supreme Court said little about how to determine which pricing agreements are permissible under the Rule of Reason and which are not, expressly inviting the lower federal courts to "establish a litigation structure" for determining which agreements serve legitimate business purposes and which serve simply to increase a manufacturer's market power.[33]

Both US antitrust enforcement agencies have offered some guidance on their preferred approaches. In May 2008, the Federal Trade Commission signaled a willingness to consider applying a "truncated" Rule of Reason analysis involving the use of various "substantive presumptions" in cases involving "inherently suspect" agreements.[34] Similarly, in October 2009, Christine Varney, then the head of the Antitrust Division of the Department of Justice, called for a "structured rule of reason analysis" that would require a plaintiff to make a "prima facie case" that a resale price maintenance agreement likely to harm competition exists, before shifting the burden to a defendant to demonstrate that the plaintiff's analysis is wrong or that the agreement will enhance competition.[35] But these entreaties are not binding on any court, and the Supreme Court has offered no further guidance since *Leegin*.

II. Reactions to Leegin

Perhaps unsurprisingly, since *Leegin* was decided, the resale price maintenance field has become more complicated rather than less so. In the few federal resale price maintenance cases that have followed, judges have followed the Supreme Court's direction and treated claims under the Rule of Reason. However, there have been rumblings of anti-*Leegin* sentiment at the Congressional level, while some states are in outright revolt against the *Leegin* doctrine.

A. Federal Reaction

Since 2007, federal courts have routinely applied the Rule of Reason standard to claims of unlawful vertical price agreements under federal law. In fact, in 2010, one federal appeals court rejected claims that a prominent mattress maker's resale price maintenance policies violated the Sherman Act for lack of evidence that competition had been harmed—even though the plaintiff, a consumer, had filed suit before *Leegin* declared that such evidence was required.[36]

On the political side, the US Congress has held hearings and, on at least two occasions, considered a form of "*Leegin* repealer" legislation. These efforts have so far failed. Perhaps more significantly, William J. Baer, whose nomination to serve as the next head of the Department of Justice's Antitrust Division is currently pending, stated at his July 2012 confirmation hearing that he would support legislation overturning *Leegin* and restoring the per se rule for minimum resale price maintenance agreements.[37] But for now, anyway, *Leegin* carries the day under federal law.

B. States' reactions

The reaction of several states to *Leegin* has been less accommodating. When *Leegin* was before the Supreme Court, more than 30 states joined in an *amicus* brief urging the court to retain the *Dr Miles* rule of per se illegality for all minimum resale price agreements. When that position did not carry the day in federal court, some states took matters into their own hands by invoking their own state antitrust and other laws. Anti-*Leegin* reactions in the states have included legislative enactments, judicial decisions setting tougher standards as a matter of state antitrust law, and even an attempt to rely on a more general state consumer protection statute, perhaps to avoid the appearance of conflict with federal antitrust law. The most prominent examples follow.

1. Maryland

In 2009, the Maryland legislature passed a "*Leegin* repealer" amendment to its antitrust statute, explicitly rejecting *Leegin* by making resale price maintenance agreements automatically illegal. In the state Attorney General's office, the Deputy Chief for antitrust

[33] *Leegin*, 551 U.S. at 898.
[34] See Order, *In re Nine West Group Inc.*, No. C-3937 (May 6, 2008), available at *http://www.ftc.gov/os/caselist/9810386/080506order.pdf* . [Accessed February 18, 2013].
[35] See Christine Varney, *Antitrust Federalism: Enhancing Federal/State Cooperation*, remarks delivered at Columbia Law School, October 7, 2009, available at *http://www.justice.gov/atr/public/speeches/250635.pdf* [Accessed February 18, 2013].
[36] See, e.g., *Jacobs v Tempur-Pedic International, Inc.*, 626 F.3d 1327, 1336 (11th Cir. 2010) ("After *Leegin* … courts must evaluate vertical resale price maintenance agreements using the rule of reason."); See also *Jacobs v Tempur-Pedic International, Inc.*, 626 F.3d 1348 (dissent from the court's opinion pointing out that *Leegin* was decided after the plaintiff's complaint was filed). Before *Jacobs*, in the spring of 2008, the state Attorneys General of New York, Illinois, and Michigan jointly brought a resale price maintenance suit in federal court that quickly settled. See Stipulated Final Judgment and Consent Decree, *Cuomo v Herman Miller, Inc.*, 08-cv-2977 (S.D.N.Y. March 25, 2008), available at *http://www.ag.ny.gov/sites/default/files/pdfs/bureaus/antitrust/Signed_FJ.pdf* [Accessed February 18, 2013]. Because the case settled so quickly, it does not offer any guidance as to applicable standards under either state or federal law.
[37] Information and a webcast of Mr. Baer's hearing is available at *http://www.judiciary.senate.gov/nominations/112thCongressExecutiveNominations/AssistantAttorneyGeneralAntitrust-WilliamBaer.cfm* [Accessed February 18, 2013].

enforcement has promised that prosecutions for "vertical price fixing … will likely increase under state antitrust laws."[38]

2. California

In February 2010, the California Attorney General obtained a consent judgment in a case it had brought against DermaQuest, Inc., a manufacturer of cosmetic products.[39] DermaQuest had signed agreements with its distributors that prohibited them from selling below the minimum prices set by the manufacturer. The consent judgment labeled these agreements per se violations of state antitrust law, instituted $120,000 in civil penalties and costs, and required the manufacturer to explicitly inform distributors that it was no longer prohibiting discounting.

In January 2011, the state obtained another consent judgment including a permanent injunction and the payment of civil penalties and costs totaling $51,000.[40] Bioelements, Inc., a maker of skin care products, and several dozen California retailers had signed agreements that stated: "Accounts shall not charge less than the Manufacturer's Suggested Resale Price ('MSRP')." As in *DermaQuest*, the judgment relied solely on state law.

3. New York

In January 2011, a state trial court dismissed a civil case brought by the Attorney General against Tempur-Pedic, a mattress manufacturer, based on Tempur-Pedic's unilateral policy of not doing business with discounters. Tempur-Pedic had announced to its retailers that it did not seek, and would not accept, any agreement on minimum prices with them, but that it would enforce its unilateral policy of refusing to deal with discounters. The New York court held that such unilateral conduct does not violate state law. Interestingly, New York chose to avoid a decision under its antitrust law, the Donnelly Act, instead bringing the action under a section of its General Business Law dealing with the enforceability of contracts. This choice may have been driven by a concern that a New York court would interpret the Donnelly Act in light of Sherman Act case law that clearly condones such unilateral policies. The trial court's dismissal of the complaint was affirmed on appeal.[41]

4. Kansas

The strongest state pushback against the US Supreme Court's *Leegin* decision is a May 2012 decision of the Kansas Supreme Court. Interestingly, the case involved some of the same pricing practices of the same defendant that, five years earlier, had successfully defended them in the US Supreme Court. This time, in *O'Brien v Leegin*,[42] the Kansas Supreme Court held that Leegin's resale price maintenance agreements were unlawful per se under the Kansas Restraint of Trade Act (KRTA), which the court found to be both "clear and dissimilar" from the Sherman Act.[43] This was the first (and so far only) time that a state court has flatly refused to follow the US Supreme Court's *Leegin* decision.

In *O'Brien*, a class of customers sued Leegin in state court, alleging that even if its resale price maintenance agreements did not violate federal law, they were illegal per se under the KRTA. The trial court, relying primary on federal antitrust precedents, applied the Rule of Reason, determined that Leegin's pricing practices did not violate the KRTA, and dismissed the case.

The Kansas Supreme Court reversed. While acknowledging that state courts often look to the substantial body of federal case law when interpreting identical state laws, the court found that the federal antitrust statutes "compel nothing" when a different state statute is at issue.[44] The Court then rejected the argument that the plaintiffs must introduce "concrete evidence" of antitrust injury, i.e. evidence that consumers actually paid higher prices for Leegin's goods.[45] Instead, the court held that the plaintiffs need show only that the agreements were designed to control prices for Leegin's goods and "tend[ed] to" do so.[46]

Rejecting the federal *Leegin* rule, the court ruled that *all* agreements on price are illegal under the KRTA, which prohibits "[a]ll arrangements, contracts, agreements, trusts or combinations between persons, designed or which tend to" fix prices.[47] Because none of the relevant Kansas statutory language "mentions reasonableness or a rule of reason," the Kansas court refused to read such a test into the Kansas statute.[48] As mentioned above, neither does the Sherman Act, even though the US Supreme Court has long read such a limitation into the very similar Sherman Act language.[49] But the Kansas court was "loathe to read unwritten elements into otherwise clear legislative language."[50] In fact, the court went so far as to overrule two of its earlier decisions that had used a "reasonableness

[38] See Alan M. Barr, Ass't Atty Gen., Antitrust Div., Office of the Atty Gen. of Md., *State Challenges to Vertical Price Fixing in the Post-Leegin World*, Fed. Trade Comm'n, Hearings on Resale Price Maintenance (May 21, 2009).
[39] See *California v Dermaquest, Inc.*, No. 10497526, 98 Antitrust & Trade Reg. Rep. (BNA) 316 (Cal. Super. Ct. Alameda Cty. February 23, 2010).
[40] See *California v Bioelements, Inc.*, No. 10011659, 100 Antitrust & Trade Reg. Rep. (BNA) 54 (Cal. Super. Ct. Riverside Cty. January 11, 2011).
[41] See *People v Tempur-Pedic Int'l*, 95 A.D.3d 539 (May 8, 2012).
[42] 277 P.3d 1062.
[43] 277 P.3d at 1079.
[44] 277 P.3d at 1079.
[45] 277 P.3d at 1075.
[46] 277 P.3d at 1075–76.
[47] 277 P.3d at 1074 (quoting the KRTA).
[48] 277 P.3d at 1079.
[49] See, e.g., *Bd. of Trade of Chicago v United States*, 246 U.S. 231 (1918).
[50] 277 P.3d at 1082.

rubric" in evaluating *non*-price restraints, holding that "[t]he clear statutory language … leaves no room for such an approach."[51] In other words, the Kansas Supreme Court eliminated the Rule of Reason under Kansas antitrust law even for non-price vertical restraints, a further departure from federal law.

Because Leegin had a system of "dual" distribution, selling directly to consumers in Kansas at one company-owned store (among 100 such stores nationwide) in addition to selling its products to retailers, the plaintiff had also accused it of horizontal price fixing. While it acknowledged that every federal appeals court to consider the question has treated dual distribution arrangements as "vertical" and analyzed them under the Rule of Reason, the Kansas Supreme Court declined to do so because the KRTA "forbid[s] all price-fixing … arrangements regardless of the applicable label."[52] So, the court held that the plaintiff had properly claimed the existence of both a vertical arrangement and a horizontal one as two independently viable theories of illegal conduct under the KRTA.

In a nod to federal law, the Kansas court held that federal precedents *do* control the question of what constitutes an "arrangement" to fix prices, because the KRTA and the Sherman Act supposedly share the same "between persons" language. Citing the US Supreme Court's *Monsanto*[53] decision, the Kansas court held that while a formal, explicit written agreement is not necessarily required to find a defendant liable, Kansas law requires "something more than merely a unilateral pricing policy."[54]

The upshot of all this is that, under Kansas law, minimum resale price maintenance agreements are illegal per se, as was the case under federal law before *Leegin*. (A state legislative effort to overturn the Kansas Supreme Court's decision failed in June 2012.)

III. Conclusions

The divergence between federal and state law, along with signs of sustained interest in overruling *Leegin* in Congress and among top antitrust enforcers, has made advising manufacturers on vertical pricing issues more complex. If a firm operates in multiple states, chances are good that it will come under the jurisdiction of at least one that treats resale price maintenance as illegal per se. And the dramatic holding of the Kansas Supreme Court may embolden the anti-*Leegin* movement and lead to additional state rulings that depart from the more defendant-friendly federal approach.

In the meantime, the landscape for private civil enforcement is not much clearer. A party wishing to challenge a manufacturer's resale price maintenance agreement under the federal Sherman Act must do so under the more difficult to prove Rule of Reason standard. In Maryland or Kansas, with clear anti-*Leegin* law in place, a potential plaintiff's task is easier. In the many other states with their own antitrust laws, the standard is less clear, although the opposition of more than 30 states to *Leegin* suggests that manufacturers' resale pricing agreements may face tough scrutiny in those states. Of course, *Colgate* is still valid, meaning that manufacturers are still on safer ground when they simply announce a unilateral policy of refusing to deal with retailers who sell below certain prices.

While no plaintiff challenging a resale price maintenance agreement has been successful under federal law since *Leegin* was decided, the same is not true in all states. California has twice prosecuted manufacturers for illegal resale price maintenance agreements under state law (both settled), while New York has tried but failed (without invoking the Donnelly Act). Maryland has enacted legislation and announced its intention to get tough, and the highest state court in Kansas has disagreed sharply with *Leegin*, holding that such agreements are automatically illegal under its state law. Additional successful private civil suits under the KRTA, or a similar statute in another state, may not be far away.

[51] 277 P.3d at 1083.
[52] 277 P.3d at 1084.
[53] *Monsanto Co. v Spray-Rite Service Corp.*, 465 U.S. 752 (1984).
[54] 277 P.3d at 1087.

UK calls for ban of parallel trade of prescription medicines—what are the EU competition law implications?

Francesco Liberatore*
Associate, Jones Day

Competition law; EU law; Parallel imports; Pharmaceuticals

Introduction

A recently published report by the UK Government's All-Party Pharmacy Group (APPG) says the United Kingdom has experienced shortages of prescription medicines over the last four years.[1] For APPG, these shortages were caused principally by the export of medicines intended for the UK market to other EU countries where the same medicines can be sold at higher prices than in the United Kingdom. The United Kingdom's Medicines and Healthcare products Regulatory Agency (MHRA) treats such shortages as very serious events because they endanger patient safety.[2] The APPG therefore called upon the United Kingdom's Department of Health to propose legislation to ban exports of prescription medicines from the United Kingdom on grounds of national public health protection. In the meantime, the APPG encouraged pharmaceuticals manufacturers and wholesalers to work more closely together to restrict such parallel trade through the introduction of quotas and other alternative supply mechanisms. However, such attempts to restrict parallel trade have attracted more than once the gimlet eye of the European Commission (commission) as potential violations of EU rules protecting free movement of goods and competition. Whilst free movement of goods rules do provide an exemption for certain goods if their free movement threatens national public health, this does not apply for competition rules. As it happens, a few weeks after the publication of the APPG report, the Commission launched a new probe under EU competition rules into pharmaceuticals' parallel trade restrictions.[3] We wait to see if this new probe will provide additional guidance on the legality under EU competition rules of drug makers' efforts to block parallel trade of their pharmaceutical products. In the meantime, this article provides an overview of the EU competition law principles applying to the most common types of restrictions on parallel trade of pharmaceuticals—namely: dual pricing; supply quota restrictions; direct to pharmacy (DTP) supply; and product life cycle management strategies—and it then considers the potential competition law implications for drug makers if the United Kingdom were to pass legislation banning parallel trade of medicines from the United Kingdom to other EU Member States.

Background

Parallel trade of prescription medicines or "skimming" consists of buying pharmaceutical products in one Member State and selling them in another at a higher price, thus making a profit from the price difference between the export country and the import country. The rewards are sometimes so attractive that individual pharmacies and wholesalers will seek to redistribute some of their stocks around Europe in order to take advantage of these price differentials.

In the United Kingdom, skimming is a legal practice, and anyone with a wholesale dealer licence (WDL) may obtain prescription medicines and, if they so choose, export them from the United Kingdom. The MHRA has issued around 1,700 WDLs to date.[4] As a result, after Germany, the United Kingdom has the second highest number of WDLs in Europe and there are more parties within the United Kingdom medicines supply chain with the ability to export medicines than almost any other Member State in the Euroepan Union.

The root of the problem lies in the way in which prices of pharmaceutical products are set in the European Union. Member States intervene to limit the prices payable for medicines within their territories. The aim of such intervention is to protect the budgets of the social health insurance funds and public health providers, which are the primary purchasers of pharmaceutical products. Member States adopt different approaches in their attempts to fix or influence the price of pharmaceutical products.[5] As a consequence, the price of pharmaceutical products in some Member States is typically much higher than in others. It is therefore the price differentials between Member States which create the opportunities

* fliberatore@jonesday.com

[1] APPG, *Report of the APPG Inquiry Into Medicines Shortages*, 2012 and related official press release: "Parliamentarians find that four years on medicines shortages continue unabated and are causing patient harm" (May 15, 2012), available at *http://www.appg.org.uk* [Accessed February 18, 2013].

[2] Marketing authorisation holders and distributors have an obligation to ensure appropriate and continued supplies to pharmacies or wholesalers so that patient needs are met (art.1(57) of Directive 2004/27/EC); failure to do so may constitute a criminal offence for marketing authorisation holders.

[3] Aoife White, "European Union opens probe of parallel drug trade", available at *http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2012/05/22/BU5T1OLPFC.DTL* [Accessed February 18, 2013].

[4] APPG, *Report of the APPG Inquiry Into Medicines Shortages*, 2012, ¶ 3.3.

[5] Some States are prepared to allow pharmaceutical products to sell at a higher price than others. This may be in recognition, explicit or implicit, of the need to allow pharmaceuticals originator companies a sufficient return to provide an incentive for the research and development (R&D) of new pharmaceutical products.

for skimming.[6] In a recent communication, published prior to the most recent enlargement of the European Union, the commission predicted that enlargement would further increase such differentials,[7] with a resulting increase of skimming.

The UK Perspective

In the United Kingdom, the APPG found that skimming has triggered shortages of various medicines with negative consequences on the availability of these medicines for those patients who need them to maintain their health and manage their condition.[8] Shortages caused by skimming can be traced back to successive cuts in the NHS price of branded medicines and to changes in the sterling/euro exchange rate circa 2008.[9] The exchange rate since that time has made UK prescription medicines cheaper than those in the Eurozone and as a result skimming of certain UK medicines has increased.[10]

A Clash of Interests

From an economic perspective, the interests of parallel traders and pharmaceuticals companies inevitably clash. On the one hand, skimming is a multi-billion euro business opportunity for those wholesalers and pharmacists who are engaged in it.[11] On the other, it is a threat to the returns, and the research and development (R&D) spending ability, of pharmaceutical companies: logically, for each unit sold at a price of 100 in the country of origin there is a corresponding unsold unit at a price of 100 + n in the country of destination.[12]

This clash of economic interests led traders to use EU competition law as a "sword" to attack attempts to restrict skimming and pharmaceutical companies to use the same set of rules as a "shield" to protect their business by devising competition law compliant strategies aimed at restricting skimming of their pharmaceutical products.

However, there is still some uncertainty around the perimeters of lawful and unlawful conduct restricting skimming of medicines. In fact, the Commission and the EU Courts have adopted sometimes diverging approaches on how to assess such restrictions under EU competition law.

The Commission's perspective

The Commission considers restrictions on parallel trade of pharmaceutical products to be amongst the most serious violations of EU competition law.[13] The Commission's approach is predicated by two principles[14]:

- First, the Single Market in pharmaceuticals requires the unhindered free movement of products—private companies cannot erect barriers to undermine this without distorting intra-brand competition; and
- Secondly, the efficiency claims advanced by the research based pharmaceutical industry are unsubstantiated—i.e. there is no evidence that partitioning the common market would spur on global investment in inter-brand innovation.

The Commission would, therefore, be very likely to investigate any attempts by pharmaceuticals manufacturers to ban skimming of medicines within the European Union. By contrast, the EU Courts have developed a more nuanced approach.

The EU Courts' perspective

The EU Courts have accepted that in certain circumstances restricting parallel trade of pharmaceutical products can be justified, having regard to the applicable legal framework and the specific features of the relevant markets.[15]

Legal framework

Two provisions of the Treaty on the Functioning of the European Union (TFEU) are relevant for the competitive assessment of restrictions on parallel trade of pharmaceutical products, namely:

- Article 101(1), which prohibits agreements and concerted practices that are restrictive of competition—unless their efficiencies outweigh their anti-competitive effects pursuant to art.101(3); and
- Article 102, which prohibits abuses of dominant position, unless objectively justified.

[6] *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) v Glaxosmithkline Plc* (C-53/03) [2005] E.C.R. I-4609; [2005] 5 C.M.L.R. 1, Opinion of Advocate General Jacobs, point 78.
[7] Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, "A Stronger European Pharmaceuticals Industry for the Benefit of the Patient—a Call for Action", COM (2003) 383 final, p.14.
[8] APPG, *Report of the APPG Inquiry Into Medicines Shortages*, 2012, paras 2.6 and 3.16.
[9] Prior to 2008 the UK saw strong parallel importing from various nations in Europe.
[10] APPG, *Report of the APPG Inquiry Into Medicines Shortages*, 2012, para.2.5.
[11] The turnover of parallel traders is approximately €3.5 billion–€5 billion in Europe, which is between 2% and 3% of the overall market. There are approximately 100 companies engaged in parallel trade in the EU employing in total between 10,000 and 15,000 people. With few exceptions, parallel traders fall within the definition of SMEs. Source: *DG Competition Staff Working Paper—Pharmaceutical Sector Inquiry Preliminary Report*, para.95.
[12] *GlaxoSmithKline Services Unlimited v Commission of the European Communities* (T-168/01) [2006] E.C.R. II-2969; [2006] 5 C.M.L.R. 29 at [258].
[13] Memo/08/567: Commission welcomes Court decision on parallel trade in the pharmaceutical sector.
[14] Nadia De Souza, Directorate-General for Competition, unit B-2, *Competition in Pharmaceuticals: the challenges ahead post AstraZeneca*, in Competition Policy Newsletter 1-2007, p.39.
[15] *Sot Lelos kai Sia EE v GlaxoSmithKline AEVE Farmakeftikon Proionton (formerly Glaxowellcome AEVE) ("Syfait II)* (C-486/06 & 478/06) [2008] E.C.R. I-7139; [2008] 5 C.M.L.R. 20 at [78]; and *GlaxoSmithKline Services Unlimited v Commission of the European Communities* (C-501, 513, 519/06 P) [2009] E.C.R. I-9291; [2010] 4 C.M.L.R. 2 at [103].

In applying these provisions to cases regarding restrictions on parallel trade, the Commission and the EU Courts have been guided by the so-called "single market imperative", which provides that a clause designed to prevent a buyer from reselling or exporting goods he has bought is liable to partition the markets within the European Union and consequently to violate EU competition law.[16] This principle has also been reaffirmed by the Court of Justice specifically in relation to restrictions on parallel trade of pharmaceuticals.[17] However, the court has also stated that the pharmaceutical markets are characterised by specific features that ought to be taken into account when applying EU competition law to restrictions on parallel trade of pharmaceutical products.[18]

Specific features of the pharmaceutical sector

Certain features of the pharmaceutical sector set it apart from all other industries engaged in the production of readily traded goods, including in particular the pervasive and diverse regulation to which pharmaceutical products are subject both at national and EU levels, including price and distribution regulations,[19] as well as the importance of innovation and very costly R&D in this sector.[20] As a result, competition in the pharmaceutical sector is not simply the interplay of supply and demand, as is the case in other industries.[21]

These specific features have important consequences for the definition of the relevant markets, both from a product and a geographic point of view.[22]

Relevant product market

The relevant product market definition of pharmaceutical products under EU competition law is based on the Anatomical Therapeutic Classification (ATC) system developed by the European Pharmaceutical Market Research Association (EPhMRA).

The ATC system classifies pharmaceutical products into groups, according to the organs or systems on which they act and their chemical, pharmacological and therapeutic properties, and divides them into five different levels. The third ATC level groups pharmaceutical products according to their therapeutic indications. The fourth ATC level normally takes into consideration the mode of action and the fifth level defines the narrowest classes, including active substances taken individually. The analysis generally starts from the third level of the ATC system. However, other ATC levels are also taken into consideration where it appears that sufficiently strong competitive constraints operate at other ATC levels and, consequently, the third ATC level does not seem to allow a correct market definition.[23]

This principle has been applied by the Commission in numerous merger decisions in the pharmaceutical sector to date. According to this consistent line of decisions, the interchangeability of pharmaceutical products depends in principle not on their physical, technical or chemical properties but on their functional substitutability as viewed by established medical practitioners. The prescription practices of medical practitioners are regularly influenced by the objective scientific knowledge available to them concerning the active properties and similarities of medicines. In the case of medicines available on prescription only, therefore, the market definition cannot be based simply on whether different medicines are prescribed for the same illness (i.e. in the same indication group). The criterion is that prescription is based on fundamentally the same medical grounds. For such prescription practice, account can be taken of whether the medicines correspond to each other, for example in terms of active principle, tolerance, toxicity, and side effects.[24]

However, parallel trade cases are concerned with competition in relation to the same pharmaceutical product (so-called intra-brand competition) that is being bought in one Member State and sold into another. They are not concerned with competition between different substitutable pharmaceutical products (so-called inter-brand competition). Therefore, the General Court found that it is not manifestly incorrect to accept that all the medicines which are capable of being subject to parallel trade in a given Member State constitute a relevant product market.[25]

Relevant geographic market

It is settled case law that the relevant geographic market is national, owing, in particular, to the existence in the Member States of different price and reimbursement regulations, different brand and packing strategies, different distribution systems and different prescribing habits.[26] However, the peculiarity of the distribution

[16] *BASF v Commission of the European Communities* (T-175/95 & T-176/95) [1999] E.C.R. II-1581, [2000] 4 C.M.L.R. 33; *Accinauto SA v Commission of the European Communities* (T-176/95) [1999] E.C.R. II-1635, [2000] 4 C.M.L.R. 67; and *Sandoz prodotti farmaceutici SpA v Commission of the European Communities* (C-277/89) [1990] E.C.R. I-45.
[17] *GSK* [2010] 4 C.M.L.R. 2 at [60].
[18] *GSK* [2010] 4 C.M.L.R. 2 at [103].
[19] *Syfait I* (C-53/03) [2005] 5 C.M.L.R. 1, Opinion of Advocate General Jacobs, para.77.
[20] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [264].
[21] *Syfait I* (C-53/03) [2005] 5 C.M.L.R. 1, Opinion of Advocate General Jacobs, paras 84–87.
[22] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [148].
[23] *AstraZeneca AB v European Commission* (T-321/05) [2010] E.C.R. II-2805; [2010] 5 C.M.L.R. 28 at [154].
[24] 97/469/EC: Commission Decision of July 17, 1996 in a proceeding pursuant to Council Regulation 4064/89 (Case No IV/M.737—Ciba-Geigy/Sandoz), para.21.
[25] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [159].
[26] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [150].

network of pharmaceutical products has sometimes led competition authorities to limit the relevant geographic market so as to coincide with the regional territory.[27]

Against this background, the most common types of restrictions of parallel trade and the way in which they have been assessed under EU competition law by the Commission and by the European Courts respectively are summarised below.

Dual Pricing

Dual pricing consists of an agreement between a pharmaceutical manufacturer and its wholesalers whereby different prices are applied depending on where the wholesalers ultimately sell the pharmaceutical products concerned:

- lower prices for domestic sales; and
- higher prices for exports into other Member States.

Dual pricing was the focus of the *GSK* case. In the *GSK* case, the Commission found that dual pricing clearly impeded parallel trade by obliging wholesalers to purchase the drugs at prices which were higher than the maximum industrial price for domestic sales and it was thus a violation of art.101(1).[28] GSK challenged the Commission's decision before the General Court. The General Court quashed the Commission's decision and found that dual pricing was not a restriction of competition by object—therefore an assessment of its effects would always be required for a finding of a violation of art.101(1).[29] The Commission appealed the General Court's judgment to the Court of Justice. In deciding the appeal, the Court of Justice disagreed with the General Court and re-instated the single market imperative, according to which an agreement aimed at limiting parallel trade is a restriction by object, without the need to assess its effects. However, the Court of Justice upheld the General Court's finding that dual pricing may in principle benefit from an exemption under art.101(3), if its efficiencies outweigh its anti-competitive effects.[30] Crucially, the Court of Justice held that such an examination requires the nature and specific features of the sector to be taken into account as those specific features are decisive for the outcome of the analysis.[31] In applying this test, the General Court found that parallel trade:

- entails a material[32] loss in efficiency[33];
- does not benefit consumers, because most, although not all, of the financial benefit accrues to the parallel trader rather than to the health care system or the patient[34]; and
- impacts negatively on technical progress[35] by reducing the capabilities for financing R&D.[36]

By eliminating the inefficiencies inherent to parallel trade, dual pricing contributes to the promotion of technical progress,[37] without eliminating competition for a substantial part of the relevant markets.[38]

It follows from this case law that dual pricing is a restriction of competition by object in violation of art.101(1), which may nevertheless benefit from an exemption under art.101(3), having regard to the specific features of the pharmaceutical sector.

Although the *GSK* case concerned only the application of art.101, the General Court provided some guidance also on the application of art.102 to dual pricing. First, the General Court recalled that art.102 does not preclude a company in a dominant position from setting different prices in the various Member States where they are applied on separate geographic markets, characterised by insufficiently homogeneous conditions of competition, regard being had in particular to the relevant regulatory framework.[39] It then went on to say that these considerations are particularly relevant to the pharmaceutical sector, insofar as the relevant geographic markets are national owing, in particular, to the differences in the national regulations on the prices and the reimbursement of the medicines in question.[40] According to the General Court, it follows that the finding of a dual pricing system based on different prices is not sufficient to support the conclusion that there is abusive discrimination in violation of art.102, even assuming a dominant position.[41]

[27] AGCM n. 14227 in C6974 *COMIFAR DISTRIBUZIONE/FARMACEUTICA BOLOGNESE*: wholesalers' distribution networks are sometimes organised at a regional level and their warehouses are located so as to enable them to make their deliveries to the pharmacies within the region or in the neighbouring regions.
[28] Commission Decision of May 8, 2001 relating to a proceeding pursuant to art.81 of the EC Treaty Cases: IV/36.957/F3 Glaxo Wellcome (notification), IV/36.997/F3 Aseprofar and Fedifar (complaint), IV/37.121/F3 Spain Pharma (complaint), IV/37.138/F3 BAI (complaint), IV/37.380/F3 EAEPC (complaint), in [2001] OJ L302/1 para.116.
[29] GSK (T-168/01) [2006] 5 C.M.L.R. 29 at [147].
[30] GSK (T-168/01) [2006] 5 C.M.L.R. 29 at [233].
[31] GSK (T-168/01) [2006] 5 C.M.L.R. 29 at [264]; and *GSK* [2010] 4 C.M.L.R. 2 at [103].
[32] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [292].
[33] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [258].
[34] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [135].
[35] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [269]–[280].
[36] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [258].
[37] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [259]–[308].
[38] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [313].
[39] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [177].
[40] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [178].
[41] *GSK* (T-168/01) [2006] 5 C.M.L.R. 29 at [179].

Supply quota system by a non-dominant company

Supply quota system consists of a supplier either ceasing to meet orders from wholesalers or, more usually, reducing the supply quota so as to provide the wholesalers with only enough products to cover domestic sales, e.g. there is no excess product with which to engage in parallel trade.[42] The analysis under EU competition law of such strategy depends on whether the supplier is in a dominant position or not. The situation in which the supplier who is not in a dominant position ceases to supply parallel traders was considered in the *Adalat* case.

In the *Adalat* case, the Commission found that such a strategy amounted to an agreement between Bayer and its wholesalers containing an export ban in violation of art.101 which could be deduced from the following factors:

- a system for detecting exporting wholesalers; and
- successive reductions in the amounts supplied where wholesalers exported all or some of the products concerned.[43]

Bayer appealed the Commission's decision. On appeal, both the General Court and the Court of Justice rejected the Commission's inference of an agreement. For the courts, it is necessary that the manifestation of the wish of one of the contracting parties to achieve an anti-competitive goal constitutes an invitation to the other party, whether express or implied, to fulfil that goal jointly and that applies all the more where, as in this case, such an agreement would not be at first sight in the interests of the other party, namely the wholesalers.[44]

It follows from this case law that, provided he does so without abusing a dominant position, and there is no concurrence of wills between him and his wholesalers, a manufacturer may adopt the supply policy which he considers necessary, even if, by the very nature of its aim, for example, to hinder parallel imports, the implementation of that policy may entail restrictions on competition and affect trade between Member States.[45]

Supply quota system by a dominant company

The situation in which the supplier who is in a dominant position ceases to supply parallel traders was considered in the *Syfait I* and *II* cases. These two cases stem from direct references to the Court of Justice for preliminary ruling.

The question referred to the court in both cases was whether there is an abuse of a dominant position contrary to art.102 if a pharmaceuticals company occupying such a position on the national market for certain medicinal products refuses to meet orders sent to it by wholesalers on account of the fact that those wholesalers are involved in parallel exports of those products to other Member States.[46]

In *Syfait I*, Advocate General Jacobs found that such a refusal is capable of objective justification, and thus of not constituting an abuse, given the complex nature and the actual development of the pharmaceutical sector.[47] However, the Court of Justice declined to decide on the merits on grounds of lack of jurisdiction.[48]

In *Syfait II*, the Court of Justice found it had jurisdiction and, this time, it had to examine the merits of the question referred to it. However, the court did not follow the Opinion given by Advocate General Jacobs in *Syfait I*. Instead, it found that[49]:

> "an undertaking occupying a dominant position on the relevant market for medicinal products which, in order to put a stop to parallel exports carried out by certain wholesalers from one Member State to other Member States, refuses to meet *ordinary* orders from those wholesalers, is abusing its dominant position. It is for the national court to ascertain whether the orders are ordinary in the light of both the size of those orders in relation to the requirements of the market in the first Member State and the previous business relations between that undertaking and the wholesalers concerned". (emphasis added)

The flip side of the court's ruling is that a dominant pharmaceutical company may legitimately refuse to supply orders that are out of the ordinary, having regard to:

- the size of those orders; and
- the previous business relations with the wholesalers concerned.

DTP

In place of the traditional supply chain model involving distribution via a range of wholesalers, DTP involves the manufacturer supplying the medicine direct to pharmacies via a chosen wholesaler and effectively allows the manufacturer a greater degree of control over the distribution of its medicines, and some cost savings as a result of working with one wholesale partner. Alongside pure DTP models, some manufacturers use Reduced Wholesaler systems, which involves the use of two or

[42] The situation only concerns orders from existing customers. There is no obligation under EU competition law to supply new customers.
[43] 96/478/EC: Commission Decision of January 10, 1996 relating to a proceeding pursuant to art.85 of the EC Treaty Case IV/34.279/F3 (Adalat), in [1996] OJ L201/1 para.156. *Commission of the European Communities v Bayer AG* (IV/34.279/F3) [1996] 5 C.M.L.R. 416.
[44] *Bundesverband der Arzneimittel-Importeure eV and Commission of the European Communities v Bayer AG* (C-2 & 3/01) [2004] E.C.R. I-23 at [2].
[45] *Adalat* at para.176.
[46] *Syfait II* (C-486/06 & 478/06) [2008] 5 C.M.L.R. 20 at [28].
[47] *Syfait I* (C-53/03) [2005] 5 C.M.L.R. 1, Opinion of Advocate General Jacobs, para.105.
[48] *Syfait I* (C-53/03) [2005] 5 C.M.L.R. 1 at [39].
[49] *Syfait II* (C-486/06 & 478/06) [2008] 5 C.M.L.R. 20 at [78].

three wholesalers, who then compete for the business and prices are reduced. In the United Kingdom, some 80 per cent of the branded medicine market by value is fulfilled by either DTP or reduced wholesaler mechanisms of supply.

The United Kingdom's Office of Fair Trading (OFT) looked at the legality of DTP in its Medicines Distribution market study.[50] In particular, the OFT considered the impact on the sector of Pfizer Ltd's exclusive DTP scheme using only one agent (UniChem), and the likely impact of other manufacturers introducing DTP schemes and/or reducing the number of distributors they use. The OFT's market study found that there was a significant risk that such exclusive DTP arrangements would result in long term competition concerns and consequently higher costs to the NHS potentially running into hundreds of millions of pounds. In addition, the OFT also found that such schemes could affect services to pharmacies and patients through, for example, longer waiting times to receive medicines.

Exclusivity is permitted under EU (and UK) competition law if the pharmaceuticals manufacturer and the distributor each has a share of the relevant market not exceeding 30 per cent and their agreement does not contain any of the following so-called hardcore restrictions[51]:

- Resale price maintenance, broadly consisting of the establishment of fixed or minimum prices—however, recommended and maximum resale prices are generally allowed[52];
- Restriction on unsolicited (passive) sales in a particular territory or group of customers by the distributor—however, the supplier is generally allowed to restrict solicited (active) sales by the distributor into an exclusive territory or to an exclusive customer group which has been reserved to another distributor or to the supplier themselves.[53]

Outside these safe harbours, if either the drug maker or its distributor holds a market share above 30 per cent, there will be no presumption that the DTP automatically infringes EU (or UK) competition rules. A full analysis of the agreement would be necessary to assess whether there is any appreciable restriction of competition. In particular, the OFT and the Commission would likely have regard to the following factors[54]:

- The market positions of the supplier and its competitors and the duration of the exclusivity—the stronger the position of the supplier and the longer the duration of the exclusivity, the greater the competition law risks;
- Entry barriers, which may make it more difficult for suppliers to appoint new distributors or find alternative agents—although entry barriers are generally less important in assessing the possible anti-competitive effects of DTP, as foreclosure at the supplier's level is not generally a problem unless combined with a non-compete provision;
- The foreclosure of other distributors or agents may become an issue where there is buying power and market power downstream (for example, where a powerful pharmacy chain becomes the only distributor of a blockbuster drug), or in cases of multiple exclusive dealership (i.e., when multiple suppliers appoint the same exclusive dealer);
- The risk of collusion on the buyer's side when exclusive distribution agreements are imposed on one or several suppliers by important buyers possibly located in different territories;
- The maturity of the relevant market—whereas the loss of intra-brand competition and price discrimination may be a serious problem in a mature market, it may be less relevant in a market with growing demand, changing technologies and changing market positions;
- The level of trade—the possible negative effects may differ between the wholesale and retail levels.

It follows that there is no "hard and fast" rule to assess the legality under competition law of DTP schemes and each scheme will need to be assessed on its own merits and facts.

Product Life Cycle Management Strategies

The Commission's Pharmaceutical Sector Inquiry Report identified a number of product life cycle management strategies that are at risk of violating EU competition law. The use of such strategies to limit parallel trade was assessed under EU competition law in the *AstraZeneca* case.

In the *AstraZeneca* case, the Commission found that AstraZeneca had abused its dominant position in relation to its blockbuster drug Losec by selectively deregistering the market authorisations for Losec capsules in three

[50] OFT 173/07, *Medicines distribution* (2007), available at *http://www.oft.gov.uk/news-and-updates/press/2007/173-07* [Accessed February 18, 2013].
[51] Commission Regulation 330/2010, [2010] OJ 2010 L102/1, arts 2, 3, and 4.
[52] Commission Regulation 330/2010, [2010] OJ L102/1, art.4(a).
[53] Commission Regulation 330/2010, [2010] OJ L102/1, art.4(b)(i).
[54] Commission Notice: Guidelines on Vertical Restraints [2010] OJ C130/01, para.192 et seq.

Member States; withdrawing Losec capsules from the market; and launching Losec tablets in those same Member States.

According to the Commission, those steps were capable of resulting in parallel importers losing their parallel import licences in the three Member States in question.[55]

AstraZeneca appealed the Commission's decision to the General Court. In its appeal, AstraZeneca contended that, in withdrawing its marketing authorisation, it exercised a fundamental EU right. This right had been recognised by the Court of Justice in *Rhône-Poulenc*[56] as well as by the commission itself in its written observations in *Rhône-Poulenc*. In particular, in those submissions, the commission said:

- the withdrawal of an authorisation is a fundamental EU legal principle;
- the applicant is master of the application procedures;
- after an authorisation is granted, the holder of the authorisation may equally demand that the authorisation should be withdrawn at any point in time without being obliged to give any reasons; and
- the concept of compulsory licensing is unknown in any EU pharmaceutical legislation.

In addition, in *Paranova*, the Court of Justice held that the withdrawal of marketing authorisations for reasons other than public health does not justify the automatic cessation of the parallel import licence.[57]

So how is it possible that the Commission found the exercise by AstraZeneca of a fundamental EU right was an abuse in violation of art.102?

On the Commission's case, the abuse comprised three ingredients:

- first, the launch of the Losec tablets on to the market;
- secondly, the withdrawal of Losec capsules from the market; and
- thirdly, the withdrawal of the marketing authorisation for the Losec capsule.

By contrast, the General Court found that there was nothing abusive in the launch of a new formulation of Losec and the withdrawal of Losec capsules. In its view, it was only the withdrawal of the marketing authorisation that amounted to an abuse.[58] The relevant test—for the General Court—is whether parallel import licences have traditionally relied on the existing marketing authorisations of a certain proprietary medicinal product. If they have, then the de-registration of the marketing authorisation for a particular product may be presumed to be capable of inducing the national medical product authority to withdraw the parallel imports licences for such a product.[59] This is the case even if the practice of the national medical product authority would be wrong in law, having regard to the legal principles set out by the Court of Justice in *Paranova*.

In applying this legal test to the facts of the *AstraZeneca* case, the General Court quashed the Commission's decision in relation to two of the Member States concerned, where the Commission had failed to establish to the requisite legal standard that deregistration of Losec capsules was capable of inducing the national medical product authority to withdraw import licences.[60] As regards the other country in question, the General Court found that it was not disputed that the medical product authority of that country considered (albeit wrongly) that parallel import licences could be granted only if valid marketing authorisations were in place. It is unambiguously clear from this—for the General Court—that the de-registration of the marketing authorisations for Losec was such to impede parallel imports in that country.[61]

In addition, the General Court found that:

- subjective intent did not need to be shown;
- actual effects on the market did not need to be shown;
- the fact that parallel importers did not lose their import licence and would have other means to enter the market did not matter; and
- the cost of maintaining the authorisation—in terms of pharmacovigilance obligations on the authorisation holder—may in theory be a valid justification, but was not supported in casu by the evidence on the Commission's file.

On appeal, the Court of Justice upheld the General Court's judgment.[62] In particular, it said that the *Paranova* judgment does not alter the fact that the withdrawal of the marketing authorisation was, at the time when the application for that withdrawal was lodged, capable of impeding parallel imports, given that the medical product authority considered (albeit wrongly) that parallel import licences could be granted only if valid marketing authorisations were in place.[63] Accordingly, AstraZeneca was under a positive obligation to ensure that its marketing authorisation was maintained so that it would

[55] Commission Decision of June 15, 2005 relating to proceedings under art.82 EC and art.54 EEA Agreement: Case COMP/A37.507/F3 (AstraZeneca), paras 788–793.
[56] *R. v Medicines Control Agency Ex p. Rhône-Poulenc Rorer Ltd* (C-94/98) [1999] E.C.R. I-8789; [2000] 1 C.M.L.R. 409, Opinion of Advocate General La Pergola, para.20.
[57] *Paranova Läkemedel AB v Läkemedelsverket* (C-15/01) [2003] E.C.R. I-4175; [2003] 2 C.M.L.R. 27 at [5]–[28] and [33].
[58] *AstraZeneca* (T-321/05) [2010] 5 C.M.L.R. 28 at [811].
[59] *AstraZeneca* (T-321/05) [2010] 5 C.M.L.R. 28 at [810].
[60] *AstraZeneca* (T-321/05) [2010] 5 C.M.L.R. 28 at [861].
[61] *AstraZeneca* (T-321/05) [2010] 5 C.M.L.R. 28 at [862].
[62] *AstraZeneca* (C-457/10 P).
[63] *AstraZeneca* (C-457/10 P) at [155].

be easier for parallel imports to continue, regardless of any subjective intent, unless objective justifications based for example on related *pharmacovigilance* obligations could be demonstrated.[64] The legal issues here go beyond the facts of this case, although the European Court of Justice's judgement does a better job than the lower court in trying to confine to the specific facts of the case the potential legal implications of this case for pharmaceuticals businesses. As a result of this ruling, many other product life cycle management strategies identified in the Pharmaceutical Sector Inquiry Report are at risk of falling foul of EU competition law, namely: marketing authorisation switches, launch of follow-on products, OTC or follow-on products switches, etc. This is despite the fact that such strategies would be legitimate under intellectual property and pharmaceutical law.

Potential implications of UK ban on parallel trade of prescription medicines

If the UK Government were to follow the APPG's recommendation to introduce legislation banning export of medicines from the United Kingdom to the other EU Member States, such parallel trade restrictions may be exempt from the EU rules protecting the free movement of goods within the European Union and the Single Market principle. However, they would still need to pass EU competition law muster in order to be lawful.

Under established EU case law, where companies engage in conduct contrary to EU competition rules and where that conduct is required or facilitated by national legislation which legitimises or reinforces the effects of the conduct, the OFT, the commission and national courts[65]:

- have a duty to disapply the national legislation;
- may not impose penalties in respect of past conduct on the companies concerned when the conduct was required by the national legislation;
- may impose penalties on the companies concerned in respect of conduct subsequent to the decision to disapply the national legislation, once the decision has become definitive in their regard; and
- may impose penalties on the companies concerned in respect of past conduct where the conduct was merely facilitated or promoted by the national legislation.

It will be for the OFT, the commission or the national courts to assess whether any national legislation under which export of medicines outside the United Kingdom is banned may be regarded as precluding drug makers from engaging in autonomous conduct which remains capable of violating EU competition law. In the meantime, pharmaceuticals companies will still need to comply with the above recalled EU competition law principles in order to be able to lawfully restrict parallel trade.

Conclusion

Despite the uncertainty created by the *AstraZeneca* judgment, what can be taken away from the jurisprudence of the EU Courts is that they are seeking to balance a broader range of concerns against the Commission's view that restrictions on parallel trade segregate the single market and so are per se anti-competitive.

Following the APPG's call to restrict parallel trade of medicines from the United Kingdom to other Member States, pharmaceutical companies have to tread carefully in order to make sure that they are legitimately protecting their commercial interests without crossing the line and engaging in anti-competitive conduct.

EU competition law is therefore likely to continue to be a determining factor in shaping the United Kingdom's future approach to parallel trade in this sector.

[64] *AstraZeneca* (C-457/10 P) at [135].
[65] *Consorzio Industrie Fiammiferi (CIF) v Autorità Garante della Concorrenza e del Mercato* (C-198/01) [2003] E.C.R. I-8055; [2003] 5 C.M.L.R. 16 at [1].

Does the Pfleiderer judgment make the fight against international cartels more difficult?

Piet Jan Slot*

Bilateral investment treaties; Cartels; Disclosure; EU law; Leniency programmes; Private enforcement; United States

1. Introduction

One of the questions raised by the *Pfleiderer* judgment[1] is whether it will weaken the effectiveness of leniency programmes and the multiple enforcement of the prohibition of cartels. As will appear from this paper, multiple enforcement is the result of an intricate network of relations consisting of a range of bilateral treaties on the application of competition law, national law provisions in the United States and the rules of the Commission in several notices and the ECN network rules. *Pfleiderer* risks to upset the balance between the objectives of leniency and pursuit of private damage claims in follow-on actions. Section 2 will provide a summary of the *Pfleiderer* case as well as subsequent judgments of national courts. Section 3 will analyse some issues that relate to the application of the ruling of the Court of Justice of the European Union (ECJ) when undertakings operate in a multi-jurisdictional context. Section 4 will look at the relevant US law, the relevant bilateral treaties and other provisions and case law. Section 5 will discuss briefly other bilateral treaties and the efforts in the OECD and the ICN. Section 6 will summarize the results and formulate further questions.

2. Pfleiderer[2] and its progenies

In the *Pfleiderer* judgment the ECJ had to weigh and balance the possibly diverging interests of ensuring the efficacy of leniency programmes established for the purpose of detecting, punishing and ultimately deterring the formation of illegal cartels pursuant to TFEU art.101, with the right of any individual to claim damages for harm suffered as a result of such cartels.

The lawyers of *Pfleiderer* were preparing to bring civil proceedings for damages against the members of a cartel of producers of décor paper. The producers had been fined with €62,000,000, by the Bundeskartelamt for price fixing. The proceedings against the cartel were based on TFEU art.101 and were the result of a leniency application by one of the parties to the cartel. Pfleiderer had purchased goods in excess of €60,000,000. Pfleiderer sought access to the file from the Bundeskartellambt. The latter sent the three decisions imposing the fines but denied access to the leniency material. Pfleiderer then brought an action against this decision before the Amtsgericht in Bonn Germany which is the competent court for appeals against decisions of the Bundeskartelambt. The national court felt that its decision could conflict with arts 11 and 12 of Regulation 1/2003 and EC art.10, second paragraph, in conjunction with EC art.3(1)(g). It therefore asked the following preliminary question:

> "Are the provisions of Community competition law — in particular Articles 11 and 12 of Regulation No 1/2003 and the second paragraph of Article 10 EC, in conjunction with Article 3(1)(g) EC — to be interpreted as meaning that parties adversely affected by a cartel may not, for the purpose of bringing civil-law claims, be given access to leniency applications or to information and documents voluntarily submitted in that connection by applicants for leniency which the national competition authority of a Member State has received, pursuant to a national leniency programme, within the framework of proceedings for the imposition of fines which are (also) intended to enforce Article 81 EC?"

The ECJ answered that:

> "the provisions of European Union law on cartels, and in particular Regulation No 1/2003, must be interpreted as not precluding a person who has been adversely affected by an infringement of European Union competition law and is seeking to obtain damages from being granted access to documents relating to a leniency procedure involving the perpetrator of that infringement. It is, however, for the courts and tribunals of the Member States, on the basis of their national law, to determine the conditions under which such access must be permitted or refused by weighing the interests protected by European Union law."

It should be noted that the way the question is phrased it may either be the National Competition Authority (NCA) or the National court that grants access. According to the ECJ:

> "That weighing exercise can be conducted by the national courts and tribunals only on a case-by-case basis, according to national law, and taking into account all the relevant factors in the case."

* Professor of law, University of Leiden, Netherlands. The article was written while the author was a Braudel fellow at European University Institute.
[1] *Pfleiderer AG v Bundeskartellambt* (C-360/09) [2011] 5 C.M.L.R. 7.
[2] This section is based on the summary in the opinion of Advocate General Mazak.

The answer of the ECJ makes it clear that it is for the National Court to weigh the interests involved. The answer does not provide a lot of guidance. It basically reiterates the two interests involved. As will be discussed below in s.4 the US Supreme Court has provided a checklist with elements to be taken into account when courts have to take a decision whether or not to order the release of confidential materials located abroad.

Subsequently, the *Amtsgericht* in Germany ruled that the interests of the protection of the leniency material was more important than the interests of private parties in the follow-on claims.[3]

In the meantime a very useful judgment was delivered in England. In *National Grid Electricity Transmission Plc v ABB Ltd* [2012] EWHC 869 (Ch) the English High Court ("the Court") (Roth J.) was required to consider the *Pfleiderer* judgment in the context of an application by the claimant for disclosure of certain documents in the possession of the defendants (all of whom were members of, or affiliated to members of, the Gas Insulated Switchgear cartel condemned by the Commission some six years ago). The judge considered that the application of the *Pfleiderer* judgment is not limited to leniency material provided in national procedures. The judge had no doubt that he did have jurisdiction to rule on the disclosure application. He recognised the difficulty of conducting the balancing test referred to in *Pfleiderer*. Furthermore, the court ruled that the defendant could not rely on the legitimate expectations that leniency material would not be disclosed. The court noted that claimants were not seeking access to full leniency statements but to extracts in the confidential version of the decision and replies to the Statement of Objections and requests for information. The court went on to state that:

> 34. "I accept the Commission's submission that one relevant factor is whether disclosure would increase the leniency applicants' exposure to liability compared to the liability of parties that did not co-operate. If only ABB had been sued (e.g., on the basis that it was not appealing the Decision so that there was no reason to delay a trial), that would be a powerful factor against disclosure of leniency materials, even allowing for the fact that ABB might then have been able to make a contribution claim against the other participants in the cartel. However, as the Commission appears to recognise (at para 17.2 of its observations), there is no prejudice of that kind to ABB or Areva in the present action. The other defendant groups are alleged to be equally liable with them. Nor does there appear any realistic prospect that NGET would apply to join any of the other leniency applicants who have not been sued so far as a result of the disclosure now sought."
>
> 37. "It is clearly relevant to consider the potential effect of a disclosure order in this case in deterring potential leniency applicants as regards other cartels as yet uncovered on the basis that subsequent disclosure may assist private claims against them. I accept that there may be some deterrent effect, and that is an important factor to put in the balance against disclosure. However, in assessing that factor I regard as relevant the gravity and duration of the infringement, and the consequent scale of the fines, imposed in this case. ABB, as a result of receiving immunity, avoided a fine calculated at over €215 million: Decision, recital 522. That reflects the fact that this was a 'very serious' cartel lasting almost 16 years (and a 50% increase because of ABB's involvement in a prior cartel): Decision, recitals 479, 510. Although any consideration of what would have been sufficient to deter ABB from informing the Commission of the cartel and thus obtaining immunity is inherently speculative, it is significant that a decision not to go to the Commission would not have given ABB any guarantee of protection from civil liability since if any of the other participants had informed the Commission the cartel would have been exposed. Then ABB would similarly have been liable to civil claims but in addition would have faced a very substantial fine. Of course, any disincentive to seek leniency because of potential disclosure in civil litigation might have dissuaded all the other participants from approaching the Commission, but this would have been a high-risk gamble for ABB to take. The same considerations would accordingly apply by analogy for an undertaking deciding whether to approach the Commission with information under its leniency programme as regards another very serious cartel."
>
> 39. "The Commission also submits that a relevant factor is whether the disclosure sought is proportionate, having regard to the potentially adverse effect of disclosure on leniency programmes. I agree, and indeed proportionality is in any event a consideration in applying the English rules on disclosure and inspection: CPR rule 31.3(2) and PD 31A, para 2. Here, because of the balancing exercise proportionality assumes particular significance in a different context from reference to the size

[3] ECN letter 1/2012.

of the claim and the amount of work involved. In my judgment, proportionality should be considered in terms of (a) whether the information is available from other sources, and (b) the relevance of the leniency materials to the issues in this case."

The court ruled that it was not enough that documents would be relevant. They had to be of such potential relevance that specific disclosure should be ordered. Moreover, it would be appropriate for it to inspect the documents and consider them individually before reaching a decision.

In the meantime the *Oberlandesgericht* of Vienna referred further questions to the ECJ in case C-536/11.[4]

1. Does EU law, in particular in the light of the judgment of the Court of Justice of June 14, 2011 in Case C-360/09 *Pfleiderer*, preclude a provision of national antitrust law which, (inter alia) in proceedings involving the application of TFEU art.101 or art.102 in conjunction with Regulation 1/2003/EC, makes the grant of access to documents before the cartel court to third persons who are not parties to the proceedings, so as to enable them to prepare actions for damages against cartel participants, subject, without exception, to the condition that all the parties to the proceedings must give their consent, and which does not allow the court to weigh on a case-by-case basis the interests protected by EU law with a view to determining the conditions under which access to the file is to be permitted or refused?

   If the answer to Question 1 is in the negative:

2. Does EU law preclude such a national provision where, although the latter applies in the same way to purely national antitrust proceedings and, moreover, does not contain any special rules in respect of documents made available by applicants for leniency, comparable national provisions applicable to other types of proceedings, in particular contentious and non-contentious civil and criminal proceedings, allow access to documents before the court even without the consent of the parties, provided that the third person who is not party to the proceedings adduces prima facie evidence to show that he has a legal interest in obtaining access to the file and that such access is not precluded in the case in question by the overriding interests of another person or overriding public interests?

It will be interesting to see whether the ECJ will elaborate on its position in *Pfleiderer*. In the next session some of the issues that arise in the case of access to confidential documents will be raised.

3. Issues raised by Pfleiderer

Background

Leniency applications often take place in a multilateral jurisdictional environment that is to say that there are often more parties in different jurisdictions involved. The decision whether or not to grant access may therefore have implications in other jurisdictions. In fact it is quite common that cartelists in international cartels will apply for leniency in several major jurisdictions. In the globalised economy cartels often operate in the United States as well as the European Union and other industrialised countries such as Canada, Japan, Australia and Korea. A typical example is the Vitamins cartels run by drug companies in Switzerland, Germany, France, the Netherlands and Japan, with important sales in the United States.[5] The cartel was prosecuted as a result of a leniency application in Brussels. In 1999 the same cartelists pleaded guilty to similar anti-competitive conduct in the United States and paid heavy fines, including US $500 million for Hoffmann La Roche, US $225 million for BASF and US $72 million for Takeda. The decisions were followed by damage claims in civil litigation.

Another landmark decision was in the *Gas Insulated Switchgear (GIS)* case.[6]

The Decision was addressed to 20 companies and found that they had been engaged in an extensive and sophisticated cartel in breach of what is now art.101 of the Treaty on the Functioning of the European Union (TFEU) regarding the supply of GIS. GIS is heavy electrical equipment used to control energy flow in electricity grids, and is therefore used as a major component for power substations. The decision found that the cartel lasted, with variation in the involvement of some of the participants, over a period of some 16 years from 1988 to 2004. The cartel involved the sharing of markets, the allocation of quotas and maintenance of market shares, the allocation of individual GIS projects to designated producers and the fixing of prices by means of complex price arrangements for projects which were not allocated. The decision imposed fines in the total amount of over €750 million, the largest set of fines imposed as at that date in respect of a single cartel.

The two applications before the court were made in a "follow-on" damages claim for breach of art.101. The claimant (NGET) owns and maintains the high-voltage

[4] [2012] OJ C13/5-6.
[5] IP/01/1625.
[6] Case Comp/F38.899—*Gas Insulated Switchgear* (GIS) January 24, 2007. The summary is provided in the first three paragraphs of the judgment of the English High Court.

electricity system in England and Wales and operates the system across Great Britain. It alleges that it suffered substantial losses by reason of overcharges resulting from the illegal cartel. The schedule to its Re-Amended Particulars of Claim lists over 40 projects which may have been affected with a total contract or out-turn value of over £383 million.

A very recent addition to this type of grand scale cartel action is the Commission's decision of December 12, 2012 to fine producers of TV and computer monitor tubes fining the participants a total of €1.47 billion.[7] The producers came from Germany, the Netherlands, Japan, and Taiwan. The commission was able to detect the cartel as a result of a leniency application by Chunghwa. The cartel was also active in the United States where last spring a verdict was reached against a Taiwanese company AU Optronics Corporation and two senior AUO executives.[8]

In January 2013, the Chinese Competition authority (National Development and Reform Commission NDRC) fined six international LCD screen producers, including Samsung, LG, Chimei, AUO, CPTT, and Hannstar for price fixing. It imposed a fine of RMB 144 million (approximately €15 million) on the companies involved).[9]

It can be expected that this will give rise to a flood of follow-on claims for damages.

Issues

Because decisions by the competition authorities have to contain sufficient reasons, they may well provide sufficient information for starting the so-called follow on claims. Given the nature of such decisions, establishing the infringement, they do not address the matter of civil damages.[10] Nevertheless, the practice of the Commission is to honour requests for confidential treatment of sensitive material. The Commission's practice is not always consistent. In the *Akzo* case the Commission intended to issue a second decision providing a fuller non-confidential version of its original decision. The Commission felt that it should publish this second version for reasons of transparency.[11] The President of the General Court suspended the operation of the Commission's decision.

In many cases additional information will be useful or even necessary to substantiate such damage claims. In the case of *Pfleiderer* and the vitamins case one could imagine the leniency statements to contain data about the price level aimed for and reached as a result of the cartel. Such information would clearly be useful for follow-on claims. Moreover, the fact that multiple applications for leniency have been submitted may lead follow-on claimants to try their luck in several jurisdictions.

The judgment of the ECJ creates the risk for applicants for leniency that data contained in their corporate statement will be divulged. The aftermath of the *Pfleiderer* case shows that this is now unlikely to happen in Germany. But it may happen in other Member States where courts may value access to documents higher than the protection of the interests of applicants for leniency. The vitamins case shows that countries with diverse access to documents policy may be involved.

Let us see what happens with leniency material in the context of the ECN and start with the position of the Commission because we may assume that most of the leniency applications will be lodged with it. The leniency material will be sought for use in bringing follow-on claims in national courts. The Commission's Leniency Notice recognizes that there is danger that:

> "Potential leniency applicants might be dissuaded from cooperating with the Commission under this Notice if this could impair their position in civil proceedings, as compared to companies who do not cooperate. Such undesirable effect would significantly harm the public interest in ensuring effective public enforcement of Article 81 EC in cartel cases and thus its subsequent or parallel effective private enforcement."

More specifically it states, in para.33, that:

> "Access to corporate statements is only granted to the addressees of a statement of objections, provided that they commit, — together with the legal counsels getting access on their behalf -, not to make any copy by mechanical or electronic means of any information in the corporate statement to which access is being granted and to ensure that the information to be obtained from the corporate statement will solely be used for the purposes mentioned below. Other parties such as complainants will not be granted access to corporate statements. The Commission considers that this specific protection of a corporate statement is not justified as from the moment when the applicant discloses to third parties the content thereof."[12]

The conclusion to be drawn from these statements is that the Commission will not give private parties engaging in follow-on claims access to the corporate statement. In addition the procedure for leniency application allows the applicants to provide the corporate statement orally.[13]

[7] IP/12/1317.
[8] Press release US Department of Justice, "*Taiwan based AU Optronics corporation sentenced to pay $500 million criminal fine for role in LCD rice-fixing conspiracy* (September 20, 2012) available at *http://www.justice.gov?opa/pr/2012/September/12-at-1140.html* [Accessed February 18, 2013].
[9] Clifford Chance Antitrust Alerter of January 4, 2013. According to this alerter: "NDRC also ordered the companies to return RMB 172 million in overpayments to Chinese colour TV manufacturers, and confiscated RMB 36.75 million as illegal gains—bringing the total penalties imposed in relation to the price fixing conduct to RMB 353 million." It is interesting to note that by ordering repayment of the overpayments the NDCR decision also addresses the issue off damages by customers.
[10] The decision of the Chinese competition authority, mentioned in fn.9, is an exception.
[11] *Akzo Nobel NV v European Commission* (T-345/12) [2013] 4 C.M.L.R. 12, judgment of November 16, 2012.
[12] Commission Notice on Immunity from fines and reduction of fines in cartel cases [2006] OJ C298/17–22.
[13] Commission Notice on Immunity from fines and reduction of fines in cartel cases [2006] OJ C298/17–22, para.32.

Such oral statements will be recorded and transcribed at the Commission's premises. Such a policy seems to be intended to provide a higher level of protection. Nevertheless it is not certain whether a national court ordering disclosure would not also grant access to recordings.

The Commission's position on access is corroborated by the position the Commission takes in its Notice on the rules for access to the files.[14]

What is the likelihood that leniency material is transferred by the Commission to NCA's? The Commission's position is stated in para.35 of the Notice:

> "Corporate statements made under the present Notice will only be transmitted to the competition authorities of the Member States pursuant to art.12 of Regulation 1/2003, provided that the conditions set out in the Network Notice are met and provided that the level of protection against disclosure awarded by the receiving competition authority is equivalent to the one conferred by the commission."

A similar rule is found in the ECN Model Leniency Model:

> "Statements (both oral and written) made under the present programme will only be exchanged between CAs pursuant to Article 12 of Regulation No 1/2003 if the conditions set out in the Network Notice are met and provided that the protection against disclosure granted by the receiving CA is equivalent to the one conferred by the transmitting CA."

Paragraph 40 of the Network notice provides:

> "Save as provided under paragraph 41, information voluntarily submitted by a leniency applicant will only be transmitted to another member of the network pursuant to Article 12 of the Council Regulation with the consent of the applicant."[15]

The Commission website contains the following statement:

> "The Commission considers that any statement submitted to it within the context of its leniency policy forms part of the Commission's file and may therefore not be disclosed or used for any other purpose than the Commission's own cartel proceedings."

As we shall see below bilateral treaties also provide that leniency material may only be transferred to other NCAs if a waiver has been granted.

Notwithstanding this clear requirement of a waiver some problems may occur. So far the position of the Commission is clear, however, it may change as a result of a judgment of Community Courts. In view of the position of the ECJ in *Pfleiderer* it is not excluded that a private party may successfully gain access to corporate statements provided to the Commission by cartelists under the leniency application. It should be noted that the High Court in the United Kingdom has ordered partial disclosure in the *National Grid Electricity Transmission* case. It would seem that if the Commission has to grant access to private parties it can no longer refuse to transfer leniency material to a national court because that court is also under an obligation to grant access to private parties.

The issues raised by the *Pfleiderer* judgment have been discussed in the ECN as a result of which the Meeting of Heads of the European Competition Authorities adopted the following resolution on the May 23, 2012:

> "CAs take the joint position that leniency materials should be protected against disclosure to the extent necessary to ensure effectiveness of leniency programmes."

It should be noted that under the ECN model leniency programme the transmission of leniency material to other NCA's is only allowed if the protection granted by the receiving NCA is equivalent to the protection provided by the transferring NCA.[16] The disclosure of certain documents may be possible if undertaking grant a waiver for such a transfer. Undertakings may be willing to do so if they would be granted leniency in other jurisdictions. However, that would require a high level of co-operation between the NCAs and the Commission as well as a high degree of harmonisation of the respective leniency programmes. A way of solving the problem would be to encourage undertakings to grant waivers allowing rules.

I note that the protection provided by the ECN rules could be undermined when at the moment of the request by an NCA the protection afforded to corporate statements under the leniency program would not be considered equivalent but subsequently national courts will order access to the material.

The Commission's clear position seems to be difficult to square with its dealings in the *Akzo* case.[17] As noted above it intends to adopt a second decision providing more information about the facts of the case. In the words of the order of the President of the General Court (GC):

> "the decision to publish a fuller version of the 2006 decision and thereby to disclose information deriving from the applicants' leniency application is contrary to the protection conferred by the leniency notice."[18]

As there is not yet a decision on the merits, it is, at present, difficult to evaluate the Commission's action in the *Akzo* case. As the President of the GC observed this

[14] Commission Notice on the rules for access to the Commission file in cases pursuant to arts 81 and 82 of the EC Treaty, arts 53, 54 and 57 of the EEA Agreement and Council Regulation 139/2004([2005] OJ C325/7.
[15] Commission Notice on cooperation within the Network of Competition Authorities [2004] OJ C101/43..
[16] Paragraph 30 of the ECN model leniency programme (as revised in November 2012).
[17] *Akzo* [2013] 4 C.M.L.R. 12.
[18] Paragraph 37 of the Order.

case raises complex issues which deserve to be thoroughly examined in the subsequent General Court judgment.[19] At first sight the proposed action of the Commission does not seem to be in line with its position advanced in the *Pfleiderer* judgment. The judgment of the National Grid judgment observing that the *Pfleiderer* rule also applies to the Commission would seem to require it to carefully assess its position.

4. The position in relation to the United States

The relevant US rules are highly important in matters of international cartel enforcement and co-operation. Many major cartels operate on its market and its specific laws and case law provide opportunities for foreign companies. The relation between the European Union and the United States can be characterized as quite developed. There are four different categories of rules that are relevant:

a) Rules in its bilateral agreements, e.g. two between the United States and the European Union.[20] There is a special IAEAA agreement with Australia and a set of best practices on co-operation in merger investigations.[21]
b) Rules in Mutual Legal Assistance Treaties (MLATS).
c) The discovery powers in particular in case of Grand Jury investigations which allow for discovery of materials located outside the United States.
d) The Intel case law which allows discovery in the United States of materials produced by US litigants in the US courts.

It should be noted that there is active co-operation between the authorities in the United States and the European Union as demonstrated in the report on the application of the agreements.[22] Furthermore, there is case law that may have a bearing on the issue.

a) **Bilateral treaties**

The main clause in the agreement relating to the exchange of information reads as follows:

Article V

Confidentiality and Use of Information

"Where pursuant to this Agreement the competition authorities of one Party provide information to the competition authorities of the other Party for the purpose of implementing this Agreement, that information shall be used by the latter competition authorities only for that purpose. However, the competition authorities that provided the information may consent to another use, on condition that where confidential information has been provided pursuant to Article IV.2 (c) (iii)[23] on the basis of the consent of the source concerned, that source also agrees to the other use .[24] Disclosure of such information shall be governed by the provisions of Article VIII of the 1991 Agreement and the exchange of interpretative letters dated May 31 and July 31, 1995."

As appears from these provisions exchange of leniency information may only take place on the basis of a waiver.

In 1994 the US Congress passed the International Antitrust Enforcement Assistance Act (IAEAA).[25] The Act was designed to address the statutory limitations on the ability of the US antitrust authorities to obtain confidential information. Under the Act bilateral treaties can be concluded that allow for more extensive co-operation provided that the counterpart has legislation that allows entry into agreements under which information may be exchanged in antitrust matters. Furthermore, such countries must have a strong regime of confidentiality laws that will protect non-public information obtained from US companies. The only agreement concluded under this act is with Australia.[26] It would at the present stage of the development of

[19] Paragraph 56 of the Order.
[20] Agreement between the Government of the United States of America and the Commission of the European Communities regarding the application of their competition laws. [1995] OJ L95/47 Approved by the decision of the Council and the Commission of April 10, 1995. Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws [1998] OJ L173.
[21] *http://ec.europa.eu/competition/mergers/legislation/best_practices_2011_en.pdf* [Accessed February 18, 2013].
[22] *Report from the Commission to the Council and the European Parliament on the application of the agreements between the European Communities and the Government of the United States of America and the Government of Canada regarding the application of their competition laws* January 1, 2002 to December 31, 2002 COM/2003/0500 final.
[23] "Inform the competition authorities of the Requesting Party, on request or at reasonable intervals, of the status of their enforcement activities and intentions, and where appropriate provide to the competition authorities of the Requesting Party relevant confidential information if consent has been obtained from the source concerned. The use and disclosure of such information shall be governed by Article V".
[24] Emphasis supplied.
[25] See Annex I-C "U.S.Experience with international antitrust enforcement cooperation." Website DOJ. M. Chowdhurry: "From Paper Promises to Concrete Commitments: Dismantling The Obstacles to Transatlantic Cooperation in Cartel Enforcement." AAI Working Paper No. 11-09.
[26] *http://www.justice.gov/atr/public/international/docs/usaus7.htm* [Accessed February 18, 2013].

EU law seem difficult for the European Union to assume obligations as specified in this treaty. Commissioner, as he then was, Monti's observations at the June 23, 2000 conference seem therefore to have been made without a thorough analysis of the obligations involved.[27]

The agreements concluded under the IAEAA have provisions on the protection of confidential and privileged information commensurate with US law.

b) **The MLATS**

The United States has a whole network of bilateral mutual legal assistance treaties. Such treaties allow for close co-operation in criminal matters.[28] They may also be used for the purpose of co-operation in the field of antitrust law provided that the antitrust laws of the partner country are also qualifying infringements of competition law as a criminal matter. For practical purposes this excludes co-operation with the European Union on the basis of such treaties. It would, however, allow co-operation with the United Kingdom after the recent changeover of the nature of their national law.

c) **The discovery powers**[29]

One of the elements that play an important role in the discussion about the protection of leniency materials are the US rules about discovery in civil litigation. The US Federal Rules of Civil Procedure allow under certain conditions US courts seized in civil actions to order the production documents located abroad. The orders may be directed at parties or at the Commission. Normally the orders will be directed at the parties. Such orders could also include the production of leniency materials. It is therefore no surprise that the Commission has always advocated against such discovery orders. It has intervened several times in US court proceedings by submitting amicus curiae briefs. It has had some success as several US District courts have denied the requests for access on grounds of international comity.[30] The effect of discovery orders can be more dramatic when the material thus introduced in private litigation may subsequently be required by the Department of Justice under subpoenas. The District Court of Northern California granted such a request. The 9th Circuit upheld the judgment of the District Court and US Supreme Court denied a petition for certiorari.[31]

There is reason to belief that the impact of the US discovery rules on the EU leniency programme may not be as drastic as it is often made out to be. In a 2007 judgment the US Supreme Court in the *Bell Atlantic Corp v Twombly*[32] held that plaintiffs have to meet the pleading standard in order to be able to bring a case in the first place. According to this standard "fishing expeditions" will not be allowed. According to Supreme Court there must be allegations plausibly suggesting that there was an agreement restricting competition. The court noted that there may be important expenses and hence pressure exerted on defendants to settle cases in an early on stage. Nevertheless, the pleading standard rule will not entirely eliminate the risks of discovery orders. There will always be cases where this standard can be met. It is difficult to imagine that Commission decisions fining cartelists would not be sufficient to meet the standard.

d) **The Intel case law**

Under the case law of the Supreme Court as expounded in the *Intel* judgment[33] materials produced in US civil court proceedings may be obtained by litigants

[27] Chowdhurry: "From Paper Promises to Concrete Commitments: Dismantling The Obstacles to Transatlantic Cooperation in Cartel Enforcement." AAI Working Paper No. 11-09, p.5. *Report from the Commission to the Council and the European Parliament on the application of the agreements between the European Communities and the Government of the United States of America and the Government of Canada regarding the application of their competition laws* January 1, 2002 to December 31, 2002 COM/2003/0500 final.

[28] See *US experience with International Antitrust Enforcement Cooperation*, Annex I-C*http://www.justice.gov/atr/icpac/finalreport.html* [Accessed February 18, 2013]; Chowdhurry: "From Paper Promises to Concrete Commitments: Dismantling The Obstacles to Transatlantic Cooperation in Cartel Enforcement." AAI Working Paper No. 11-09, p.8.

[29] The following paragraph is based on the very useful overview of this topic by Alex Petrasincu: "Discovery revisited—the impact of the US discovery rules on the European Commission's leniency programme" [2011] E.C.L.R. 356. See also Ingrid VandenBorre: "The confidentiality of EU Commission cartelrecords in civil litigation: the ball is in the EU Court" [2011] E.C.L.R. 116.

[30] Chowdhurry: "From Paper Promises to Concrete Commitments: Dismantling The Obstacles to Transatlantic Cooperation in Cartel Enforcement." AAI Working Paper No. 11-09, p.17, fn.91. She also refers to US Supreme Court test laid out in *Societé Nationale Industrielle Aérospatiale v United States District Court for the Southern District of Iowa*, 482 U.S. 522, 536–544 (1987), in the comity analysis of a discovery request, the court must consider a number of factors: (1) how important is the requested information to the litigation; (2) how specific is the request; (3) did the information originate in the United States; (4) are there alternative means of securing the information; (5) how much would refusing the request undermine important United States interests, and how much would complying with the request undermine important foreign sovereign interests.

[31] Chowdhurry: "From Paper Promises to Concrete Commitments: Dismantling The Obstacles to Transatlantic Cooperation in Cartel Enforcement." AAI Working Paper No. 11-09, p.17.

[32] 550 U.S. 544 (2007).

[33] (542 U.S. 241 *Intel v Advanced Micro Devices*). The summary is copied from the judgment.

> for use in procedures outside the United States. Respondent Advanced Micro Devices, Inc. (AMD), filed an antitrust complaint against petitioner Intel Corporation (Intel) with the EU Commission, alleging that Intel had violated European competition law. After the Commission declined AMD's recommendation to seek documents Intel had produced in a private antitrust suit in an Alabama federal court, AMD petitioned the District Court for the Northern District of California under §1782(a) for an order directing Intel to produce those documents. The District Court concluded that §1782(a) did not authorize such discovery. The Ninth Circuit reversed and remanded with instructions to rule on the application's merits. The Appeal Court observed that §1782(a) includes matters before bodies of a quasi-judicial or administrative nature, and, since 1964, has contained no limitation to foreign proceedings that are "pending." A proceeding judicial in character, the Ninth Circuit noted, was a likely sequel to the Commission investigation. The Court of Appeals rejected Intel's argument that §1782(a) called for a threshold showing that the documents AMD sought, if located in the European Union, would have been discoverable in the Commission investigation. Nothing in §1782(a)'s language or legislative history, the Ninth Circuit said, required a "foreign-discoverability" rule of that order.

The Supreme Court held that s.1782(a) authorises, but does not require, the District Court to provide discovery aid to AMD. Pp. 254–266. Contrary to the opinion expressed by the Commission in its brief before the Supreme Court, the court held that the Commission was to be considered a judicial body for the purposes of the application of s.1782(a). The important point for our subject is that if for some reason parties have brought sensitive materials such as leniency materials in US procedures they may be brought back into proceedings before courts in the EUropean Union. That raises the question whether in such a situation the Commission may lift the specific protection afforded to leniency statements. It should be recalled that according para.33 of the leniency notice:

> "The Commission considers that this specific protection of a corporate statement is not justified as from the moment when the applicant discloses to third parties the content thereof."

It would seem to me that this is not the case.

It is important to note that according to the Intel case law all materials produced in US court procedures may be covered thus such orders may include materials originating in jurisdictions outside the United States.

As has been observed above as a result of the Intel judgment the Commission is willing to take oral evidence in leniency procedures when parties face the risk of Intel like discoveries.[34]

5. Other Bilateral Treaties

Bilateral treaties on competition law normally have provisions on the exchange of confidential information. An example is the Agreement between the European Communities and the Government of Canada regarding the application of their competition laws.

Article VII of this agreement provides as follows: Exchange of Information

> "1. In furtherance of the principles set forth in this Agreement, the Parties agree that it is in their common interest to share information which will facilitate the effective application of their respective competition laws and promote better understanding of each others enforcement policies and activities.
>
> 2. Each Party agrees to provide to the other Party on request such information within its possession as the requesting Party may describe that is relevant to an enforcement activity that is being contemplated or conducted by the requesting Party's competition authority.
>
> 3. In the case of concurrent action by the competition authorities of both Parties with a view to the application of their competition law, the competition authority of each Party shall, on request by the competition authority of the other Party, ascertain whether the natural or legal persons concerned will consent to the sharing of confidential information related thereto between the Parties' competition authorities.
>
> 4. During consultations pursuant to Article III, each Party shall provide the other with as much information as it is able in order to facilitate the broadest possible discussion regarding the relevant aspects of a particular transaction."

It may be noted that according to this agreement exchange of information is only possible with the consent of the natural or legal persons concerned i.e. a waiver.

[34] Paragraph 32 of the leniency notice.

The ECN has drafted a model leniency programme.[35] Paragraph 30 of the model provides that statements may only be exchanged between CAs pursuant to art.12 of regulation 1/2003 if the conditions set out in the Network Notice are met and provided that the protection against disclosure is equivalent to the one conferred by the transmitting CA.

The OECD has produced some useful documents, such as the "Best practices for the formal exchange of information between Competition Authorities in hard core cartel investigations."[36] The report notes that most member states do not exchange information obtained from an amnesty applicant without the applicant's prior permission.

Similar observations are made in the International Competition Network paper of May 2007.

6. Conclusions

The *Pfleiderer* judgment has raised important questions about access to confidential material including leniency material. The effects of the judgment may be even more worrying when the international context briefly outlined in this paper is taken into account. There are some positive developments within the Community legal order, in particular the *National Grid* judgment shows that national courts may be able to handle the ambiguous message of the ECJ. Furthermore, a new reference from the Austrian court may provide the ECJ with an opportunity to provide better guidance. On the other hand the Commission's handling of the *Akzo* case seems to send unclear signals. This may be clarified when the Commission has published a communication on this matter. Guidance from the EU courts will not be forthcoming in the near future because it may take quite some time before they will have reviewed the Commission's action.

There seems to be a risk that providing access to leniency material in an EU Member State will have an effect on the normal rule contained in bilateral treaties, i.e. that no exchange of confidential information will take place without a waiver. Once a national court of an EU Member State or the EU GC has ordered that access to such materials should be granted such material could be seen as being in the public domain. If that view is accepted there seems to be no reason to refuse access under bilateral treaties.

Another question is the effect of disclosure on the US discovery procedures. It is not excluded that disclosure ordered by a court in an EU Member State may affect the willingness of US courts to accept the Foreign sovereign immunity privilege or similar privileges raised by the Commission or NCAs. Similarly US courts may be less inclined to accept privileges that private party defendants could raise. It is very difficult to evaluate these risks in the abstract. As the case law, e.g. in the *Vitamins* case[37] shows it may be easier to assess such risks in concrete cases.

It is even less clear what effect court orders granting access would have on the applicability of the Intel case law. It is conceivable that in a concrete case the party having obtained the order could introduce the material in a US private claim action. This in turn could lead another party which was excluded from the benefit of the order by the court in a member state to seek discovery under the Intel jurisprudence.

A review of bilateral treaties shows that granting a waiver can facilitate international co-operation. An applicant for leniency will grant a waiver if that is beneficial for it. The benefit would be that one application would give the applicant immunity in all jurisdictions involved. The present state of international co-operation, ECN, ICN or bilateral treaties (the US-Australia agreement may be the exception) does not seem to be mature enough to allow such advanced co-operation and nor does it provide an impetus for such harmonisation.

Finally, it may be useful to have a closer look at the balancing tests discussed above. The best news comes from the United Kingdom where the High Court judge after noting that the balancing test is a difficult exercise nevertheless came up with, in my view, very useful elements to be taken into account.

- That the claimant was not seeking access to full leniency statements but rather to extracts from those statements incorporated into the confidential version of the decision and replies to the SO and requests for information/explanations.
- That disclosure would not increase the immunity/leniency applicants' exposure to liability compared with liability of parties that did not co-operate.
- That, although there may be "some deterrent effect" on potential leniency applicants as regards other cartels as yet uncovered on the basis that subsequent disclosure applications may be made against them, that had to be set against the gravity and duration of the infringement and consequent scale of the penalties imposed here: if any party were to decide not to seek immunity on the basis of the risk of a later disclosure order being made, that would be a big risk to take in light of the chance of another party seeking immunity in its place, thereby exposing the first undertaking to a large fine and full civil liability in any case.

[35] The most recent version was published in November 2012.
[36] OECD Competition Committee, October 2005.
[37] 2002 US Dist. Lexis 26490 January 23, 2002.

- That proportionality pointed in favour of disclosure (subject to what is said below), based on the facts that (i) the information sought was not available from other sources, such as "pre-existing" documents, which by their nature are limited in number and whose meaning is often opaque, and (ii) the leniency materials were (again, subject to what is said below) likely to be relevant.[38]

In US jurisprudence a similar test has been developed. This test has the purpose to decide whether or not a request for production of documents located outside the United States should be granted. The Supreme Court has laid out a test in *Societé Nationale Industrielle Aérospatiale v United States District Court for the Southern District of Iowa*.[39] Applying the comity analysis of a discovery request, the court must consider a number of factors:

(1) how important is the requested information to the litigation;
(2) how specific is the request;
(3) did the information originate in the United States;
(4) are there alternative means of securing the information; and
(5) how much would refusing the request undermine important US interests, and how much would complying with the request undermine important foreign sovereign interests.

It would seem that the balancing test in the *National Grid* case and the elements propounded by the US Supreme Court in the *Société Nationale* provide useful elements for a further development of the criteria to be applied in future cases where discovery is sought of leniency materials. All elements enumerated in the *National Grid* judgment are useful to this could be added the first, second, and fourth elements of US case law. Furthermore, as was argued above, the effects of granting an order on bilateral treaties and the effects this may have on the discovery of materials by a US court as well as the possible implications for the applicability of the *Intel* jurisprudence should be taken into account.

[38] As summarised by Christopher Brown in the website: *http://eutopialaw.com/2012/05/15/national-grid-shining-pfleiderers-light-on-access-to-eu-leniency-documents/* [Accessed February 18, 2013].
[39] 482 U.S. 522 (1987), at pp.536–544.

The European Commission's Decision-making on State Aid for Financial Institutions—Good Regulation in the Absence of Good Governance?

Mara Hellstern

Christian Koenig*

Debt restructuring; Divestiture; Economic conditions; EU law; Financial institutions; State aid

Introduction

Since the beginning of the financial and, later, the sovereign debt crisis, EU Member States have granted numerous aids for the rescue and restructuring of financial institutions. Like any other State aid, rescue and restructuring aids for financial institutions need to comply with the EU State aid regime. Article 107 (1) TFEU provides a general prohibition of State aid. However, under exceptional circumstances, State aid is (TFEU art.107(2)) or may be permitted if it is considered compatible with the internal market (TFEU art.107(3) or art.106(2)) subject to the Commission's approval sanctioned by a pre-approval implementation ban (stand still) under TFEU art.108(3). While general rescue and restructuring aid has been traditionally approved under TFEU art.107(3)(c) and the Community Guidelines on State aid for rescuing and restructuring firms in difficulty[1] (the "Rescue and Restructuring Guidelines"), the financial and sovereign debt crisis has triggered off the application of TFEU art.107(3)(b), i.e. compatible aid to remedy a serious disturbance in the economy of a Member State. However, the Commission's exclusive authority to permit State aid under TFEU art.108(3) according to these exceptions has been preserved.[2] State aid measures in favour of financial institutions during the financial and sovereign debt crisis with which the Commission has been confronted comprise, inter alia, State guarantees as well as granting of credit, the purchase of voting or non-voting shares of ailing banks for the purpose of recapitalisation[3] or hybrid capital and the acquisition of risk positions, especially impaired assets, and the installation of bad banks.[4] Faced with such different instruments of State aid for the rescue and restructuring of financial institutions during the crisis, the Commission has developed a distinct set of crisis rules since 2008. This article examines how the Commission applies the EU State aid rules, in particular TFEU art.107(3)(b), to State aids for financial institutions during the crisis, thereby shaping the post-crisis architecture of the financial sector.

Legal framework of the EU State aid control in the financial sector

Before adopting a series of specific communications to remedy the consequences of the crisis between October 2008 and July 2009, the Commission applied the same rules, the Rescue and Restructuring Guidelines, to aids for firms of all sectors other than the coal and steel sectors.[5] However, in the aftermath of the collapse of Lehman Brothers in September 2008, the Commission qualified the crisis as a serious disturbance in the economy of the Member States within the meaning of TFEU art.107(3)(b), thereby acknowledging that State aid for financial institutions suffering from the crisis is not primarily a mean to help the ailing financial institution itself, but serves to combat systemic risks and to prevent a severe disruption of the financial system and the economy as a whole.[6]

The Commission's Communications on the application of article 107(3)(b) TFEU to State aid granted to financial institutions during the crisis

The Commission has issued a number of specific communications on the application of TFEU art.107(3)(b) to State aid granted to financial institutions during the crisis. Those communications are:

* Mara Hellstern is a legal intern in the service of the State of Hesse and Senior Fellow at the Center of European Integration Studies (ZEI) of the university of Bonn. Univ.-Prof. Dr. iur. Christian Koenig, LL.M. (LSE) is a director of the ZEI.

[1] [2004] OJ C244/2.

[2] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.28.

[3] *Allied Irish Banks/Educational Building Society and Irish Life & Permanent Group Holdings* (SA.33296).

[4] The *CEPS Task Force Report*, October 2010) (pp.8–9) differentiates between four main forms of State aid to the financial sector: (1) guarantees for bank deposits, bank bonds or all bank liabilities, (2) equity support to strengthen the capital base of financial institutions, (3) creation of a bad bank in which banks get a delay to reimburse their creditors until the financial system normalises and assets recover and (4) nationalisation of banks, whereas the latter itself is not a form of State aid; it is rather the capital injection in a bank in trouble that forms State aid.

[5] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" [2012] *European State Aid Law Quarterly* 767.

[6] In no. I.2. and I.3. of its Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis [2011] OJ C 356/7, the Commission indicated that it considered that the requirements for State aid to be approved pursuant to art.107(3)(b) of the Treaty were still fulfilled and would continue to be fulfilled beyond the end of 2011.

- the Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (the "Banking Communication")[7];
- the Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (the "Recapitalisation Communication")[8];
- the Communication on the treatment of impaired assets in the community banking sector (the "Impaired Assets Communication"),[9] all three of the latter concerning the compatibility prerequisites of the main types of State aid, which are guarantees on liabilities, recapitalisations and asset relief measures;
- the Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (the "Restructuring Communication")[10] setting out the particular features for restructuring and viability plans in the specific context of crisis-related State aid granted to financial institutions under TFEU art.107(3)(b);
- the Communication on the application, from January 1, 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis (the "First Prolongation Communication")[11] extending the Restructuring Communication—the only one of the four aforementioned Communications with a specified expiry date—on amended terms; and
- the Communication on the application, from January 1, 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis (the "Second Prolongation Communication"),[12] extending the Restructuring Communication beyond December 31, 2011 and supplementing "the Recapitalisation Communication by providing more detailed guidance on ensuring adequate remuneration for capital instruments that do not bear a fixed return; [explaining] how the Commission will undertake the proportionate assessment of the long-term viability of banks in the context of the banking package; and [introducing] a revised methodology for ensuring that the fees payable in return for guarantees on bank liabilities are sufficient to limit the aid involved to the minimum"[13].

By setting out the principles under which the Commission assesses State aid for financial institutions during the financial crisis, those crisis-specific rules for the financial sector outline the Commission's scope for imposing conditions (1) subject to which an aid may be considered compatible with the internal market and (2) to safeguard compliance with the decision to be monitored pursuant to art.7(4) of Council Regulation (EC) 659/1999,[14] which provides procedural rules for State aid. Although the Commission's communications are non-binding ("soft law"), they provide an "authoritative guide (…) to the Commission's methodology and would certainly be taken into consideration by the European Courts in exercising their judicial review function."[15]

Key principles of State aid control in the financial sector

The Commission's assessment of State aids for financial institutions during the financial crisis as set out by the abovementioned rules distinguishes between rescue aid and restructuring aid.[16] Rescue aid is designed as short-term aid "to give the beneficiary the necessary breathing space to develop a detailed restructuring or liquidation plan"[17]. Therefore it is granted in principle for a period of no longer than six months, whilst restructuring aid is usually granted for a longer period of time to enable its beneficiary to implement its restructuring or liquidation plan. With regard to the compatibility assessment under TFEU art.107(3)(b), both forms of aid need to comply with three key principles, which base on the (general) Rescue and Restructuring Guidelines of the Commission, but have been modified with regard to the particularities of the financial sector during the crisis[18]:

[7] [2008] OJ C270/8.
[8] [2009] OJ C10/2.
[9] [2009] OJ C72/1.
[10] [2009] OJ C195/9.
[11] [2010] OJ C329/7.
[12] [2011] OJ C356/7.
[13] No. I.5. of the Second Prolongation Communication.
[14] [1999] OJ L83/1.
[15] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.31.
[16] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.
[17] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.
[18] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.41; Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145; Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.

1. It needs to be shown that the beneficiary can achieve long-term viability without State aid within a reasonable period of time.
2. Shareholders and hybrid capital holders need to contribute through bans on dividends or coupon payments and limitations on the repurchase of capital instruments; and additionally, the aid needs to be adequately remunerated by the beneficiary ("burden sharing" as a mean to limit State aid to the minimum necessary and to minimise the State's, i.e. the taxpayers' burdens). This concept of "burden sharing" has been designed to replace the "50 per cent own contribution" under the Rescue and Restructuring Guidelines in order to avoid contagious fire sales of assets by the beneficiary.[19]
3. Beneficiaries need to provide measures like capacity reductions and divestments going beyond those required to ensure the beneficiary's viability to limit the distortions of competition caused by the aid to the minimum necessary. Compared to the traditional concept of compensatory measures as established by the Rescue and Restructuring Guidelines, this requirement includes "a greater focus on market competition conditions rather than compensation of competitors as well as the development of behavioural measures for situations where sufficient divestments could not be found without threatening viability"[20] to "ensure an effective restructuring of the banking sector while maintaining an adequate flow of credit to the real economy (both within and beyond the domestic markets of the banks that received aid)"[21] in regard of the interconnectedness of financial institutions across the EU and beyond. This reflects an important evolution in the State aid clearing practice of the Commission and its objectives in the past four years: At the beginning of the financial crisis, the main focus was on rescuing banks by providing liquidity and reinforcing the capital base, while today State aid measures approved by the Commission aim at the recovery of the long-term viability of the aid recipient or—if long-term viability without State aid cannot be achieved within a reasonable period of time—its liquidation.[22]

The Commission's practice of controlling State aid for financial institutions

Though the key principles that underpin the EU State aid regime and its implementation by the Commission are clearly pronounced in the Commission's communications and its case practice, applying them in practice is rather difficult due to highly speculative ex ante assessments, in particular under the conditions of the evolving sovereign debt crisis. What, for example, is the strictest minimum contribution of a (sovereign debt infected) State-aided financial institution, its shareholders and hybrid capital holders to restructuring costs? What conditions can the Commission impose on an aid-recipient? The Commission assesses and answers those questions on a case-by-case-basis due to the different structures, business models, sizes and operating areas of State-aided financial institutions. Yet, there are certain basic considerations that the Commission consistently applies. Those are adequate remuneration, dividend and/or coupon payment ban and price leadership ban.[23] What differs are the degrees of downsizing and the core market reduction by, for example, divesting non-core subsidiaries.[24]

Restructuring aid

In general, the Commission will only consider an aid to be compatible with the internal market on the basis of TFEU art.107(3)(b) if the aid is presented within a restructuring plan that is apt to restore the financial institution's long-term viability whilst ensuring burden sharing and limiting distortion of competition in the relevant markets. To ensure the latter, the Commission may impose conditions and obligations according to art.7(4) of Regulation 659/1999 or ask for appropriate optional commitments by the beneficiary. Most of such measures aim at reducing the business activities of the beneficiary.[25] In 2011, for example, the Commission approved aid by the Greek State for the Agricultural Bank of Greece (ATE), the fifth largest banking group in Greece having approximately 6 per cent of total bank assets in Greece, considering the restructuring plan of ATE not only apt to restore the bank's long-term viability, but also apt to ensure ATE shares the burden of its

[19] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.
[20] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.
[21] Pesaresi and Mamdani, "Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty" (2012) *European State Aid Law Quarterly* 767, 768.
[22] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[23] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.15.
[24] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.15.
[25] Soltész, "Von der Beihilfekontrolle zur Neugestaltung des Marktes—Schafft die Kommission eine ‚bessere Bankenwelt'?" (2010) *Wirtschaft und Wettbewerb* 743, 748.

restructuring and to limit distortion of competition in the Greek retail banking market by committing to reduce its overall assets by 25 per cent during the restructuring period through sales, the run-off of certain securities portfolios and reduction of total loan balances.[26]

The degree of balance sheet reduction of State-aided financial institutions, however, differs considerably. Whilst the Commission was content with the reduction of the State-aided bank's overall assets by 25 per cent in the ATE case, for example, the degree of downsizing and the core market reduction has been considerably higher in other State aid cases as the Hypo Real Estate (HRE) case[27] shows: The banking group HRE faced a severe liquidity shortage in 2008 as the interbank lending markets dried up in the aftermath of the Lehman Brothers bankruptcy. After the nationalisation of HRE in 2009, the Commission cleared a restructuring aid for HRE on July 18, 2011 judging the restructuring plan of HRE and its core bank Deutsche Pfandbriefbank (Pbb), which is essentially active in public investment and real estate finance, apt to restore Pbb's long-term viability whilst ensuring that the bank and its former owners adequately contribute to the restructuring costs and that distortion of competition will be adequately mitigated by phasing out all business activities of the HRE other than the activities of its core bank Pbb, so that Pbb's adjusted balance sheet size at the end of 2011 would be about 85 per cent smaller than HRE group's balance sheet size at the end of 2008.

Liquidation aid

Regarding State aid for the liquidation of ailing banks, the Commission basically focuses on the question whether the aid is limited to what is necessary to carry out an orderly winding-up of the bank. Therefore, safeguards have to be implemented that those parts of the bank which are not sold will not pursue any new activities but merely phase out on-going operations in order to limit potential distortions of competition. On those conditions, the Commission authorised aid by the Danish State for the liquidation of the Eik Bank, until 2010 the biggest financial institution in the Faroe Islands with significant retail and corporate banking activities in the rest of Denmark.[28] The bank entered into the Danish scheme for the winding-up of financial institutions in distress and some of its activities were offered for sale in a public tender while others were transferred to the publicly owned Danish Financial Stability Company (FSC), to be either sold or liquidated within a maximum of five years.

Rescue aid

Rescue aid is only approved temporarily and it is in general subject to the submission of a revised restructuring plan with the final approval of the measure being conditional on the restructuring plan's compliance with the abovementioned three key principles of State aid for financial institutions during the financial crisis: (1) a return to long-term viability of the bank; (2) adequate participation in the restructuring costs by shareholders and hybrid capital holders ("burden sharing"); and (3) proper measures to limit the distortion of competition created by the State aid.[29]

Involvement of the beneficiary

While the Commission focuses on the compliance with the three aforementioned key principles, the concrete phrasing of details of restructuring lays in the hand of the beneficiary and its Member State. However, the Commission's control does go further than merely receiving and assessing restructuring concepts presented by the Member States and the beneficiary. Restructuring plans are often the result of close communications and negotiations between the Commission, the Member State granting aid and the beneficiary. Thus, restructuring plans are only—and yet at least—in very broad terms based on proposals worked out between the State-aided financial institution and the Member State concerned. In the HRE case,[30] for example, Germany notified the first version of the restructuring plan in 2009. As the Commission had doubts on the bank's viability, the adequacy of the measures addressing burden sharing and the limitation of distortion of competition, it opened an in-depth investigation. In the course of that investigation, the restructuring plan was finally agreed on by all parties including the Commission and finally updated in June 2011. However, the Commission itself generally emphasises that many if not all measures taken in a single case (e.g. radical divestments like in the ING case) have usually been proposed by the beneficiary itself.[31] In any case, the beneficiary and the Member State, which can usually better assess the feasibility of a measure, have at least the prerogative of first initiative and of first proposal in formulating commitments.[32] However, it may turn out to be difficult to comply with divestments agreed on or imposed by the Commission due to the present market circumstances, especially due to the risks of contagious fire sales of assets. The Commission has proven flexibility in handling divestment obligations and behavioural measures that it had imposed, accepting, for example, proposals to modify contagious or impracticable

[26] SA.31154 (N429/2010).
[27] SA.28264.
[28] SA.31945.
[29] SA.33216; Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.32.
[30] SA.28264 (ex C 15/2009 and N 196/2009).
[31] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.40 with regard to the ING, KBC and Lloyds cases.
[32] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.

divestment obligations.[33] It is nevertheless important to underline that neither the TFEU nor the Council Regulation 659/1999 constitute any legal basis for "hearings" of recipients of aid or their competitors by the Commission, although in practice, the Commission is usually willing to receive written submissions by interested third parties including aid recipients or to hold meetings.[34] Yet, the notification procedure remains a bilateral procedure between the Commission and the Member State concerned. The degree of involvement of a financial institution that shall receive State aid is at the discretion of the Commission and the Member State concerned regardless of how useful such participation would be with regard to the complex economic and case-specific issues to be solved when granting restructuring, liquidation or rescue aids to ailing financial institutions.[35]

Execution of divestment obligations

EU State aid law conforming execution of divestment obligations is driven by the key principle of market economy price maximising. This principle derives from the market economy investor (market vendor) principle, which excludes the presence of State aid if State sales are on (hypothetical) private vendor terms. Although TFEU art.107(1) addresses the Member States, not strictly private undertakings, those principles apply to State aid driven divestment procedures requested by the commission as condition subject to which an aid may be considered compatible with the internal market pursuant to TFEU art.107(3)(b).[36] This is based on the assumption that the best price achievable at the market will ensure the beneficiary's contribution to the restructuring, so that in turn, the State aid contribution is limited to the necessary minimum. Moreover, divestment at the best achievable price also ensures that the buyer does not gain any benefits under unusual market terms from a divestment which might not have been initiated if not imposed by the Commission, thereby avoiding unnecessary distortions of competition by such divestment. To achieve the objective of price maximising, the Commission draws on two key principles as confirmed by the General Court: (1) the conduct of an open, transparent, unconditional and non-discriminatory tender; and (2) the acceptance of the highest bid after the tender.[37]

EU State aid law requirements on tendering procedures

Difficulties to divest under the market tendering terms as requested by the Commission and the General Court may not only arise from the crisis market environment, but also from the formal requirement of conducting an open, transparent, unconditional and non-discriminatory tender, which applies to divestments of subsidiaries or other businesses by State-aided institutions.[38] The Commission and the General Court have developed rather formalised requirements for tendering procedures under the terms of EU State aid law,[39] although the typical private vendor would never subscribe to such a high degree of formalisation.[40] Due to gambling strategies of potential purchasers, a formalised tender might even be counterproductive to the objective of achieving the highest price in the market. This issue is particularly sensitive with regard to the basic principles of openness and transparency, which might appear to be a market ideology driven myth in the real world of gambling strategists among the bidders. Therefore, a private vendor wishing to maximise the price would conduct a structured (tender) procedure using the expertise of an investment bank or other agencies, which, at least in the initial phase, directly contact potential bidders upon terms of confidentiality and selectively negotiate with them, in order to gain, in favour of the vendor, information on, inter alia, bidders' financial reliability, strategic alliances (bidders' cartels), substantial or procedural preferences.[41] Such a structured procedure can help to maximise the price, even if it does not comply with the principles of an open, transparent, unconditional and non-discriminatory tender. Thus, the Commission and the General Court should handle the prerequisites imposed on tendering or sales procedures more private-vendor-like flexible to avoid unnecessary exacerbation of divestment obligations, which, indeed, risk to reduce the price of assets.[42]

The requirement of accepting the highest bid

The General Court's judgment in the *Burgenland* case[43] emphasises the imperative of accepting the highest bid after a tender within a privatisation procedure. Due to the troubled internal market and acquisition restrictions for State aid supported institutions, the highest bidder might come from a third state making it difficult to judge its financial and transactional reliability.[44] Nevertheless, the

[33] SA.34539.
[34] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.31.
[35] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) pp.31, 32.
[36] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[37] General Court, *Land Burgenland and Austria v Commission* (T-268/08 & T-281/08), judgment of February 29, 2012, not yet reported.
[38] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[39] General Court, *Land Burgenland and Austria v Commission* (T-268/08 & T-281/08).
[40] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[41] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[42] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[43] General Court, *Land Burgenland and Austria v Commission* (T-268/08 & T-281/08).
[44] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.

Commission and the General Court follow a very restrictive approach in affirming non-feasibility of a divestment to the highest bidder.[45]

The concept of burden sharing

While the requirement of long-term viability without State aid after a reasonable period of time ensures that State aid is only granted as a remedy for a serious disturbance in the economy of a Member State or—in the case of the current crisis—of the Member States as a whole and not as a restructuring aid to financial institutions that are ailing due to non-crisis related difficulties, the concept of burden sharing provides for a maximised contribution to the restructuring costs by the aid recipient, thereby making sure that State aid is limited to the minimum necessary.

How can the burden of restructuring be shared conforming to EU State aid law?

The restructuring aid to NORD/LB[46] cleared by the Commission's decision of July 25, 2012 implies a rather flexible concept of burden sharing. Besides adequate remuneration of the public authorities that granted the aid, NORD/LB will also use the aid to strengthen its capital in the coming years by respecting a ban on dividends and hybrid coupon payments as well as on acquisitions during the restructuring period and by divesting profitable subsidiaries. Moreover, the NORD/LB will follow a cost-optimisation programme. Finally, a reduction of total assets by 15 per cent in 2016 in comparison with the end of 2011, restrictions of some business activities, divestments of non-core subsidiaries and behavioural commitments limit the distortions of competition created by the restructuring aid. The Commission's approach, however, appears more generous in that case than the clearance decision of July 25, 2012 suggests at first sight once taking into account that the clause of accessoriness between the ban on dividends and coupon payments under the silent partnership contract had been withdrawn the day before the Commission's decision of July 25, 2012, on July 24, 2012.[47] That accessoriness clause under the silent partnership contract excluded payments on T1 coupons in the case of a ban on dividends as imposed by the Commission's decision of July 25, 2012. Since the withdrawal of that accessoriness clause, payments on T1 coupons are allowed during the restructuring period of the bank in spite of the dividend ban. This eases the hybrid capital holders' contribution to the restructuring costs by a more near-term return on these hybrid restructuring investments.[48] Payments on T1 coupons might be justified (despite the dividend ban) only in the case of the hybrid capital holders' pure public status as a State aid donor (without any competitive functions as an undertaking). By contrast, if the hybrid capital holder is a public savings bank, i.e. an undertaking in highly competitive (retail) markets, the ban on coupon payments must not be compromised in order to avoid any watering down of regulatory coherency of the concept of burden sharing.

"Freeloader" asymmetries in burden sharing

Moreover, the NORD/LB case vividly demonstrates an asymmetry in burden sharing, that can be found in other cases as well and is yet unresolved. After the successful restructuring period, an asymmetry between the shareholder's ratio in the equity capital qualifying for dividends and their ratio in the contribution to the restructuring costs may arise from an unadjusted application of the usual dividend payment scheme under corporate law providing for an equal distribution of dividends to all shareholders of the same category of voting or non-voting (preferential) shares regardless of the individual shareholder's extra-contribution to the restructuring costs during the restructuring period. Thus, shareholders ("freeloaders") who have contributed less than others (e.g. less than the aid granting public shareholder/hybrid capital holder) might receive a disproportional share of the profit by virtue of (unadjusted) regular dividend payment schemes compared to their input during the restructuring period. In the case of NORD/LB, for example, the savings banks ("Sparkassen") own 38 per cent of the equity and bear less than 7 per cent of the restructuring costs, while the States of Lower Saxony and Saxony-Anhalt contribute much more to the restructuring costs. Yet, after the successful restructuring period, i.e. after the withdrawal of the ban on dividends, the savings banks will receive dividends according to their ratio of 38 per cent of the equity regardless of them bearing less than 7 per cent of the restructuring costs.[49] To eliminate such "freeloader" asymmetries in burden and profit sharing, EU State Aid control would be well advised to develop and implement a concept which ensures the proportional correlation of a shareholder's contribution to burden sharing and his post-restructuring dividends and capital gains.[50] In doing so, due regard must be given to the circumstance that—following the Commission's approach—contributions to the restructuring costs do not only embrace a transfer of resources, but also the risk of short-term as well as long-term dilutions of a shareholder's earning rights.[51] However, the approval of coupon payments (by contrast to the dividend ban) in favour of public hybrid capital holders in their role as

[45] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 146.
[46] SA.34381, see IP/12/838.
[47] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 147.
[48] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 147.
[49] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 147.
[50] Koenig and Soltész, "Regulierung durch EU-Beihilfenrecht in der Finanz-und Staatsschuldenkrise" (2013) *Wertpapier-Mitteilungen* 145, 147.
[51] In the NORD/LB case, for example, the Commission stated that the dilution suffered by the shareholders following the recapitalisation, together with a ban on dividend and hybrid coupon during the period of restructuring, also contribute to an appropriate burden sharing of the restructuring costs (IP/12/838).

restructuring aid donors does not adequately remedy the aforementioned asymmetry in burden sharing, at least not according to an adequate adjustment under market economy investor terms.

Re-privatisation

The requirement of a market economy investor return that proportionally correlates to the ratio of burden sharing raises the question when Member States should sell back shares acquired for the purpose of recapitalisation during the crisis to the private market. The answer is: as soon as the market has stabilised, Member States concerned have to abide the momentum for a market economy investor sale, i.e. not sell back shares earlier as it seems at least likely ex ante for a market economy investor to make a reasonable risk adjusted profit. Of course, the market economy investor momentum can only be temporised with the assistance of an investment bank's expertise. Thus, the governments' political promise that their aid measures are merely temporary, and that the ultimate objective is to return the State-aided institution as soon as possible completely to the private sector is scrutinised under the market economy investor test.[52] However, the State aid law scrutiny of the market economy investor momentum of sale as such does "in no way prejudice the rules in Member States governing the system of property ownership" according to TFEU art.345. In case of re-privatisation, EU State aid law merely requires a market economy remuneration of the State capital invested, but does not impose an obligation on Member States to re-privatise a financial institution that has been partly or totally nationalised during the crisis, unless otherwise agreed in the context of a State aid procedure[53] and in conformity with TFEU art.345.

Conclusions …

In spite of the exceptional circumstances of the financial and sovereign debt crisis, in particular the vast number of State aids granted and assessed since the beginning of the crisis, the Commission has succeeded in integrating the crisis-related State aid measures into the "classical" schemes de lege lata under arts 107 (1) and (3) sanctioned by the pre-approval implementation ban (stand still) under TFEU art.108(3). This success story is due to the Commission's flexible and pragmatic approach through legally non-binding communications on the Commission's intended application of the State aid rules combined with a sophisticated consensual and at the same time regulatory approach during the crisis while avoiding—for most decisions—judicial review by the European Courts,[54] thereby strengthening the level playing field for financial institutions in the post crisis internal market. However, the Commission's assessment of State aids for financial institutions during the crisis does go further than a mere legal control of compliance with EU State aid law. The compatibility assessment under TFEU art.107(3)(b) allows the Commission for a remarkable scope of discretion and economic appreciation in determining the form and content of national restructuring measures by the Member States, in particular by imposing divestment obligations and behavioural measures on the aid recipient to limit distortions of competition. Those obligations and measures will sustainably govern the aid recipients future business operations and growth agenda, thereby influencing and shaping the entire or at least great parts of the present and, more important, the post crisis financial sector. Even if the Commission contests the assertion of its subtle regulatory approach, there are obvious parallels with the Commission's merger policy striving for regulatory coherency of behavioural or structural conditions imposed by the approval decision with special regard to interdependent market structures, i.e. neighbouring, upstream and downstream markets, from a ratione temporis as well as from a ratione materiae perspective.

… and Philosophy

Notwithstanding the allegations of legal conservatism, under the crisis conditions, the thin line between *instant* emergency *law* making and interpretation has vanished, and under these conditions, the Commission has done a brilliant job all in all. Indeed, the Commission has exercised good regulation in the absence of good governance by sovereign debtors and financial institutions. Or to put it in modern platonic terms: EU State aid law regulation stems from the kingdom of thought, whereas public and corporate good governance stems from the reign of political and corporate feasibility!

[52] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.21.
[53] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.22.
[54] Lannoo, Sutton and Napoli, "Bank state aid in the financial crisis—fragmentation or level playing field?" (A Centre for European Policy Studies (CEPS) Task Force Report, October 2010) p.34.

From the Nexans judgment to the "next" improvements of the EU dawn raid procedure?

Angela Laghezza*

Dawn raids; EU law; European Commission

1. Introduction

This article will discuss the Commission's power to carry out dawn raids in light of two recent judgments in the *Nexans* and *Prysmian* cases.[1] The interest of the cases mainly resides in the Court's discussion of the requirements for the Commission to have sufficient evidence to launch the inspection and to define the scope of the investigation. Although the scope of this article will be limited to that question, it is worth noting that the cases also raise the question of the powers of the Commission during a dawn raid and (in)appropriate judicial control of the Commission's conduct during the dawn raid.

On January 28, 2009, the European Commission (hereafter the "Commission") carried out an inspection of two manufacturers of undersea cables, Nexans and Prysmian (hereafter "the two companies") on the suspicion that they were involved in a cartel on the market for high-voltage cables. The inspection decision covered:

> "the supply of electric cables and material associated with such supply, including, amongst others, high voltage underwater electric cables and, in certain cases, high voltage underground electric cables".[2]

This decision was challenged by the two companies on the ground that its scope was too broad. The two Companies also challenged the fact that the Commission copied two entire hard-drives for later inspection by the case team, back in their offices in Brussels.

On November 14, 2012 the General Court of the European Union (hereafter "the Court") annulled part of the Commission's inspection decision.[3] This partial annulment represents one of the rare situations where the Court has taken such decision.

This article will briefly summarise the cases and discuss one of the main questions of principles raised by the judgment, namely the standard of evidence required for the Commission to conduct a dawn raid.

2. The Commission's power of inspection

In order to fight against cartels, the Commission has been granted broad investigative powers by Regulation 1/2003.[4] The Commission is in particular entitled to inspect the premises of undertakings suspected of having infringed EU competition law.[5] In that regard, the Commission's powers notably include the right to check books and records[6] as well as the right to take copies of documents deemed to be useful to the investigation. As in most of the Member States, inspections decisions are binding on the targeted undertakings which have an obligation to comply and co-operate, without prejudice to their right to legally oppose an inspection which goes beyond the scope of the investigation as described in the inspection decision.[7] In case of non-co-operation, the Commission cannot coerce the inspected companies but it may request the assistance of national authorities and impose penalties to ensure compliance.[8]

3. Obligation to define the subject matter of the inspection and to have reasonable grounds to justify the inspection

The two companies brought an action for annulment of the inspection decisions on the grounds that "the Commission was imprecise in the inspection decision in its delimitation of the products concerned".[9] As already mentioned above, the inspection decisions were broadly worded to cover:

> "the supply of electric cables and material associated with such supply, including, amongst others, high voltage underwater electric cables and, in certain cases, high voltage underground electric cables".[10]

The applicants took issue with the use of such non-limitative language that rendered the description of the concerned market so vague that their rights of defence were infringed. They argued that the imprecise wording

* Avvocato (Brindisi Bar), Degree of Law (University of Salento) LL.M (Stockholm University) former stagiaire at DG Competition (Brussels). The present views are strictly personal to the author. The article was completed on December 20, 2012.

[1] Judgment of the General Court of November 14, 2012 in *Nexans France a.o. v Commission* (T-135/09), not yet reported; judgment of the General Court of November 14, 2012 in *Prysmian SpA a.o. v. Commission* (T-140/09), not yet reported.

[2] *Nexans France a.o. v Commission* (T-135/09) at [3] and *Prysmian SpA a.o. v Commission* (T-140/09) at [3].

[3] Commission decisions C (2009) 92/1 and 92/2 of January 9, 2009.

[4] Regulation 1/2003 on the implementation of the rules on competition laid down in arts 81 and 82 of the Treaty ([2003] OJ L1/1).

[5] Article 20(2) (b) of Regulation 1/2003.

[6] Article 20(2) (b) of Regulation 1/2003.

[7] ECN—Investigative powers report of October 31, 2012, p.19.

[8] Article 20(6) of Regulation 1/2003.

[9] *Nexans France a.o. v Commission* (T-135/09) at [35] and *Prysmian SpA a.o. v Commission* (T-140/09) at [66].

[10] *Nexans France a.o. v Commission* (T-135/09) at [3].

of the decision prevented them in practice to control whether the Commission was going beyond the scope of the inspection. They also argued that the Commission had actually suspicion only with regard to high voltage underwater cables and could not enlarge the scope of its inspection to the applicants' entire cable activities.

In its defence, the Commission claimed that the inspection did not cover any electrical cable but was clearly limited to specific cables. The Commission also argued that it had reasonable grounds for ordering an inspection covering all electric cables.

On the first point, the Court agreed with the applicant that the inspection decision: "could cover all the activities of an undertaking manufacturing cables for conducting electricity, even though those activities might relate to very different sectors"[11] and "could have been less ambiguous"[12] Nevertheless, the Court considered that the Commission had "*met his obligation to define the subject—matter of its investigation*".[13] The Court held that the wording of the decision enabled the applicants to assess the scope of their duty to co-operate and the Court to exercise its judicial review.[14] It also held that a single inspection decision could legitimately cover different markets.[15]

On the second ground, the Court started by recalling that the Commission's powers of investigation cannot be limited to ask for documents identified in advance.[16] However, the Court also recognised that the Commission "is required to restrict its searches to the activities of that undertaking relating to the sectors indicated in the decision ordering the inspection".[17] It held that:

> "65 First of all, if the Commission were not subject to that restriction, it would in practice be able, every time it has indicia suggesting that an undertaking has infringed the competition rules in a specific field of its activities, to carry out an inspection covering all those activities, with the ultimate aim of detecting any infringement of those rules which might have been committed by that undertaking. That is incompatible with the protection of the sphere of private activity of legal persons, guaranteed as a fundamental right in a democratic society.[18].
>
> 66 Next, the obligation on the Commission to indicate the purpose and the subject-matter of the inspection in decisions taken under Article 20(4) of Regulation No 1/2003 would be a mere technicality if it were defined in the manner suggested by the Commission. The case law according to which the purpose of that obligation is, in particular, to enable the undertakings concerned to assess the scope of their duty to co-operate would not be complied with, inasmuch as that obligation would be systematically extended to all the activities of the undertakings at issue.[19]
>
> 67 It must therefore be held that, in the present case, the Commission was under an obligation, in order to adopt the inspection decision, to have reasonable grounds to justify an inspection at the applicants' premises covering all the applicants' activities in relation to electric cables and the material associated with those cables.[20]"

In the present cases, the Court remarkably reviewed in detail the evidence in the Commission's possession before the dawn raid to verify that the Commission had reasonable grounds to justify the broad scope of its inspection. It concluded that it was not the case: on the basis of the public version of the judgment, it seems that most of the evidence solely related to high voltage cables.[21] As a consequence, the Court annulled the decision "in so far as it concerns electric cables other than high voltage underwater and underground electric cables and the material associated with those other cables".[22]

4. A judgment with broad procedural implications

In my view, the Court's judgment is disappointing as regards the obligation to define the scope of the inspection but crucial in spelling out the requirement for the Commission to have reasonable grounds to justify carrying out an inspection.

First, as regards the definition of the scope of the investigation, the Court had previously held that:

> "although the Commission is not required to communicate to the addressee of a decision ordering an investigation all the information at its disposal

[11] *Nexans France a.o. v Commission* (T-135/09) at [52] and *Prysmian SpA a.o. v Commission* (T-140/09) at [43].
[12] *Nexans France a.o. v Commission* (T-135/09) at [53] and *Prysmian SpA a.o. v Commission* (T-140/09) at [46].
[13] *Nexans France a.o. v Commission* (T-135/09) at [53] and *Prysmian SpA a.o. v Commission* (T-140/09) at [46].
[14] *Nexans France a.o. v Commission* (T-135/09) at [54]–[55] and *Prysmian SpA a.o. v Commission* (T-140/09) at [47]–[48].
[15] *Nexans France a.o. v Commission* (T-135/09) at [56] and *Prysmian SpA a.o. v Commission* (T-140/09) at [49].
[16] *Prysmian SpA a.o. v Commission* (T-140/09) at [60] and *Nexans France a.o. v Commission* (T-135/09) at [62]: *"[the Commission's] powers of investigation would serve no useful purpose if it could do no more than ask for documents which it was able to identify with precision in advance. On the contrary, its right to investigate implies the power to search for various items of information which are not already known or fully identified*".
[17] *Nexans France a.o. v Commission* (T-135/09) at [64] and *Prysmian SpA a.o. v Commission* (T-140/09) at [62].
[18] Corresponding to [63] of *Prysmian SpA a.o. v Commission* (T-140/09)
[19] Corresponding to [64] of *Prysmian SpA a.o. v Commission* (T-140/09).
[20] Corresponding to [65] of *Prysmian SpA a.o. v Commission* (T-140/09).
[21] *Nexans France a.o. v Commission* (T-135/09) at [83]–[89] and *Prysmian SpA a.o. v Commission* (T-140/09) at [81]–[87].
[22] *Nexans France a.o. v Commission* (T-135/09), operative part, at [1] and *Prysmian SpA a.o. v Commission* (T-140/09), operative part at [1].

> concerned the presumed infringements or to make a precise legal analysis of those infringements, it must none the less *clearly indicate the presumed facts which it intends to investigate"*.[23]

It is therefore surprising that the Court accepted the Commission's description of the scope of the investigation after having expressly pointed out the vagueness of the wording and the breadth of the scope as defined by the decision.

It is worth recalling that pursuant to Regulation 1/2003,[24] the Commission before launching a dawn raid has to clearly indicate in its decision: (a) the subject-matter and (b) the purpose of the investigation.[25] I would therefore submit that the definition of the scope of the inspection is too important to accept imprecise or vague language that leaves doubt as regards the exact scope of the investigation. It is true that, as the Court noted in *Prysmian*,

> *"si deve infatti ricordare che gli accertamenti promossi dalla Commissione mirano a raccogliere la documentazione necessaria per accertare la verità e la portata di una determinata situazione di fatto e di diritto in merito alla quale l'istituzione suddetta dispone già di informazioni"*.[26]

However, the Commission is not entitled to embark in a fishing expedition.

The text of the decision defining the scope of the investigation is the only benchmark against which the inspected companies and the Court can assess whether the Commission remains within limits during the inspection. Therefore, the Commission should make sure it is sufficiently familiar with the industry targeted and could perhaps use the opinion of experts of the specific sectors to be investigated in order to define more precisely the relevant products subject to the inspection.

Secondly, the judgment constitutes an improvement in EU procedural competition law as it stresses more clearly than ever before the obligation for the Commission to have reasonable grounds before carrying out a dawn raid. The "reasonable ground" test places a clear limit on the Commission's powers of inspection which is especially important given that the Commission does not need to obtain any warrant prior to the dawn raid. Moreover, the Court demonstrated in the *Nexans* and *Prysmian* cases that it was ready to verify in detail the existence of such reasonable grounds. Again, such a bolstering of the ex post judicial review is crucial in my view given the lack of ex ante judicial control that was pointed out by several authors.[27] It may also help the European competition law system to be more compliant with the requirements of sufficient ex post judicial review under the ECHR, as emphasised by the Strasbourg Court in *Ravon*.[28]

The obligation to have reasonable ground has also important consequences for the leniency programme. In order to meet its obligation, it is evident that the Commission must receive sufficient information and enough evidence before launching an inspection. As demonstrated by the two cases discussed in this article, the quality of the information provided by leniency applicants is therefore crucial. Indeed, the only information at the Commission's disposal before inspection will often come from leniency applicants. This is proven by the fact that the first undertaking:

> "to submit information and evidence which in the Commission's view will enable it to carry out a targeted inspection in connection with the alleged cartel"

will be granted immunity from fines pursuant to the Leniency Notice.[29] The reinforcement of the necessity for the Commission to have sufficient evidence before carrying out a dawn raid following the *Nexans* and *Prysmian* cases might thus prompt the Commission to raise the evidentiary standard to obtain immunity from fines.

In the present cases, the leniency application appears to have been characterised by the impreciseness of the leniency applicant's declarations. For instance, in the *Nexans* case the leniency applicant had initially informed the Commission orally:

> "of a cartel covering high voltage underground and underwater cables, of which the applicants were members […] and of a '[confidential] arrangement for medium voltage [electric] cable contracts'".[30]

[23] *Dow Chemical Ibérica SA v Commission of the European Communities* (97–99/87) [1989] E.C.R. 3165 at [45].
[24] Article 20(4) of the Commission Regulation 1/2003.
[25] Important assumptions are underlined in the *Prysmian* and *Nexans* cases taking into account the previous earlier case *Dow Chemical Ibérica* with regard to these requirements. Indeed, among the preliminary observations, respectively at points 34 and 39, it is observed that: "the Commission is required to specify the subject-matter and purpose of the investigation. That obligation is a fundamental requirement not merely in order to show that the investigation to be carried out on the premises of the undertakings concerned is *justified* but also to enable those undertakings to assess the scope of their duty to co-operate while at the same time *safeguarding the rights of the defence*."
[26] *Prysmian SpA a.o. v Commission* (T-140/09) at [38] and *Nexans France a.o. v Commission* (T-135/09) at [42], "it must be borne in mind that the investigations carried out by the Commission are intended to enable it to gather *the necessary documentary evidence* to check the actual existence and scope of a given factual and legal situation concerning which the Commission already possesses certain information".
[27] Pascal Berghe and Anthony Dawes, "Little Pig, Little Pig, Let me come in: an evaluation of the European Commission's Powers of Inspection in competition cases" [2009] E.C.L.R. 407.
[28] Judgment of February 21, 2008, Application number 1849703.
[29] Commission notice on immunity from fines and reduction of fines in cartel cases [2006] OJ C298/17, para.8.
[30] *Nexans France a.o. v Commission* (T-135/09) at [74] and *Prysmian SpA a.o. v Commission* (T-140/09) at [72].

However, it appears that later the leniency applicant "was no longer able to check [confidential] whether [confidential] collusive conduct took place in relation to medium voltage cables".[31] This constitutes an illustration of the sometimes questionable reliability of leniency applications.[32] In other words, there is a risk that a leniency applicant in order to guarantee his position to obtain total immunity under the leniency policy will exaggerate in its statements describing the cartel in which it took part. Therefore, in order to avoid any potential risks of untruthful evidence being provided by leniency applicants, the Commission should systematically try to verify the accuracy of the information provided by leniency applicants and impose tough penalties on leniency applicants submitting misleading applications.

5. Conclusion

By imposing on the Commission a clear obligation to have reasonable grounds to carry out a dawn raid, the *Nexans* and *Prysmian* judgments enhance the judicial protection of inspected undertakings and may lead the way to the next improvement of EU dawn raid procedure.

[31] *Nexans France a.o. v Commission* (T-135/09) at [76] and *Prysmian SpA a.o. v Commission* (T-140/09) at [74].
[32] As Mr Forrester suggested in his article, "the leniency system presents an important risk in that it offers an opportunity to cause damage to a rival by implicating it in wrong doing". See I. Forrester, "Facts are chiels that winna ding", Paper presented at the 38th Annual Conference on International Antitrust Law & Policy 2011, 2011 Fordham Corp. L. Inst. 175, B. Hawk (Editor) (New York: Juris Publishing, Inc., 2012).

Is Trinko a useful model for the European Union?

John B. Meisel*

Abuse of dominant position; Comparative law; Competition law; EU law; Unfair pricing; United States

Section I. Introduction

Since 1890, the antitrust laws have played a critical role to ensure that the predominantly free-market economic system relied upon in the United States operates in a competitive manner.[1] It is widely accepted that competitive markets contribute to consumer welfare since, in general, they lead to lower prices, better products, and more efficient production methods compared to the performance of non-competitive markets. Given the pivotal role played by the antitrust laws in the US economy, situations in which antitrust is precluded from constraining the conduct of market participants have been historically carefully circumscribed. One traditional precluding situation involves markets subject to sector-specific economic regulation. In such a situation, antitrust courts are sometimes asked to step aside and let the appropriate regulatory authority have sole jurisdiction over any potentially anticompetitive conduct of incumbents in the market for antitrust enforcement may interfere with the ability of the regulator and/or the regulated company to achieve the often noncompetition goals of the governing regulatory statute.

It is generally agreed that since the 2004 Supreme Court *Trinko* decision[2] involving refusal-to- deal antitrust doctrine set in a regulated market, the situations in which antitrust law is precluded in telecommunications markets have been expanded.[3] In this decision, the Supreme Court discovered a new way, involving a cost/benefit analysis of antitrust enforcement, to rule out antitrust enforcement on top of the existing, extensive regulation in a telecommunications market. In the first decade of the 21st century, specific market behavior in regulated telecommunications markets subject to this pattern of a narrowing role for antitrust involves dominant firms' refusals-to-deal with competitors and price squeeze pricing practices. This pattern of expanding antitrust immunity in regulated markets reflects a several decades-long concern in the United States with the costs of antitrust enforcement (especially in the case of private antitrust cases) and an increasing faith in the ability of expert regulators to enforce the antitrust laws.[4]

As the United States has been following a pattern of increasing the likelihood of preclusion of antitrust intervention in regulated telecommunications markets, the European Union, clearly illustrated by the European Court of Justice's (ECJ) *Deutsche Telekom* decision,[5] has moved in the opposite direction, by confirming the critical, continuing role played by the competition laws to supplement the authority of a regulatory agency over regulated markets. Some commentators find merit in the *Trinko* decision and advocate applying its lessons to the European Union.[6] But, what exactly are those US lessons that may aid the European Union to better balance the interrelationship between competition laws and regulation.

The objective of the article is to assess whether the *Trinko* model can provide useful lessons for the European Union. In s.II, the *Trinko* model is described. It is important to distinguish between the procedural guidelines of the model (described in this section) from the substantive legal decisions regarding refusal- to-deal antitrust liability (analysed in s.IV) contained in the decision. Section III applies the *Trinko* model to the *Deutsche Telekom* case. Section IV offers a critical appraisal of two issues regarding the implementation of substantive principles in the *Trinko* model. Section V offers a conclusion.

Section II. The Trinko Model

The *Trinko* model provided an innovative method to apply antitrust law to the facts of a specific case in a regulated market. It is important to understand the method used in legal analysis for how the court goes about examining an antitrust claim opens certain possibilities in the analysis and, at the same time, closes other possibilities.[7] The regulated market involved is one subject to a

* Professor of Economics, Southern Illinois University Edwardsville, email: jmeisel@siue.edu

[1] The pedestal upon which the antitrust laws are placed is reflected in the following often-quoted statement from a 1972 Supreme Court decision: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete—to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster." *United States v Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972).

[2] *Verizon Communications Inc. v. Law Offices of Curtis v Trinko*, 540 U.S. 398 (2004) (hereinafter referred to as *Trinko*).

[3] For a superb demonstration of this point see, Howard A. Shelanski, "The Case for Rebalancing Antitrust and Regulation" (2011) 109 *Michigan Law Review* 683.

[4] See Richard M. Brunell, "*The Regulated Conduct Defence*," Working Party No. 2 on Competition and Regulation, Directorate for Financial and Enterprise Affairs Competition Committee, Organisation for Economic Co-operation and Development, February 14, 2011, p.23.

[5] *Deutsche Telekom AG v European Commission* (C-280/08 P) [2010] 5 C.M.L.R. 27 (hereinafter referred to as *Deutsche Telekom*).

[6] For example, see Damien Geradin, "Limiting the Scope of Article 82 of the EC Treaty: What can the EU learn from the U.S. Supreme Court's Judgment in Trinko in the wake of Microsoft, IMS, and Deutsche Telekom?" *Common Market Law Review*, December 2005. Available at SSRN: *http://ssrn.com/abstract=617263* [Accessed February 18, 2013] (concluding that EC competition lawyers can learn a great deal from the *Trinko* decision). Also, see George A. Hay and Kathryn McMahon, "The Diverging Approach to Price Squeezes in the United States and Europe" (2012) *Cornell Law Faculty Working Papers* 91 (arguing "the EU courts may be advised to adopt the approach of the US Supreme Court in *Trinko* of a diminished role for antitrust in regulated markets.").

[7] My interest in the method of analysis in the *Trinko* case was sparked by the following article: James E. Scheuermann and William D. Semins, "A New Method for Regulatory Antitrust Analysis? Verizon Communications Inc. v Trinko," *Richmond Journal of Law & Technology*, (2005) XII(1). The authors compare and contrast the method introduced in *Trinko* from two pre-existing methods used to examine antitrust claims in regulated markets.

competition-enhancing regulatory statute (Telecommunications Act of 1996[8]) that is intended to facilitate the movement of the monopoly-regulated telecommunications market to a competitive market.[9] In other words, the market in question is neither the traditional natural monopoly market subject only to regulation[10] nor the fully competitive market subject only to the antitrust laws. Rather, it is a dynamic market in transition, characterised simultaneously by natural monopoly upstream components (e.g., the local loop from a residence to a telephone company central office) subject to regulation and competitive downstream components (e.g., retail phone service or retail DSL broadband service) subject to the antitrust laws. In such a deregulating market environment, how should an antitrust court (or competition authority) proceed to investigate an allegation of an antitrust violation in a market still subject to sector-specific regulation.

In *Trinko*, the antitrust complaint involved the wholesale market for leasing network elements. The specific element in question was access to operations support services (OSS) for a competitive local exchange carrier (AT&T) from the incumbent local exchange carrier (Verizon). The antitrust complaint was brought by a customer of AT&T (the law offices of Curtis V. Trinko). The Federal Communications Commission (FCC) and the New York State Public Service Commission had previously investigated the OSS complaint from competitive local exchange carriers, found a regulatory violation, and imposed financial penalties on the incumbent.

The first step in the *Trinko* method is to examine whether the challenged conduct is immune from the antitrust laws based on traditional implied immunity doctrine in US law. The two laws involved in the analysis are each federal laws so one does not take supremacy over the other. However, it is clear that a grant of antitrust immunity has over time been strictly construed and only granted to the minimum extent necessary for the regulatory statute to achieve its goals.[11] Specifically, traditional antitrust immunity has been developed in the context of a regulatory statute that relies on a regulatory agency to pursue noncompetition goals and, if a conflict (i.e., "plain repugnance") exists between a regulator's view of the challenged conduct and the antitrust view of that conduct, then antitrust law should step aside. Initially, the *Trinko* court argued that the detailed regulatory regime created by the Act was a good candidate for satisfying traditional immunity doctrine "to avoid the real possibility of judgments conflicting with the agency's regulatory scheme that might be voiced by courts exercising jurisdiction under the antitrust laws."[12] However, such a conclusion was ruled out in the Telecommunications Act due to the presence of an express antitrust saving clause.[13] Thus, the Supreme Court next had to address how it was going to incorporate the saving clause into its method for considering the antitrust complaint.

Since there was no justification for a finding of antitrust immunity based on traditional immunity doctrine, the second step in the *Trinko* method requires an antitrust court to determine if the complaint falls into one of two categories; (1) pre-existing antitrust law or (2) an expansion of pre-existing law.[14] This categorisation was how the Supreme Court gave operational meaning to the saving clause. Claims arising in a regulated market that fall within the pre-existing zone of antitrust liability for a refusal to deal with a rival (or for a price squeeze/margin squeeze) are still valid and should proceed in the courts as a viable antitrust claim. Claims that do not fall within the pre-existing zone but may cause the zone of pre-existing liability to expand may be precluded in the face of a regulatory regime that performs the antitrust function. Thus, if the plaintiff can show that the alleged complaint falls within pre-existing law (as it was determined at the time of the Telecommunications Act); the claim can potentially create antitrust liability for the defendant. In the *Trinko* case, this would mean that the regulatory violation could also lead to an antitrust violation. Actually, in the *Trinko* case, the claim was rejected as a matter of antitrust law for it failed to satisfy pre-existing refusal-to-deal law.[15] Then, the claim was rejected as an expansion of pre-existing law given the competition-oriented regulatory regime. Most narrowly and, perhaps, most usefully, the *Trinko* court held that a violation of a regulatory rule, by itself, does not automatically create an antitrust violation. Such a narrow holding ensures that the regulatory rule does not, by itself, become responsible for modifying pre-existing antitrust law.

An innovative aspect in step two of the *Trinko* method of analysis is that a claim determined to be novel can be precluded from antitrust liability if the court determines that the regulatory regime can deter and remedy anticompetitive conduct. This means that, given the regulatory structure in place, the court examines the impact of regulation on the applicability of the antitrust

[8] Public Law Number 104-104 s.401, 110 Stat. 56, 128–29 (1996). The regulatory statute was passed with the express purpose of promoting competition in local telephone markets. Any other goals (such as universal service or more rapid deployment of new technology) of the regulatory statute had to be achieved in a manner consistent with the promotion of competitive markets.

[9] Distinguishing between the goals of the regulatory statute (i.e., non-competition versus competition goals) is critical for understanding the relationship between antitrust and regulation. For an insightful analysis of the importance of such a distinction, see Steven Semeraro, "The Antitrust-Telecom Connection" (2003) *San Diego Law Review* 490, 555.

[10] Typically, this involved the grant of an exclusive geographical franchise and the regulation of rates to protect consumers.

[11] *Silver v New York Stock Exchange*, 373 U.S. 341 (1963).

[12] *Verizon Communications Inc. v. Law Offices of Curtis v Trinko*, 540 U.S. 398 (2004) (hereinafter referred to as *Trinko*) at 406.

[13] The clause reads as follows; "nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws." Public Law Number 104-104 s.401, 110 Stat. 56, 128–29 (1996) at 143.

[14] A third possibility exists if the claim fails to satisfy the necessary requirements for an antitrust claim. No further analysis is then required.

[15] It has been argued persuasively that *Trinko* narrowed pre-existing law in its legal analysis, thus, in effect, modifying existing law in contravention to its own framework. For a superb demonstration of this point see Shelanski, "The Case for Rebalancing Antitrust and Regulation" (2011) 109 *Michigan Law Review*, 696–699.

laws in the market. In general, this means that the court may find that the regulatory regime makes it highly unlikely that an antitrust violation will be found, has no effect on the likelihood of finding an antitrust violation, or increases the likelihood of finding an antitrust violation.[16] In other words, to conduct an appropriate analysis of a monopolist's conduct under s.2 of the Sherman Act, one must incorporate into the analysis the context of the market, which includes the influence of regulation on the market's structure and firm behavior.[17]

This places the responsibility for the enforcement of the antitrust laws into the hands of a sector-specific regulatory agency even in the face of an antitrust saving clause contained in the Telecommunications Act and a lack of repugnance between antitrust law and regulation. This means that the agency assumes responsibility for both identifying and remedying regulatory violations and antitrust violations. The justification for this total reliance on the regulatory agency is based on an economic analysis of the marginal benefits and marginal costs of antitrust enforcement in a market already subject to a regulatory regime. The Supreme Court determined, on the basis of certain assumptions (that are open to rebuttal), that the additional benefits of antitrust enforcement were small given the detailed regulatory scheme and that the additional and realistic assessment of the costs (e.g., inability of a court to identify unilateral anticompetitive conduct, the risk of false positives, institutional limitations of courts versus a regulatory agency in determining and supervising access conditions) to society from antitrust intervention were large.[18] Thus, based on a simple cost-benefit analysis grounded in certain presumptions about those marginal benefits and costs, antitrust enforcement does not make economic sense.

In short, in a market subject to competition-enhancing regulation, antitrust enforcement of a claim that falls within pre-existing antitrust law is still viable but a claim deemed to be novel is likely to be precluded (subject to what has been labeled "quasi-immunity"[19]) in the face of a competition-oriented regulatory statute. It naturally follows that the more likely an antitrust claim is determined by the court to be novel in a regulated industry, the more likely that such conduct is excluded from antitrust liability. Thus, a critical factor for implementation of the *Trinko* model is the width of the zone of pre-existing liability in antitrust law (or competition law) for a specific business practice such as a refusal-to-deal or a price squeeze/margin squeeze.

Section III. Application of the Trinko model to Deutsche Telekom

The facts of the telecommunications environment in the *Deutsche Telekom* case match up closely to the price squeeze and refusal-to-deal telecommunications cases in the United States (price squeeze analysis in the United States was based on the *Trinko* decision).[20] The European Union created a regulatory structure[21] that was intended to be competition-enhancing as was the Telecommunications Act in the United States. Similarities between the regulatory models used in the United States and European Union include: (1) telecommunications markets that are in transition from historically regulated monopolies to competitive market: (2) remaining bottleneck or natural monopoly elements in parts of the telecommunications markets: and (3) the need for mandatory access to these elements in order to spur competition in downstream, retail markets.

The entrants were dependent on incumbents (that were determined to possess significant market power) to provide equal access to bottleneck facilities for it was highly unlikely that entry would occur without such mandated access. Access was to be enforced in each member country by the national regulatory authority (NRA). As was the case in the United States, entrants generally operated in downstream markets while the incumbents were vertically integrated and in control of critical upstream inputs. Given the dependence of entrants on access to incumbent's facilities, it is not surprising that incumbents in the United States and European Union were not totally welcoming of the new competition and engaged in conduct, such as a price squeeze, that placed their emerging competitors at a competitive disadvantage. Based on a review of national case law on abusive margin squeezes in the period 2003–2009, more than 70 per cent of the cases involved the recently liberalised electronic communications sector.[22] In *Deutsche Telekom*, it was found that the dominant company engaged in a prolonged price squeeze in which the wholesale price actually exceeded its retail price (a so-called margin crush).

Applying the *Trinko* model, the first question concerns whether the conduct of the regulated undertaking should be subject to competition law immunity based on traditional doctrine. The standard for granting immunity in the European Union, the regulated conduct defense, is considerably lower than in the United States. The regulated undertaking was subject to cost-based regulation of its wholesale charges and subject to price cap regulation of its retail charges. Such extensive price

[16] A price squeeze allegation in a fully regulated market was examined in a widely-cited Court of Appeals decision written by Justice (Judge at the time) Breyer in which he found the likelihood of an antitrust violation to be so small given the regulatory structure in place at both the federal and state levels that a price squeeze does not ordinarily violate the antitrust laws. See *Town of Concord v. Boston Edison Co.* 915 F.2d (1st Cir. 1990) (hereinafter called *Town of Concord*). The reasoning in this decision provided the intellectual foundation for the analysis used by the Supreme Court in its recent refusal-to-deal and price squeeze cases.

[17] Keith S. Watson and Thomas W. Brunner, "Monopolization by Regulated "Monopolies": The Search for Substantive Standards" [1977] *The Antitrust Bulletin* 559

[18] *Verizon Communications Inc. v. Law Offices of Curtis v Trinko*, 540 U.S. 398 (2004) (hereinafter referred to as *Trinko*) at 411–415.

[19] See Jonathan Rubin, "Regulation-based Antitrust Quasi-Immunity" (2005) 1 *American Antitrust Institute* 12 .

[20] In *Pacific Bell v linkLine Communications, Inc.* 129 Supreme Court 1109 (2009) (hereinafter referred to as *linkLine*), the Supreme Court described a price squeeze claim as a new theory of antitrust liability (placing it in the novel category) and held that a price squeeze claim is dependent on the presence of an antitrust duty to deal for the defendant. In contrast, the ECJ held that a price squeeze can be a standalone form of abuse, regardless of the regulatory status of a market.

[21] Directive 2002/21/EC of the European Parliament and of the Council, March 7, 2002, on a common regulatory framework for electronic communications networks and services (Framework Directive).

[22] Nicolas Petit and Elise Provost, "Abusive margin squeeze: An overview of European national case laws", *e-Competitions*, N 29532.

regulation in the United States, based on the *Town of Concord* standard, would suggest granting implied antitrust immunity. However, in the European Union, as long as the regulated undertaking retained some commercial discretion in setting its retail prices (which it did given how a price cap regime works), the undertaking is responsible for the competition law consequences of the resulting price squeeze.[23] A dominant firm in the European Union is held to a higher standard of responsibility for its conduct than a dominant firm in the United States. Thus, immunity under traditional EU doctrine was denied.[24]

The next step in the *Trinko* methodology involves placing the challenged conduct into the appropriate category as either a pre-existing claim or as a novel claim. It is clear that a price squeeze falls under pre-existing law in the European Union as it is conceptualized as a standalone abuse not dependent on a refusal-to-deal at the wholesale level or predatory pricing at the retail level, as is the case in the United States. The abuse is based on the difference between the two prices and not the absolute level of either price. Since the allegation falls under pre-existing EU law, competition authorities should proceed with a normal investigation under TFEU art.102 standards of conduct for a dominant firm. This is what the competition authority and courts did and they found a competition law abuse and fined the undertaking for its price squeeze.[25]

One interesting aspect of the case is that the NRA did not find a regulatory violation even though it reviewed the pricing practices of the regulated undertaking several times during the period of the margin squeeze. It determined that the margin squeeze could be avoided by including in the firm's retail revenues both local network access revenues and telephone call revenues.[26] The ECJ found this to be an incorrect way to measure the presence of a margin squeeze. In other words, the standard that the ECJ used to determine a margin squeeze was more demanding on the defendant than the standard used by the NRA. This contrasts with the situation in *Trinko* where the regulatory standard for a refusal-to-deal was more demanding on the defendant than the antitrust law standard. The ECJ found a violation of competition law where the Supreme Court found no antitrust violation.

If the complaint had fallen, instead, into the novel category, then an assessment of the work of the NRA would be conducted to determine if it satisfied the requirements to be deemed an effective steward of the antitrust function. The competition claim, even though categorized as novel, is likely to still have been allowed to proceed through the court system given the less than satisfactory performance of the NRA. The failure of the NRA in *Deutsche Telekom* to enforce the competition laws is part of a pattern in which it has been suggested that the European Commission lacks trust in the ability of NRAs "to act independently of the government and of the incumbent operator."[27] This seems to be an essential, minimum requirement for the NRA to perform effectively the antitrust function.

Therefore, the conclusion of the ECJ is likely to have been the same as if it had used the *Trinko* method of analysis. However, the outcome is likely to have been significantly different if the ECJ also employed the substantive legal principles of the *Trinko* and *linkLine* decisions.

Section IV. An assessment of the Trinko model

The method suggested by the *Trinko* decision for investigating an antitrust claim in a regulated (or more accurately, deregulating) market is sound. The application of pre-existing law by the Supreme Court to the facts of *Trinko* is another thing. There are two critical substantive issues that need to be discussed: (1) the standard for the zone of pre-existing liability and (2) the standard for a regulatory agency to be deemed to have fulfilled the antitrust function.

The *Trinko* method can be implemented substantively in either a narrow or much broader way depending on the approach taken by the courts to the two issues identified above. If the courts interpret the zone of pre-existing liability narrowly, then most claims fall into the novel category with a strong presumption that they can be adequately addressed by the regulator, perhaps only requiring the mere presence of a regulatory regime. Since the 1970s, the United States has increasingly narrowed the zone of pre-existing liability with respect to unilateral behavior by a dominant firm. The Supreme Court, in particular, has developed a highly suspicious attitude toward claims involving a combination of treble damages, juries, and private litigants. In response to these hypothesized flaws in elements of the US antitrust system, a process described as judicial equilibration takes hold and the zone of pre-existing liability is narrowed to offset perceived excesses in the legal framework governing remedies available from private enforcement of the antitrust laws.[28] For example, the *Trinko* and *linkLine* decisions have considerably narrowed the zone of pre-existing liability for refusal-to-deal and margin squeeze conduct. The European Union's zone of pre-existing liability for these two forms of conduct is

[23] *Deutsche Telekom* at [80] ("According to the case-law of the Court of Justice, it is only if anti-competitive conduct is required of undertakings by national legislation, or if the latter creates a legal framework which itself eliminates any possibility of competitive activity on their part, that arts 81 and 82 EC do not apply").
[24] The EU regulated conduct defense standard has been argued to be both impractical and unfair to the regulated firm. See Robert O'Donoghue, "*Regulating the Regulated: Deutsche Telekom v European Commission*," GCP, May 2008, Release One.
[25] The amount of the fine was reduced somewhat to account for the role played by the NRA in the abusive conduct.
[26] Robert O'Donoghue, "Regulating the Regulated: Deutsche Telekom v European Commission" (2008) May GCP, Release One, 4–5 for a presentation of the salient facts of the case.
[27] See Giorgi Monti, "Managing the Intersection of Utilities Regulation and EC Competition Law" (2008) 4(2) The *Competition Law Review* 125.
[28] This explanation for the narrowing zone of existing liability for unilateral conduct is developed in the following article: William E. Kovacic, "The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix" (2007) 1 *Columbia Business Law Review* 62.

much broader. Thus, more claims, such as those that pertain to the facts of the *Deutsche Telekom* case, are likely to fall into the pre-existing competition law category.[29]

Faith in the ability of the regulator to perform the antitrust function effectively is a key factor in determining the breadth of the *Trinko* method. It is probably true that, given the facts of *Trinko*, the FCC and the state performed the antitrust function effectively.[30] However, the Supreme Court never clearly identified a standard for effective performance of the antitrust function. Factors that should go into such an evaluation of the performance of the NRA include: (1) does the NRA see promoting competition as a core aspect of its mission; (2) does the NRA show signs of being captured by the regulated firm or the national government; (3) are the penalties available to the NRA sufficient to deter anticompetitive conduct; (4) does the regulatory scheme create opportunities for the regulated firm to game the system,[31] and; (5) does the NRA have authority over the challenged conduct and is that authority actively enforced. One other complication for the European Union is that in the United States the FCC is a single federal agency that can be relied on to perform this function across telecommunications markets throughout the nation. In the European Union, each NRA would become responsibility for the antitrust function in its jurisdiction and given the multiplicity of jurisdictions, a consistent application of competition law across regulated markets is less likely to result.

Section V. Conclusion

Does *Trinko* provide useful lessons for the European Union? The correct answers are yes and no. On one hand, the innovative method of analysis in *Trinko* is a logical, systematic way to evaluate the viability of an antitrust claim in a deregulating market subject to a competition-enhancing regulatory statute. On the other hand, the substantive contributions for antitrust law contained in *Trinko* are of a much more questionable source of valuable lessons.

The breath of the *Trinko* decision is dependent on how the courts apply the *Trinko* method. The higher the standard for the regulatory regime to be deemed effective, the less likely antitrust claims will be precluded in regulated markets. If courts take a very narrow view of what constitutes expansion of pre-existing antitrust law (implying a broader view of pre-existing antitrust liability), the less likely that antitrust claims will be precluded in regulated markets. If courts only broadly apply the substantive principles of *Trinko* to private cases, the less likely that antitrust claims will be precluded when the government is the plaintiff in a regulated market. *Trinko* has provided the European Union with a useful methodology but not substantive law if the European Union is interested in continuing its vigorous approach to competition law enforcement in regulated markets. At one time, the United States equated in importance to the nation the Sherman Act to the Magna Carta. That, sadly, no longer appears to be the case.

[29] On the other hand, it has been argued that the substantive zone of EU liability has expanded too far due to the intervention and use of competition law in regulated markets. See, Hendrik Auf'mkolk, "The 'Feedback Effect' of Applying EU Competition Law to Regulated Industries: Doctrinal Contamination in the Case of Margin Squeeze" (2012) *Journal of European Competition Law & Practice*.

[30] One can glean from the decision a standard involving three conditions that are necessary to justify the rejection of the antitrust claim: (1) the specific regulatory duty is based on a more demanding standard on the defendant than the corresponding standard for an antitrust duty, (2) there is clear regulatory authority over the challenged conduct, and (3) there is active and continuing enforcement of that authority. See Shelanski, "The Case for Rebalancing Antitrust and Regulation" (2011) 109 *Michigan Law Review* 702.

[31] For how a price squeeze can be, in the context of a regulatory structure that exists to promote competition, used in an anti-competitive manner to advance the private interests of the regulated firm, see, Stacey L. Dogan and Mark A. Lamley, "Antitrust Law and Regulatory Gaming," (2009) 87 *Texas Law Review* 685. In a case of regulatory gaming, the marginal benefit of antitrust enforcement in a regulated industry increases substantially.

Cunning as a Fox—Dutch Competition Authority clears long-term acquisition of Dutch football broadcasting rights

Ben Van Rompuy *

Broadcasting right; Commercial broadcasting; Competition law; Exclusive supply agreements; Football; Netherlands; Satellite television

Introduction

On August 8, 2012, Eredivisie Media & Marketing C.V. (EMM), the media and commercial arm of the Premier football league (Eredivisie) in the Netherlands, announced a long-term partnership with Fox International Channels Inc (Fox). Fox, a broadcast subsidiary of News Corporation, acquired a majority stake in EMM. Fox will pay €1,02 billion over a period of twelve years encompassing the 2013–2014 to the 2024–2025 seasons. The Eredivisie clubs will receive payments rising from €60 million in the first year to €100 million in the last year. Fox also agreed to underwrite the €60 million of debt attached to Eredivisie's own pay-TV platform Eredivisie Live.

On November 29, 2012, the Netherlands Competition Authority (NMa) approved the broadcasting deal, which is the largest of its kind in the history of Dutch football. The NMa adopted a formal decision, clearing the acquisition of EMM by Fox, and an informal opinion on the proposed modes of exploitation of the Eredivisie broadcasting rights. This article scrutinizes these decisions and reveals a worrying sign of competition law enforcement fatigue in the area of sports media rights.

Background

For many years, the Eredivisie live broadcasting rights were sold exclusively to one domestic broadcaster. In 1997, the Eredivisie clubs joined into a private limited partnership named Eredivisie C.V. (ECV), which sold the live broadcasting rights in a single bundle to pay-TV channel Canal Plus. The contract with Canal Plus was renewed in 2001 for a period of four years. After a lengthy antitrust investigation, the NMa prohibited the joint selling arrangement.[1] Consequently, the ECV put forward a new arrangement for the marketing of the Eredivisie broadcasting rights for the 2005–2006 and 2007–2008 seasons. In line with the principles set out by the European Commission in its *UEFA Champions League* decision,[2] the ECV proposed to unbundle the live broadcasting rights by splitting them up into smaller rights packages. The NMa agreed to this new arrangement without making a formal decision.[3] The Eredivisie clubs, however, were unsatisfied with the revenues generated under the new joint selling arrangement. The ECV looked for alternatives and decided to launch its own branded pay-TV channel Eredivisie Live. For this purpose, the joint venture EMM was established between ECV and Dutch TV production company Endemol, with Eredivisie Beheer B.V. (EBV) as administrative partner. Since 2008, EMM exploits all commercial Eredivisie rights (e.g. media, merchandising, and sponsorship) on behalf of the clubs. In 2010, the Dutch Football Federation (KNVB) also took share in EMM. The major difference with the previous ECV broadcasting deals is that the Eredivisie Live channels are not exclusively tied to one or two particular broadcasters. EMM agrees distribution deals with all interested platforms (including cable, satellite, terrestrial, and IPTV platforms), giving control of price to the platforms to market the Eredivisie Live product. This innovative non-exclusive distribution model is based on royalties paid by the platforms for each subscriber.[4]

The acquisition

On August 29, 2012 the parties notified the proposed concentration by which Fox acquires a majority stake of 51 per cent in EMM and in the administrative partner EBV. As a consequence, Fox will be able to exert decisive influence over both EMM and EBV. Eredivisie N.V. will hold 39.2 per cent of EBV's shares, the remainder being held by Endemol (9.8 per cent). ECV, Endemol, and KNVB remain minority partners of ECV with respective shares of 35.3 per cent, 8.8 per cent, and 4.9 per cent.

After examination of the notification, the NMa concluded that the notified operation is a concentration in the meaning of art.27(1)(b) of the Dutch Competition Act and thus subject to the scope of the Dutch merger provisions. The NMa focused its analysis on the possible horizontal and vertical effects of the transaction on the markets for the licensing of audiovisual content, the wholesale supply of TV channels, and TV advertising.

* Dr Ben Van Rompuy is a senior researcher and consultant at the T.M.C. Asser Instituut, The Hague, The Netherlands and associated research fellow at iMinds-SMIT, Brussels, Belgium.

[1] Dutch Competition Authority (NMa), "Eredivisie N.V.—wijze van exploitatie van live uitzendrechten van eredivisie-voetbalwedstrijden" (Joined Cases 18 and 1162), November 19, 2002.

[2] European Commission (Case COMP/37.398) UEFA Champions League [2003] OJ L291/25.

[3] Dutch Competition Authority (NMa), "Informele zienswijze Eredivisie CV—exploitatierechten", September 23, 2005.

[4] For a detailed analysis of Eredivisie Live, see Tom Evens, Daniel Geey, Katrien Lefever, and Ben Van Rompuy, "A Dutch solution to Premier League TV issues: part 1 and 2" (2010) 8 *World Sports Law Report* 9.

Consistent with the decisional practice of the European Commission,[5] the NMa concluded that the geographical scope of these relevant product markets is national.

On the basis of the following considerations, the NMa concluded that the transaction is unlikely to significantly impede effective competition in the relevant markets.

First, the NMa found no reason to believe that the transaction would give rise to horizontal concerns given the parties' very limited market shares. Even on the narrowest product market definitions, the parties hold no significant market power. In its decision, the NMa refers to: (1) the large number of considerably stronger competing content providers, including the other Hollywood majors, international and national sports organizers, and national producers of news, drama and, entertainment; (2) the small combined market share (i.e. below five per cent) of EMM and Fox on the market for the wholesale supply of TV channels[6]; and (3) the collective dominance of RTL Nederland, SBS Nederland, and NOS on the market for TV advertising.

Secondly, the NMa concluded that the transaction is unlikely to give rise to non-co-ordinated vertical effects that would significantly impede competition. In assessing the likelihood of input foreclosure, the NMa notes that Fox has an extensive portfolio of content, which is also licensed to third parties (i.e. free-to-air or pay TV broadcasters). Moreover, there is a multitude of competing content providers from which competitors can acquire attractive content.[7] In assessing the likelihood of customer foreclosure, the NMa reiterates that Fox and EMM only have limited market power in the Dutch television market.[8]

The marketing and exploitation of the Eredivisie rights

By way of an informal opinion, the NMa also gave its view on the parties' co-operation agreement regarding future modes of exploitation of the Eredivisie rights. In a "Co-operation Agreement in respect of the marketing and exploitation of the Eredivisie rights", the parties stipulated that over the period of twelve years (i.e. from the 2013–2014 season until the end of the 2024–2025 season) the self-exploited Eredivisie Live channels will continue to provide live coverage of the Eredivisie matches. Also, the highlights rights are likely to fall into Rupert Murdoch's hands. The match summaries are currently broadcasted by NOS, one of the Dutch public service broadcasters. This license expires on July 1, 2014. After this date, the parties envisage moving the higlights to a new sports channel, Fox NL. This new channel will need to be free-to-air: under Dutch media law, the football highlights need to be broadcast on a channel accessible to 75 per cent of all Dutch households, without additional costs.

In its earlier decisional practice, the NMa determined that the football clubs participating in the Eredivisie are the owner of their home game broadcasting rights.[9] Subsequently, a joint selling arrangement, which prevents the clubs to individually market their live broadcasting rights, may constitute an agreement between undertakings caught by art.6(1) of the Dutch Competition Act (DCA) and TFEU art.101(1).

The NMa identified two ways in which the intended exploitation of Eredivisie rights could affect competition in the downstream markets, i.e. the markets on which television broadcasters and distribution platforms compete.

First, the NMa considered that competition between distribution platforms could be restricted if access to the Eredivisie Live channels and/or Fox NL would be foreclosed. As indicated above, the Eredivisie Live channels are currently distributed on a non-exclusive basis by multiple platforms. The parties ensured that this non-exclusive, multi-platform distribution model will remain the same. All distribution platforms will be offered access to the Eredivisie Live channels in a non-discriminatory fashion. To this end, the parties provided various detailed commitments, such as compliance monitoring by an independent accountant. Regarding the eventual new Fox NL channel, the parties guaranteed that they would offer the free-to-air channel to all interested distribution platforms for as long as it has the exclusive right to broadcast the Eredivise highlights. Fox, however, retains the right to sell the Fox NL channel only as a bundle. In other words, Fox can make the purchase of the Fox NL channel conditional on also purchasing other Fox content. In its opinion, the NMa indicates that the underlying rationale—i.e. a combined offer is essential for succesfully entry and positioning into the free-to-air television market—is unconvincing. Given the attractiveness of the Eredivisie highlights, the other Fox channels, rather than Fox NL, would benefit from this strategy.[10] Yet the NMa finds no need to address this potential problem. It merely stresses that when discriminatory distribution deals would significantly restrict competition between distribution platforms, it could decide to revise its informal opinion.

Secondly, the NMa considered that competition between broadcasters could be restricted when the duration of the parties' exclusive control over the Eredivisie live broadcasting rights and highlights rights

[5] See, e.g. European Commission (Case COMP/M.6369) HBO/Ziggo/HBO Nederland [2012] OJ C72/3); European Commission (Case COMP/M.5932) Newscorp/BSkyB [2011] OJ C37/2.
[6] Fox also distributes National Geographic, National Geographic Wild, Foxlife, and 24Kitchen in the Netherlands.
[7] Dutch Competition Authority (NMa), "Besluit inzake melding voorgenomen concentratie Fox Entertainment Group, Eredivisiebeheer B.V. en Eredivisie Media & Marketing C.V." (Case 7500), November 29, 2012, pp.9–10.
[8] Dutch Competition Authority (NMa), "Besluit inzake melding voorgenomen concentratie Fox Entertainment Group, Eredivisiebeheer B.V. en Eredivisie Media & Marketing C.V." (Case 7500), November 29, 2012, p.10.
[9] Dutch Competition Authority (NMa), "Eredivisie N.V.—wijze van exploitatie van live uitzendrechten van eredivisie-voetbalwedstrijden" (Joined Cases 18 and 1162), November 19, 2002.
[10] Dutch Competition Authority (NMa), "Informele zienswijze Fox/Eredivisie", November 29, 2012, p.8.

would be excessive. Regarding the highlights rights, the NMa states in its opinion that they should periodically become available on the market. At the request of the competition authority, EMM therefore committed to reduce the length of exclusivity in the anticipated supply contract to Fox NL to six years.[11] On the basis of the business case put forward by EMM and Fox, the NMa deems a period of six years proportionate to facilitate the market introduction of Fox NL. After this period, third parties will be given a chance to bid for the rights following a non-discriminatory public tender procedure. The broadcaster that makes the most attractive offer—be it Fox NL or a competitor—will then acquire the highlights rights. Regarding the Eredivisie live broadcasting rights, third parties observed that the decision to continuously exploit these rights on the Eredivisie Live channels for a period of twelve years is disproportionate. In its informal opinion, the NMa firmly rejects this argument. The NMa notes that these rights are not indispensable for broadcasters to compete on the market for pay-TV. Furthermore, the NMa reiterates that the non-exclusive distribution of the Eredivisie Live channels encourages wide multi-platform diffusion of the Eredivisie Live product.

In light of the above, the NMa concludes that the parties' co-operation agreement regarding future modes of exploitation of the Eredivisie rights is unlikely to significantly restrict competition in the relevant downstream markets.

Access foreclosure to premium content

With 570,000 subscribers and an outstanding debt of €60 million, the Eredivisie Live station has so far fallen short of high expectations. Since the launch of Eredivisie Live in 2008, the annual revenues for the Eredivisie clubs dropped below €40 million. It is not surprising that the 18 Eredivisie clubs unanimously welcomed Ruport Murdoch's arrival as a breakthrough that will inject more money into the Dutch Premier football league and raise the quality and attractiveness of Eredivisie Live.

Much more remarkable is the NMa's conclusion that the unusually long broadcasting deal raises no appreciable competition concerns in the downstream pay-TV market. In its informal opinion on the future modes of exploitation of the Eredivisie rights, the NMa strongly downplays the importance of the Eredivisie live broadcasting rights as a driver for pay-TV subscriptions or for the take-up of new media services. First, the NMa observes that past ownership of these rights has not been decisive in the battlefield for market positions in the Dutch pay-TV market.[12] In 1996, the KNVB and a consortium of investors launched a new sports channel (Sport 7) that was scrapped after a few months. In 2005, telecom operator Tele2 acquired the live rights to rollout its triple-play services in the Netherlands. After three seasons, it was unable to renew the contract as a result of high losses and accumulated deficit. Yet it must be considered that, due to the high penetration of cable, the digitalisation of television has been slower in the Netherlands than in virtually all other Western European countries. In recent years, however, the number of Dutch households with digital TV connections has steadily increased. An agreement that forecloses access to the live rights for competing broadcasters for a period of 12 years should not be examined (exclusively) in light of past trends. The competitive assessment should rather anticipate current and future developments, especially in a rapidly evolving market. Secondly, the NMa notes that remedies imposed by the European Commission and National Competition Authorities to improve competition in the markets for the acquisition of sports media rights, such as the segmentation of the rights in evenly balanced packages, have proven to be unsuccessful.[13] In most cases, the NMa argues, the various packages are still acquired by one pay-TV operator.[14] This worrying sign of enforcement fatigue overlooks the specific circumstances of the cases referred to, in particular the presence of a dominant incumbent operator.[15] Moreover, it constitutes neither an argument for inaction nor evidence that the acquisition of sports broadcasting rights would be unimportant for effective competition between pay-TV broadcasters.

Another notable feature of the NMa's informal opinion is its position vis-à-vis the availability of the Eredivisie highlights rights. On the one hand, the NMa acknowledges that periodical access to these rights is essential for both existing broadcasters and new entrants. The NMa therefore required the parties to reduce the length of the exclusive supply contract to Fox NL to six years. After this period, other interested free-to-air broadcasters will be given the opportunity to also bid for the rights. On the other hand, the NMa leaves open the question whether the channel airing the Eredivisie highlights rights represents "must have" content for distribution platforms. It accepts that the purchase of Fox NL can be made conditional upon the purchase of other Fox channels. This implies that Fox NL might be offered to interested distribution platforms on discriminatory terms. Ironically, the NMa mentions that *if* Fox NL would turn out to be "must have" content for distribution platforms (which is already assumed), this practice could amount to an abuse of a dominant position, despite the limited market shares of the parties. Storing up problems for later?

[11] Dutch Competition Authority (NMa), "Informele zienswijze Fox/Eredivisie", November 29, 2012, p.8..
[12] Dutch Competition Authority (NMa), "Informele zienswijze Fox/Eredivisie", November 29, 2012, p.5.
[13] The NMa makes reference to European Commission (Case COMP/37.214) DFB (2005) and European Commission (Case COMP/38.173) FAPL (2006).
[14] Dutch Competition Authority (NMa), "Informele zienswijze Fox/Eredivisie", November 29, 2012, p.5.
[15] See, e.g. Ben Van Rompuy, "Fair access to exclusive sports rights still a long shot in the UK pay TV market" (2009) 14 *Communications Law* 4, 118.

Conclusion

Rupert Murdoch certainly got his timing right. Fox's acquisition of a majority stake in EMM and EBV comes at a time when Eredivisie clubs are hit by financial woes and are losing ground to their European rivals. Various top clubs, such as Ajax, have openly expressed dissatisfaction with the revenues generated from Eredivisie Live and launched their own on-demand club channel with interviews, behind the scenes footage, etc. in an attempt to boost media revenues. The strategic importance of the €1,02 billion deal might also have persuaded the NMa to opt for a hands-off approach. Various potential competition issues linger, however. Hopefully the real problem will not turn out to be the identified lack of effective remedies, but lack of enforcement.

National Reports

MERGER REGULATIONS

Prior notifications of proposed concentrations

Ageas/Groupama Insurance Company

Case Comp/M.6733
3.10.12 OJ C297/4

Triton/European Directories

Case Comp/M.6732
3.10.12 OJ C297/6

Carlyle/DuPont Performance Coatings Business

Case Comp/M.6727
3.10.12 OJ C297/7

ARM/Gisecke & Devrient/Gemalto/JV

Case Comp/M.6564
3.10.12 OJ C297/8

Abertis Infraestructuras/Brookfield/Participes

Case Comp/M.6725
3.10.12 OJ C297/9

CD&R/Wilsonart

Case Comp/M.6710
5.10.12 OJ C300/16

Sun Capital/Rexam Personal and Home Care Packaging Business

Case Comp/M.6665
5.10.12 OJ C300/17

SK Innovation Co/Continental AG

Case Comp/M.6706
5.10.12 OJ C300/18

Glencore/Xstrata

Case Comp/M.6541
9.10.12 OJ C304/6

MOL/KMG EP/JV

Case Comp/M.6677
9.10.12 OJ C304/7

GE/Accenture/Taleris

Case Comp/M.6675
12.10.12 OJ C308/14

Toyota Tsusho Corporation/CFAO

Case Comp/M.6718
12.10.12 OJ C308/16

First Reserve Management/SK Capital Partners/TPC

Case Comp/M.6721
13.10.12 OJ C310/41

Kinnevik/Billerud/Korsnas

Case Comp/M.6682
16.10.12 OJ C312/23

Helvetia/Certain parts of Gan Eurocourtage's Transport and Marine Insurance Portfolio

Case Comp/M.6694
16.10.12 OJ C312/24

Terex/GAZ/JV

Case Comp/M.6686
18.10.12 OJ C314/14

Procter & Gamble/Teva Pharmaceuticals OTCII

Case Comp/M.6705
18.10.12 OJ C314/15

Whirlpool/ALNO

Case Comp/M.6717
20.10.12 OJ C317/21

Talisman/Sinopec/JV

Case Comp/M.6700
24.10.12 OJ C322/2

Advent/Douglas Holding

Case Comp/M.6711
24.10.12 OJ C322//3

Eaton Corporation/Cooper Industries

Case Comp/M.6642
25.10.12 OJ C324/14

Talanx International/Meiji Yasuda Life Insurance Company/HDI Poland

Case Comp/M.6743
27.10.12 OJ C330/14

Koch Industries/Guardian

Case Comp/M.6745
27.10.12 OJ C330/15

SNCF/Haselsteiner Familien-Privatsiftung/Augusta Holding/Rail Holding

Case Comp/M.6745
27.10.12 OJ C 330/16

Magna/ixetic

Case Comp/M.6748
30.10.12 OJ C332/12

AAEC/Rabo Investments/Vecelia/HVEG

Case Comp/M.6726
30.10.12 OJ C332/13

LBO France/Aviapartner

Case Comp/M.6672
30.10.12 OJ C332/14

Canada

MERGERS

Film distribution—Alliance Films Holdings Inc/Entertainment One Ltd—Position statement

Acquisitions; Canada; Distributors; Film industry; Films; National competition authorities

On January 3, 2013 the Competition Bureau released a Position Statement regarding the proposed acquisition of Alliance Films Holdings Inc. (Alliance) by Entertainment One Ltd. (eOne).

The Bureau issued a "no action letter" notwithstanding that the Canadian films distributed by the parties account for the vast majority of the revenues generated by Canadian films. Distribution of Canadian films was determined to be a distinct product market as a result of government cultural initiatives and funding programmes.

The Bureau determined that the merged entity would be constrained in its ability to reduce minimum guarantees paid to producers of Canadian films or to increase the distribution fees paid by the producers.

The Bureau also concluded that if the merged entity distributed fewer Canadian films post-merger, smaller Canadian distributors would likely expand and distribute the films.

Finally, the Bureau found that any associated anti-competitive effects from the merger would likely be very small, relative to the efficiencies likely to result from the merger.

Peter Glossop

Canada

MERGERS

Hog rearing and pork—Vertical mergers—No action letters

Acquisitions; Canada; Meat; National competition authorities; Pigs

On December 17, 2012 the Bureau released a Position Statement regarding the proposed acquisition of Big Sky Farms Inc. (the largest independent hog producer on Western Canada) by Olymel LP, (which has a processing plant in Alberta) and the proposed acquisition of Puratone Corporation (a Manitoba producer) by Maple Leaf Foods Inc. (which has plants in Alberta and Manitoba).

The Bureau reviewed the transactions separately and in the order they were filed. It issued no action letters to both acquirors. In both cases, the Bureau concluded the transactions were unlikely to create or increase market

power upstream due to an excess demand for hogs, and the inability to create or increase market power downstream due to effective remaining competition.

Although Olymel and Maple Leaf would likely have the ability and incentive post-merger to harm rivals by foreclosing access to hogs, they were unlikely to lessen or prevent competition because effective competition would remain downstream, including between Maple Leaf and Olymel.

The Bureau found that Olymel and Maple Leaf would likely have the ability to harm rivals by foreclosing hog producers' access to a sufficient customer base as Olymel and Maple Leaf control a significant amount of processing capacity in western Canada. However, they would not have the incentive to foreclose rival hog producers since the costs of foreclosing access would exceed the gains from doing so.

Peter Glossop

Canada

MERGERS

Electricity distribution—EECOL Electric Corp/WESCO Distribution Inc—Position statement

Acquisitions; Canada; Electricity distribution; National competition authorities

On December 7, 2012 the Bureau released a Position Statement regarding the proposed acquisition of EECOL Electric Corp (EECOL) by WESCO Distribution Inc. (WESCO). Although the parties were significant competing distributors in Western Canada in low voltage and high voltage electrical components, a no action letter was issued. The Bureau found that there were at least two effective competitors remaining post-merger in each relevant geographic area. Key manufacturers had significant bargaining power and the ability to switch distributors or sponsor new entry.

Peter Glossop

Czech Republic

ANTI-COMPETITIVE AGREEMENTS

Waste disposal—Cartel—Infringement—Penalties

Cartels; Competition agreements; Czech Republic; Fines; Leniency programmes; National competition authorities; Waste disposal

The Competition Office (the Office) has settled a cartel investigation with four companies active in the market for waste collection and disposal and some of them also in the market for road maintenance. The companies A.S.A, van Gansewinkel, SITA and AVE were fined a total of CZK 96.579 million (approx. €3,825,000) for operating a cartel that restricted competition on the Czech market. In doing so, they breached s.3(1) of the Czech Competition Act.

The fine on all companies includes a reduction of 20 per cent for acknowledging their participation in the cartel, thereby helping the Office to conclude the case more rapidly. In addition, companies A.S.A and AVE were granted reductions of their respective fines amounting to 50 per cent (A.S.A.) and 30 per cent (AVE) for co-operation under the Leniency programme. Accordingly, for the infringement, A.S.A. was fined CZK 24,289,000, van Gansewinkel CZK 10,870,000, SITA CZK 19,753,000 and AVE CZK 41,667,000.

The Office uncovered the cartel by its own investigation and found that for four years, between 2007 and 2011 (SITA and van Gansewinkel only between 2008 and 2010), these companies shared markets, allocated customers between themselves and exchanged commercially sensitive information, particularly by co-ordinating their bids in public tenders for waste disposal and road maintenance. The Office concluded that the cartel members participated in an illegal cartel on the basis of numerous documents

discovered during on-site inspections. According to the Office, these documents show that the companies co-ordinated their bids in order to secure contracts from contracting authorities for the cartel members. For this purpose, members of the cartel prepared sham bids by the companies not supposed to win the tender, in order to leave an impression of genuine competition or, on the other hand, agreed to abstain from bidding. On that basis the Office held that these practices are a very serious infringement of the Czech anti-trust rules and imposed fines on the cartel members for the infringement thereof.

The above decision clearly demonstrates that the Czech Competition Authority is serious about dealing with cartel agreements resulting in harm to the interests of direct customers and final consumers.

Tomáš Fiala
Vejmelka & Wünsch

Denmark

LEGISLATION

Competition Act—Amendments—Procedure—Personal sanctions

Cartel offences; Cartels; Denmark; Fines; Imprisonment; Sentencing powers

The Danish Competition Act has been amended resulting in an increase of fining levels and imprisonment of parties involved in operating cartels. Besides that, minor procedural changes have been made.

Further to our contribution in the second issue of 2013, the draft Bill amending the Danish Competition Act has now been passed December 19, 2012. The Bill comprises an increase of fines for operating cartels and imprisonment of the involved parties. The Bill will enter into force March 1, 2013.

Thus, the explanatory notes to the bill states that the base amount for fines regarding “less serious” infringements is raised from between DKK 10,000 and DKK 400,000 to as much as DKK 4 million; “serious infringements” is raised from between DKK 400,000 and DKK 15 million to between DKK 4 million and DKK 20 million; and “very serious” infringements are raised from DKK 15 million to upwards of DKK 20 million. To assure compliance with EU competition law it is underlined that the fines are not to exceed the 10 per cent turnover limit known from the EU Commission. Along with this serious increase of fines for the involved undertakings the Bill also sets out an escalation of the personal fines; usually the persons in charge of the undertakings.

Furthermore the Bill comprises imprisonment of the persons operating cartels. The main rule will be up to an 18 month imprisonment in cases of serious cartel offences and with a penalty of six years of imprisonment under very aggravating circumstances. The penalty of six years of imprisonment very conveniently triggers the possibility of using wiretapping and other serious investigative actions on the alleged cartel participants.

Jens Munk Plum
Kromann Reumart

Denmark

ANTI-COMPETITIVE AGREEMENTS

Adult education—Association—Commitments offered

Articles of association; Commitments; Denmark; Educational institutions; Market sharing; National competition authorities

The articles of association of the Danish provider of adult liberal education (FOF) prohibited the existence of more than one local department within one municipality, unless the national executive board had given its permission. It also limited the local associations' possibilities to conduct their business in other municipalities, having their own local departments, unless these local departments agreed to it.

On May 29, 2012, the Danish Competition and Consumer Authority (DCCA) sent its statement of objection to FOF, stating that the relevant provisions in the constitution infringed s.6 of the Danish Competition Act (regarding competition limiting agreements). The DCCA found that the relevant provisions in the articles of association comprised market splitting with the effect of limiting the competition.

To meet DCCA's concerns, FOF offered to submit certain commitments, which DCCA accepted. The commitments consisted of: (i) removing the provisions in the articles of association; (ii) refrain from adopting similar provisions again; and (iii) communicating the commitments to the members of FOF and documenting that the commitments were actually complied with.

The case was then closed after FOF's compliance with the commitments.

Jens Munk Plum
Kromann Reumart

Denmark

MERGERS

Broadcasting—Modern Times Group MTG A/S/TV 2 Danmark A/S ("TV 2")—Conditional clearance

Broadcasters; Commitments; Denmark; Football; Mergers

Modern Times Group MTG A/S (MTG) and TV 2 Danmark A/S (TV 2) jointly owned TV 2 Sport A/S (TV 2 Sport). MTG then submitted its acquisition of TV 2's shares, resulting in MTG's total ownership of TV 2 Sport.

The Danish Competition and Consumer Authority (DCCA) found that the merger would result in MTG having greater disposal over the rights to transmit top class football than before. The transmission rights will be put out to tender in 2015, where multiple interested competitors are expected to bid.

The DCCA found that the merger would result in a risk of limiting the competition, because of the accumulation of the most important football rights being at MTG's disposal until 2015. Therefore, MTG proposed to submit certain commitments, consisting of: (i) an obligation to service TV 2 Sport with the existing content of top football; (ii) not tying the sale of TV 2 Sport together with other of MTG's products; (iii) not require TV 2 Sport to be included in certain packages at the distributors; and (iv) sublicensing a part of the rights to the Danish "Superliga" (according to the British Premier League) football matches. The commitments are limited until the tender begins in 2015, since the acquisition does not result in MTG obtaining a permanent dominant position.

DCCA found that the commitments ensured that MTG cannot misuse the accumulation of rights to top football until 2015. Therefore, the commitments make sure that the effective competition is not restricted in the period until 2015, for which reason DCCA accepted the commitments and approved the merger.

Jens Munk Plum
Kromann Reumart

Denmark

ANTI-COMPETITIVE AGREEMENTS

Real estate—Association—Infringement decision—Appeal—Outcome

Access; Anti-competitive practices; Denmark; Estate agents; Vertical agreements; Websites

Further to our contribution in the second issue of 2012, the Danish Competition Council's (DCC) decision regarding the concerted practice of the Danish Association of Chartered Estate Agents (DE) and its members was appealed to the Danish Competition Appeals Tribunal (DCAT), which has now ruled on the matter.

DCAT upheld the main part of the decision, finding that the real estate chains and DE had participated in arrangements, which consisted in denying one particular real estate search portal, boliga.dk, access to photos of real estate for sale on the internet, to protect the DE members' own competing real estate search portal, which is the only other portal of any importance in the Danish market (boligsiden.dk).

However, the decision was changed on one point. DCC had ordered the participants to refrain from *any* vertical restrictions internally in the chains. This part of the decision was annulled by DCAT, which only ordered the participants to refrain from implementing the horizontal agreements vertically in the chains.

DCAT furthermore found that—unusual for franchise relationships—it was the franchisee and not the franchisor who offered the IP rights, and thus the European Commission's group exemption on vertical agreements did not apply. Therefore, any future agreements internal to the chains (vertical agreements), shall be assessed individually.

Jens Munk Plum
Kromann Reumart

France

ANTI-COMPETITIVE AGREEMENTS

Audio and visual products—Selective distribution—Ban on Internet sales—Infringement—Penalties

Anti-competitive practices; Audio equipment; Fines; France; Selective distribution agreements

On December 12, 2012, the French Competition Authority ruled on the validity of Bang & Olufsen selective distribution agreement forbidding mail order sellings, including internet sales.

In its decision dated October 13, 2011 in the *Pierre Fabre Dermo-Cosmétique* case, the European Court of Justice considered that the legitimacy of a clause forbidding de facto internet sales by the members of the selective distribution network should be analyzed by the State Court. Yet the court also indicated that the objective of protecting a prestigious brand image should not constitute a legitimate objective in order to restrict competition.

In view of the above, the Competition Authority considered that by excluding a distribution channel such as the internet, Bang & Olufsen limits unilaterally the commercial liberty of the retailers members of a selective distribution network to sell their goods to more customers. For the Authority, such customers would also be restricted from the benefit of a more vast choice, with easier access to products and better prices.

Moreover, the Authority noted that Bang & Olufsen did not present any objective justification for banning mail order and internet sales and did not ask for an individual exemption.

Thus considering that banning internet sales should be considered as a hardcore restriction, in the absence of a request for individual exemption this ban cannot be considered as justified under TFEU art.101 para.3 or art.L.420-4 of the French Commercial Code.

Consequently, the Authority imposed a fine of €900.000 to Bang & Olufsen and requested the modification of the selective distribution agreements applicable in Bang & Olufsen's network in order to state clearly that authorized retailers are allowed to sell the brand goods on the internet channel.

Yann Utzschneider
Gide Loyrette Nouel A.A.R.P.I.

Alexandre Glatz
Gide Loyrette Nouel A.A.R.P.I.

Germany

ABUSE OF DOMINANT POSITION

Port facilities—Access—Essential facilities—Conditions—Case referral

Abuse of dominant position; Access; Ferries; Germany; Ports

On December 11, 2012 the German Federal Court of Justice (*Bundesgerichtshof*—BGH) annulled the decision of the Higher Regional Court in Düsseldorf (*Oberlandesgericht*—OLG) which had considered the refusal of a ferry port owner and provider of ferry services to grant potential competitors access to its ferry port to be objectively justified and therefore not abusive.

Scandlines Deutschland GmbH (Scandlines) owns the ferry port Puttgarden/Fehrmarn and provides the only ferry service from there to Rødby/Denmark. Two Norwegian companies intend to also offer a ferry service on this route. They request permission to jointly use the ferry port Puttgarden. Scandlines refused to grant access to the landward and seaward port facilities.

With decision of January 27, 2010 the German Federal Cartel Office (*Bundeskartellamt*—FCO) had held that Scandlines' refusal to grant the applicants access to its infrastructure facilities in return for a reasonable payment and its refusal to provide or allow for the necessary provisions for a joint use of the ferry port infringed TFEU art.102 and s.19(4) of the German Act against Restraints of Competition (GWB). The FCO therefore had ordered Scandlines to enter into negotiations with the two applicants and to provide a proposal for non-discriminatory access to enable the applicants to offer competing ferry services.

Upon appeal of Scandlines the OLG on December 7, 2011 annulled the FCO's decision as unlawful, stating that Scandlines did not infringe s.19(4) GWB or TFEU art.102.

Section 19(1) GWB corresponds to TFEU art.102 and prohibits as unlawful an undertaking's abuse of a dominant position. As an example of such abuse, s.19(4) GWB lists the refusal to grant access to infrastructure facilities, the joint use of which is indispensable for such undertaking to operate as a competitor of the dominant undertaking on the upstream or downstream market (essential facility); however, such refusal does not constitute an abuse if the dominant undertaking demonstrates that the joint use is impossible or unacceptable.

The OLG left open whether Scandlines was in fact in a dominant position and therefore subject to s.19 GWB or TFEU art.102 and whether the existing ferry port could actually not be duplicated and was indispensable for the applicants. It concluded that, in any event, Scandlines' refusal to grant access was justified because the joint use of the ferry port was impossible for legal reasons due to the fact that the areas intended by the applicants to be used as parking zones were reserved for railway traffic. It was not predictable with sufficient probability whether this obstacle could be removed. In view of the OLG, the uncertainty in this respect was to the detriment of the FCO and the applicants. Whilst the facility's owner had to provide evidence of the existence of obstacles within the meaning of s.19(4) GWB, the owner's property right guaranteed under constitutional law required that if a legal

obstacle for the joint use of an essential facility has been established and it cannot be clarified whether it could be removed, such uncertainty would be to the detriment of the undertaking requesting access.

However, on appeal the BGH annulled the OLG's decision and referred the case back to the OLG. The BGH stated that the assessment of a justification for the refusal to grant access due to an alleged impossibility or unacceptability within s.19(4) GWB always requires a prognosis. In particular, complex projects could hardly be executed without obtaining prior decisions by the authorities, frequently without fully predictable outcome. According to the statutory distribution of the burden of proof, the uncertainty as to whether the joint use was possible would be to the disadvantage of the owner of the infrastructure facility. This applied in particular to the joint use of port facilities to enable competition on the downstream market of ferry traffic as an application of s.19(4) GWB.

The BGH concluded that on the basis of the facts so far established by the OLG a permanent impossibility of the joint use and, therefore, an objective justification of the refusal to grant access within s.19(4) GWB could not be assumed. The serious, not merely vague possibility that parts of the currently unused railway infrastructure might be required for future railway projects and that therefore the joint use of the ferry port as required by the applicants might not receive the necessary concessions by the authorities are not sufficient for an objective justification for a refusal to grant access. Therefore, an abuse of a dominant position under s.19(4) GWB or TFEU art.102 by Scandlines' refusal to grant the Norwegian applicants access to the ferry port could not be excluded with that argument.

The case in hand is in no way settled. The OLG will now have to reconsider the matter. The decision of the BGH clarifies that the owner of an essential facility bears the full burden of proof under s.19(4) GWB that its rejection to grant access is objectively justified because joint use would be impossible or inacceptable. However, the case also demonstrates that, depending on the procedural approach, it can be a time-consuming exercise to secure access to infrastructure owned by a third party based on the essential facility doctrine, even in view of the specific codification of that doctrine in the GWB and the FCO's active enforcement approach.

Dr. Ingo Klauß

Nina Laskey
Linklaters LLP, Düsseldorf

Slovenia

PROCEDURE

Enforcement—Case backlog—Approach

Delay; National competition authorities; Press releases; Slovenia

On July 2, 2012 the Competition Protection Office (hereinafter CPO or the Office) published a press release as a response to media accusations on caseload backlogs in administrative procedures conducted on the basis of the Prevention of Restriction of Competition Act.

According to the press release, most of the above-mentioned procedures have been completed within the time limits laid down by the relevant legislation, but some of them remain unsolved due to an ongoing human resources problem. The entire Office consists of merely 16 officials entrusted not only with administrative procedures on the basis of the Prevention of Restriction of Competition Act but also with minor offence proceedings and administrative procedures on the basis of the Access to Public Information Act. Furthermore, the officials are responsible for giving opinions and clarifications to other public authorities and individuals on issues related to competition law. According to statistical data presented by the Office, 14 out of 40 Antitrust and 4 out of 20 Merger procedures introduced since 2005

remain unsolved, and most of them are not older than two years. The press release and the statistical data show that the Office indeed recognises the alleged backlogs but attributes them to a combination of staff shortage and procedure complexity.

Since this seems to be an ongoing issue, the CPO on July 19, 2012 notified the public about the establishment of a task force entrusted with three key tasks:

1. Examination of pending administrative cases dated 2008 and earlier;
2. Elaboration of the Plan for elimination of caseload backlogs in administrative procedure conducts, primarily establishing deadlines for decision issuing;
3. Designation of officials responsible for allocated administrative procedures, which have to provide updated information about the procedure to a member of the task force overseeing this individual procedure.

The task force is to complete these tasks by July 31, 2013.

Urša Horvat
University of Ljubljana

Slovenia

LEGISLATION

Competition Protection Agency—Independence

National competition authorities; Slovenia

On March 29, 2011, the National Assembly adopted an amendment to the Prevention of Restriction of Competition Act that provided for a conversion of the Competition Protection Office (hereinafter CPO) into the Slovenian Competition Protection Agency (hereinafter SCPA). The new agency was first intended to come into operation on January 1, 2012, but the conversion was then delayed and is finally being put into action at the end of 2012. To account for the delay, three governmental decrees concerning the establishment of the SCPA have also been adopted, the last of them adopted in August of 2012.

The most important change the conversion will bring relates to the legal status of an agency. While the current CPO is a body affiliated to the Ministry of Economic Development and Technology, the anticipated Agency will be an independent authority. It is important to note that this conversion was largely influenced by the opinion of the OECD and by the European Union's policy. The latter encourages the establishment of such independent regulatory agencies due to the following advantages:

- agencies are separate legal entities, which means they are not part of the state administration;
- directors of such agencies cannot be banned from their function for political reasons (staff autonomy); and
- as one of the most important advantages, agencies are required to receive most of their resources from private or otherwise independent sources or from an independent budgeting item (financial autonomy).

In accordance with the amended Prevention of Restriction of Competition Act, the members of the SCPA shall not be bound by any guidelines and instructions of any state authority, unless these are adopted by the Government or by the National Assembly. Even such guidelines shall only be of a general nature and shall not interfere with the conduct of SCPA's proceedings in concrete cases.

The SCPA will have two bodies—the Council and the Director General. The Council will consist of five members, including the President, and will be elected by the National Assembly upon the proposal of the Government. This is supposed to contribute towards a greater independence of the Agency, as opposed to the current situation where the Director of CPO is named directly by the Government.

At the time of writing, the Agency has not yet been established.

Dr. Matej Accetto
University of Ljubljana

Urša Horvat
University of Ljubljana

Sweden

ANTI-COMPETITIVE AGREEMENTS

Vehicle parts—Warranty conditions—Unlawful

Anti-competitive practices; Competition agreements; Duration; Motor dealers; Motor vehicles; Repairs; Spare parts and accessories; Sweden; Warranties

On December 4, 2012, the Swedish Market Court (the court) announced its judgment in a case between the association of Swedish independent vehicle parts retailers (SBF) and Kia Motors Sweden (Kia). The proceedings touched upon a number of questions for which there were no clear legal precedents at either EU or national level. The court ruled in accordance with the plaintiff's main claim, obligating Kia to cease applying a clause in its warranty conditions, according to which regular car servicing had to be carried out at workshops authorised by Kia in order for the full seven-year warranty period to apply. The court's conclusion was that the relevant clause was considered to constitute an anti-competitive agreement between Kia and the authorised workshops.

Daniel Kim
Mannheimer Swartling

Sweden

ANTI-COMPETITIVE AGREEMENTS

Sports league—Player contracts—Restrictions—Lawful

Anti-competitive practices; Competition agreements; Ice hockey; Sportspersons; Sweden

In a decision in September 2012, the Swedish Competition Authority (SCA) took the view that the decision of Svenska Hockeyligan AB (Sweden's elite ice hockey league, "Hockeyligan") to prevent its member clubs from signing contracts with ice hockey players affected by the lockout in North America's National Hockey League, NHL, constituted an agreement restricting competition in breach of TFEU art.101 (and the equivalent national provision). Therefore, the SCA issued an interim decision prohibiting Hockeyligan from entering into such an agreement until the case was finally settled. However, on December 18, 2012, the Swedish Market Court found that the agreement in question did in fact serve a legitimate purpose and was proportionate. The SCA's decision was therefore overruled.

Daniel Kim
Mannheimer Swartling

Sweden

ANTI-COMPETITIVE AGREEMENTS

Mobile telephony—Investigation—Closed

Competition agreements; Mobile payments; Mobile telephony; National competition authorities; Sweden

On December 21, 2012, the SCA closed its investigation into suspected anti-competitive co-operation between the leading four mobile operators in Sweden for the creation of a mobile payments platform (initially called T4 and later renamed WyWallet). The investigation was closed as it did not support the finding of a breach of the competition rules.

Daniel Kim
Mannheimer Swartling

Sweden

ANTI-COMPETITIVE AGREEMENTS

Motor sport—Competitive rules—Restriction—Infringement

Competition agreements; Motor sports; Sporting events; Sweden

On December 20, 2012, the Swedish Market Court found that certain loyalty rules agreed between the members of the Swedish Automative Federation (*Sw: Svenska Bilsportförbundet*), prohibiting drivers and officials from participating in competitions that had not been sanctioned by the Federation, constituted a breach of TFEU art.101 (and the equivalent national provision).

Daniel Kim
Mannheimer Swartling

Switzerland

ANTI-COMPETITIVE AGREEMENTS

Mountaineering equipment—Resale price maintenance—Infringement—Penalties

Anti-competitive practices; Competition agreements; Fines; National competition authorities; Resale price maintenance; Switzerland; Wholesale trade

On August 20, 2012, the Swiss Competition Commission (ComCo) imposed a fine of CHF 470,000 (approx. €380,000) on Roger Guenat SA (as of 2011 Altimum SA) for engaging in re-sale price maintenance between 2006 and 2010. The investigation was opened with a dawn raid taking place at Roger Guenat SA's premises. In its official press release, the ComCo emphasizes the importance of the decision due to its major impact on consumers. According to ComCo, the decision further follows the legislator's will to lower high prices in Switzerland.

The ComCo assessed whether Roger Guenat SA imposed minimum resale prices on its independent resellers. Roger Guenat SA is a wholesaler of different brands of mountaineering gear in Switzerland and in particular acted as Petzl's general importer for Switzerland during the period under examination. The pricing mechanism in question was straightforward: all prices have been calculated by Roger Guenat SA based on Petzl's wholesale price list: Roger Guenat SA itself purchased according to Petzl's wholesale price list by multiplying the price with the current Euro-Swiss Francs exchange rate. By multiplying Petzl's list price with a certain factor, Roger Guenat SA then calculated the final selling price for Switzerland. Resellers were provided with a price list containing these final selling prices on an annual basis. Finally, Roger Guenat SA deducted a variable percentage from the final selling price, resulting in the reseller's purchase price. Only by telephone,

Roger Guenat SA would let its resellers know the details of the price mechanism: they were allowed to grant rebates of up to 10 per cent on the final selling prices.

In addition, Roger Guenat SA closely monitored, whether its resellers adhered to the price mechanism. If they priced too low (e.g. granting higher rebates than 10 per cent), they were warned that deliveries would be delayed or entirely suspended. Such warnings have in at least one case been turned into reality. As for big re-sellers, monitoring was facilitated due to catalogues and online shops (transparency). Regarding small resellers, Roger Guenat SA paid unannounced visits or was informed about too low prices in the market by the non-complying reseller's competitors. ComCo concluded that Roger Guenat SA did not only recommend resale prices but indirectly fixed minimum resale prices as its final selling prices were only allowed to be undercut to a certain extent. Therefore, the agreement was deemed to fall within the legal presumption of eliminating effective competition.

In its assessment of the market situation, ComCo found that intra-brand competition has been eliminated. As a general importer, Roger Guenat SA was the only supply source in Switzerland. On an international level, general importers allegedly referred potential foreign buyers to the general importer responsible for the territory (however, the scope of the investigation did not cover potential market foreclosure). As for inter-brand competition, all affected markets were characterized by an oligopolistic structure of three big players, Roger Guenat SA always being one of them. With the exception of the market for headlamps, there was sufficient inter-brand competition leading to a rebuttal of the presumption of eliminating effective competition. However, the ComCo found that there was a significant restriction of effective competition as the parameter price was concerned and Roger Guenat SA's market shares ranged from 10 per cent–20 per cent in the market for ropes up to 25 per cent–45 per cent in the market for helmets and harnesses. Since there were no grounds for justification based on economic efficiencies, a fine of CHF 470,000 has been imposed on Roger Guenat SA.

Samuel Howald
Schellenberg Wittmer

Turkey

MERGERS

Turnover thresholds—Amendment

Acquisitions; Merger control; Mergers; National competition authorities; Notification; Turkey; Turnover thresholds

Shortly after the release of the Discussion Paper on threshold limits in September 2012 by the Authority, the *Communique* on Mergers and Acquisitions Requiring Permission from the Competition Board has been amended. Adopted in 2010, the new *Communique* had abandoned market threshold altogether, accepting a dual turnover threshold. The first one, based on aggregate and individual domestic turnovers of the merging companies is left untouched while the one based on the global (500 million Turkish lira—approx. €214 million) and the domestic (5 million Turkish lira—approx. €2.14 million) turnovers of the merging undertakings respectively has been amended. Pursuant to the new rule, those acquisition transactions where the acquired assets or activities exceed 30 million Turkish lira (approx. €12.82 million) and those mergers transactions where the domestic turnover of at least one of the parties exceeds the same shall require permission from the Board provided that at least one of the other parties' global turnover exceeds 500 million Turkish lira as well. Moreover, the affected market exception, relating to those transactions exceeding the thresholds, but regarding which there are no affected markets, has been abolished. Thus, even those mergers and acquisitions between undertakings

that are neither in a horizontal nor vertical relationship shall have to be notified to the Authority for permission if the transaction is exceeding any of the dual thresholds. The new rules shall enter into force on February 1, 2013.

Asc. Prof. Dr. N. Ayşe ODMAN BOZTOSUN
Akdeniz University, Antalya

Turkey

ANTI-COMPETITIVE AGREEMENTS

Media rights—Football—Investigation

Anti-competitive practices; Broadcasting right; Exclusive distribution agreements; Exemptions; Football matches; National competition authorities; Tendering procedures; Turkey

The broadcasting rights for the Turkish Premier League matches had been acquired by Krea İçerik Hizmetleri ve Prodüksiyon Corp. (popularly known as "Digiturk") at the public tender organised by the Turkish Football Federation (TFF) in 2010 until the end of the 2014–2015 season. TFF and Digiturk concluded a Supplementary Agreement in 2012, extending the term of the exclusive broadcasting rights until the end of the 2017–2018 football season, against which Dogan Media Corp. complained to the Authority. Shortly after the Board decided to investigate whether the agreement would merit an individual exemption, TFF objected to this decision, claiming that the Board was acting inconsistently with its previous decisions where it declined from reviewing the public tender process on the grounds that TFF was authorised by law to market the relevant broadcasting rights at its own discretion. It was a close decision by four against three votes, where the Board decided not to grant an individual exemption to the Supplementary Agreement, arriving at the conclusion that competition would be seriously restricted in the relevant market and that such restriction was disproportionate to the expected benefits. One of the suggestions in the decision to achieve a better balance was to decrease the term of the Agreement, which the parties took up later in the year and limited the term up until the end of the 2016–2017 season. Nevertheless, the Board was not satisfied by this arrangement and recently decided to investigate whether the renewed Supplementary Agreement could be held exempt or not. The decision is awaited eagerly by the Turkish football community and media.

Asc. Prof. Dr. N. Ayşe ODMAN BOZTOSUN
Akdeniz University, Antalya

Turkey

ABUSE OF DOMINANT POSITION

Telecommunications—Turk Telecom—Margin squeeze—Re-examination

Abuse of dominant position; National competition authorities; Pricing; Telecommunications; Telephone charges; Turkey

In 2008, the Turkish Competitive Telco Operators Association (TELKODER) had filed a complaint with the Authority against Türk Telekomünikasyon Corp (Türk Telekom), claiming that retail prices for end users were set at a level below wholesale prices charged from rival long distance telephone service providers, an act, which in the complainant's view constituted an abuse of dominant position. The Board had decided otherwise[1] and TELKODER had appealed to the Council of State against this decision. The 13th Circuit of the Council of State finally decided in favour of TELKODER last May,[2] upon which the Board decided to review the case.

The main argument of the Board in rejecting the complaint was the fact that the prices set by Türk Telekom had already been approved by the relevant regulatory body, i.e. the Information and Communication Technologies Authority (ICTA—the then Telecommunication Authority). According to the Board, investigating the pricing policy of Türk Telekom would amount to reviewing ICTA's decision, in which case it would be contrary to the principles of administrative law to assume the role of the

[1] Date and number of decision: September 11, 2008, 08-52/792-321.
[2] Date and number of decision: May 8, 2012, 2012/960.

judiciary as an administrative authority and to decide on the legality of another administrative authority. The Council of State, on the other hand, rendered that the Board's authority to review abuse of dominance cases was uncontested, so was the fact that price squeezing constituted a type of such abuse. This line of reasoning led the Council of State to arrive at the conclusion that approval by a sectoral authority of certain practices carried out by undertakings would not give rise to immunity from the application of competition law and that the Board is required by law to pursue such cases. The possible acceptance of this view by the Board would definitely lead to a less secure environment for dominant undertakings in the Turkish telecommunication market.

Asc. Prof. Dr. N. Ayşe ODMAN BOZTOSUN
Akdeniz University, Antalya

UK

ANTI-COMPETITIVE AGREEMENTS

Food retail—Diary products—Concerted Practice—Infringement decision—Appeal—Partial annulment—Approach to hub-and-spoke concertation

☞ Anti-competitive practices; Concerted practices; Data sharing; Milk products; Pricing; Supermarkets

On December 20, 2012, the Competition Appeal Tribunal (CAT) handed down judgment on the liability aspect of Tesco's appeal against the OFT's dairy retail price initiatives decision.

The OFT found that, in both 2002 and 2003, a number of competing undertakings, including Tesco, had indirectly exchanged their future retail pricing intentions via their common suppliers (so-called "hub and spoke exchanges"). In relation to the 2002 alleged concerted practice, the CAT found that the OFT had established to the requisite legal standard that Tesco had infringed the Ch.I prohibition by participating in A-B-C information exchanges on three occasions. However, the CAT concluded that there was insufficient evidence to support the OFT's findings in relation to five other information exchanges in 2002. In addition, the CAT concluded that there was insufficient evidence to support the OFT's findings in relation to Tesco's involvement in the alleged 2003 infringement.

The judgment reviews and discusses the legal requirements for establishing a concerted practice by way of an A-B-C (or hub and spoke) information exchange. This is the first time that the CAT has had to consider such arrangements since the judgment of the Court of Appeal in replica kit and toys ([2006] EWCA Civ 1318), and, as the CAT notes, there are no EU cases dealing:

> "specifically with the circumstances in which there can be a concerted practice by virtue of indirect contact between two or more undertakings via a common supplier".

The judgment applies the Anic presumption, namely that where a party receives information about the future conduct of a competitor, the law presumes that that party cannot fail to take that information into account when determining its own future policy on the market, unless it rebuts that presumption.

There were a number of disputes about how the CAT should assess the evidence in the case, in particular concerning early resolution agreements and the OFT's decision not to call witnesses. Tesco argued that no weight should be attached to the early resolution agreements at all. The CAT did not accept Tesco's argument that the early resolution agreements were of no evidential value at all. However, it did hold that, in the context of Tesco's appeal, the early resolution agreements held little or no probative value, even for the limited purpose of proving the state of mind of the retailers which entered into the agreements. The CAT noted that the early resolution agreements are unsworn documents containing admissions that Tesco did not have the opportunity to test by the cross-examination of relevant

individuals. They were vague as to what precisely was being admitted. Furthermore, they were commercial documents which may have been signed in order to limit fines and protracted proceedings, and may be in part untrue or about matters which the company had not investigated.

The CAT will now receive further submissions in order to determine whether the three occasions on which Tesco was found to have breached the Ch.I prohibition are sufficient to amount to participation by Tesco in the single overall concerted practice identified in the OFT's decision, or whether those three instances should be viewed as three separate infringements. It will also hear arguments on the level of fine imposed on Tesco.

Peter Citron
Hogan Lovells

US

MERGERS

PCIe switch market—PLX Technology, Inc/Integrated Device Technology Inc—Challenge

Hardware; Mergers; National competition authorities; United States

The Federal Trade Commission (FTC) filed a Complaint in *In re Integrated Device Technology, Inc.*, challenging the proposed $330 million merger of PLX Technology, Inc. (PLX) and Integrated Device Technology Inc. (IDI). The FTC alleged that the merged company would have 85 per cent of the PCIe switch market and that the merger would eliminate the intense price and innovation competition between the two companies and hurt consumers. (FTC, Dkt. No. 9354, 12/18/12).

Both PLX and IDT are publicly traded companies. IDT is based in San Jose, Cal., with revenues from the last fiscal year totalling $526.7 million, of which $19.6 million stems from PCIe products. PLX is based in Sunnyvale, Cal. with sales of $115.8 million in 2011. The FTC alleges that the agreement and plan of merger, signed on April 30, would violate Clayton Act § 7, 15 U.S.C. §18, and FTC Act §5, 15 U.S.C. §45.

According to the complaint, PCIe switches are circuits used in a variety of computer and embedded electronic applications to connect input/output devices and microprocessors. The FTC's position is that PLX and IDI are the leaders in the PCIe market since when users "issue requests for quotations, IDT and PLX are often the only companies from whom PCIe switch users solicit bids." In a press release, Richard Feinstein, Director of the FTC's Bureau of Competition explained that "combination of IDT and PLX would hurt competition and lead to higher switch prices, lower innovation in the marketplace, and reduced customer service."

Furthermore, IDT and PLX are currently the only two firms offering 3rd generation PCIe switches. Thus, the FTC argues that the merger will indisputably lead to a monopoly in the market for this new generation of switches.

In addition to issuing the complaint, the commission authorized its staff to seek a preliminary injunction in federal district court or other relief necessary to stop the deal, pending a full administrative trial.

An evidentiary hearing before an administrative law judge is scheduled for May 20.

Douglas Broder
K&L Gates LLP

Albert Levi
K&L Gates LLP

US

ANTI-COMPETITIVE AGREEMENTS

Land leases—Bidding—Collusion—Proposed settlement—Rejected

Anti-competitive practices; Collusive tendering; Public interest; Settlement; United States

The US District Court for the District of Colorado rejected a proposed consent decree between the Department of Justice (DOJ) and Gunnison Energy Corp. (GEC), SG Interests I Ltd., and SG Interests II Ltd (SGI) over allegations that the defendants violated s.1 of the Sherman Act by colluding in a bid for federal land leases. (*United States v SG Interests I Ltd.*, D. Colo., No. 12-cv-00395-RPM-MEH, 12/12/12). In rejecting the agreement as "not in the public interest," the court cited numerous public comments in opposition to the agreement as well as the "unrepentant arrogance" of GEC. The court further noted that the agreement improperly dismissed both the DOJ action and a whistleblower's separate 2009 *Qui Tam* action arising out of the same events.

In 2005, the defendants executed a memorandum of understanding stating that SGI would submit bids on Federal Lands up for lease by the Bureau of Land Management on behalf of both parties. If SGI won, the defendants agreed they would split the interest in the land and form a joint venture. Using this strategy, SGI successfully purchased twenty-two parcels of government land, four of which resulted in the government receiving substantially less then they would have in a collusion-free auction according to the DOJ.

The proposed settlement agreement called for a combined penalty of $550,000—approximately seven times the amount of SGI's bids on the four leases. However, because part of the settlement was to go to the whistleblower that brought the *Qui Tam* action and his attorney, the government would only recover $390,000.

The opinion cited a number of public comments received regarding the proposed settlement. Many of the comments felt that the penalty was a slap on the wrist that ignored the defendant's collusion regarding the remaining 18 parcels of land. The DOJ responded that it had determined that, under the rule of reason, the remaining parcels of land were "reasonably related to a broader, efficiency enhancing collaboration between the two companies." GEC responded to the public comments by stating that it considered the underlying action to be meritless.

The Court held that it is not in the public interest to settle the case for "nothing more than the nuisance value of the litigation" or to "approve a final judgment that permits defendant to leave its civil action in such a smirking, self righteous attitude."

Douglas Broder
K&L Gates LLP

Albert Levi
K&L Gates LLP

US

GENERAL

DOJ Antitrust Division—New head appointed

Appointments; Competition law; United States

On December 30, 2012, the US Senate confirmed William Baer as Assistant Attorney General in charge of the Department of Justice Antitrust Division. Mr Baer, who was nominated for the position by President Obama on February 6, 2012, is taking over from Renata B. Hesse, who was appointed Acting Assistant Attorney General in November 2012. The position was vacated by Christine Varney who served from 2009 to August of 2011. Since August of 2011, the vacant position has been run by acting chiefs including; Sharis Pozen, Joseph Wayland, and most recently Ms Hesse.

Mr Baer, a Wisconsin native, graduated with his law degree from Stanford University in 1975 and immeditately took a job with the Federal Trade Commission. While at the FTC, Baer acted as a trial attorney for the Bureau of Consumer Protection.

In 1980, Mr Baer left the FTC to take a job in private practice in Washington, D.C. In 1995, he returned to the FTC to act as Director of its Bureau of Competition, a position he held until 1999. Under Mr Baer's leadership, the FTC's antitrust enforcement was considered to be the most aggressive it had been in 25 years. In 2000, Baer again returned to private antitrust practice in Washington.

With over 35 years of antitrust experience, Mr Baer is a highly regarded and well-respected antitrust attorney. He is expected to pursue an aggressive antitrust enforcement agenda, having been quoted as commending the DOJ's pattern of aggressive enforcement and vowing to continue along the same path.

Douglas Broder
K&L Gates LLP

Jessica Baer
K&L Gates LLP

US

ANTI-COMPETITIVE AGREEMENTS

Patent licensing—DOJ policy

Anti-competitive practices; Licensing; Patents; Standards; United States

In a recent speech before a conference in Brussels, a top official of the US Department of Justice's Antitrust Division commented on the competitive harms that can result from abuses of standard-essential patent licensing. A standard-essential patent (SEP) is a patent that must be used to comply with an industry standard set by a standard setting organisation. In her remarks, Fiona M. Scott-Morton, Deputy Assistant Attorney General for Economic Analysis of the Antitrust Division of the Department of Justice, explained that "[w]e believe declared SEPs can be a powerful weapon, perhaps enhanced by over declaration, and can be used to harm competition through holdup" or licensing on terms that are unreasonable or discriminatory.

In connection with a standard setting organisation's declaration that use of a particular patent is necessary to comply with an industry standard, the patent owner often commits to license the patent on fair, reasonable and non-discriminatory (F/RAND) terms to implementers of the standard. The patent owner thus loses the right to exclude; by making a F/RAND commitment "it is explicitly agreeing that users of its [intellectual property] may compensate the owner with money."

Ms Scott-Morton explained that SEPs are often the subject of the increasing patent litigation over smart phone or tablet platform technologies because such devices "could end up implementing hundreds of standards and reading on many thousands of patents." Due to the fierce competition for such devices, platform makers seek to tip demand in their favour through "scale-generating effects" where "the more users of a platform there are, the more complementary products are created, which in turn attracts more users." According to Ms Scott-Morton, "[i]t is therefore critical for players in this marketplace to use every possible tool at their disposal"—including litigation—"to gain a competitive advantage for their platforms while they have a chance of tipping a platform in their favor or stopping tipping against themselves."

Ms Scott-Morton stated that competitive harms can result where the SEP owner engages in "holdup," or demands "licensing terms that are not consistent with this F/RAND promise, and couple[s] that demand with the threat of injunction or other exclusionary relief." While patents that are non-essential can also be used to hold up licensees, the difference with

SEPs is that "standard essential patents achieve their status through collective action at the [standard setting organisations]." Ms Scott-Morton explained that such collaboration by competitors "is the difference that causes F/RAND encumbered SEPs to be of concern to competition authorities including the Department of Justice."

The DOJ has encouraged standard setting organisations to take a number of steps to reduce the potential for anti-competitive holdup by SEP owners. These steps include making a conscious decision about what patented technologies should be include or excluded from the standard, making it clear that the F/RAND commitments bind subsequent owners of the SEP and all implementers of the standard, limiting the ability of the SEP owner to obtain an injunction only where an implementer of the standard is unwilling to have a neutral third party determine the appropriate F/RAND terms, and taking other steps to limit the transaction cost of determining such terms.

Ms. Scott-Morton explained that the "number of 'essential' patents encumbered by F/RAND licensing commitments at certain standards bodies has increased exponentially in recent years," but that:

> "recent litigation in the United States has demonstrated that a number of patents declared essential to a standard are not, in fact, essential because standards-compliant products did not infringe on them."

This is a problem because in some cases, excluding competitors from using the technology may be a better driver of innovation and competition than mandatory licensing on F/RAND terms. "If, as a rule, truly innovative features that build on a standard" but that are not technically necessary to comply with that standard "need to be shared with competitors, incentives to innovate could be dulled."

Douglas Broder
K&L Gates LLP

Tim Hobbs
K&L Gates LLP

US

MERGERS

HSR threshold—Annual adjustment

Merger control; Mergers; National competition authorities; Notification; Turnover thresholds; United States

On January 10, 2013, the Federal Trade Commission (FTC) announced its annual revisions to the thresholds that determine whether companies are required to notify US federal antitrust authorities about a proposed transaction under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act. Beginning February 11, 2013, transactions valued at more than $70.9 million may require the parties to file Premerger Notification Reports. This number represents an increase from the current filing threshold of $68.2 million.

Pursuant to legislation adopted in 2000, the dollar values in the tests are adjusted annually for changes in the gross national product. The same adjustment factors are also applied to the transaction-size criteria that determine the amount of the filing fee paid for transactions in which a filing is required.

The HSR Act requires certain persons making acquisitions of assets, voting securities and non-corporate interests (i.e., interests in partnerships and limited liability companies): (a) to file premerger notifications with the FTC and the DOJ; and (b) to wait until the expiration of a waiting period (usually 30 days) before consummating the acquisition.

After the effective date of the amendment to the rules, the following transactions will generally be subject to the HSR Act's notification and waiting period requirements:

- Transactions in which the acquirer will acquire or hold voting securities, assets and non-corporate interests of the target company that have an aggregate value in excess of $283.6 million[1]; and
- Transactions in which the acquirer will acquire or hold voting securities, assets and non-corporate interests of the target company with an aggregate value in excess of $70.9 million but not more than $283.6 million, provided that either the acquiring or the acquired person has net sales or total assets of $141.8 million or more and the other person in the transaction has net sales or total assets in excess of $14.2 million.

All transactions valued at $70.9 million or less need not file under the HSR Act. Note, however, that in determining the "value" of a transaction, the acquiring person must include the value of certain voting securities, assets, or non-corporate interests of the target company that the acquiring person may have acquired earlier. Note also that acquisitions of interests in non-US companies or of non-US assets may require notification if the companies or assets are responsible for sales in or into the US at specified levels.

Although a premerger notification may be required prior to the acquisition of as little as $70.9 million in voting securities, a person who files a notification for an acquisition at that level would have to file additional notifications for the acquisition of additional voting securities before crossing further thresholds of: (a) $141.8 million; (b) $709.1 million; (c) 25 per cent of voting securities of an entity worth $1,418.1 million or more; and (d) 50 per cent of voting securities of an entity valued at $70.9 million or more.

As mentioned above, the thresholds for the various levels of filing fees will also change although the size of the fees has not changed:

If the size-of-transaction is valued at *more than* $70.9 million but *less than* $141.8 million, the filing fee will be $45,000;
If the size-of-transaction is valued at $141.8 million *or more* but *less than* $709.1 million, the filing fee will be $125,000; and
If the size-of-transaction is valued at $709.1 million or more, the filing fee will be $280,000.

Douglas Broder
K&L Gates LLP

Brian McCalmon
K&L Gates LLP

Kenneth Knox
K&L Gates LLP

[1] For a premerger notification filing to be required under the HSR Act for the acquisition of non-corporate interests, an acquiring person must obtain as a result of the acquisition the right to 50 percent or more of the profits of the non-corporate entity, or the right in the event of a dissolution to 50 per cent or more of its assets after the payment of its debts.



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History of competition policy in Brazil: 1930–2010

BY FRANCISCO RIBEIRO TODOROV*
AND MARCELO MACIEL TORRES FILHO**

As Brazil moved from a highly controlled and concentrated economy to a freer and more competitive one, the antitrust regime developed. The article outlines this historical process. We begin by addressing how the first norms with antitrust-like provisions were created from the 1930s until 1962. We then discuss the difficult operation of the competition authority (CADE) during the military regime from 1964 to 1985. After examining a transition period marked by democratization and a new constitutional order, we correlate the market-oriented reforms of the 1990s with what became the first antitrust statute to be effectively implemented. We then present the more well-known history of this 1994 statute: the initial focus on merger control and the subsequent shift toward cartel enforcement. The article concludes by examining the main challenges facing the Brazilian competition authorities today, including the implementation of the new antitrust statute passed in December 2011.

KEY WORDS: *Antitrust, Competition, History, Brazil, Industrialization, Development, Institutions, Liberalization, Brazilian Competition Commission, Conselho Administrativo de Defesa Econômica—CADE.*

* Partner, Trench, Rossi e Watanabe Advogados, associated with Baker & McKenzie International, Swiss Verein.

** LL.M. Candidate (2012), Stanford Law School.

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I. INTRODUCTION

In recent years, competition law in Brazil (or the State) has finally been consolidated into a prominent public policy instrument aimed at ensuring the good functioning of the country's market economy. This is the outcome of a lengthy development process dating back to the introduction of the first competition-related regulations in the first half of the 20th century. All the way through this process, the roles assumed by competition policy instruments have been in tandem with changes in the overall institutional landscape of the country, which has transformed itself from a predominantly agricultural society in the early 20th century into today's highly complex economy.

Initially, Brazil moved from a situation in which no competition law existed to a position in which the antitrust legislation, although formally in existence, was disregarded by the government in favor of other public policy instruments. During this period, which spanned from the 1930s until the mid-1990s, state-led interventions in the economy left little or no room for an effective competition law regime to function.

A significant breakthrough in this history was the enactment of a new competition statute in 1994, Law No. 8884/94, which is still in force at this writing.[1] This legislation was introduced along with a range of other reforms that were being implemented in Brazil in an attempt to liberalize the economy. An antitrust regime was thought to be a good fit for the new model of economic organization that was being adopted in the 1990s, in which market forces were given more prominence.

This article will first examine the different stages of this historical process. It will then focus on some of the current challenges for the advancement of competition law in Brazil. Certain broadly defined phases will be discussed:

(1) the 1930–1962 period, during which the first efforts led by the State to develop strong industries in the country were accompanied by the first unsuccessful attempts to establish antitrust-inspired regulations;

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[1] Lei No. 8.884, de 11 de junho de 1994, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 13.6.1994.

(2) the 1962–1988 period, during which more substantial antitrust legislation was passed (Law No. 4137/62),[2] but never fully implemented. This was the time of the 1964 autocratic military regime, which deepened earlier industrialization efforts with heavy State-led interference in the economy;

(3) the 1988–1994 period, during which transition to democracy and a new constitution brought about institutional changes that eventually opened the door for what would result in a successful antitrust regime in years to come;

(4) the 1994–2000 period, during which a new antitrust law was enacted among many other institutional reforms that collectively created an environment that was more favorable to the implementation of an effective competition policy; and

(5) the 2000–2010 period, during which the Brazilian antitrust authorities tried to set in motion a significant shift in their enforcement priorities, focusing more on cartels and abuse of dominance cases, thus raising the profile of the antitrust law in the eyes of the business community, the general public, and other government agencies.

Finally the article will discuss some of the future challenges facing competition authorities in Brazil, including the implementation of the new antitrust statute approved in December 2011 that will replace Law No. 8884/94.[3]

Of course, one should not adhere too strictly to the above division of the institutional development of competition law in Brazil. Separation into different stages is useful for analytical purposes, but in reality the historical processes are far more fractured and complex. This article does not intend to give a profound account of all the factors that have influenced the development of antitrust law in Brazil. More modestly, its objective is to summarize the most important historical aspects in such a way as to give a macroscopic view of the development of the law.

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[2] Lei No. 4.137, de 10 de setembro de 1962, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 12.11.1962.

[3] Lei No. 12.529, de 30 de novembro de 2011, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 1.12.2011. The statute will come into force 180 days after its publication in the official federal journal.

II. 1930–1962

A. Early attempts at introducing competition principles into the economy

The first half of the 20th century was marked by initial efforts to industrialize the Brazilian economy, which was overwhelmingly agrarian at the beginning of the century. By the 1930s, significant changes in the political arena were also taking place. These two factors—politics and the economy—are fundamental in understanding the first initiatives attempted in the field of antitrust law at that time.

From the inception of the Brazilian Republic[4] in 1889 until 1930, Brazil was ruled by elite groups that dominated the more or less independent states of the federation. Although specific political forces varied from state to state, the main characteristic of the period is that power was held mainly by political and economic groups linked to the land, which formed the basis of the economy.[5]

This political system went through a significant change in the 1930s, when the governor of the southernmost state—Rio Grande do Sul—became President. Getúlio Vargas was elected after a disruption in the delicate balance of power between the most important states, which in turn had been caused by the world economic downturn and its impact on Brazilian coffee exports (at that time the main export commodity). Vargas governed Brazil from 1930 to 1945, first as transition governor (1930–1934), then as president under a new constitution (1934–1937), and finally as an authoritarian leader (1937–1945).

While in office, Vargas initiated a process of concentration of political power in the hands of the Federal Executive branch, with the consequence that economic policies began to be both devised and implemented centrally. This process of political centralization had

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[4] Brazil became independent from Portugal in 1822. The country was then a monarchy until November 15, 1889, when a military revolution created the Republic. *See generally* RAYMUNDO FAORO, OS DONOS DO PODER: FORMAÇÃO DO PATRONATO POLITICO BRASILEIRO (3rd ed. rev. 2001) (1958). *See also* BORIS FAUSTO, HISTÓRIA DO BRASIL 261–74 (13th ed. 2008) (1994).

[5] This period of Brazilian history has come to be known as the Old Republic (or República Velha in Portuguese).

already begun in 1930[6] and became institutionalized and gained impetus from 1937 onward under the authoritarian regime.[7] Direction of economic affairs under Vargas reflected these changes in the political arena and became characterized by the active presence of the State in steering the industrialization process, mainly after 1937. Indeed, if during the early Vargas years state-led interventionist policies were still not sufficiently coordinated,[8] after 1937 the government's industrialization effort became more systematic and was mainly based on import substitution strategies and on the development of core industries such as oil and steel.

It is important to note that many factors other than the government itself were contributing to the industrial development in this period, such as urban development and the increasing size of the domestic market, the Second World War, the behavior of export markets, and relationships with key trading partners. However, the government's role in this environment was unabashedly proactive. For example, the Federal Executive branch installed a plethora of regulatory and financial agencies to foster industrialization.[9] This apparatus consisted of various federal agencies and commissions in charge of regulating selected sectors of the economy and promoting others through incentive mechanisms. The State also turned itself into an economic player, with publicly owned enterprises dominating many segments of the economy, such as mining, metallurgy, banking, steel, and oil.

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[6] For example, in November 1930, Vargas dissolved the National Congress as well as local and state assemblies. Vargas also replaced state governors with directly appointed intendants. *See* FAUSTO, *supra* note 4, at 333.

[7] The 1937 Constitution stated that elections should be called for the Parliament at the federal, state, and local levels. The President would be allowed to govern through decree-laws in the meantime. A provisional state of emergency was put in place, severely curtailing individual rights. The elections for parliament never took place, and the "provisional" emergency state was never revoked. *See id*. at 366.

[8] *See id*. at 369.

[9] *See* Marcus Faro de Castro & Maria Izabel de Carvalho, *Globalization and Recent Political Transitions in Brazil*, 24 INT'L POL. SCI. REV. 465 (2003).

In a nutshell, Vargas pressed for the transformation of the Brazilian economy from a predominantly rural, export-based system to an urban industrialized society. Although some industries had already been established in Brazil before the 1930s,[10] the economy as a whole was principally based on the export of primary goods. It was only under Vargas's leadership that industrialization actually took off.[11] When Vargas left power in 1945, industries had already secured a prominent place in the domestic economic landscape.[12]

From 1946 until the 1964 military coup, a brief democratic interlude took place in Brazil, first with President Gaspar Dutra, followed by the return of Vargas in 1951, and then by Juscelino Kubitschek, Jânio Quadros, and João Goulart, together with a few other interim governments. Many of the industrialist policies of the earlier 1930–1945 era were kept after the end of the Vargas dictatorship in 1945. Notwithstanding differences between specific economic policies adopted by each administration, this was a period of continuing industrial development promoted by the State, along the same lines as the development model initiated by Vargas in the 1930s.[13]

B. Initial regulation and the Antitrust Act of 1962

Given the prominent role of the State in the promotion of Brazilian industry from 1930 to 1962, the lack of a significant antitrust

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[10] *See generally* Maria Teresa Versiani & Flávio Versiani, *A Industrialização Brasileira antes de 1930: Uma Contribuição*, *in* FORMAÇÃO ECONÔMICA DO BRASIL—A EXPERIÊNCIA DA INDUSTRIALIZAÇÃO 121 (Flávio Versiani & José Roberto Mendonça de Barros eds., 1978).

[11] Eli Diniz, Empresário, Estado e Capitalismo no Brasil: 1930–1945, Remarks at International Seminar Da Vida para a História: O Legado de Getúlio Vargas (August 18–20, 2004), *available at* http://neic.iesp.uerj.br/artigos.html.

[12] *See* PEDRO CEZAR DUTRA FONSECA, O CAPITALISMO EM CONSTRUÇÃO, 1906–1954 (1989).

[13] For example, Juscelino Kubitschek, who presided over the country from 1956 to 1960, was responsible for implementing an economic plan whose objective was condensed in the motto "fifty years in five," and which involved significant levels of public expenditure and public debt to stimulate the economy as a whole.

regime in Brazil in this period, or even in the following thirty years, is hardly surprising. The three constitutions of the time—enacted in 1934, 1937, and 1946—and the respective legal frameworks with antitrust-related rules all reflected this state of affairs.

The 1934 Constitution was conceived at a time when the President was amassing greater political power. Following models set by other countries and mimicking social-democratic ideals of the time, this constitution contained several provisions concerning the regulation of market forces by the State. Of special note is Article 116, which gave the Executive branch the power to intervene and effectively monopolize sectors of the economy.[14] The constitution also introduced the concept of "popular economy," which was then absorbed by the legal vocabulary and reproduced in subsequent legal texts.[15]

Authoritarian ideas were ubiquitous in the 1937 Constitution. This authoritarian streak matched the government's desire—which had previously been shown by the former administration—of intervening in the economy and regulating market forces.[16] For example, one of the articles in the 1937 Constitution stated that economic freedom should be dictated by the "common good" and by national development and that public intervention in the economy should instill the nation's interest into the competitive forces of the marketplace.[17] According to

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[14] Article 116 of the 1934 Constitution reads as follows: "Based on the national interest and as long as authorized by special legislation, the Union is allowed to monopolize certain industry or economic activity . . . ."

[15] The concept of "popular economy" was set forth in Article 117 of the 1934 Constitution, which stated that legislation would have to be passed in order to promote the popular economy, credit development, and the progressive nationalization of deposit banks. According to BENJAMIN SHIEBER, ABUSOS DO PODER ECONÔMICO 3 (1966), this concept is the legal root of the following antitrust statute that would be passed in 1962.

[16] Tércio Sampaio Ferraz Jr., *Lei de Defesa da Concorrência, Origem Histórica e Base Constitucional*, 45 ARQUIVOS DO MINISTÉRIO DA JUSTIÇA 175, 176-77 (1992).

[17] *See* 1937 Constitution, art. 135 ("National prosperity and wealth is based on the individual initiative and on the individual's creation power, organization and invention, exercised in the limits of the common good. Intervention by the State is only legitimate in order to complete deficiencies

this constitution, crimes against the "popular economy" were to be severely punished.[18]

The aforementioned crimes against the popular economy were established by Decree-law No. 869 in 1938.[19] The list of such crimes included, among many other more or less precisely defined practices, attempts to manipulate demand and supply, price-fixing agreements, sales below cost, and exclusivity arrangements, to name but a few. The decree also attempted to cover widely different business practices, many of which would nowadays not be considered akin to antitrust violations. Given its criminal nature, Decree-law No. 869 was applicable only to natural persons, who could be imprisoned for up to ten years depending on the infraction and other factors.

The antitrust-related provisions of Decree-law No. 869 were never fully implemented.[20] Just one noteworthy antitrust case actually came to light during the period, but not as a criminal investigation.[21] The case involved Standard Oil Co., which submitted to the government a

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of individual initiative and to coordinate factors of production, so as to avoid or solve their conflicts and introduce in the game of individual competition the thought of the Nation's interest, represented by the State. Intervention in the economic domain may be direct or indirect, by means of control, stimulus of direct management.").

[18] *See id.* art. 141 ("Crimes against popular economy are comparable to crimes against the State, and severe sanctions must be set by law, which must also establish proceedings and judgments adequate to their quick and secure punishment.").

[19] Decreto-lei No. 869, de 18 de novembro de 1938, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 21.11.1938.

[20] *See* SHIEBER, *supra* note 15, at 6 ("Despite the broad language of these provisions, they were not actually put into effect . . . . Decree-law No. 869 had some impact on the areas of price regulation and enforcement against the fraudulent selling of goods, but not in the area of antitrust abuse. In our view, one important contributing factor to this situation was that no specialized agency was in place to enforce the decree's antitrust provisions.").

[21] *See id.* See also the legal opinion issued by the attorney general. Aníbal Freire da Fonseca, *Standard Oil Co. of Brazil. Contratos de comissão mercantil, em face do Decreto-lei n.º 869*, 32 Pareceres da CGR 251 (1939), *available at* http://www.agu.gov.br/sistemas/site/PaginasInternas/NormasInternas/AtoDetalhado.aspx?idAto=3119.

consultation concerning its exclusivity and retail price arrangements with gas retailers. The government answered by means of a presidential decision, which was based on an opinion issued by the attorney general. After making reference to U.S. legislation and case law, the opinion concluded that the company's agreements should indeed be modified so as not to violate the provisions of Decree-law No. 869. No sanctions were imposed.

Another antitrust-inspired decree was enacted in 1945, as a result of the efforts of Agamenon Magalhães, a traditional politician of the Vargas cabinet. Decree-law No. 7666/1945[22] may be considered a more technical legal text.[23] The somewhat vague concept of "popular economy" was replaced by practices that could be characterized as an "abuse of economic power." Another step forward was that this new decree established administrative sanctions to the anticompetitive practices, instead of regulating them by means of criminal law. The offenses were to be investigated by an administrative unit, the Administrative Commission of Economic Defense (Comissão Administrativa de Defesa Econômica in Portuguese), a distant relative of the current competition tribunal—CADE. Companies, as opposed to natural persons, were now targeted by the law.

The strong political backlash triggered by this new decree was part of a campaign against the Vargas authoritarian rule. This involved criticism of the government's dirigisme and nationalist bent and of the possibility that the new law could be used as an instrument against opposing political groups.[24] After the fall of Vargas, also in 1945, the new decree was revoked having being in force only for a few unsuccessful months.[25]

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[22] Decreto-lei No. 7.666, de 22 de junho de 1945, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 22.06.1945.

[23] For a more detailed discussion of this decree-law, see PAULA FORGIONI, OS FUNDAMENTOS DO ANTITRUSTE 120–22 (2d ed. 2005) (1998).

[24] *See* THOMAS SKIDMORE, POLITICS IN BRAZIL, 1930–1964: AN EXPERIMENT IN DEMOCRACY 51 (1967).

[25] The revoking statute is Decree-law No. 8167, passed on November 9, 1945 and signed by President José Linhares. Decreto-lei No. 8.167, de 9 de novembro de 1945, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 13.11.1945.

Agamenon Magalhães overturned this withdrawal shortly thereafter as a congressman in the subsequent parliamentary assembly that drafted the 1946 Constitution. He pressed for the inclusion of Article 148 in the new constitution, in order to consolidate the language of "abuse of economic power." This article stated that a statute should be passed to prohibit practices such as "the grouping of companies aimed at dominating national markets, eliminating competition or arbitrarily raising profits."[26] The language referring to antitrust infringements as an abuse of economic power would carry through into all future antitrust legislation.

Once again, the good intentions of the constitution were lost in the complexity of political and economic reality. The government of the time was heavily involved in the promotion of industry and was not willing to fight cartels and other anticompetitive practices in a consistent way. Furthermore, the 1948 bill of law proposed by Congressman Magalhães to put the relevant constitutional provisions into effect did not bode well. Prolonged debates about this bill within the House of Representatives and the Senate took place throughout the 1950s.[27] The antitrust bill was heavily amended, discussed, substi-

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[26] The entire article reads as follows: "Article 148. All types of abuse of economic power will be sanctioned by law, including mergers or the grouping of individual or social companies aimed at dominating national markets, eliminating competition or arbitrarily raising profits."

[27] In 1951, two additional laws protecting the "popular economy" were enacted. Lei No. 1.521, de 26 de dezembro de 1951, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.12.1951, revived the tradition of the 1938 decree-law and specified crimes against the popular economy. Lei No. 1.522, de 26 de dezembro de 1951, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 26.12.1951, in its turn, authorized government officials to intervene in economic activities (including the possibility of directly selling and distributing products, fixing prices and supply conditions, and expropriating goods and ordering private persons to provide services). This law also created a federal commission with the authority to fix prices for goods and services. This commission was not very successful and was replaced in 1962 by another federal body, the National Superintendency of Supply, with broad jurisdiction over setting price and supply conditions for a very wide range of products. *See* Milton da Mata, *Controles de Preços na Economia Brasileira: Aspectos Institucionais e Resultados*, 10 PESQUISA E PLANEJAMENTO ECONÔMICO 911 (1980), *available at* http://ppe.ipea.gov.br/index.php/ppe/article/viewFile/462/405.

tuted, and even remodeled during the period.[28] A fragile political consensus was only achieved in 1962, when Law No. 4137/1962 was passed and sanctioned by President Goulart.

The 1962 statute created the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica in Portuguese, or CADE), an arm of the federal government that was given the responsibility to investigate and sanction anticompetitive conduct.[29] This was the first time that a fully functioning competition authority had been set up with legal powers to curtail anticompetitive behavior. However, soon thereafter Brazil's experiment with a multiparty democracy was cut short by a military coup in 1964. The antitrust statute had been passed in 1962, but its implementation was left to the upcoming authoritarian regime. The statute proved to be largely ineffective. To understand the reason behind this failure one has to delve into the prevailing political and economic circumstances from 1964 to 1988.

III. 1964–1988

A. Authoritarian rule and redemocratization

From the end of the Second World War until the end of the 1970s, Brazil completed the process initiated under Vargas by means of which industry became one of the most important engines of the economy. Imports and exports declined in relation to the overall economic activity, despite growth of foreign investment. Cities continued to grow resulting in significant development of the tertiary sector of the economy.[30]

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[28] For a detailed account of these labyrinthine debates, see generally SHIEBER, *supra* note 15, and JOSÉ INÁCIO GONZAGA FRANCESCHINI & JOSÉ LUIZ VICENTE FRANCESCHINI, PODER ECONÔMICO: EXERCÍCIO E ABUSO (1985).

[29] The formation of an "economic defense commission" had previously been envisaged in 1945 within Decree-law No. 7666. However, as discussed, this decree was revoked a few months after being signed.

[30] See José Serra, *Ciclos e Mudanças Estruturais na Economia Brasileira do Após-guerra*, 2 REVISTA DE ECONOMIA POLÍTICA 5 (1982), for an overall account of the structural changes that took place in the Brazilian economy in the period.

There were periods of both rapid and slow economic growth. Under President Kubitschek and until the beginning of the 1960s, state-led investment spurred a significant development of important industry segments, such as steel, oil, non-ferrous metals, and pulp and paper, to name but a few.[31] Inflation and trade imbalances dominated the 1963–1967 period,[32] which was marked by significantly lower growth rates and by the corresponding macroeconomic adjustment measures initiated by President Goulart in 1962 and implemented mainly by the post-1964 military government.[33]

From 1967 to 1973, Brazil saw the so-called "economic miracle," in which growth and low inflation rates were accompanied by heavy doses of state and private investment, together with high external debt. Orthodox policies of the post-1964 years were put aside, and newly established technocrats led by Finance Minister Delfim Neto implemented an ambitious economic agenda.[34] The military dictatorship coordinated industrial diversification, expansion, and concentration (although some sectors, such as automobiles, were favored over others).[35]

Smaller growth rates persisted from 1974 until the early 1980s. This was the result of many interconnected causes, including production imbalances at the core of the "miraculous" growth of the preceding years, Brazil's dependency on oil imports, inflation, trade deficits, shortage of agricultural goods, the global economical slowdown

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[31] FAUSTO, *supra* note 4. *See also* Claudio Monteiro Considera & Paulo Corrêa, *The Political Economy of Antitrust in Brazil: From Price Control to Competition Policy* (Working Paper, Jan. 2002), *available at* http://www.seae.fazenda.gov.br/document_center/working-papers/2002-1/doctrab11.pdf.

[32] THOMAS SKIDMORE, THE POLITICS OF THE MILITARY RULE IN BRAZIL, 1964–1985, at 11–12 (1988).

[33] *See id.* at 30.

[34] Delfim's policies involved easing credit in order to stimulate demand. In Delfim's own words, the goal was "rapid development without inflationary pressures." *See also* SKIDMORE, *supra* note 32, at 70 ("To constrain inflationary expectations they resorted to a distinctly un-free market enterprise solution: price control.").

[35] *See id.* at 139.

caused by the two oil crises of 1974 and 1978, and increasing foreign borrowing.[36] These were also the root causes of the economic problems that would soon become evident at the onset of the 1980s.

The beginning of the 1980s was marked by a recessive economy and the corresponding economic policies implemented by the government to overcome some of the most serious trade and financial imbalances of previous years.[37] The downturn was aggravated by high inflation rates, a problem that would persist throughout the whole decade. Several economic plans were implemented during this period to try to thwart inflation. However, over and over again, such measures were defeated by the inflationary tendencies of the economy.[38]

In broad strokes, despite the ups and downs of the 1964–1988 period, the development model set out during the Vargas years was largely maintained, but supplemented with populist economic policies that disregarded concerns with inflation and external constraints in favor of growth and income redistribution.[39] The State continued to actively implement several industry-promotion measures throughout the military dictatorship. This was particularly true of the economic policies adopted by the government until the end of the 1970s. State involvement was either direct, through publicly owned companies operating in sectors such as banking, telecommunications, energy, and oil, or indirect, through diversified industrial policies, which in general involved the creation and expansion of large companies in already concentrated markets.[40]

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[36] Serra, *supra* note 30, at 111. *See also* SKIDMORE, *supra* note 32.

[37] President Figueiredo took office in 1979 and handed power to the first civilian president after the military dictatorship in 1985.

[38] These gloomy years were thoroughly described by Dionísio Dias Carneiro & Eduardo Modiano, *Ajuste Externo e Desequilíbrio Interno: 1980–1984*, *in* A ORDEM DO PROGRESSO: CEM ANOS DE POLÍTICA ECONÔMICA REPUBLICANA 323 (Marcelo de Paiva Abreu ed., 1997).

[39] *See* Faro & Carvalho, *supra* note 9, at 469.

[40] *See* Serra, *supra* note 30, at 16–17 ("One of the hallmarks of Brazilian capitalist development concerns the significant role assumed by the State in fostering the industrialization process. This role not only consisted of monetary and fiscal policies, labor market control policies and the provision of

Market forces were heavily controlled by state-led interventions, which also encouraged the formation of large companies in selected sectors of the economy. Concentration was the leitmotiv of the industrial policies implemented by the military government.[41] An illustration of this recurring theme was the 1974 Second National Development Plan, which stated that mergers and acquisitions should be promoted in those sectors in which an excessive number of national companies would render them easy prey for foreign competitors.[42] A similar concern informed numerous other laws that sponsored large companies, and various mechanisms (such as price control measures and tax exemptions) were used by the State to realize its economic goals and the desired level of market concentration. Economic benefits of competition were not regarded as important by government officials, to say the very least.

B. Enforcement of the existing Antitrust Law

Law No. 4137/1962 incorporated the CADE into the Brazilian legal framework. In its substantive provisions, the statute listed several practices, constituting an abuse of economic power, to be investigated and sanctioned by the antitrust authorities. The language employed by the statute to list the various anticompetitive practices was imprecise, as judged by today's standards, allowing for the punishment of business practices that would nowadays not be regarded as problematic.

A far more serious problem was the context in which the 1962 statute was to be enforced. During the period in which the antitrust law was in force, the Brazilian government actively regulated and intervened in the economy as a whole. On the one hand, it is true that

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public goods, it also included (i) definition, operation and financial support of large investment blocks that determined structural changes in the post-war economy, and (ii) creation of infra-structure and direct production of the intermediate inputs necessary for heavy industrialization.").

[41] *See* César Mattos, *The Recent Evolution of Competition Policy in Brazil: An Incomplete Transition*, 4 REVISTA DO IBRAC No. 6, at 175 (1997).

[42] The plan was approved through Lei No. 6.151, de 4 de dezembro de 1974, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 06.12.1974.

the simple existence of a strong industrial policy does not render antitrust enforcement impossible. On the other hand, it is also a fact that the Brazilian government itself did not have the slightest bit of interest in applying the existing antitrust legislation in a serious and consistent manner.[43]

The military government was not willing to rely on market economy mechanisms or antitrust law as a basis for industrialization efforts of the time or, for that matter, the development process in general. The executive branch employed general price-control mechanisms in various sectors of the economy. Private enterprises relied on the numerous incentives provided by the government's industrial policy measures.[44] Ever-increasing concentration levels were the state-declared objectives for the industries that were consolidating. Moreover, the existing regulation in the economy not only favored coordinated practices, but in many cases it also inspired them.[45]

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[43] *See* Rogerio Terra de Oliveira, Política de Defesa da Concorrência no Brasil e o Conselho Administrativo de Defesa Econômica: 1901–1984 (1994) (unpublished thesis, University of Brasília, on file with Central Library of the University of Brasília). *See also* Considera & Côrrea, *supra* note 31, at 9. For example, Mário de Souza Martins, a CADE commissioner during the military regime, appallingly wrote: "The '64 Revolution soon decided to do away with CADE. . . . Pressure began to mount against CADE. . . . As the decision date of the [soda ash] case approached, we received a verbal communication from a colonel in the President's Military Cabinet stating that no decision should be taken before further instructions by the government. I found this odd and talked to the head of Civil Affairs, Luís Viana Filho. I made him aware of what had taken place and stated that CADE would not accept interference from the Executive under any circumstances. He said that there had probably been a mistake, as the President would never meddle in CADE's matters. Shortly thereafter, General Ernesto Geisel, who had been contacted by his close friend Vítor do Espírito Santo, also reassured us with equal certainty. However, the pressure continued. A few weeks later, the President of the Republic himself issued an order directing all CADE staff to return to their previous jobs. Given that the commission lacked its own staff, this order effectively led to CADE's termination. We therefore decided to renounce our mandates as commissioners.", *quoted in* PEDRO DUTRA, CONVERSANDO COM O CADE 10 (2009).

[44] Ferraz, *supra* note 16, at 180–81.

[45] Considera & Côrrea, *supra* note 31, at 11.

Price control by government agencies is rightly regarded as the utmost example of how an effective antitrust system could not exist in Brazil during the military regime. Centralized price management was seen by government officials as one of the central tenets of their inflation control measures.[46] The government's first experiments with price-control mechanisms date back to the 1930s. However, after 1964, economic policies made such measures far more pervasive and widespread. An optional scheme was created in 1965, whereby companies would agree to price controls in exchange for tax and credit incentives. Mandatory price control was introduced in 1967. An Interministerial Price Council (the CIP) began to operate in 1968 with authority to analyze and approve price increases.[47] The CIP had the authority to select the companies or sectors that would fall within its jurisdiction. Companies willing to raise prices had to submit their requests in advance, although across-the-board sectoral price fixing was also possible. Government officers then analyzed whether or not the increasing costs faced by the applicants actually warranted the requested price increases.[48]

In short, if the aim of the antitrust law was to protect and promote competition as the cornerstone of a market economy, there was very little room for real action in Brazil, given that various forms of public intervention hampered competition in several sectors of the economy. The government was not interested in promoting competition. Its efforts were concentrated on achieving a high degree of industrial development by mechanisms other than the antitrust law. As rightly put by Eduardo Fiuza, "government policy was not only negligent to competition, but actually opposed it."[49]

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[46] Da Mata, *supra* note 27, at 912.

[47] "The new government now committed itself to all-out price control. Tough penalties were specified for violators. The CIP became a central policy-making organ, with most businesses needing its approval to raise prices." SKIDMORE, *supra* note 32, at 70.

[48] Da Mata, *supra* note 27, analyzes in detail the administrative proceedings at CIP and the criteria used by the officials to choose companies and sectors and then to analyze the requests.

[49] Eduardo Sampaio Fiuza, Três Ensaios Sobre Diferenciação de Produto (2001) (unpublished doctoral dissertation, Escola de Pós-Graduação em Economia da Fundação Getúlio Vargas) *available at* http://virtualbib.fgv.br/dspace/handle/10438/1040.

For example, there was a clear mindset behind the above-mentioned Second National Development Plan, enacted in 1974, toward concentration of domestic industries, so that they could achieve scale and face foreign competition. The argument was that this would actually enhance competition, not undermine it. The plan listed price control and prevention of the abuse of economic power as measures to alleviate any harm caused by excessive concentration. Interestingly, instead of resorting to antitrust law with regard to the issue of abuse of economic power, the plan mentions that such abuses would be prevented through price control and "economic instruments," such as fiscal and credit incentives against "oligopolistic practices."[50]

This state of affairs was reflected in CADE's relatively low importance vis-à-vis other administrative bodies in charge of the Brazilian economy. Indeed, within the executive branch hierarchy, the actual political dealings between government officials and the business community were concentrated in bodies such as the CIP and the National Monetary Council (Conselho Monetário Nacional in Portuguese). CADE's low stature was reflected in the number of cases it presided over, the types of disputes that were brought before it, and the low financial penalties it was legally permitted to impose.[51]

All in all, CADE was operating in a hostile or, at best, an indifferent environment. The government clearly had little or no interest in using antitrust legislation to promote competition.[52] The economy was

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[50] *See* Lei No. 6.151, de 4 de dezembro de 1974, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 6.12.1974, II Plano Nacional de Desenvolvimento (1975–1979), at 38–39, *available at* http://www.planalto.gov.br/ccivil_03/LEIS/1970-1979/anexo/ANL6151-74.PDF.

[51] After researching CADE's case law between 1962 and 1990, Farina concluded that "CADE did not decide a single case of importance in its entire history that may have given the agency more exposure . . . . The vast majority of complaints submitted to CADE may be considered negligible in a heavily oligopolized economy, such as that of Brazil. The significance of cases involving important companies in the domestic market was low, due to the fact that the light sanctions specified in Law No. 4137/62 were unable to deter anticompetitive behavior." Elizabeth Farina, *Política Antitruste: A Experiência Brasileira*, 1999 ANAIS DO XVIII ENCONTRO NACIONAL DE ECONOMIA—ANPEC 455, 471.

[52] Quoting the late politician and diplomat Roberto Campos, both a supporter and an official of the military regime: "The low profile assumed by

subjected to several state intervention mechanisms, which left little space for antitrust policy to be implemented effectively. CADE was regarded as a second-class agency, with very little political weight and almost no practical significance.[53] In short, although it may be said that CADE was at least able to keep the flame of the antitrust debate alive in Brazil between 1964 and 1988,[54] it was in fact only during the 1990s that the goal of a market economy that was minimally based on free-market principles would actually be realized. The historical reasons behind this are quite clear and will now be elaborated.

IV. 1988–2010

A. The new Constitution and the institutional development of competition policy

The 1980s were generally marked by runaway inflation and a recessive economy.[55] However, Brazil also underwent profound social

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CADE is completely understandable. The government's credibility in promoting competition was comparable to a Soviet bureaucrat teaching management techniques, to Fidel Castro supporting democracy, or even to Messalina preaching chastity in a convent." Roberto Campos, *O Pecador Arrependido* (Aug. 10, 1997), http://pensadoresbrasileiros.home.comcast.net/~pensadoresbrasileiros/RobertoCampos.

[53] Elizabeth Farina analyzed in detail CADE's low productivity during the military rule in Brazil. Elizabeth Farina, Oligopólio e Política Antitruste: Desenvolvimentos Recentes 10 (Dec. 2000) (unpublished manuscript), *available at* http://www.fclar.unesp.br/eco/14.pdf ("In almost 30 years, 337 cases were brought before CADE, with 117 proceedings, but only 16 convictions. No case had any significant repercussion and the efficacy of the few convictions was minimal due to the light sanctions specified by the law. . . . Although timid, CADE's performance started to improve at the onset of the New Republic, principally because of individuals, not institutions. Between 1986 and 1990, CADE examined 90 out of 117 administrative proceedings that had been open since 1962. In all, it decided 66 cases, some of which had been ongoing for more than 10 years, and it maintained 28 open, which, in addition to the preliminary inquiries, were left to the new Commission.") (quoting research in Farina, *supra* note 51).

[54] As argued by José Tavares de Araújo Jr., *Preface* to CÉSAR MATTOS, A REVOLUÇÃO DO ANTITRUSTE NO BRASIL 5–7 (2004).

[55] Considera & Côrrea, *supra* note 31, at 17.

and political changes at this time. The military dictatorship was replaced by a democratic regime. The 1988 Constitution reshaped the law in fundamental ways, primarily by consolidating democracy and laying out an agenda for the country's future. This was also the period during which the balance between the State and private enterprise began to be gradually tipped in favor of free market principles, thereby allowing the development throughout the 1990s of an antitrust regime with at least a certain level of efficacy.

Brazil's transition to democracy began when the presiding generals gradually softened the military rule from 1974 to 1982. This period was characterized by domestic and global economic downturns, internal conflicts within the Army over whether or not to mitigate the authoritarian rule, and by important steps towards the replacement of the military regime, such as the general amnesty granted in 1979.[56] Political transition gained momentum between 1982 and 1985, even though popular demonstrations in favor of direct presidential elections failed to gather sufficient support in Congress. In 1985, power was finally transferred to civilians for the first time in twenty-one years. The indirectly elected President, Tancredo Neves died without actually taking office. Vice-President José Sarney was then handed the presidency.

The fact that Sarney, a former supporter of the military dictatorship, was the first civilian president in the newly established regime symbolizes the very peculiar nature of Brazil's transition to democracy. As previously mentioned, economic policies adopted since 1930 were characterized by high doses of state intervention to promote industrial development and, from the military regime onward, by economic growth combined with a certain disregard for inflation and high external debt. Transition to democracy would later change this state of affairs, but the former political and economic mindset was still embedded within the institutional framework. Therefore, it is no surprise that Sarney maintained some of the economic and political practices of the past. But the new political and economic environment would not allow such practices to be preserved for long. What had changed?

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[56] *See* Maria D'alva Kinzo, *A Democratização Brasileira: Um Balanço do Processo Político desde a Transição*, 15 SÃO PAULO EM PERSPECTIVA 3 (Dec. 2001).

As explained by Faro and Carvalho, Brazil's transition to democracy was marked by a gradual, rather than immediate, distribution of social and political power to different groups. This process lasted throughout the 1980s, and involved several factors that fundamentally altered the institutional environment of the political system and, consequently, how economic policies were discussed and put into practice.[57] One major step of this process was the overhaul of the military regime features by the 1988 Constitution, which introduced significant changes such as a comprehensive agenda of fundamental rights, an arguably stronger federalist system, and the empowerment of Congress and the judiciary.[58] Of course, these domestic changes occurred amid other structural political and economic transformations that were taking place at the global level from the late 1970s and throughout the 1980s.

At the risk of oversimplifying the whole process, it would be fair to say that Brazil was generally leaning toward a more liberal mindset, favoring less state intervention with more reliance on market mechanisms, within a context in which the executive branch was losing some of its former power. This is an oversimplification insofar as all levels of the bureaucracy continued to play a key role in steering the economy. The benefits of competition were still not actually perceived by many government officials, who continued to favor coordination and concentration in the marketplace. In any case, the overall development model adopted in the preceding decades was being cast aside, albeit slowly. The consequence was that, from 1990 on, the Brazilian institutional environment gradually became more market friendly.

The paradoxical and complex nature of the shift to a more open marketplace was reflected in the 1988 Constitution, which incorporated many different, and sometimes contradictory, principles regarding the relationship between State and private enterprise. Economic policies had to conform to constitutional principles as diverse as the protection of consumers, state sovereignty, competition, full employment, a reduction in social and regional inequalities, and social jus-

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[57] Faro & Carvalho, *supra* note 9.

[58] *Id.*

tice. In short, the constitution comprised a comprehensive agenda that mixed liberal and interventionist ideas, reflecting the multitudinous interests and ambiguities of society as a whole.[59] Formulation of an antitrust law regime would be influenced by these diverse and sometimes antagonistic principles.[60]

The first attempt to implement such a regime was by President Fernando Collor (1990–1992). It is interesting to consider how this president implemented his economic policies in general. On the one hand, Collor did not adhere to the old development model of the 1930–1985 period, which was also strongly featured in the Sarney administration. On the other hand, his policy-making style, defined by centralized decision making and little deference to other political players, was also not in tune with the post-1980s environment.[61] President Collor ended up being ousted following a highly publicized impeachment on corruption charges. However, before this, his administration managed to implement profound changes that were continued by his successors, including a trade liberalization agenda and the first initiatives aimed at the privatization of state-owned companies.

The same overall agenda was adopted by Fernando Henrique Cardoso, first as the Minister of Finance under Itamar Franco,[62] and second as president from 1994 to 2002. However, his first and foremost achievement was a series of successful economic and legal reforms implemented in 1994, including the creation of the Real currency, which finally put an end to the hyperinflation problem. Inflation had been a concern in Brazil at least since the 1970s, and several different economic plans and currencies failed to solve this problem

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[59] A detailed analysis of the differing principles embraced in the 1988 Constitution and the various forms of state intervention in the marketplace can be found in EROS GRAU, A ORDEM ECONÔMICA NA CONSTITUIÇÃO DE 1988: INTERPRETAÇÃO E CRÍTICA (9th. ed. rev. 2004) (1990).

[60] *See* CARLOS JACQUES GOMES, ORDEM ECONÔMICA CONSTITUCIONAL E DIREITO ANTITRUSTE (Sergio Antonio Fabris ed., 2004).

[61] *See* Faro & Carvalho, *supra* note 9.

[62] Collor's vice-president, who then inherited the presidency after Collor's impeachment.

throughout the 1980s and in the early 1990s.[63] Cardoso's first economic reforms also carved the path for other policies that were adopted during the following years.[64]

Cardoso was not only able to work within the new political environment created during the 1980s, but was also able to perform a major restructuring of the bureaucratic apparatus that would oversee and regulate the market forces that were being set free by liberalization policies. A major government plan was issued in 1995 aimed at reducing bureaucracy and implementing managerial techniques throughout the public service. Several regulatory agencies were subsequently created, following deregulation and privatization measures proposed by the government. An example of this process was the privatization of the state telecommunications monopoly in 1998 following a new legal framework and the creation of a regulatory agency in 1997.

Many other policies and reforms were implemented under Cardoso's stewardship. The result was an environment in which market forces were allowed to play a greater role.[65] This impulse was not undermined by President Luís Inácio Lula da Silva, who took office in 2002. Although President Lula's stance on state-market interactions was more interventionist, and his government was indeed friendlier to industrial policy measures, the overall institutional groundwork of the previous decade was not ignored. In fact, as discussed below, the level of institutional maturity in Lula's administration increased in many areas. An example of this is the strengthening of antitrust policy by competition authorities during Lula's term.

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[63] Economic reforms implemented by Cardoso were deep and manifold, involving measures as diverse as budget control, market liberalizations, monetary and fiscal policy adjustments. *See* Considera & Côrrea, *supra* note 31, at 18.

[64] *See* Faro & Carvalho, *supra* note 9, at 481.

[65] Oliveira & Konichi outline five factors influencing the increasing importance of antitrust policy during the period: trade liberalization, privatization of state-owned companies, increasing complexity of the regulatory framework, macroeconomic stabilization and peer pressure derived from a changing international environment. *See* Gesner Oliveira & Cinthia Konichi, Aspects of Brazilian Competition Policy (Fundação Getulio Vargas, Escola de Economia de São Paulo, Discussion Paper No. 150, May 2006), *available at* http://virtualbib.fgv.br/dspace/handle/10438/1869

B. *The final years of Law No. 4.137/1962 and the criminalization of antitrust—1988–1994*

Throughout the 1980s and until the 1988 Constitution, attempts were made to revive CADE as an effective and operational administrative unit. The commission was transferred from Rio de Janeiro to Brazil's capital Brasília. A taskforce was formed to prepare a regulation for the 1962 antitrust statute, and a decree was issued in January 1986.[66] In August 1986, another presidential decree reorganized CADE's composition by reverting back to the original composition of a chairperson and four commissioners with fixed mandates, all of whom were directly appointed by the president and approved by the Senate.[67] New commissioners took office in 1986 and remained at CADE until their mandates expired at the end of 1989.

However, as with the 1962 statute itself, these new attempts to revive CADE were still not sufficient to consolidate antitrust policy in Brazil. A few important cases were decided during the period, but the old institutional apparatus concerning regulation of the economy with heavy State intervention—including pervasive price-control—was still present. CADE suffered from a severe lack of institutional capacity to fulfill its role.[68] Therefore, it did not come as a surprise that

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[66] Mauro Grinberg, who participated in this taskforce and who was named as one of CADE's commissioners in 1986, describes in an interview how this process to revive CADE in 1985 took place. DUTRA, *supra* note 43, at 18 ("The commission met at the Ministry of Justice in Brasília . . .; these meetings were very rich given that, as no one had experience on the subject, we did a brainstorming, ideas were put on the table and we debated them."). This resulted in Decreto No. 92323, de 23 de janeiro de 1986, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 24.01.1986, which, among other provisions, organized the types of proceedings that could be opened by CADE and established procedures that CADE would follow to impose sanctions.

[67] Decreto No. 93083, de 7 de agosto de 1986, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 8.8.1986.

[68] *See* DUTRA, *supra* note 43, at 23 ("It was not possible, however, for CADE to function well; in the three years that I spent there we had no room, library, files, nothing . . . . Today, CADE is very different from the CADE of my time; it was then in an embryonic stage, some of the decisions that I read today seem infantile, there was no economic sophistication . . . . Moreover, CADE fought against adversities that are no longer in place, such as prestige

no replacements were named after the mandates of CADE's chairman, Werter Faria, and its commissioners expired in 1989. CADE became inoperative for approximately three years until 1992. In the meantime, and despite the fact that CADE was not functioning, significant institutional developments were taking place which paved the way for the first attempts under the 1988 Constitution to renew antitrust enforcement in Brazil.

As previously mentioned, the 1988 Constitution had many provisions concerning regulation of the economy. According to the constitution, market principles should be the norm and competition the cornerstone of the "economic order."[69] The constitution also repeated the same provisions contained in earlier legislation stating that abuses of economic power would not be tolerated. In this new institutional context, the old interventionist project that marked the whole 1930–1985 period began to be broken up. Price fixing by government agencies was scaled back. The CIP was dismantled.[70] The Collor administration (1990–1992) also began the privatization of state-owned companies (a process that would last the entire 1990s) and adopted a trade liberalization agenda.

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in the government's eyes. CADE was not recognized by other government segments; the Ministry of Finance was really averse to CADE. Economic decision-making was totally centralized . . . .[;] government structures were still too conditioned by the centralism of the military government . . . .") (quoting Mauro Grinberg).

[69] *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), COMPETITION LAW AND POLICY IN BRAZIL, A PEER REVIEW 17 (2005), *available at* http://www.oecd.org/dataoecd/12/45/35445196.pdf ("The Brazilian Constitution of 1988 establishes an explicit foundation for competition policy. Article 173, paragraph 4 provides that '[t]he law shall repress the abuse of economic power that aims at the dominance of markets, the elimination of competition, and the arbitrary increase of profits.' More generally, Article 170 contemplates that the 'economic order' of Brazil shall be 'founded on the appreciation of the value of human work and on free enterprise,' and shall operate with 'due regard' for certain principles, including 'free competition,' 'the social role of property,' 'consumer protection,' and 'private property'.").

[70] The CIP was terminated in 1990. The Brazilian government took longer to do away with the National Superintendency of Supply, but its role over price regulation was severely scaled back. See Oliveira & Konichi, *supra* note 65, for further detail.

The first antitrust statute to be passed in this new environment was Law No. 8158, of January 8th, 1991, which actually superseded a few provisional measures that had already been enacted directly by the president in 1990.[71] This new antitrust statute did not revoke the former 1962 antitrust legislation, and both statutes would have to be implemented together.

One goal of the 1991 statute was to overcome the perceived inefficiency of the previous CADE investigations into anticompetitive practices. A new unit within the Ministry of Justice—the National Secretariat of Economic Law (Secretaria Nacional de Direito Econômico in Portuguese, or SNDE)—was created with the authority to conduct more agile procedures and impose preventive measures in its investigations. The SNDE was given investigative powers, but CADE would still make the final decision on cases relating to enforcement against anticompetitive practices (which could then be appealed to the Minister of Justice).

However, given that there were no commissioners at CADE, a paradoxical situation lasted from 1991 to 1993. The SNDE could investigate cases related to anticompetitive behavior, but there was no one to decide them until 1992, when CADE's new commissioners took office.[72] Another problem was the juxtaposition of the substantive provisions of Law No. 8158 and the provisions of Law No. 4137, which was still in force.[73]

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[71] Lei No. 8.158, de 8 de janeiro de 1991, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 09.01.1991.

[72] Elizabeth Farina, *Desregulamentação e o Controle do Abuso do Poder Econômico: Teoria e Prática*. 14 REVISTA DE ECONOMIA POLÍTICA 78, 91 (1994), *available at* http://www.rep.org.br/pdf/55-6.pdf. Farina analyzes the way Brazilian policy makers paid lip service to the fight against anticompetitive practices, while encouraging the formation of industry groups between the government and the private sector to implement industrial policy measures.

[73] This problem would be aggravated with the passing of yet another statute criminalizing certain practices in December 1990, discussed below. *Id.* at 91–92. According to Farina, the existence of five different antitrust-related statutes simultaneously in force—the 1962 antitrust statute, the 1990 criminal statute (Law No. 8137/1990), the new 1991 statute (Law No. 8158/1991), the 1951 statute concerning crimes against the popular economy (Law No. 1521/1951, discussed *supra* note 27), and a 1962 law concerning crimes against the supply system—rendered the Brazilian antitrust system unnecessarily complex and difficult from a legal standpoint.

The new statute also attempted to introduce a more effective system of submission and approval of acts that could limit competition. With the new statute, the SNDE was given the responsibility of examining and approving transactions that could restrict competition, including mergers.[74] In practice, however, a full-fledged mandatory merger control system was still lacking.[75]

Despite all the hurdles, CADE managed to slowly become more active. For example, an important case was decided in 1993 against Xerox Corp. The company was accused of tying the sales of original equipment to services in the aftermarket, which allegedly would have had the effect of hurting rival companies that wanted to service Xerox machines. The case resulted in CADE issuing a fine against the defendant.[76]

A criminal statute that defined certain business practices, mostly cartel activities, as crimes was also passed at the beginning

[74] Article 13 of Law No. 8158/1991, which rephrased Article 74 of Law No. 4137/1962. Under the 1962 statute, submission of transactions for approval was not mandatory in most circumstances, although CADE had the power to investigate certain agreements or transactions that could limit competition. See generally Tércio Sampaio Ferraz Jr., *A Concentração Econômica e Fiscalização Administrativa*, 193 REVISTA DE DIREITO ADMINISTRATIVO, July–Sept. 1993, at 65, for a description of the merger control system introduced by Law 8158/1991 and a comparison with the provisions of Law 4137/1962.

[75] According to Tércio Sampaio Ferraz Jr., Brazilian companies were used to operating in a marketplace heavily controlled by the State, and it would take almost a decade for changes in the antitrust regimen to become ingrained in the corporate mindset. *See* Interview by Aline Pinheiro e Lilian Matsuura with Tércio Sampaio Ferraz Jr., *Sistema de Defesa da Concorrência Criou Segurança* (June 14, 2009), http://www.conjur.com.br/2009-jun-14/entrevista-tercio-sampaio-ferraz-junior-advogado-empresarial.

[76] CADE, PA No. 0023/1991, Relator: Marcelo Soares, 31.03.1993, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 16.04.1993, 7. This administrative fine was confirmed by a first instance court in 1999 in a lawsuit filed by Xerox against CADE's decision. JFDF, No. AO 93.00.06161-5/DF, Relatora: Gilda Sigmaringa, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 9.12.1999. At this writing, an appeal against this first instance decision was pending at the Federal Court of Appeals, First Circuit, TRF-1, Docket No. App. 2001.01.00.036742-5.

of the 1990s.[77] This law remains in force today, and its enforcement against natural persons involved in cartel activities has been steadily increasing since 2005.[78] This is another example of the way Brazil moved early as regards antitrust legislation (in theory, if not in practice). Not many jurisdictions had criminal enforcement against cartels in 1991, just as few jurisdictions had any antitrust law in 1962, the year in which the previous antitrust statute had been enacted.

However, legislation alone was not sufficient to curb cartel behavior. In fact, the criminal statute against cartels was rarely used until the turn of the century, and even today it is far from being the important deterrent of cartel behavior that it could be. As indicated, its effectiveness is growing, although penalties established in the law are very mild.[79] Only in 1994 was an effective antitrust law finally introduced into the Brazilian legal system. This was Law No. 8884, to which we now turn.

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[77] Lei No. 8.137, de 27 de dezembro de 1990, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 28.12.1990.

[78] This increase in enforcement derives mostly from cooperation efforts undertaken by the Secretariat of Economic Law (SDE) together with criminal prosecutors. The SDE has formal cooperation agreements in place with several state public prosecutor bodies. Since 2005, many cartel investigations in Brazil have been conducted both at the administrative and criminal levels.

[79] Price fixing and other cartel behavior is punished with two to five years' imprisonment or a fine. According to Brazilian criminal procedure, given that a fine is the lowest sanction, this type of violation can be settled without jail time being imposed. Therefore, no individual will actually serve jail time for violating the cartel criminal statute, and most can get away with a simple settlement. More severe sanctions may be applied if cartels operate in the context of public bids (for which the law has specific criminal provisions), but even so actual jail time as a result of the final criminal conviction is very unlikely. The new antitrust statute, enacted in December 2011, eliminates the alternative of a fine to jail time. This is not likely to result in actual or significant jail time for first-time offenders, although it will eliminate the possibility of a settlement during the process, which means that defendants will have to bear the consequences of a criminal conviction (which can itself be devastating for a corporate executive).

C. The enactment of the 1994 Antitrust Act —1994–2000

The year 1994 can be seen as a relevant mark in the Brazilian antitrust system, due to the enactment of Law No. 8884/1994, which, at this writing, is still in force. The most significant change brought about by this new law is not any specific provision it contained, but rather the obvious desire of the government to strengthen competition compliance in the country. In this sense, the enactment of the new law is in line with the movement of expansion of antitrust systems around the world, mostly felt from the 1990s onward.[80] In a way, it would not be proper to state that Brazil was joining the group of countries with a competition policy, as a competition law existed since 1962. It would be correct, however, to say that the enactment of Law No. 8884/1994 put Brazil on a course to become one of the select jurisdictions with an actual and (somewhat) effective competition policy.

Two changes in the legislation, which were instrumental in the increase of power of the competition authorities, should be highlighted. Firstly, CADE was elevated to the status of an autonomous legal entity ("autarquia") within the Federal Government, and its commissioners were granted two-year mandates, renewable once. The purpose of this change was to grant CADE independence from the political influence of the Brazilian executive branch.[81] This independence is reflected in the law by Article 50, which states that CADE's decisions cannot be appealed within the administration.[82]

The other significant change was the adoption of an effective mandatory merger control system. Law No. 8884/94 (still in force at this writing) established that any transaction that meets either of the following thresholds must be submitted for approval: (1) either party

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[80] *See* Damien Geradin, *The Perils of Antitrust Proliferation: The Globalization of Antitrust and the Risks of Overregulation of Competitive Behavior*, 10 CHI. J. INT'L L. 189 (2009).

[81] This is not to say, obviously, that CADE commissioners would always be impervious to lobbying efforts of government officials or anyone else. As is always the case everywhere, institutional independence leaves the decision maker free to be influenced by whomever she wants.

[82] Judicial recourse, obviously, is always available.

has revenues of over R$400 million in the preceding year; or (2) the transaction involves a relevant market in which the participants hold more than a twenty percent share.[83]

A couple of decisions of the CADE commissioners under the new law had a significant impact on the number of merger control submissions. CADE concluded that the revenue to be considered for assessment of the threshold was not only that of the legal entity involved in the transaction, but that of all the economic group of either party involved. In addition, CADE determined that the revenues to be considered were worldwide revenues, not just Brazilian revenues.[84] Absent in the legislation, or in CADE's interpretation, was any requirement related to the value of the transaction itself or its impact in the Brazilian market. That led, and still leads, to confusion as to when foreign-to-foreign mergers should be submitted in Brazil, when no Brazilian assets are involved.

The result of all this was that whenever a large multinational corporation acquired, or sold, any business that had any dealings with Brazil, a notification would be required. These extremely broad merger rules became even broader with time as the Brazilian currency, the real, lost value in relation to the dollar. In 1994, one Brazilian real equaled US$1.18. In 2003, one Brazilian real equaled only US$0.35.[85] In effect, that actually meant a significant expansion of an already broad merger control requirement. The effect of this

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[83] The twenty percent market share threshold was established just a few days after Law No. 8884/94 was passed. Article 55, Medida Provisória No. 542, de 30 de junho de 1994, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 30.6.1994. The R$400 million turnover threshold was first established in Law No. 8884/94 through a 1995 provisional measure. Article 16, Medida Provisória No. 1138, de 28 de setembro de 1995, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 29.9.1995.

[84] The relevant provision of the law does not state either way—it mentions the revenues of the "participant," allowing for the conclusion that it is in fact worldwide revenues, if the participant is a multinational corporation. This interpretation was changed by CADE in 2005, in the effort to reduce the amount of time spent on merger filings with no actual impact on competition.

[85] In 1994, the revenue threshold, in dollars, was US$472 million. In 2003, it was only US$140 million.

combination of legal provisions and interpretation was a significant number of merger control filings after 1994.[86]

As one might have expected, the number of cases in which any material restrictions were imposed was insignificant. In fact, this period is characterized by an extreme rigor in the requirements for filing,[87] but none in the material review of the cases. In fact, the two transactions that come to mind were mergers that, although leading to a significant market concentration, were approved by the authorities with minor restrictions.

The first of such cases was the Colgate/Kolynos merger, which was reviewed and approved in 1996. The merger led to a 78.1% market share in the toothpaste market, but was approved by CADE following a behavioral remedy accepted by the company consisting of the exclusion from the market of a famous name brand for a period of four years.[88]

The other was the famous AmBev case, the merger of Brazilian brewers Brahma and Antartica,[89] which was approved in by CADE in

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[86] There were 19 submissions in 1996; 46 in 1997; 144 in 1998; 266 in 1999; and 523 in 2000. Data on number of merger control filings is found in CADE's annual reports, all of which are available at http://www.cade.gov.br.

[87] CADE was at that time obsessed with the need for parties to file on time and thus imposed significant lateness fines. Bizarrely, CADE was famous for changing its interpretation of when a transaction had to be filed and, on more than one occasion, applied the new interpretation retroactively to the detriment of parties. In 2000, about twenty percent of all merger filings were deemed late and received lateness fines. This calculation was made based on information provided in CADE's 2000 Annual Report, *available at* http://www.cade.gov.br.

[88] CADE, AC No. 0027/1995, Relatora: Lúcia Helena Salgado, 18.09.1996, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.09.1999. The *rapporteur* of the case at CADE published in 2006 an article on this landmark decision. *See* Lucia Helena Salgado, *O Caso Kolynos-Colgate e a Introdução da Economia Antitruste na Experiência Brasileira*, *in* MATTOS, *supra* note 54, at 29, *available at* http://works.bepress.com/lucia_salgado/5.

[89] CADE, AC No. 08012.005846/1999-12, Relatora: Hebe Romano, 3.03.2000, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 11.04.2000, at 1. This merger led to the creation of AmBev, which subsequently merged with Interbrew to create Inbev, which then went on to acquire Anheuser-Busch in 2008.

2000. In view of the high market share that the companies would have in the beer market following the transaction, CADE imposed as a condition for approval certain behavioral remedies and a very limited partial divestiture order. This case was particularly peculiar since CADE had only a couple of years before denied approval to cooperation agreements between Miller/Brahma and Anheuser-Busch/Antartica,[90] even though the American brewers were not present in the Brazilian market, on potential competition concerns.

In the midst of a significant number of merger filings, fines for late notification, and lack of actual teeth on the material review of the cases, what was strikingly absent was any serious enforcement against cartels and abuse of dominance. It might be unfair, however, to blame CADE for the lack of a relevant decision on anticompetitive conduct. There was no conscious effort on the part of the authorities to focus on mergers instead of cartels and other antitrust violations. It was just that there were no anticompetitive investigations to be decided by CADE, while the 1994 law created an obligation of CADE to review mergers. In other words, merger cases came to the authorities, but the authorities had to "go out and get" anticompetitive conduct cases. Moreover, CADE was not (and is not) in charge of initiating antitrust investigations. Under the 1994 statute, CADE is basically a tribunal, with authority to rule on mergers and conduct cases. Initiation of conduct cases, however, is the responsibility of the Secretariat of Economic Law of the Ministry of Justice (SDE). A review of CADE decisions, however, provides a clear indication of what occupied the competition enforcers at the time. And the result is clear—it was all about merger filings.[91]

Once again, it is not fair to say that this was a result of a mistaken perception of priority by the authorities. The 1994–2000 period of (at

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[90] Miller/Brahma, CADE, AC No. 58/1995, Relator: Renault Castro, 06.06.1997, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.06.1997, 11, and Anheuser-Busch/Antartica, CADE, AC No. 83/1996, Relatora: Lúcia Helena Salgado, 18.06.1997, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.06.1996, at 22.

[91] According to CADE's 1998/1999 Annual Report, from March 1994 to February 1999, 73% of CADE's decisions concerned merger filings. From May 1996 to May 1998, the figure was 86%. *See* CONSELHO ADMINISTRATIVO DE DEFESA ECONÔMICA, RELATÓRIO ANUAL 1998/99 23, *available at* http://www.cade.gov.br.

least formal) merger enforcement should be compared with the pre-1994 period of no enforcement at all. In this sense, the system improved with the establishment of a merger control regime. As stated, this can be done merely by creating a law with the obligation to submit transactions for approval. But the law alone will not increase the number of cartel cases—this is done through investigative tools (which should be available to the authorities) and manpower. And this is what the competition authorities realized, and acted upon, with the 2000 amendments to the competition law, which we now turn to.

D. Refocus to cartel enforcement—The Leniency Statute: 2000–2010

In 2000, two important amendments to the antitrust law were introduced.[92] They would shape how competition enforcement would be carried out in the following years in Brazil. The first amendment related to the possibility of allowing companies to apply for leniency in relation to cartel activity. The leniency system was introduced to allow a company to report an anticompetitive agreement in exchange for immunity from administrative fines and criminal sanctions for its executives. The second amendment related to the new powers that were granted to the SDE and CADE in conducting antitrust investigations, the most important of which was the possibility of asking a court (through federal public attorneys) to authorize the conduct of unannounced dawn raids in the investigated parties' premises.[93]

These two changes, however, were not implemented until 2003, when the first leniency agreement was executed with the SDE and the

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[92] Lei No. 10.149, de 21 de dezembro de 2000, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 22.12.2000.

[93] Prior to the introduction of unannounced dawn raids in 2000, the authorities were required to issue a notice twenty-four hours before entering the company's premises, which significantly reduced the usefulness of the searches. The authorities can still opt for announced inspections, which do not require a court order. However, understandably, the authorities prefer to obtain warrants for the unannounced dawn raids, which were obviously more effective in gathering evidence of cartel behavior.

first dawn raid took place.[94] The 2000–2003 period, in this sense, may be seen as a transition phase in which a major redirection of the antitrust enforcement in Brazil was being gestated. Not unlike in other jurisdictions, it takes time for companies to warm to the benefits of a leniency program, and a three-year gap between the availability of the legal instrument and its use is in this respect quite normal. The outcome was that the earlier focus on merger enforcement was radically altered, with the authorities undertaking a clear and consistent effort to prosecute more cartel cases and other antitrust offenses and with a reduction in the number of merger filings.

As to the leniency regime itself, it is broadly in line with the model set by other modern antitrust legislation worldwide. Prospective applicants must meet certain criteria in order to secure an agreement with the SDE.[95] If all requirements are met, full immunity is granted to the successful leniency applicant. However, if the SDE already had information on the cartel that was the object of the application, the applicant will be awarded only partial immunity.[96] Criminal immunity is also granted to individuals who sign leniency agreements. Although second-ins are not allowed to sign a leniency agreement, they might disclose to the SDE the existence of another

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[94] The first leniency application in Brazil (signed in 2003) led to the uncovering of a bid-rigging cartel involving private security companies with activities in the Brazilian southern region. CADE, PA No. 08012.001826/2003-10, Relator: Abraham Sicsú, 19.09.2007, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 04.10.2007, at 29. The first dawn raid in Brazil, in its turn, took place in July 2003 during an investigation into the gravel market in São Paulo. The headquarters of Sindipedras, a trade association, were searched, and several documents were seized. CADE, PA No. 08012.002127/2002-14, Relator: Luiz Carlos Prado, 13.07.2005, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 01.08.2005, at 66. *See* SECRETARIA DE DIREITO ECONÔMICO & CONSELHO ADMINISTRATIVO DE DEFESA ECONÔMICA (SDE & CADE), FIGHTING CARTELS: BRAZIL'S LENIENCY PROGRAM 11–14, 19 (3rd ed. 2009), *available at* http://portal.mj.gov.br/sde.

[95] Under the 1994 statute, the SDE is the administrative unit responsible for negotiating and signing leniency agreements. CADE's responsibility is limited to evaluating whether the applicant company complied with all the requirements set forth in the leniency agreement.

[96] Partial immunity can result in a reduction of one- to two-thirds of the ultimate fine to be imposed.

cartel, in which case the SDE might grant leniency immunity in relation to this second cartel and suggest the reduction of the fine in relation to the first one (this is the "leniency plus" system).

In 2006, further adjustments to the Brazilian leniency system were made by the SDE. Through an internal ruling of the Ministry of Justice,[97] a marker system was formally introduced, allowing a company to secure its place in line while leniency negotiations take place. The new regulation also allowed companies to present their leniency applications orally. (Of course, the agreement to be eventually signed will have to be in written form.) The last major concern addressed by the 2006 regulation concerns the procedures to be followed in leniency applications: negotiations are conducted solely by the head of the SDE (with a Chinese wall established with the SDE's competition division), and if an agreement is not reached all documents are returned to the applicant party.

Of course, leniency agreements were not the sole enforcement instrument used by the SDE to uncover illegal activities. Dawn raids have also been an important part of the work conducted by the SDE since 2003, and they are usually employed in investigations triggered by leniency agreements. In Brazil, dawn raids may be used to gather all kinds of evidence related to the investigation being conducted by the antitrust authorities. After proper court authorization, officials may be entitled to search not only the company's premises, but also the houses of the managers who are suspected to be part of the illegal activities. These procedures must be ordered by a court, and they usually involve a large number of officials from the SDE and the Federal Police.

In sum, the leniency program and dawn raids have been combined by the SDE in order to improve cartel detection and punishment in Brazil. These are the two most important underpinnings of the change that was implemented in the Brazilian antitrust regime during the 2000–2010 period. However, other significant institutional

[97] Ordinance No. 4/2006 of the Ministry of Justice, Ministério da Justiça, Portaria No. 4, de 5 de janeiro de 2006, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 06.01.2006. This internal regulation was replaced in March 2010 by a new ordinance, which further detailed procedures concerning leniency applications. Ministério da Justiça, Portaria No. 456, de 15 de março de 2010, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 16.03.2010.

developments must be noted, given that they have also contributed to the recent improvements. These include, for example, formal and informal cooperation efforts with state prosecutors and the Federal Police, involving the exchange of information, intelligence, and capacity building. They also include the participation of the Brazilian authorities in discussions with peer agencies worldwide in forums such as the International Competition Network and the OECD.[98]

Another important highlight of this period was the use of settlements to terminate cartel investigations. Up to 2000, the antitrust law allowed all investigations to be settled by CADE, without the imposition of any penalties whatsoever. It was up to CADE to determine whether or not settlement was in the "public interest." In order to prop up the leniency program, Law No. 10149/2000, the leniency program statute, expressly prohibited settlements in cartel investigations.[99] However, settlements in cartels were once again allowed by another amendment to the law,[100] with a twist—a "pecuniary payment"[101] would be mandatory, and admission of guilt might also be required depending on an analysis of the specific case. The purpose of the new amendment was to reduce investigation costs and to allow for the immediate collection of the "pecuniary payments" that would be made by the parties under investigation. Since 2007, negotiation

[98] For example, in 2005 the OECD issued a very thorough peer review of the Brazilian competition regime, containing an analysis of the progress of the antitrust regime to date and with suggestions for improvement that would eventually be adopted by the authorities. OECD, *supra* note 69. A follow-up peer review was published in 2010. OECD, COMPETITION LAW AND POLICY IN BRAZIL, A PEER REVIEW (2010), *available at* http://www.oecd.org/dataoecd/42/45154362.pdf.

[99] The idea was that settlements were a disincentive to leniency applications. If cartelists knew that even if caught they could still settle their way out of the problem, without financial consequences, they had no incentive to stop the practice and seek leniency. By excluding the possibility of settlement in cartel cases, the authorities hoped to create the necessary incentive for leniency applications.

[100] Lei No. 11.482, de 31 de maio de 2007, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 31.5.2007, which altered Article 53 of the antitrust law.

[101] If the payments come out of a settlement, the word "fine" cannot be used, as the party was not properly found guilty of a violation.

procedures have been somewhat clarified and cartel settlements have slowly gained ground.[102]

The last step the antitrust authorities took to consolidate this new focus on enforcement against anticompetitive behavior came in the form of increasing levels of fines applied to companies and individuals. Two recent decisions are noteworthy in this respect. In September 2009, CADE levied a BRL 352.7 million fine on Brazilian brewer AmBev for abuse of dominance.[103] AmBev was found to have been leveraging its dominant position in the beer market through a discount/loyalty program in order to prevent rivals from competing effectively. The second decision was taken in September 2010, in an investigation involving an alleged cartel among suppliers of industrial/medicinal gases. The investigation led to the largest fines ever imposed by the Brazilian authorities.[104] Irrespective of the merits of CADE's analysis in these two cases (both decisions are being challenged in court), the fact is that they can be seen as a clear statement by the Brazilian authorities of their intention to heighten antitrust enforcement in general.

V. AS WE MOVE FORWARD—2011 AND BEYOND

Despite the success of the recent history of the Brazilian competition enforcement, demonstrated by the implementation of a merger control system and by the subsequent efforts to create an environment

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[102] So far, there have been settlements in important investigations such as the marine hose case, the hermetic compressors investigation, a cartel investigation against cement companies, the case involving an alleged buyers' cartel of Brazilian meat-packers, and an investigation into an alleged cartel involving the flexible packaging industry.

[103] CADE, PA No. 08012.003805/2004-10, Relator: Fernando Furlan, 22.07.2009, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 05.08.2009, at 29.

[104] CADE, PA No. 08012.009888/2003-70, Relator: Fernando Furlan, 22.09.2010, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 27.09.2010, at 32. The fine on White Martins (Praxair group) was approximately BRL 1.7 billion (US$1 billion). Fines levied against all defendants totaled approximately BRL 2.3 billion (US$1.3 billion). The decision applied a twenty-five percent fine to the companies' total turnover in the year preceding the launch of the investigation. White Martins' fine was doubled to fifty percent due to recidivism.

of effective deterrence on anticompetitive practices, many structural problems have been identified since the enactment of the antitrust statute in 1994. Some of the most difficult problems will be discussed in the next section of this article, which deals with the future of the competition enforcement in Brazil. One of the main challenges will be the implementation of a new antitrust statute that was enacted in December 2011. This new statute introduces important changes to the Brazilian antitrust regime. Its main contours are summarized below.

A. The new Antitrust Act

The year 2011 saw the enactment by the Brazilian President of a new antitrust act, after many years of gestation. Discussions regarding a new law began as early as 2000, during the Fernando Henrique Cardoso administration, with a proposed regulatory agency for competition and consumer protection.

Although that idea did not take hold, a bill of law, in many ways based on the earlier work, was prepared by the Lula administration and sent to Congress in 2005. After many changes in its text, the bill was approved by both houses of Congress and subsequently by the President. Following a reconciliation process, the Lower House of Congress approved the final version of the text on October 5, 2011, which was then signed into law on December 1, 2011, by the President with a number of presidential vetoes to some articles. The new statute enters into force in 180 days.

The text of the new statute is the result of prolonged debates within the government and the antitrust community aimed at addressing some of the major concerns regarding the current antitrust system, such as lengthy proceedings, duplication of work among different government units, and mandatory submission of transactions having almost no effect on competition in Brazil.[105]

The first major change to the current antitrust system in Brazil is that the SDE will no longer exist as a separate entity. The current

[105] For example, under the current structure of the competition authorities in Brazil, some cases are reviewed by the Secretariat of Economic Monitoring of the Ministry of Finance (SEAE), the SDE, CADE and, sometimes, by the CADE's General Attorney Office and by the Federal Prosecutor's Office at CADE.

antitrust functions of the SDE will be incorporated into CADE, which will in turn be divided into three new main divisions: an Administrative Tribunal (which will comprise the current commissioners and the chairman), a Superintendency-General (which, in broad strokes, will be responsible for merger reviews and investigations on anticompetitive behavior), and a Department of Economic Studies.

The most significant change for the business community will probably be the substantial alteration in the merger control process. The 1994 statute established a post-closing notification process, under which approval of CADE is not a condition for the closing of transactions.[106] This now changes with the new law, under which Brazil joins more traditional jurisdictions with a prenotification process that requires antitrust approval for closing and fines for gun-jumping. This new system could benefit companies that need merger approval, provided CADE can deliver on the promise of an expedited review process, because, delays in the review process would force parties to delay closings.

The second remarkable change concerns the merger control thresholds, which were altered so that only transactions involving parties with a sizable presence in Brazil will have to be submitted for approval.[107]

The importance of this new threshold is the substantial reduction in the number of transactions to be submitted. As indicated above, under Law No. 8884/94 any transaction involving a conglomerate with more than R$400 million of annual revenues in Brazil needs to be submitted for approval, as long as the target has some presence in

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[106] Currently, transactions that create a prima facie competitive problem are usually subject to negotiations between CADE and the parties, leading to a "halting" order that remains in place during the merger review process. CADE also has the power to impose a halting order if a negotiated solution is not sought or reached.

[107] The current relevant market threshold was eliminated, and there are now two turnover thresholds. CADE will have the discretion to ask for the ex-post submission of transactions that do not meet these criteria, a power that is being granted to the antitrust authority because many smaller (but potentially anticompetitive) transactions would not be caught by the turnover thresholds.

the country (even if through exports only, regardless of volume of sales). With the new law, a second threshold is created: the second party to the transaction must have R$30 million of revenue, which means that both groups involved will now have a sizeable presence in Brazil (even though there is no specific threshold for revenues of the target of a transaction). This change alone will significantly reduce the number of filings, given that many foreign-to-foreign mergers that are currently submitted would not meet the two-party revenue threshold.[108]

Outside the merger control arena, the changes are more limited. There are no significant alterations in the definition of which business practices constitute antitrust violations, although the anachronistic definition of a violation for "excessive pricing" has been removed from the law. Certain changes are made to the level of fines that can be imposed. Currently, fines are imposed based on a percentage of total revenues of the company in one year, while the new law reduces the base to the affected business sector.

There are no significant changes to the leniency regime. The most noteworthy is the removal of the prohibition against "leaders" of cartels benefiting from the program. The requirement that "leaders" could not apply, although understandable in terms of principle, actually created insecurity over whether certain companies could apply—and expose cartel violations—in certain circumstances.

Many other changes are established in the law, mostly in relation to procedures for assessment of merger control and antitrust violations. These significant changes will represent a major challenge for the authorities in charge of implementing the new systems. We now look into these and other challenges Brazil faces.

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[108] According to former CADE chairwoman Elizabeth Farina, a 2008 study estimated that the introduction of a BRL 30 million revenue threshold for the second notifying party would yield a twenty-five percent decrease in the number of merger control notifications. *See* Elizabeth Farina & Fabiana Tito, *A Premiação Internacional e a Demora Legislativa*, VALOR ECONÔMICO, Mar. 14, 2011. Another newspaper article quotes an internal CADE study predicting a fifty percent reduction in the number of notifications, should the BRL 400 million threshold be increased to BRL 1 billion in the new statute. *See* Juliano Basile, *Com a Nova Lei, Julgamento de Fusões Cairá Pela Metade, Prevê o CADE*, VALOR ECONÔMICO, Dec. 16, 2010. Note that the Brazilian authorities will have the power to increase the new notification thresholds.

B. Challenges to be faced

As seen above, the 2000–2010 period was marked by efforts to shift attention from merger review to cartel prosecution. Although this move has generated remarkable success in the level of enforcement in the country, significant improvement of the overall regime requires certain structural changes, some, but not all, of which are addressed by the new law expected to come into effect shortly. An effective competition regime depends on an efficient legal instrument. But that is not sufficient—competent and modern implementation of the law is also required. These are the challenges as we look to the future of competition enforcement in Brazil.

First of all, although recent decisions taken by CADE are important, it must be noted that increased enforcement against cartels and abuse of dominance is not really within the scope of the activities of CADE. There is no question that CADE has a role to play in this effort, but one should not forget the fact that, under current legislation, CADE is actually an administrative tribunal, with the function of deciding investigations that itself has no power to initiate. (The SDE, which will be the replaced by the Superintendency under the new statute, has this power.)

Therefore, CADE's role should not be viewed as increasing the level of enforcement against any particular behavior, no more than a court of law's role is to increase the level of enforcement against any particular crime. CADE's role is to apply the legislation, deciding cases that are brought to it by the investigation authority. When deciding a case, obviously, CADE should have in mind the public goal of increasing efforts against cartels in general, but it has a duty to evaluate whether, in the particular case, a cartel did in fact exist. The administrative tribunal has to be impartial in the decision of any particular case, just as a judge must be when ruling on any judicial dispute, whether criminal or not.

Antitrust enforcement, as is true for law enforcement in general, rests on the efforts of the investigation authorities. In the case of the current Brazilian competition regime, this role is performed by the SDE (which will become the Superintendency of the new CADE). In the framework of the 1994 statute, its role and structure is similar to

that of the Antitrust Division of the U.S. Department of Justice. The SDE is a division within the Ministry of Justice. It has broad powers to investigate antitrust behavior, but it does not have authority to impose sanctions—it sends the cases for a final decision of CADE. In that respect, the success of any efforts against cartel practices or other types of infractions depends primarily on the SDE. If the SDE does not open investigations, or does not conduct investigations properly, CADE will not be in a position to impose any sanctions. The question, then, is whether the SDE is well placed to perform its role in a satisfactory way. In this respect, the verdict is mixed.

There is no question that the SDE authorities have been focused on the need to increase efforts against cartel behavior (other types of infractions coming second in the agency's priorities). As indicated, this is a trend dating from the introduction of the leniency program and additional investigative powers such as dawn raids authorized by a court, in 2000. The SDE places absolute priority on increasing the number of cartel investigations, especially through leniency applications. The view is that leniency applications are the fastest way to mount a cartel case, and a successful leniency program will create additional risk for the practice itself, as a cartelist may fear application for amnesty from one of its coconspirators, instead rushing to obtain the benefit itself (as only the first through the door can apply).

Leniency negotiations are highly favorable to the applicant, which has the flexibility of backing away from the deal at any time without the risk of having any information passed on to the authorities used against it.[109] The number of applications so far shows that the program has had a medium level of success. In a country where accusations against "peers," such as those required for leniency, are not part of the culture (and are actually seen by some as unethical), the existence of any applications could be viewed, in and of itself, as a success. The SDE has indicated that sixteen leniency agreements were executed so

[109] The SDE has prepared a revised guideline on the leniency program to add comfort to applicants. Ministry of Justice Ordinance No. 456/2010, Mar. 15, 2010, Portaria No. 456, de 15 de março de 2010, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.03.2010.

far, and a few are under negotiation.[110] It may be fair to say that the authorities were expecting more applications in the approximately ten years in which the legal instrument has been available.

Although cultural aspects may play a role against leniency applications, that is perhaps not the primary reason for the relatively few number of cases. A leniency program can be effective only if (1) the legal instrument is wide-ranging, covering all or almost all of the legal risks affecting the applicant; and (2) there is a sufficient perception of risk to convince a cartelist to give up the highly lucrative practice to enter into the program.

The legal instrument for leniency in Brazil is perhaps sufficiently wide-ranging to encourage applications. Moreover, the leniency negotiations, as indicated, are highly favorable to the applicant, which is also an encouragement for companies that seek the protection. The authorities themselves understand the importance of providing incentives to attract applications and have acted accordingly. Naturally, the application does not cover all legal risks faced by cartelists, but does cover the basic ones.[111]

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[110] According to a recent news report of statements made by a senior SDE official, sixteen leniency agreements have been signed. *See* Mariana Ghirello, *Acordo de Leniência Poderá ser Enviado por E-mail*, Mar. 10, 2010, CONSULTOR JURÍDICO, http://www.conjur.com.br/2010-mar-19/peticao-acordo-leniencia-enviada-mail-sde. The OECD 2010 peer review reports that fifteen leniency agreements had been signed up to 2009. OECD, *supra* note 98, at 16 ("Between 2003 and 2009 SDE entered into 15 leniency agreements, and others were being negotiated. Approximately 60% of these agreements were with parties to international cartels, in situations in which the participants had entered into leniency agreements in other countries. Still, there were also some prosecutions of domestic cartels resulting from leniency agreements.").

[111] In this regard, the program gives full immunity for the company and executives involved against the administrative fines that are imposed by CADE and also gives full criminal immunity for the executives, as creation of and participation in a cartel is also a criminal offense. There is no protection against private damages actions. Under the current statute, there is also no protection against prosecution for other criminal offenses that may be involved in a cartel. (For example, in a public bidding cartel other crimes may exist that are not covered by the leniency program.) However, the leniency provisions of the new statute extend criminal immunity to related crimes, such as conspiracy and bid rigging.

The great challenge will be to change the perception of the level of enforcement. The SDE authorities are aware of this fact and highly publicize all actions taken against cartels, such as the opening of new investigations, number of executives arrested (even if they are quickly released on bail), and number of dawn raids. The purpose, of course, is to increase the perception of the risk of engaging in cartel practices, so that companies will either seek leniency applications (thus increasing the level of enforcement) or just stop the illegal action altogether. Although marketing efforts are valuable to attract media coverage to enforcement, and competition authorities do receive significant amount of coverage from business newspapers, the real goal is to effectively increase enforcement. This challenge has not yet been met.

There is no question that effective enforcement against cartels depends on a few factors: (1) detection of violations so that investigations can be launched; (2) efficient investigation procedures; and (3) the ability to execute any final decision imposing sanctions. By these measures, there is still a long way to go before cartelists in Brazil will give up their lucrative dealings for fear of being penalized by the authorities.

Although the "busting" of cartels is highly publicized in Brazil, the overall number of cases is not significant in comparison with the size and diversity of the Brazilian economy (and the tradition, foremost in Brazilian concerns, of "cooperation," dating back from when the government itself expected industries to coordinate, as discussed above). Even so, the number of cases brought up every year is clearly well above the capacity of the SDE to handle. In fact, the SDE is not efficient in the conduct of its investigations, due mostly to its small budget and to the reduced number of officials[112] in comparison with the number of investigations on anticompetitive practices.[113] The

[112] The SDE had thirty-two professionals (as opposed to nonprofessional support staff) in 2009. See OECD, *supra* note 98, at 48, for a chart detailing the number of the professional and support staff at CADE, SDE, and SEAE from 2005 to 2009.

[113] According to the 2009 Report of the SDE's Competition Division there were 507 investigations pending at that time. This figure includes formal administrative proceedings (116), preliminary investigations (131), and informal preliminary inquiries (260). It should be stressed, however, that not

result of this absurd ratio of investigations to officials is quite simple. Officials are unable to move the cases along, which means that only a few reach CADE for a final decision every year.

The numbers presented by the SDE are sufficient for this conclusion. Although Article 40 of the law states that the investigation must be concluded as quickly as possible, according to official figures of the SDE itself, the average time spent in an investigation, at the SDE phase alone, is almost five years.[114] On top of that, it can take about another year for CADE to decide the case after it receives the investigation from the SDE. It is not uncommon for it to take more than a year for a cartel investigation—even one that is deemed a priority—to advance, for instance, from the review of the defenses to the beginning of the evidentiary phase.

The lack of staff at the Secretariat is in fact the major impediment to the advancement of the competition regime in Brazil. Given the significant shortage of people, the decision of the SDE to prioritize the opening of new cases—usually after intensive work on dawn raids that mobilize dozens of officials for a substantial amount of time—actually makes the situation worse. There are more cases to be handled, but the number of officials has not increased.

In addition, even when the investigations do reach CADE, and heavy fines are imposed on cartel practices, there is still the challenge of sustaining those decisions in court. If the investigations at the

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all cases have the same level of complexity, and many of these informal inquiries probably relate to complaints received by the SDE with no antitrust issues at all. On the other hand, it is also true that not all SDE officials are directly responsible for the conduct of the cases at SDE. SECRETARIA DE DIREITO ECONÔMICO, MINISTÉRIO DA JUSTIÇA, RELATÓRIO DE GESTÃO SDE, EXERCÍCIO 2009, 137–47 (2010), *available at* http://portal.mj.gov.br/sde.

[114] According to the SDE's Competition Division 2009 Report, the average time spent by the SDE in the investigation of the formal proceedings referred to CADE was 1801 days. However, it should be noted that—as one would expect with such old cases—a great part of the backlog comprises cases opened in previous SDE administrations. The SDE's efforts to reduce this backlog are commendable, all the more so in light of the scant resources with which the agency has to work. SECRETARIA DE DIREITO ECONÔMICO, MINISTÉRIO DA JUSTIÇA, *supra* note 113, at 139.

administrative stage are slow,[115] the judicial dispute over any fine imposed by CADE, on any case, is much slower. A lawsuit to challenge a CADE decision can easily last for ten years, considering all possible appeals that can be filed by either side. Although there is usually the need to offer a guarantee in court pending final decision (such as a bond issued by a bank), this alternative is clearly less costly than the immediate payment of the fine. More importantly, the possibility of discussing the case for over a decade in court adds to the perception that the risks of punishment are relatively small, while the gains related to the involvement in the cartel are real and substantial.

Therefore, the great challenge for the authorities in Brazil is not establishing themselves as an important regulator of the behavior of companies in the marketplace, but in establishing themselves as effective instruments of punishment and dissuasion of anticompetitive behavior. Unless significant changes take place in the law, and in the structure of the authorities, this is unlikely to happen.

The revision of the filing thresholds in the new law should reduce the number of notifications that are filed. However, as CADE approval will become a condition for closing of transactions, there will be additional pressure on officials to quickly rule on the fewer mergers that are submitted (although the President vetoed a provision in the new statute that would automatically have approved the notified transaction if the authorities did not comply with the statutory deadlines). Hopefully the overall result will be the reduction of time spent on simple merger filings. This, however, is not certain.

In any event, the ability of the authorities to devote more time to analysis of investigations depends, necessarily, on an increase in the number of case handlers. This, again, is far from certain. Although the bill foresees the hiring of additional staff, there is no guarantee that such hiring will take place.[116] Decisions to increase the number of public servants are made at the highest levels of government, and differ-

[115] As seen above, SDE took five years on average to conclude the investigation of formal administrative proceedings. These cases are then sent to CADE, which may take a couple of years more to finally decide on them.

[116] Article 81 of Law No. 8884/1994 also stated that a specific career of competition enforcers would be created. This never happened.

ent agencies fight for additional resources. Whether competition authorities will be able to secure additional resources will depend on the priority that is given by the government to competition policy. Traditionally there is no priority at all, as evidenced by the fact that the bill remained in Congress from 2004 to 2011.

As the prospect of additional resources to deal with the major challenges of cartel and abuse of dominance enforcement is uncertain, the question is what could be accomplished now to streamline the investigation process. Certain actions have already been taken by the authorities. As mentioned, changes in interpretation of the law have had the effect of reducing the number of mergers that have to be notified for approval in Brazil. Moreover, the authorities have also been effective in reducing the amount of time spent on the review of simple merger filings, freeing more resources for antitrust investigations.[117]

However, most of these gains have already been incorporated into the new process and might even have been offset already by the increasing number of investigations that have been initiated. One solution to the problem lies in the behavior of the SDE itself. Currently, the SDE, in an effort to increase the public perception of the level of enforcement, invests time and resources to launch any cartel investigation that falls into its hands. This, however, traps scarce resources in cases that have only a localized impact (such as gas station cartels, which, although egregious, are local in nature) or in international cartel investigations in which no evidence of activity in Brazil was uncovered prior to the initiation of the case. Even though the law does not allow authorities to choose which infractions to investigate, more attention could be given to cartels of national scope or cases in which there is substantial evidence available, instead of any and all cases.

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[117] In its 2008 submission to the OECD, CADE prepared a graph showing that the average amount of time spent in merger review procedures has been constantly decreasing. In 2005, total merger review time (including time taken by the SEAE and the SDE to prepare their opinions) was 252 days. This number dropped to 226 days in 2006, 199 days in 2007 and 165 days in 2008. CONSELHO ADMINISTRATIVO DE DEFESA ECONÔMICA, ANNUAL REPORT ON COMPETITION POLICY 2008 (Apr. 2009), *available at* http://www.cade.gov.br/upload/Annual_Report_OCDE_BCPS_2008_final.pdf.

In short, an effective competition policy requires a significant level of detection of anticompetitive behavior, efficient and quick investigation processes, and the ability to execute the final decisions. Unless a significant expansion of available resources accompanies the drive of the authorities to increase their powers, and given their strategy to go after every single case, no matter how small, the overall result will be an inefficient antitrust policy.

The success of any such policy should not be measured by the number of investigations that are opened, but rather by the number of cases that are successfully closed, or, more important, by the reduction of violations that take place in the market (this, of course, being extremely difficult to evaluate, if possible at all). That is the major challenge of the next years for the authorities in Brazil: transforming a system from one that is unable to cope with the number of cases it has into an effective enforcer of competition policy.

In this respect, it is unclear whether the new law will help or hurt the effort, given that the prenotification approval process will significantly strain the limited resources available. As stated, it will all come down to the resources that will be allocated to the new CADE. It is difficult to predict whether significant additional resources will be added in the near future, as CADE will have to fight against other governmental agencies to secure additional staff, regardless of whether such increase is foreseen in the new law.

Naturally, with the new law the authorities aim at having a more functional system (especially in merger control), and a more efficient handling of matters (with the integration of the SDE into CADE). There is no doubt that an increase in efficiency is the goal of the authorities. The question is whether they will have the necessary tools and will make the correct decisions to succeed, or whether the pressure created by a prenotification system will drain the strength of the new agency, actually reducing the level of efficiency that has now been achieved.

VI. CONCLUSION

This article presents a summary of the evolution of the Brazilian competition system from its inception to the challenges of the present

and the future. It is clear that the Brazilian competition system has matured significantly in recent years, and further developments are expected for the future. In comparison with other countries in the Latin American region, the Brazilian regime seems to be at a more advanced stage, not only in the type and number of investigations it has, but also in its independence from political pressure.

In certain ways, the development of Brazilian competition policy walks in tandem with the development of the Brazilian economy. As the country moved from a highly controlled and concentrated economy to a freer and more competitive one, the competition regime developed. And this synchronicity is expected to continue. As Brazil's economy continues to gain in size and complexity, antitrust law will increasingly have a more prominent role to play in securing the benefits of competition to consumers and to the development process in general.

However, antitrust policy has never been the driver of the process of change, but rather came along with changes in the economy throughout the different periods of the country's development. Moreover, it is one thing to have legislation establishing rules, goals, and penalties. It is quite another to be able to implement them. And last but not least, it is even harder, and clearly crucial, to apply them well—that is, to apply the laws to limit anticompetitive behavior and concentrations, while preserving efficiency-enhancing business activity.

In fact, one could attempt to evaluate the evolution of the Brazilian competition system based on three different criteria. The first is the existence of legal instruments that allow for review of anticompetitive mergers and for punishment of cartel and abusive behavior.

In Brazil, legal instruments have existed for decades, although it would be possible to claim that a cohesive and comprehensive structure was brought about only after the 1994 statute. Even so, work on the legal framework has naturally continued, with the 2000 reform that allowed for the leniency program and enhanced investigation techniques, and arguably now with the new law that will introduce premerger clearance in the control of concentrations.

The second criterion is the existence of actual enforcement of the available legal instruments. Here the process is generally of gradual evolution, rather than clearly identified shifts in paradigm. Naturally, the prerequisite of actual enforcement is the existence of sufficient legal instruments, which means that there will always be a lag between the latter and the former.

In the case of Brazil, legal instruments have existed in one way or another for many decades. But actual enforcement began only after 1994, with the introduction of the competition statute that is now being replaced. As indicated in this article, enforcement began with merger review, which enabled the authorities to assume a more passive role: Given that the law mandated the submission of filings for CADE to approve, no actual investigations were required for the merger review system to exist. After a few years, the authorities perceived the need to be more proactive so as to heighten enforcement, and this was the driver of the development of new legal tools.

The shift in priority from merger review to cartel enforcement was demonstrated by the 2000 legal reform. We now see the final steps of this process, with the new competition statute that will replace the 1994 legislation. The new statute, which will come into force soon, will likely reduce the number of merger filings, so that the very limited resources of the competition authorities can be made available for prosecution of anticompetitive agreements and behavior.

If a society is successful in meeting the first two criteria—existence of modern and adequate legal instruments and availability of resources and political will for implementation—then perhaps the most important of all criteria will come into play: Competition law must be applied consistently to achieve its goals. Obviously, given the costs that a competition policy might impose on society (such as administrative costs or even overdeterrence that chills competitive behavior), the existence of a competition regime will make sense only if the results it brings outweigh them.[118]

And what should those results be? Reduction of inefficient and abusive behavior, protection of efficiency-enhancing activity, and vig-

[118] *See* HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 54 (2008)

orous competition in the marketplace, leading to lower prices and better quality for consumers. Although the goals can be easily laid out (or maybe not, given the controversy over what the goals of competition policy should be),verifying whether they are being achieved is quite complex. But this does not mean that it should not be attempted. If one cannot evaluate the benefits of the policy to society, then what is the point of undertaking all the necessary costs?

In this regard—arguably the most important criterion of all—the Brazilian regime faces great challenges. One can change the legislation and increase available resources, but without a record of consistent implementation, society will simply not benefit from the effort.

The greatest difficulty that the Brazilian authorities face on this issue is that, contrary to the experience of other jurisdictions, there is no culture in the Brazilian competition community of impartial evaluation of the impact on the marketplace of decisions reached by CADE. In other words, there is very little debate as to whether past decisions of the authorities were correct or led to the results they had in mind. Or, when such work exists, it is usually authored by stakeholders in such decisions,[119] which undermines the credibility of this exercise (although it does not eliminate its value in terms of doctrine).

Therefore, the third criterion, which involves an impartial critique of decisions and outcomes of the policy, is essential if we are to have in the country a consistent discussion of the goals of the application of competition law and the effectiveness of its implementation. The competition authorities should not fear that this approach is a form of rating their personal abilities or their wisdom in applying the law. This would be a short-sighted way to address the problem of consistency and effectiveness. Rather, given the limited antitrust debate that exists in academia in Brazil, the authorities should take the lead and seek to stimulate such a critique, welcome the feedback received, and look for ways to better their own performance.

However, we cannot see in the current debate any discussion about assuring constructive criticism of decisions taken by the author-

[119] *See, e.g.*, A REVOLUÇÃO DO ANTITRUSTE NO BRASIL 2: A TEORIA ECONÔMICA APLICADA A CASOS CONCRETOS (César Mattos ed., 2008).

ities. The proposed new law does not advance that idea, and the authorities themselves have not publicized an interest in moving in that direction. Hopefully, as competition law evolves in Brazil and gains ground in universities, there will be more interest in evaluating the effectiveness of decisions that are reached by the competition authorities and the courts.

In any event, as we compare the Brazilian competition experience with that of other similar economies, we can reasonably conclude that antitrust enforcement in Brazil is significantly more robust than elsewhere. Laws have been in place for decades, criminalization of cartel conduct has been in place for more than twenty years, and the authorities have sought at least since 1994 to effectively implement the available legislation. This is no doubt a record of success, and as the Brazilian economy grows, antitrust legislation will secure an even greater presence in the country. Moreover, debate over consistency and results achieved is possible only when decisions affecting relevant interests are made, and that is the case in Brazil as of now.

The historical development of antitrust in Brazil is a clear indication that competition policy can exist only in a market-driven economy. Therefore, there is no surprise that the liberalization of the 1990s was the key driver in the increase in status of antitrust law in Brazil. As the country seems set to stay on the path of economic development through a market economy, there is no reason to believe that the process of antitrust will be reversed. Now that we have antitrust in Brazil, we should be looking at making sure that it is bringing to society the benefits that we all believe it can bring.

TRENCH, ROSSI E WATANABE ADVOGADOS

ASSOCIADO A BAKER & MCKENZIE INTERNATIONAL

Competition Policy in Brazil

Francisco Todorov
francisco.todorov@bakermackenzie.com

Chicago – May 2013



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Summary

Part 1 – Merger Control in Brazil – Before and Now

1. Structural Changes
2. Substantive Changes
3. Practical Considerations

Part 2 – Cartel and Conduct Investigations in Brazil

1. Overview of the Legislation
2. Fines
3. Prosecution of International Cartels
4. Expected Developments

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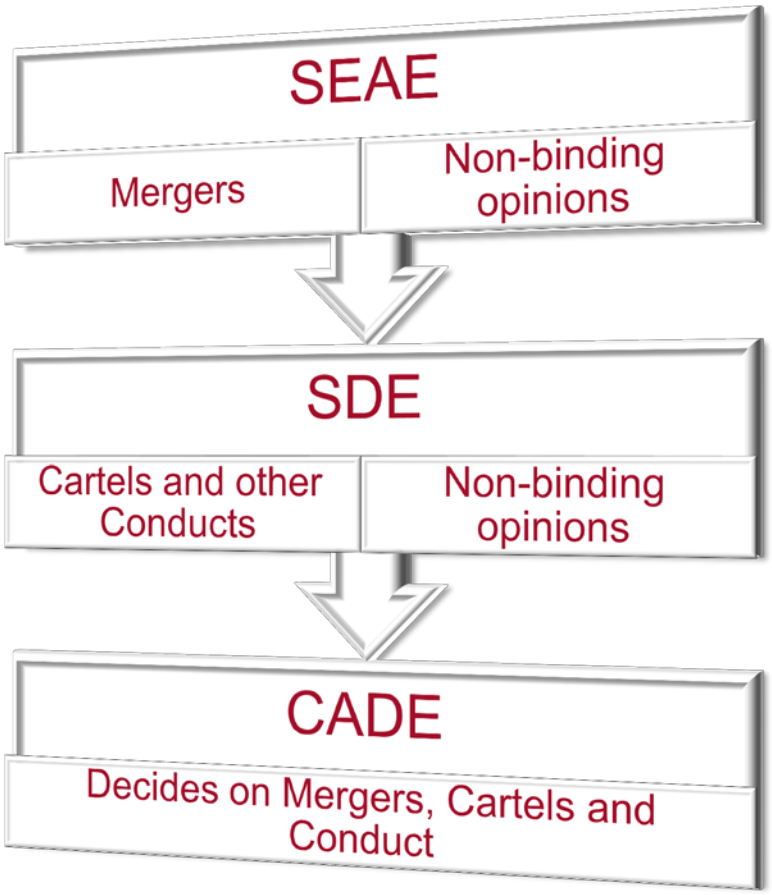
Part 1 - Merger Control in Brazil - Before and Now

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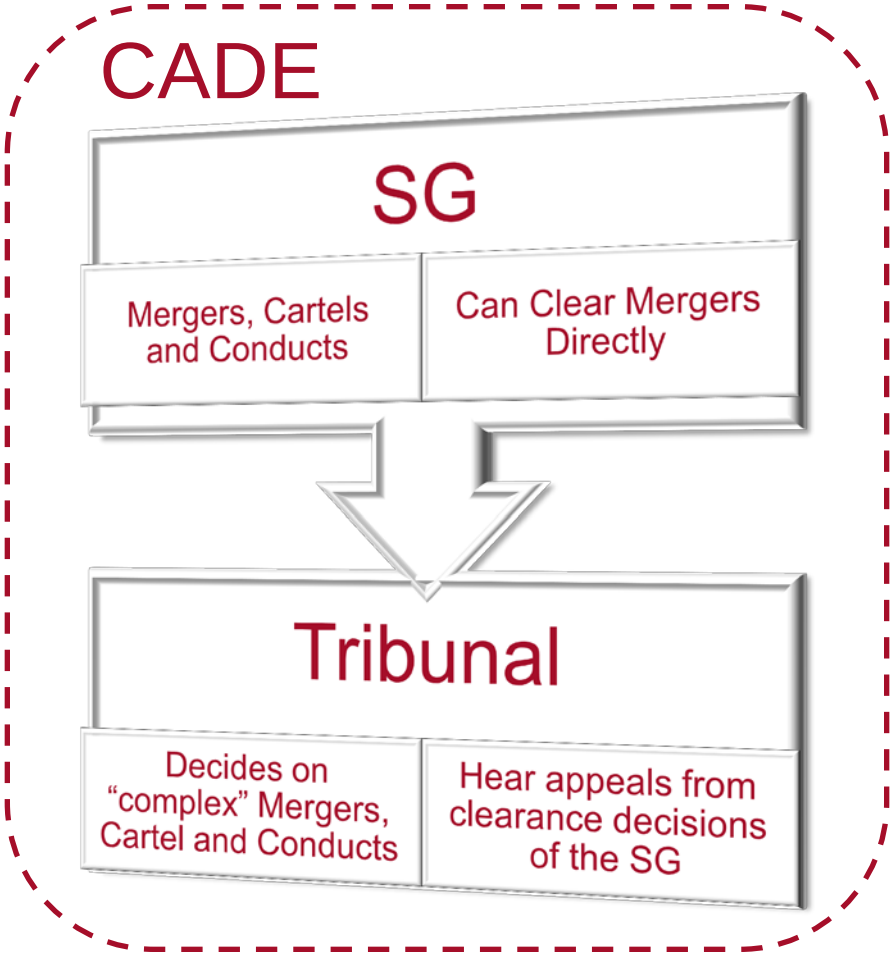
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Structural Changes

Old Law



New Law



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Substantive Changes

	Old Competition Law	Current Competition Law
What is a "Merger" subject to Mandatory Notification?	**Law:** "*any act that can prejudice competition or result in a dominant position*" **Case Law:** limited the scope of the provision	**Law:** - Mergers, and Incorporations - Acquisition of shares or assets - Joint-Venture and Consortia - Associative agreements
Notification Thresholds	- if any group involved has a turnover > $200 million in Brazil - 20% market share	- one economic group with a turnover > $375 million in Brazil - other economic group with a turnover > $37,5 million in Brazil
Standard of Review	- Ordinary Procedure - Fast Track Procedure	Ordinary Procedure - Fast Track Procedure
Filing Deadline	15 business days after closing	No deadline
Waiting Period	90 days (*possibility of stop the clock several times during review)	240 days (possibility of a 90 days extension; no stop the clock)
Suspensory	NO	YES

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Substantive Changes

	Old Competition Law	Current Competition Law
What is a "Merger" subject to Mandatory Notification?	any act that can prejudice competition or result in a dominant position	(i) Mergers, and Incorporations; (ii) **Acquisitions of shares or assets**; (iii) Joint-Ventures and Consortia; (iv) **Associative agreements**
	Having effects in the Brazilian Market, even if limited and only potential	

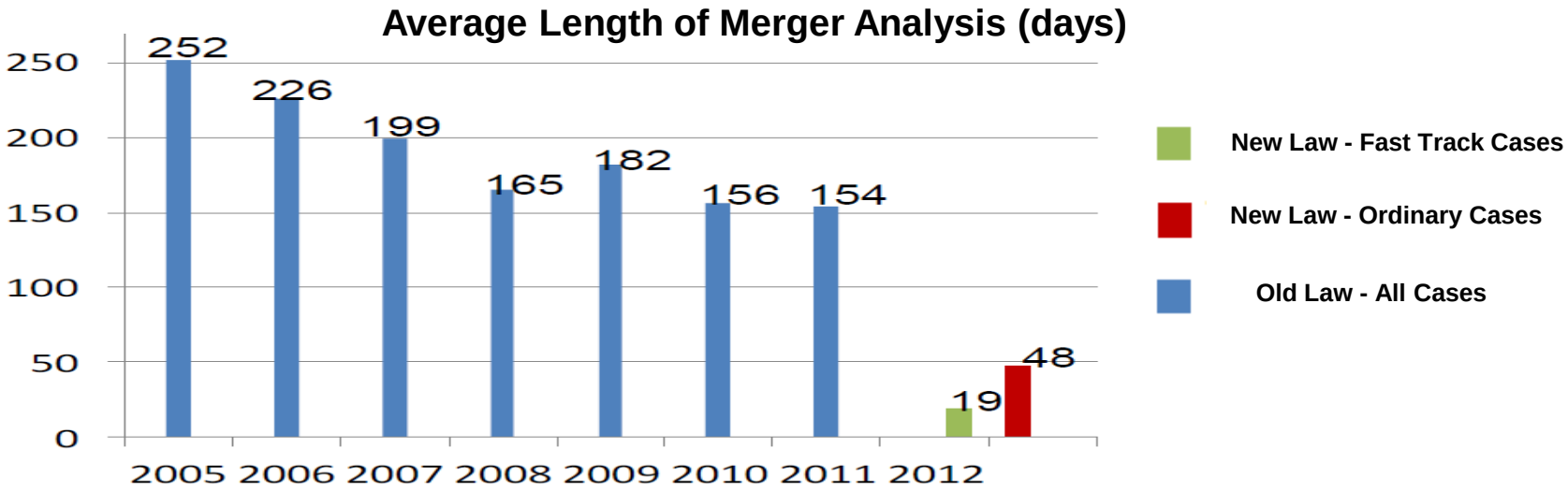
- Acquisitions of Control
- Minority Shares – 20% (5%)
- No guidance as to assets acquisitions
- Uncertainty as to the meaning of "associative agreements"
- Foreign to Foreign Mergers - No threshold for target revenues

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Practical Considerations

- Pre-merger + analysis





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Part 2 – Cartel and Conduct Investigations in Brazil

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Overview of the Legislation

- "Anticompetitive Conduct" is forbidden in general
  - "*acts which have as their object or may effect the distortion of competition*"
  - No "agreement" is needed for cartel characterization
- Companies, Individuals, and Associations can be punished (fines)
- Individuals also serve prison time for Cartels (***potential***)
- **Extraterritorial Jurisdiction:** any conduct with effects in Brazil

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Fines

Companies	Individuals

▪ 0,1% to 20% of gross pre tax turnover
▪ Relevant turnover is that:
  ▪ of the financial year prior to the opening of the investigation
  ▪ accrued in the "***industry segment***" where the infringement took place
  ▪ adjusted by SELIC until the date of payment
	▪ 1% to 20% of the fine applied to the corporation
	
	▪ In case of Cartel, there can be a parallel criminal suit: imprisonment from 2 to 5 years *and* criminal fines – not applied by CADE

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Largest Brazilian Fines

Defendant (FY)	Product	Fine (USD M)*	% of Turnover (estimated)	Conduct
White Martins (2010)	Industrial e Medicinal Gases	$879	50%	Cartel
AMBEV (2009)	Beer	$176	2%	Loyalty Rebates
Gerdau (2006)	Steel Rod	$122	7%	Cartel
Air Liquide Brasil Ltda. (2010)	Industrial e Medicinal Gases	$99	25%	Cartel
Linde Gases Ltda. (2010)	Industrial e Medicinal Gases	$94	25%	Cartel
Air Products Brasil Ltda. (2010)	Industrial e Medicinal Gases	$90	25%	Cartel
Peróxidos Ltda. (Solvay) (2012)	Hydrogen Peroxide	$67	Confidential	Cartel
Belgo-Mineira (2006)	Steel Rod	$38	7%	Cartel
Barra Mansa (2006)	Steel Rod	$12	7%	Cartel

* considering 1 USD = 2 BRL

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Prosecution of International Cartels

- Brazil has been opening investigations on international cartels since 2000 (Vitamins/Lysine)

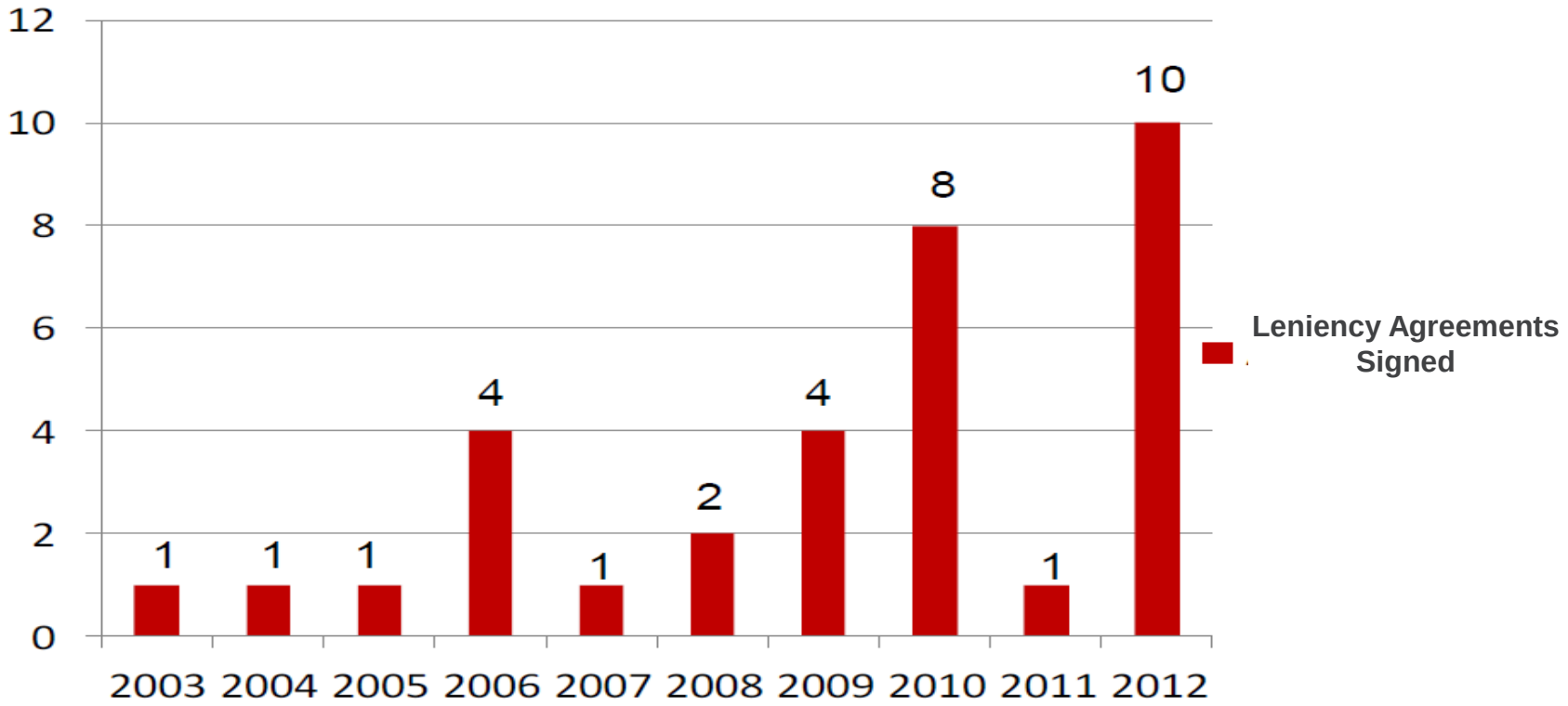
- There are about 17 international cartel cases

  - **Vitamins (2000)**
  - **Lysine (2000)**
  - **Air Cargo (2006)**
  - **GIS (2006)**
  - **Marine hose (2008)**
  - **Compressors (2009)**
  - **CRT glass (2009)**
  - **Graphite Electrodes (2009)**
  - **Freight Forwarders (2009)**
  - **DRAM (2010)**
  - **Color display tube (2010)**
  - **Color picture tube (2010)**
  - **Soda Ash (2010)**
  - **Optical Disk Drive (ODD) (2011)**
  - **TFT-LCD (2008/2011)**
  - **Plastic products: ABS, PS, AS and PMMA (2011)**
  - **AIS / Transformers / FACTS / Others (2006/2012)**

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Expected Developments

– **Scenario**: (i) Record number of Leniency agreements signed in 2012; (ii) several being negotiated, mostly with respect to international cartels where applications for leniency were filed in other countries.



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Thank you!

Francisco Todorov
francisco.todorov@bakermackenzie.com

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VENTURING OUTSIDE THE US—ANTITRUST ISSUES IN COMPETITOR COLLABORATIONS, JOINT VENTURES, STRATEGIC ALLIANCES, TEAMING AGREEMENTS

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES

EUROPEAN COMMISSION

COMMUNICATION FROM THE COMMISSION

Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements

(Text with EEA relevance)

(2011/C 11/01)

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1. INTRODUCTION

1.1. Purpose and scope

1. These guidelines set out the principles for the assessment under Article 101 of the Treaty on the Functioning of the European Union (*) ('Article 101') of agreements between undertakings, decisions by associations of undertakings and concerted practices (collectively referred to as 'agreements') pertaining to horizontal co-operation. Co-operation is of a 'horizontal nature' if an agreement is entered into between actual or potential competitors. In addition, these guidelines also cover horizontal co-operation agreements between non-competitors, for example, between two companies active in the same product markets but in different geographic markets without being potential competitors.

2. Horizontal co-operation agreements can lead to substantial economic benefits, in particular if they combine complementary activities, skills or assets. Horizontal co-operation can be a means to share risk, save costs, increase investments, pool know-how, enhance product quality and variety, and launch innovation faster.

3. On the other hand, horizontal co-operation agreements may lead to competition problems. This is, for example, the case if the parties agree to fix prices or output or to share markets, or if the co-operation enables the parties to maintain, gain or increase market power and thereby is likely to give rise to negative market effects with respect to prices, output, product quality, product variety or innovation.

4. The Commission, while recognising the benefits that can be generated by horizontal co-operation agreements, has to ensure that effective competition is maintained. Article 101 provides the legal framework for a balanced assessment taking into account both adverse effects on competition and pro-competitive effects.

5. The purpose of these guidelines is to provide an analytical framework for the most common types of horizontal co-operation agreements; they deal with research and development agreements, production agreements including subcontracting and specialisation agreements, purchasing agreements, commercialisation agreements, standardisation agreements including standard contracts, and information exchange. This framework is primarily based on legal and economic criteria that help to analyse a horizontal co-operation agreement and the context in which it occurs. Economic criteria such as the market power of the parties and other factors relating to the market structure form a key element of the assessment of the market impact likely to be caused by a horizontal co-operation agreement and, therefore, for the assessment under Article 101.

6. These guidelines apply to the most common types of horizontal co-operation agreements irrespective of the level of integration they entail with the exception of operations constituting a concentration within the meaning of Article 3 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings [1] ('the Merger Regulation') as would be the case, for example, with joint ventures performing on a lasting basis all the functions of an autonomous economic entity ('full-function joint ventures') [2].

(*) With effect from 1 December 2009, Article 81 of the EC Treaty has become Article 101 of the Treaty on the Functioning of the European Union ('TFEU'). The two Articles are, in substance, identical. For the purposes of these guidelines, references to Article 101 of the TFEU should be understood as references to Article 81 of the EC Treaty where appropriate. The TFEU also introduced certain changes in terminology, such as the replacement of 'Community' by 'Union' and 'common market' by 'internal market'. The terminology of the TFEU will be used throughout these guidelines.

[1] OJ L 24, 29.1.2004, p. 1.

[2] See Article 3(4) of the Merger Regulation. However, in assessing whether there is a full-function joint venture, the Commission examines whether the joint venture is autonomous in an operational sense. This does not mean that it enjoys autonomy from its parent companies as regards the adoption of its strategic decisions (see Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ C 95, 16.4.2008, p. 1, paragraphs 91–109 ('Consolidated Jurisdictional Notice')). It also needs to be recalled that if the creation of a joint venture constituting a concentration under Article 3 of the Merger Regulation has as its object or effect the coordination of the competitive behaviour of undertakings that remain independent, then that coordination will be appraised under Article 101 of the Treaty (see Article 2(4) of the Merger Regulation).

7. Given the potentially large number of types and combinations of horizontal co-operation and market circumstances in which they operate, it is difficult to provide specific answers for every possible scenario. These guidelines will nevertheless assist businesses in assessing the compatibility of an individual co-operation agreement with Article 101. Those criteria do not, however, constitute a 'checklist' which can be applied mechanically. Each case must be assessed on the basis of its own facts, which may require a flexible application of these guidelines.

8. The criteria set out in these guidelines apply to horizontal co-operation agreements concerning both goods and services (collectively referred to as 'products'). These guidelines complement Commission Regulation (EU) No […] of […] on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements ([1]) ('the R&D Block Exemption Regulation') and Commission Regulation (EU) No […] of […] on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements ([2]) ('the Specialisation Block Exemption Regulation').

9. Although these guidelines contain certain references to cartels, they are not intended to give any guidance as to what does and does not constitute a cartel as defined by the decisional practice of the Commission and the case-law of the Court of Justice of the European Union.

10. The term 'competitors' as used in these guidelines includes both actual and potential competitors. Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, in the absence of the agreement, in case of a small but permanent increase in relative prices it is likely that the former, within a short period of time ([3]), would undertake the necessary additional investments or other necessary switching costs to enter the relevant market on which the latter is active. This assessment has to be based on realistic grounds, the mere theoretical possibility to enter a market is not sufficient (see Commission Notice on the definition of the relevant market for the purposes of Community competition law) ([4]) ('the Market Definition Notice').

11. Companies that form part of the same 'undertaking' within the meaning of Article 101(1) are not considered to be competitors for the purposes of these guidelines. Article 101 only applies to agreements between independent undertakings. When a company exercises decisive influence over another company they form a single economic entity and, hence, are part of the same undertaking. ([5]) The same is true for sister companies, that is to say, companies over which decisive influence is exercised by the same parent company. They are consequently not considered to be competitors even if they are both active on the same relevant product and geographic markets.

12. Agreements that are entered into between undertakings operating at a different level of the production or distribution chain, that is to say, vertical agreements, are in principle dealt with in Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on

([1]) OJ L […], […], p. […].
([2]) OJ L […], […], p. […].
([3]) What constitutes a 'short period of time' depends on the facts of the case at hand, its legal and economic context, and, in particular, on whether the company in question is a party to the agreement or a third party. In the first case, that is to say, where it is analysed whether a party to an agreement should be considered a potential competitor of the other party, the Commission would normally consider a longer period to be a 'short period of time' than in the second case, that is to say, where the capacity of a third party to act as a competitive constraint on the parties to an agreement is analysed. For a third party to be considered a potential competitor, market entry would need to take place sufficiently fast so that the threat of potential entry is a constraint on the parties' and other market participants' behaviour. For these reasons, both the R&D and the Specialisation Block Exemption Regulations consider a period of not more than three years a 'short period of time'.
([4]) OJ C 372, 9.12.1997, p. 5, paragraph 24; see also the Commission's Thirteenth Report on Competition Policy, point 55 and Commission Decision in Case IV/32.009, *Elopak/Metal Box-Odin*, OJ L 209, 8.8.1990, p. 15.
([5]) See, for example, Case C-73/95, *Viho*, [1996] ECR I-5457, paragraph 51. The exercise of decisive influence by the parent company over the conduct of a subsidiary can be presumed in case of wholly-owned subsidiaries; see, for example, Case 107/82, *AEG*, [1983] ECR-3151, paragraph 50; Case C-286/98 P, *Stora*, [2000] ECR-I 9925, paragraph 29; or Case C-97/08 P, *Akzo*, [2009] ECR I-8237, paragraphs 60 *et seq*.

the Functioning of the European Union to categories of vertical agreements and concerted practices ([1]) ('the Block Exemption Regulation on Vertical Restraints') and the Guidelines on Vertical Restraints ([2]). However, to the extent that vertical agreements, for example, distribution agreements, are concluded between competitors, the effects of the agreement on the market and the possible competition problems can be similar to horizontal agreements. Therefore, vertical agreements between competitors fall under these guidelines ([3]). Should there be a need to also assess such agreements under the Block Exemption Regulation on Vertical Restraints and the Guidelines on Vertical Restraints, this will be specifically stated in the relevant chapter of these guidelines. In the absence of such a reference, only these guidelines will be applicable to vertical agreements between competitors.

13. Horizontal co-operation agreements may combine different stages of co-operation, for example research and development ('R&D') and the production and/or commercialisation of its results. Such agreements are generally also covered by these guidelines. When using these guidelines for the analysis of such integrated co-operation, as a general rule, all the chapters pertaining to the different parts of the co-operation will be relevant. However, where the relevant chapters of these guidelines contain graduated messages, for example with regard to safe harbours or whether certain conduct will normally be considered a restriction of competition by object or by effect, what is set out in the chapter pertaining to that part of an integrated co-operation which can be considered its 'centre of gravity' prevails for the entire co-operation ([4]).

14. Two factors are in particular relevant for the determination of the centre of gravity of integrated co-operation: firstly, the starting point of the co-operation, and, secondly, the degree of integration of the different functions which are combined. For example, the centre of gravity of a horizontal co-operation agreement involving both joint R&D and joint production of the results would thus normally be the joint R&D, as the joint production will only take place if the joint R&D is successful. This implies that the results of the joint R&D are decisive for the subsequent joint production. The assessment of the centre of gravity would change if the parties would have engaged in the joint production in any event, that is to say, irrespective of the joint R&D, or if the agreement provided for a full integration in the area of production and only a partial integration of some R&D activities. In this case, the centre of gravity of the co-operation would be the joint production.

15. Article 101 only applies to those horizontal co-operation agreements which may affect trade between Member States. The principles on the applicability of Article 101 set out in these guidelines are therefore based on the assumption that a horizontal co-operation agreement is capable of affecting trade between Member States to an appreciable extent.

16. The assessment under Article 101 as described in these guidelines is without prejudice to the possible parallel application of Article 102 of the Treaty to horizontal co-operation agreements ([5]).

17. These guidelines are without prejudice to the interpretation the Court of Justice of the European Union may give to the application of Article 101 to horizontal co-operation agreements.

([1]) OJ L 102, 23.4.2010, p. 1.
([2]) OJ C 130, 19.5.2010, p. 1.
([3]) This does not apply where competitors enter into a non-reciprocal vertical agreement and (i) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level, or (ii) the supplier is a provider of services at several levels of trade, while the buyer provides its goods or services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services. Such agreements are exclusively assessed under the Block Exemption Regulation and the Guidelines on Vertical Restraints (see Article 2(4) of the Block Exemption Regulation on Vertical Restraints).
([4]) It should be noted that this test only applies to the relationship between the different chapters of these guidelines, not to the relationship between different block exemption regulations. The scope of a block exemption regulation is defined by its own provisions.
([5]) See Case T-51/89, *Tetra Pak I*, [1990] ECR-II 309, paragraphs 25 *et seq.* and Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7 ('Article 102 Guidance Paper').

18. These guidelines replace the Commission guidelines on the applicability of Article 81 of the EC Treaty to horizontal co-operation agreements [1] which were published by the Commission in 2001 and do not apply to the extent that sector specific rules apply as is the case for certain agreements with regard to agriculture [2], transport [3] or insurance [4]. The Commission will continue to monitor the operation of the R&D and Specialisation Block Exemption Regulations and these guidelines based on market information from stakeholders and national competition authorities and may revise these guidelines in the light of future developments and of evolving insight.

19. The Commission guidelines on the application of Article 81(3) of the Treaty [5] ('the General Guidelines') contain general guidance on the interpretation of Article 101. Consequently, these guidelines have to be read in conjunction with the General Guidelines.

1.2. **Basic principles for the assessment under Article 101**

20. The assessment under Article 101 consists of two steps. The first step, under Article 101(1), is to assess whether an agreement between undertakings, which is capable of affecting trade between Member States, has an anti-competitive object or actual or potential [6] restrictive effects on competition. The second step, under Article 101(3), which only becomes relevant when an agreement is found to be restrictive of competition within the meaning of Article 101(1), is to determine the pro-competitive benefits produced by that agreement and to assess whether those pro-competitive effects outweigh the restrictive effects on competition [7]. The balancing of restrictive and pro-competitive effects is conducted exclusively within the framework laid down by Article 101(3) [8]. If the pro-competitive effects do not outweigh a restriction of competition, Article 101(2) stipulates that the agreement shall be automatically void.

21. The analysis of horizontal co-operation agreements has certain common elements with the analysis of horizontal mergers pertaining to the potential restrictive effects, in particular as regards joint ventures. There is often only a fine line between full-function joint ventures that fall under the Merger Regulation and non-full-function joint ventures that are assessed under Article 101. Hence, their effects can be quite similar.

22. In certain cases, companies are encouraged by public authorities to enter into horizontal co-operation agreements in order to attain a public policy objective by way of self-regulation. However, companies remain subject to Article 101 if a national law merely encourages or makes it easier for them to

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[1] OJ C 3, 6.1.2001, p. 2. These guidelines do not contain a separate chapter on 'environmental agreements' as was the case in the previous guidelines. Standard-setting in the environment sector, which was the main focus of the former chapter on environmental agreements, is more appropriately dealt with in the standardisation chapter of these guidelines. In general, depending on the competition issues 'environmental agreements' give rise to, they are to be assessed under the relevant chapter of these guidelines, be it the chapter on R&D, production, commercialisation or standardisation agreements.

[2] Council Regulation (EC) No 1184/2006 of 24 July 2006 applying certain rules of competition to the production of, and trade in, agricultural products, OJ L 214, 4.8.2006, p. 7.

[3] Council Regulation (EC) No 169/2009 of 26 February 2009 applying rules of competition to transport by rail, road and inland waterway, OJ L 61, 5.3.2009, p. 1; Council Regulation (EC) No 246/2009 of 26 February 2009 on the application of Article 81(3) of the Treaty to certain categories of agreements and concerted practices between liner shipping companies (consortia), OJ L 79, 25.3.2009, p. 1; Commission Regulation (EC) No 823/2000 of 19 April 2000 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices between liner shipping companies (consortia), OJ L 100, 20.4.2000, p. 24; Guidelines on the application of Article 81 of the EC Treaty to maritime transport services, OJ C 245, 26.9.2008, p. 2.

[4] Commission Regulation (EU) No 267/2010 of 24 March 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector, OJ L 83, 31.3.2010, p. 1.

[5] OJ C 101, 27.4.2004, p. 97.

[6] Article 101(1) prohibits both actual and potential anti-competitive effects; see for example Case C-7/95 P, *John Deere*, [1998] ECR I-3111, paragraph 77; Case C-238/05, *Asnef-Equifax*, [2006] ECR I-11125, paragraph 50.

[7] See Joined Cases C-501/06 P and others, *GlaxoSmithKline*, [2009] ECR I-9291, paragraph 95.

[8] See Case T-65/98, *Van den Bergh Foods*, [2003] ECR II-4653, paragraph 107; Case T-112/99, *Métropole télévision (M6)* and others, [2001] ECR II-2459, paragraph 74; Case T-328/03, *O2*, [2006] ECR II-1231, paragraphs 69 *et seq*., where the General Court held that it is only in the precise framework of Article 101(3) that the pro- and anti-competitive aspects of a restriction may be weighed.

engage in autonomous anti-competitive conduct ([1]). In other words, the fact that public authorities encourage a horizontal co-operation agreement does not mean that it is permissible under Article 101 ([2]). It is only if anti-competitive conduct is required of companies by national legislation, or if the latter creates a legal framework which precludes all scope for competitive activity on their part, that Article 101 does not apply ([3]). In such a situation, the restriction of competition is not attributable, as Article 101 implicitly requires, to the autonomous conduct of the companies and they are shielded from all the consequences of an infringement of that article ([4]). Each case must be assessed on its own facts according to the general principles set out in these guidelines.

1.2.1. *Article 101(1)*

23. Article 101(1) prohibits agreements the object or effect of which is to restrict ([5]) competition.

(i) Restrictions of competition by object

24. Restrictions of competition *by object* are those that by their very nature have the potential to restrict competition within the meaning of Article 101(1) ([6]). It is not necessary to examine the actual or potential effects of an agreement on the market once its anti-competitive object has been established ([7]).

25. According to the settled case-law of the Court of Justice of the European Union, in order to assess whether an agreement has an anti-competitive object, regard must be had to the content of the agreement, the objectives it seeks to attain, and the economic and legal context of which it forms part. In addition, although the parties' intention is not a necessary factor in determining whether an agreement has an anti-competitive object, the Commission may nevertheless take this aspect into account in its analysis ([8]). Further guidance with regard to the notion of restrictions of competition by object can be obtained in the General Guidelines.

(ii) Restrictive effects on competition

26. If a horizontal co-operation agreement does not restrict competition by object, it must be examined whether it has appreciable restrictive effects on competition. Account must be taken of both actual and potential effects. In other words, the agreement must at least be likely to have anti-competitive effects.

27. For an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation. Agreements can have such effects by appreciably reducing competition between the parties to the agreement or between any one of them and third parties. This means that the agreement must reduce the parties' decision-making independence ([9]), either due to obligations contained in the agreement which regulate the market conduct of at least one of the parties or by influencing the market conduct of at least one of the parties by causing a change in its incentives.

([1]) See judgment of 14 October 2010 in Case C-280/08 P, *Deutsche Telekom*, ECR I not yet reported, paragraph 82 and the case-law cited therein.

([2]) See Case C-198/01, *CIF*, [2003] ECR I-8055, paragraphs 56–58; Joined Cases T-217/03 and T-245/03, *French Beef*, [2006] ECR II-4987, paragraph 92; Case T-7/92, *Asia Motor France II*, [1993] ECR II-669, paragraph 71; and Case T-148/89, *Tréfilunion*, [1995] ECR II-1063, paragraph 118.

([3]) See Case C-280/08 P, *Deutsche Telekom*, paragraph 80-81. This possibility has been narrowly interpreted; see, for example, Joined Cases 209/78 and others, *Van Landewyck*, [1980] ECR 3125, paragraphs 130–134; Joined Cases 240/82 and others, *Stichting Sigarettenindustrie*, [1985] ECR 3831, paragraphs 27–29; and Joined Cases C-359/95 P and C-379/95 P, *Ladbroke Racing*, [1997] ECR I-6265, paragraphs 33 *et seq*.

([4]) At least until a decision to disapply the national legislation has been adopted and that decision has become definitive; see Case C-198/01, *CIF*, paragraphs 54 *et seq*.

([5]) For the purpose of these guidelines, the term 'restriction of competition' includes the prevention and distortion of competition.

([6]) See, for example, Case C-209/07, *BIDS*, [2008] ECR I-8637, paragraph 17.

([7]) See, for example, Joined Cases C-501/06 P and others, *GlaxoSmithKline*, paragraph 55; Case C-209/07, *BIDS*, paragraph 16; Case C-8/08, *T-Mobile Netherlands*, ECR [2009] I-4529, paragraph 29 *et seq*.; Case C-7/95 P, *John Deere*, paragraph 77.

([8]) See, for example, Joined Cases C-501/06 P and others, *GlaxoSmithKline*, paragraph 58; Case C-209/07, *BIDS*, paragraphs 15 *et seq*.

([9]) See Case C-7/95 P, *John Deere*, paragraph 88; Case C-238/05, *Asnef-Equifax*, paragraph 51.

28. Restrictive effects on competition within the relevant market are likely to occur where it can be expected with a reasonable degree of probability that, due to the agreement, the parties would be able to profitably raise prices or reduce output, product quality, product variety or innovation. This will depend on several factors such as the nature and content of the agreement, the extent to which the parties individually or jointly have or obtain some degree of market power, and the extent to which the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power.

29. The assessment of whether a horizontal co-operation agreement has restrictive effects on competition within the meaning of Article 101(1) must be made in comparison to the actual legal and economic context in which competition would occur in the absence of the agreement with all of its alleged restrictions (that is to say, in the absence of the agreement as it stands (if already implemented) or as envisaged (if not yet implemented) at the time of assessment). Hence, in order to prove actual or potential restrictive effects on competition, it is necessary to take into account competition between the parties and competition from third parties, in particular actual or potential competition that would have existed in the absence of the agreement. This comparison does not take into account any potential efficiency gains generated by the agreement as these will only be assessed under Article 101(3).

30. Consequently, horizontal co-operation agreements between competitors that, on the basis of objective factors, would not be able to independently carry out the project or activity covered by the co-operation, for instance, due to the limited technical capabilities of the parties, will normally not give rise to restrictive effects on competition within the meaning of Article 101(1) unless the parties could have carried out the project with less stringent restrictions ([1]).

31. General guidance with regard to the notion of restrictions of competition by effect can be obtained in the General Guidelines. These guidelines provide additional guidance specific to the competition assessment of horizontal co-operation agreements.

Nature and content of the agreement

32. The nature and content of an agreement relates to factors such as the area and objective of the co-operation, the competitive relationship between the parties and the extent to which they combine their activities. Those factors determine which kinds of possible competition concerns can arise from a horizontal co-operation agreement.

33. Horizontal co-operation agreements may limit competition in several ways. The agreement may:

— be exclusive in the sense that it limits the possibility of the parties to compete against each other or third parties as independent economic operators or as parties to other, competing agreements;

— require the parties to contribute such assets that their decision-making independence is appreciably reduced; or

— affect the parties' financial interests in such a way that their decision-making independence is appreciably reduced. Both financial interests in the agreement and also financial interests in other parties to the agreement are relevant for the assessment.

34. The potential effect of such agreements may be the loss of competition between the parties to the agreement. Competitors can also benefit from the reduction of competitive pressure that results from the agreement and may therefore find it profitable to increase their prices. The reduction in those competitive constraints may lead to price increases in the relevant market. Factors such as whether the parties to the agreement have high market shares, whether they are close competitors, whether the customers have limited possibilities of switching suppliers, whether competitors are unlikely to increase supply if prices increase, and whether one of the parties to the agreement is an important competitive force, are all relevant for the competitive assessment of the agreement.

([1]) See also paragraph 18 of the General Guidelines.

35. A horizontal co-operation agreement may also:

— lead to the disclosure of strategic information thereby increasing the likelihood of coordination among the parties within or outside the field of the co-operation;

— achieve significant commonality of costs (that is to say, the proportion of variable costs which the parties have in common), so the parties may more easily coordinate market prices and output.

36. Significant commonality of costs achieved by a horizontal co-operation agreement can only allow the parties to more easily coordinate market prices and output where the parties have market power, the market characteristics are conducive to such coordination, the area of co-operation accounts for a high proportion of the parties' variable costs in a given market, and the parties combine their activities in the area of co-operation to a significant extent. This could, for instance, be the case, where they jointly manufacture or purchase an important intermediate product or jointly manufacture or distribute a high proportion of their total output of a final product.

37. A horizontal agreement may therefore decrease the parties' decision-making independence and as a result increase the likelihood that they will coordinate their behaviour in order to reach a collusive outcome but it may also make coordination easier, more stable or more effective for parties that were already coordinating before, either by making the coordination more robust or by permitting them to achieve even higher prices.

38. Some horizontal co-operation agreements, for example production and standardisation agreements, may also give rise to anti-competitive foreclosure concerns.

Market power and other market characteristics

39. Market power is the ability to profitably maintain prices above competitive levels for a period of time or to profitably maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a period of time.

40. In markets with fixed costs undertakings must price above their variable costs of production in order to ensure a competitive return on their investment. The fact that undertakings price above their variable costs is therefore not in itself a sign that competition in the market is not functioning well and that undertakings have market power that allows them to price above the competitive level. It is when competitive constraints are insufficient to maintain prices, output, product quality, product variety and innovation at competitive levels that undertakings have market power in the context of Article 101(1).

41. The creation, maintenance or strengthening of market power can result from superior skill, foresight or innovation. It can also result from reduced competition between the parties to the agreement or between any one of the parties and third parties, for example, because the agreement leads to anti-competitive foreclosure of competitors by raising competitors' costs and limiting their capacity to compete effectively with the contracting parties.

42. Market power is a question of degree. The degree of market power required for the finding of an infringement under Article 101(1) in the case of agreements that are restrictive of competition by effect is less than the degree of market power required for a finding of dominance under Article 102, where a substantial degree of market power is required.

43. The starting point for the analysis of market power is the position of the parties on the markets affected by the co-operation. To carry out this analysis the relevant market(s) have to be defined by using the methodology of the Commission's Market Definition Notice. Where specific types of markets, such as purchasing or technology markets, are concerned these guidelines will provide additional guidance.

44. If the parties have a low combined market share, the horizontal co-operation agreement is unlikely to give rise to restrictive effects on competition within the meaning of Article 101(1) and, normally, no further analysis will be required. What is considered to be a 'low combined market share' depends on the type of agreement in question and can be inferred from the 'safe harbour' thresholds set out in various chapters of these guidelines and, more generally, from the Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*) ([1]) ('the *De Minimis* Notice'). If one of just two parties has only an insignificant market share and if it does not possess important resources, even a high combined market share normally cannot be seen as indicating a likely restrictive effect on competition in the market ([2]). Given the variety of horizontal co-operation agreements and the different effects they may cause in different market situations, it is not possible to give a general market share threshold above which sufficient market power for causing restrictive effects on competition can be assumed.

45. Depending on the market position of the parties and the concentration in the market, other factors such as the stability of market shares over time, entry barriers and the likelihood of market entry, and the countervailing power of buyers/suppliers also have to be considered.

46. Normally, the Commission uses current market shares in its competitive analysis ([3]). However, reasonably certain future developments may also be taken into account, for instance in the light of exit, entry or expansion in the relevant market. Historic data may be used if market shares have been volatile, for instance when the market is characterised by large, lumpy orders. Changes in historic market shares may provide useful information about the competitive process and the likely future importance of the various competitors, for instance, by indicating whether undertakings have been gaining or losing market shares. In any event, the Commission interprets market shares in the light of likely market conditions, for instance, if the market is highly dynamic in character and if the market structure is unstable due to innovation or growth.

47. When entering a market is sufficiently easy, a horizontal co-operation agreement will normally not be expected to give rise to restrictive effects on competition. For entry to be considered a sufficient competitive constraint on the parties to a horizontal co-operation agreement, it must be shown to be likely, timely and sufficient to deter or defeat any potential restrictive effects of the agreement. The analysis of entry may be affected by the presence of horizontal co-operation agreements. The likely or possible termination of a horizontal co-operation agreement may influence the likelihood of entry.

1.2.2. *Article 101(3)*

48. The assessment of restrictions of competition by object or effect under Article 101(1) is only one side of the analysis. The other side, which is reflected in Article 101(3), is the assessment of the pro-competitive effects of restrictive agreements. The general approach when applying Article 101(3) is presented in the General Guidelines. Where in an individual case a restriction of competition within the meaning of Article 101(1) has been proven, Article 101(3) can be invoked as a defence. According to Article 2 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty ([4]), the burden of proof under Article 101(3) rests on the undertaking(s) invoking the benefit of this provision. Therefore, the factual arguments and the evidence provided by the undertaking(s) must enable the Commission to arrive at the conviction that the agreement in question is sufficiently likely to give rise to pro-competitive effects or that it is not ([5]).

([1]) OJ C 368, 22.12.2001, p. 13.
([2]) If there are more than two parties, then the collective share of all co-operating competitors has to be significantly greater than the share of the largest single participating competitor.
([3]) As to the calculation of market shares, see also Market Definition Notice, paragraphs 54–55.
([4]) OJ L 1, 4.1.2003, p. 1.
([5]) See, for example, Joined Cases C-501/06 P and others, *GlaxoSmithKline*, paragraphs 93–95.

49. The application of the exception rule of Article 101(3) is subject to four cumulative conditions, two positive and two negative:

— the agreement must contribute to improving the production or distribution of products or contribute to promoting technical or economic progress, that is to say, lead to efficiency gains;

— the restrictions must be indispensable to the attainment of those objectives, that is to say, the efficiency gains;

— consumers must receive a fair share of the resulting benefits, that is to say, the efficiency gains, including qualitative efficiency gains, attained by the indispensable restrictions must be sufficiently passed on to consumers so that they are at least compensated for the restrictive effects of the agreement; hence, efficiencies only accruing to the parties to the agreement will not suffice; for the purposes of these guidelines, the concept of 'consumers' encompasses the customers, potential and/or actual, of the parties to the agreement ([1]); and

— the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

50. In the area of horizontal co-operation agreements there are block exemption regulations based on Article 101(3) for research and development ([2]) and specialisation (including joint production) ([3]) agreements. Those Block Exemption Regulations are based on the premise that the combination of complementary skills or assets can be the source of substantial efficiencies in research and development and specialisation agreements. This may also be the case for other types of horizontal co-operation agreements. The analysis of the efficiencies of an individual agreement under Article 101(3) is therefore to a large extent a question of identifying the complementary skills and assets that each of the parties brings to the agreement and evaluating whether the resulting efficiencies are such that the conditions of Article 101(3) are fulfilled.

51. Complementarities may arise from horizontal co-operation agreements in various ways. A research and development agreement may bring together different research capabilities that allow the parties to produce better products more cheaply and shorten the time for those products to reach the market. A production agreement may allow the parties to achieve economies of scale or scope that they could not achieve individually.

52. Horizontal co-operation agreements that do not involve the combination of complementary skills or assets are less likely to lead to efficiency gains that benefit consumers. Such agreements may reduce duplication of certain costs, for instance because certain fixed costs can be eliminated. However, fixed cost savings are, in general, less likely to result in benefits to consumers than savings in, for instance, variable or marginal costs.

53. Further guidance regarding the Commission's application of the criteria of Article 101(3) can be obtained in the General Guidelines.

1.3. **Structure of these guidelines**

54. Chapter 2 will first set out some general principles for the assessment of the exchange of information, which are applicable to all types of horizontal co-operation agreements entailing the exchange of information. The subsequent chapters of these guidelines will each address one specific type of horizontal co-operation agreement. Each chapter will apply the analytical framework described in section 1.2 as well as the general principles on the exchange of information to the specific type of co-operation in question.

([1]) More detail on the concept of consumer is provided in paragraph 84 of the General Guidelines.
([2]) R&D Block Exemption Regulation.
([3]) Specialisation Block Exemption Regulation.

2. GENERAL PRINCIPLES ON THE COMPETITIVE ASSESSMENT OF INFORMATION EXCHANGE

2.1. Definition and scope

55. The purpose of this chapter is to guide the competitive assessment of information exchange. Information exchange can take various forms. Firstly, data can be directly shared between competitors. Secondly, data can be shared indirectly through a common agency (for example, a trade association) or a third party such as a market research organisation or through the companies' suppliers or retailers.

56. Information exchange takes place in different contexts. There are agreements, decisions by associations of undertakings, or concerted practices under which information is exchanged, where the main economic function lies in the exchange of information itself. Moreover, information exchange can be part of another type of horizontal co-operation agreement (for example, the parties to a production agreement share certain information on costs). The assessment of the latter type of information exchanges should be carried out in the context of the assessment of the horizontal co-operation agreement itself.

57. Information exchange is a common feature of many competitive markets and may generate various types of efficiency gains. It may solve problems of information asymmetries [1], thereby making markets more efficient. Moreover, companies may improve their internal efficiency through benchmarking against each other's best practices. Sharing of information may also help companies to save costs by reducing their inventories, enabling quicker delivery of perishable products to consumers, or dealing with unstable demand etc. Furthermore, information exchanges may directly benefit consumers by reducing their search costs and improving choice.

58. However, the exchange of market information may also lead to restrictions of competition in particular in situations where it is liable to enable undertakings to be aware of market strategies of their competitors [2]. The competitive outcome of information exchange depends on the characteristics of the market in which it takes place (such as concentration, transparency, stability, symmetry, complexity etc.) as well as on the type of information that is exchanged, which may modify the relevant market environment towards one liable to coordination.

59. Moreover, communication of information among competitors may constitute an agreement, a concerted practice, or a decision by an association of undertakings with the object of fixing, in particular, prices or quantities. Those types of information exchanges will normally be considered and fined as cartels. Information exchange may also facilitate the implementation of a cartel by enabling companies to monitor whether the participants comply with the agreed terms. Those types of exchanges of information will be assessed as part of the cartel.

Concerted practice

60. Information exchange can only be addressed under Article 101 if it establishes or is part of an agreement, a concerted practice or a decision by an association of undertakings. The existence of an agreement, a concerted practice or decision by an association of undertakings does not prejudge whether the agreement, concerted practice or decision by an association of undertakings gives rise to a restriction of competition within the meaning of Article 101(1). In line with the case-law of the Court of Justice of the European Union, the concept of a concerted practice refers to a form of coordination between undertakings by which, without it having reached the stage where an agreement properly so-called has been concluded, practical cooperation between them is knowingly substituted for the risks of competition [3]. The criteria of coordination and cooperation necessary for determining the existence of a concerted practice, far from requiring an actual plan to have been worked out, are

[1] Economic theory on information asymmetries deals with the study of decisions in transactions where one party has more information than the other.

[2] See Case C-7/95 P, *John Deere*, paragraph 88.

[3] See for example Case C-8/08, *T-Mobile Netherlands*, paragraph 26; Joined Cases C-89/85 and others, *Wood Pulp*, [1993] ECR 1307, paragraph 63.

to be understood in the light of the concept inherent in the provisions of the Treaty on competition, according to which each company must determine independently the policy which it intends to adopt on the internal market and the conditions which it intends to offer to its customers [1].

61. This does not deprive companies of the right to adapt themselves intelligently to the existing or anticipated conduct of their competitors. It does, however, preclude any direct or indirect contact between competitors, the object or effect of which is to create conditions of competition which do not correspond to the normal competitive conditions of the market in question, regard being had to the nature of the products or services offered, the size and number of the undertakings, and the volume of the said market [2]. This precludes any direct or indirect contact between competitors, the object or effect of which is to influence conduct on the market of an actual or potential competitor, or to disclose to such competitor the course of conduct which they themselves have decided to adopt or contemplate adopting on the market, thereby facilitating a collusive outcome on the market [3]. Hence, information exchange can constitute a concerted practice if it reduces strategic uncertainty [4] in the market thereby facilitating collusion, that is to say, if the data exchanged is strategic. Consequently, sharing of strategic data between competitors amounts to concertation, because it reduces the independence of competitors' conduct on the market and diminishes their incentives to compete.

62. A situation where only one undertaking discloses strategic information to its competitor(s) who accept(s) it can also constitute a concerted practice [5]. Such disclosure could occur, for example, through contacts via mail, emails, phone calls, meetings etc. It is then irrelevant whether only one undertaking unilaterally informs its competitors of its intended market behaviour, or whether all participating undertakings inform each other of the respective deliberations and intentions. When one undertaking alone reveals to its competitors strategic information concerning its future commercial policy, that reduces strategic uncertainty as to the future operation of the market for all the competitors involved and increases the risk of limiting competition and of collusive behaviour [6]. For example, mere attendance at a meeting [7] where a company discloses its pricing plans to its competitors is likely to be caught by Article 101, even in the absence of an explicit agreement to raise prices [8]. When a company receives strategic data from a competitor (be it in a meeting, by mail or electronically), it will be presumed to have accepted the information and adapted its market conduct accordingly unless it responds with a clear statement that it does not wish to receive such data [9].

63. Where a company makes a unilateral announcement that is also genuinely public, for example through a newspaper, this generally does not constitute a concerted practice within the meaning of Article 101(1) [10]. However, depending on the facts underlying the case at hand, the possibility of finding a concerted practice cannot be excluded, for example in a situation where such an announcement was followed by public announcements by other competitors, not least because strategic responses of competitors to each other's public announcements (which, to take one instance, might involve readjustments of their own earlier announcements to announcements made by competitors) could prove to be a strategy for reaching a common understanding about the terms of coordination.

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[1] See Case C-7/95 P, *John Deere*, paragraph 86.
[2] Case C-7/95 P, *John Deere*, paragraph 87.
[3] See Cases 40/73 and others, *Suiker Unie*, [1975] ECR 1663, paragraph 173 *et seq*.
[4] Strategic uncertainty in the market arises as there is a variety of possible collusive outcomes available and because companies cannot perfectly observe past and current actions of their competitors and entrants.
[5] See for example Joined Cases T-25/95 and others, *Cimenteries*, [2000] ECR II-491, paragraph 1849: '[…] the concept of concerted practice does in fact imply the existence of reciprocal contacts […]. That condition is met where one competitor discloses its future intentions or conduct on the market to another when the latter requests it or, at the very least, accepts it'.
[6] See Opinion of Advocate General Kokott, Case C-8/08, *T-Mobile Netherlands*, [2009] ECR I-4529, paragraph 54.
[7] See Case C-8/08, *T-Mobile Netherlands*, paragraph 59: 'Depending on the structure of the market, the possibility cannot be ruled out that a meeting on a single occasion between competitors, such as that in question in the main proceedings, may, in principle, constitute a sufficient basis for the participating undertakings to concert their market conduct and thus successfully substitute practical cooperation between them for competition and the risks that that entails.'
[8] See Joined Cases T-202/98 and others, *Tate & Lyle* v *Commission*, [2001] ECR II-2035, paragraph 54.
[9] See Case C-199/92 P, *Hüls*, [1999] ECR I-4287, paragraph 162; Case C-49/92 P, *Anic Partezipazioni*, [1999] ECR I-4125, paragraph 121.
[10] This would not cover situations where such announcements involve invitations to collude.

2.2. **Assessment under Article 101(1)**

2.2.1. *Main competition concerns* [1]

64. Once it has been established that there is an agreement, concerted practice or decision by an association of undertakings, it is necessary to consider the main competition concerns pertaining to information exchanges.

Collusive outcome

65. By artificially increasing transparency in the market, the exchange of strategic information can facilitate coordination (that is to say, alignment) of companies' competitive behaviour and result in restrictive effects on competition. This can occur through different channels.

66. One way is that through information exchange companies may reach a common understanding on the terms of coordination, which can lead to a collusive outcome on the market. Information exchange can create mutually consistent expectations regarding the uncertainties present in the market. On that basis companies can then reach a common understanding on the terms of coordination of their competitive behaviour, even without an explicit agreement on coordination. Exchange of information about intentions concerning future conduct is the most likely means to enable companies to reach such a common understanding.

67. Another channel through which information exchange can lead to restrictive effects on competition is by increasing the internal stability of a collusive outcome on the market. In particular, it can do so by enabling the companies involved to monitor deviations. Namely, information exchange can make the market sufficiently transparent to allow the colluding companies to monitor to a sufficient degree whether other companies are deviating from the collusive outcome, and thus to know when to retaliate. Both exchanges of present and past data can constitute such a monitoring mechanism. This can either enable companies to achieve a collusive outcome on markets where they would otherwise not have been able to do so, or it can increase the stability of a collusive outcome already present on the market (see Example 3, paragraph 107).

68. A third channel through which information exchange can lead to restrictive effects on competition is by increasing the external stability of a collusive outcome on the market. Information exchanges that make the market sufficiently transparent can allow colluding companies to monitor where and when other companies are attempting to enter the market, thus allowing the colluding companies to target the new entrant. This may also tie into the anti-competitive foreclosure concerns discussed in paragraphs 69 to 71. Both exchanges of present and past data can constitute such a monitoring mechanism.

Anti-competitive foreclosure

69. Apart from facilitating collusion, an exchange of information can also lead to anti-competitive foreclosure [2].

70. An exclusive exchange of information can lead to anti-competitive foreclosure on the same market where the exchange takes place. This can occur when the exchange of commercially sensitive information places unaffiliated competitors at a significant competitive disadvantage as compared to the companies affiliated within the exchange system. This type of foreclosure is only possible if the information concerned is very strategic for competition and covers a significant part of the relevant market.

71. It cannot be excluded that information exchange may also lead to anti-competitive foreclosure of third parties in a related market. For instance, by gaining enough market power through an information exchange, parties exchanging information in an upstream market, for instance vertically integrated companies, may be able to raise the price of a key component for a market downstream. Thereby, they could raise the costs of their rivals downstream, which could result in anti-competitive foreclosure in the downstream market.

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[1] The use of the term 'main competition concerns' means that the ensuing description of competition concerns is neither exclusive nor exhaustive.

[2] With regard to foreclosure concerns that vertical agreements can give rise to, see paragraphs 100 *et seq.* of the Guidelines on Vertical Restraints.

2.2.2. *Restriction of competition by object*

72. Any information exchange with the objective of restricting competition on the market will be considered as a restriction of competition by object. In assessing whether an information exchange constitutes a restriction of competition by object, the Commission will pay particular attention to the legal and economic context in which the information exchange takes place ([1]). To this end, the Commission will take into account whether the information exchange, by its very nature, may possibly lead to a restriction of competition ([2]).

73. Exchanging information on companies' individualised intentions concerning future conduct regarding prices or quantities ([3]) is particularly likely to lead to a collusive outcome. Informing each other about such intentions may allow competitors to arrive at a common higher price level without incurring the risk of losing market share or triggering a price war during the period of adjustment to new prices (see Example 1, paragraph 105). Moreover, it is less likely that information exchanges concerning future intentions are made for pro-competitive reasons than exchanges of actual data.

74. Information exchanges between competitors of individualised data regarding intended future prices or quantities should therefore be considered a restriction of competition by object ([4]) ([5]). In addition, private exchanges between competitors of their individualised intentions regarding future prices or quantities would normally be considered and fined as cartels because they generally have the object of fixing prices or quantities. Information exchanges that constitute cartels not only infringe Article 101(1), but, in addition, are very unlikely to fulfil the conditions of Article 101(3).

2.2.3. *Restrictive effects on competition*

75. The likely effects of an information exchange on competition must be analysed on a case-by-case basis as the results of the assessment depend on a combination of various case specific factors. The assessment of restrictive effects on competition compares the likely effects of the information exchange with the competitive situation that would prevail in the absence of that specific information exchange ([6]). For an information exchange to have restrictive effects on competition within the meaning of Article 101(1), it must be likely to have an appreciable adverse impact on one (or several) of the parameters of competition such as price, output, product quality, product variety or innovation. Whether or not an exchange of information will have restrictive effects on competition depends on both the economic conditions on the relevant markets and the characteristics of information exchanged.

76. Certain market conditions may make coordination easier to achieve, sustain internally, or sustain externally ([7]). Exchanges of information in such markets may have more restrictive effects compared to markets with different conditions. However, even where market conditions are such that coordination

([1]) See, for example, Joined Cases C-501/06 P and others, *GlaxoSmithKline*, paragraph 58; Case C-209/07, *BIDS*, paragraphs 15 *et seq*.

([2]) See also General Guidelines, paragraph 22.

([3]) Information regarding intended future quantities could for instance include intended future sales, market shares, territories, and sales to particular groups of consumers.

([4]) The notion of 'intended future prices' is illustrated in Example 1. In specific situations where companies are fully committed to sell in the future at the prices that they have previously announced to the public (that is to say, they can not revise them), such public announcements of future individualised prices or quantities would not be considered as intentions, and hence would normally not be found to restrict competition by object. This could occur, for example, because of the repeated interactions and the specific type of relationship companies may have with their customers, for instance since it is essential that the customers know future prices in advance or because they can already take advanced orders at these prices. This is because in these situations the information exchange would be a more costly means for reaching a collusive outcome in the market than exchanging information on future intentions, and would be more likely to be done for pro-competitive reasons. However, this does not imply that in general price commitment towards customers is necessarily pro-competitive. On the contrary, it could limit the possibility of deviating from a collusive outcome and hence render it more stable.

([5]) This is without prejudice to the fact that public announcements of intended individualised prices may give rise to efficiencies and that the parties to such exchange would have a possibility to rely on Article 101(3).

([6]) Case C-7/95 P, *John Deere* v *Commission*, paragraph 76.

([7]) Information exchange may restrict competition in a similar way to a merger if it leads to more effective, more stable or more likely coordination in the market; see Case C-413/06 P, *Sony*, [2008] ECR I-4951, paragraph 123, where the Court of Justice endorsed the criteria established by the General Court in Case T-342/99, *Airtours*, [2002] ECR II-2585, paragraph 62.

may be difficult to sustain before the exchange, the exchange of information may change the market conditions in such a way that coordination becomes possible after the exchange – for example by increasing transparency in the market, reducing market complexity, buffering instability or compensating for asymmetry. For this reason it is important to assess the restrictive effects of the information exchange in the context of both the initial market conditions, and how the information exchange changes those conditions. This will include an assessment of the specific characteristics of the system concerned, including its purpose, conditions of access to the system and conditions of participation in the system. It will also be necessary to examine the frequency of the information exchanges, the type of information exchanged (for example, whether it is public or confidential, aggregated or detailed, and historical or current), and the importance of the information for the fixing of prices, volumes or conditions of service [1]. The following factors are relevant for this assessment.

(i) Market characteristics

77. Companies are more likely to achieve a collusive outcome in markets which are sufficiently transparent, concentrated, non-complex, stable and symmetric. In those types of markets companies can reach a common understanding on the terms of coordination and successfully monitor and punish deviations. However, information exchange can also enable companies to achieve a collusive outcome in other market situations where they would not be able to do so in the absence of the information exchange. Information exchange can thereby facilitate a collusive outcome by increasing transparency in the market, reducing market complexity, buffering instability or compensating for asymmetry. In this context, the competitive outcome of an information exchange depends not only on the initial characteristics of the market in which it takes place (such as concentration, transparency, stability, complexity etc.), but also on how the type of the information exchanged may change those characteristics [2].

78. Collusive outcomes are more likely in transparent markets. Transparency can facilitate collusion by enabling companies to reach a common understanding on the terms of coordination, or/and by increasing internal and external stability of collusion. Information exchange can increase transparency and hence limit uncertainties about the strategic variables of competition (for example, prices, output, demand, costs etc.). The lower the pre-existing level of transparency in the market, the more value an information exchange may have in achieving a collusive outcome. An information exchange that contributes little to the transparency in a market is less likely to have restrictive effects on competition than an information exchange that significantly increases transparency. Therefore it is the combination of both the pre-existing level of transparency and how the information exchange changes that level that will determine how likely it is that the information exchange will have restrictive effects on competition. The pre-existing degree of transparency, inter alia, depends on the number of market participants and the nature of transactions, which can range from public transactions to confidential bilateral negotiations between buyers and sellers. When evaluating the change in the level of transparency in the market, the key element is to identify to what extent the available information can be used by companies to determine the actions of their competitors.

79. Tight oligopolies can facilitate a collusive outcome on the market as it is easier for fewer companies to reach a common understanding on the terms of coordination and to monitor deviations. A collusive outcome is also more likely to be sustainable with fewer companies. With more companies coordinating, the gains from deviating are greater because a larger market share can be gained through undercutting. At the same time, gains from the collusive outcome are smaller because, when there are more companies, the share of the rents from the collusive outcome declines. Exchanges of information in tight oligopolies are more likely to cause restrictive effects on competition than in less tight oligopolies, and are not likely to cause such restrictive effects on competition in very fragmented markets. However, by increasing transparency, or modifying the market environment in another way towards one more liable to coordination, information exchanges may facilitate coordination and monitoring among more companies than would be possible in its absence.

[1] Case C-238/05, *Asnef-Equifax*, paragraph 54.

[2] It should be noted that the discussion in paragraphs 78 to 85 is not a complete list of relevant market characteristics. There may be other characteristics of the market which are important in the setting of certain information exchanges.

80. Companies may find it difficult to achieve a collusive outcome in a complex market environment. However, to some extent, the use of information exchange may simplify such environments. In a complex market environment more information exchange is normally needed to reach a common understanding on the terms of coordination and to monitor deviations. For example, it is easier to achieve a collusive outcome on a price for a single, homogeneous product, than on numerous prices in a market with many differentiated products. It is nonetheless possible that to circumvent the difficulties involved in achieving a collusive outcome on a large number of prices, companies may exchange information to establish simple pricing rules (for example, pricing points).

81. Collusive outcomes are more likely where the demand and supply conditions are relatively stable ([1]). In an unstable environment it may be difficult for a company to know whether its lost sales are due to an overall low level of demand or due to a competitor offering particularly low prices, and therefore it is difficult to sustain a collusive outcome. In this context, volatile demand, substantial internal growth by some companies in the market, or frequent entry by new companies, may indicate that the current situation is not sufficiently stable for coordination to be likely ([2]). Information exchange in certain situations can serve the purpose of increasing stability in the market, and thereby may enable a collusive outcome in the market. Moreover, in markets where innovation is important, coordination may be more difficult since particularly significant innovations may allow one company to gain a major advantage over its rivals. For a collusive outcome to be sustainable, the reactions of outsiders, such as current and future competitors not participating in the coordination, as well as customers, should not be capable of jeopardising the results expected from the collusive outcome. In this context, the existence of barriers to entry makes it more likely that a collusive outcome on the market is feasible and sustainable.

82. A collusive outcome is more likely in symmetric market structures. When companies are homogenous in terms of their costs, demand, market shares, product range, capacities etc., they are more likely to reach a common understanding on the terms of coordination because their incentives are more aligned. However, information exchange may in some situations also allow a collusive outcome to occur in more heterogeneous market structures. Information exchange could make companies aware of their differences and help them to design means to accommodate for their heterogeneity in the context of coordination.

83. The stability of a collusive outcome also depends on the companies' discounting of future profits. The more companies value the current profits that they could gain from undercutting versus all the future ones that they could gain by the collusive outcome, the less likely it is that they will be able to achieve a collusive outcome.

84. By the same token, a collusive outcome is more likely among companies that will continue to operate in the same market for a long time, as in such a scenario they will be more committed to coordinate. If a company knows that it will interact with the others for a long time, it will have a greater incentive to achieve the collusive outcome because the stream of future profits from the collusive outcome will be worth more than the short term profit it could have if it deviated, that is to say, before the other companies detect the deviation and retaliate.

85. Overall, for a collusive outcome to be sustainable, the threat of a sufficiently credible and prompt retaliation must be likely. Collusive outcomes are not sustainable in markets in which the consequences of deviation are not sufficiently severe to convince coordinating companies that it is in their best interest to adhere to the terms of the collusive outcome. For example, in markets characterised by infrequent, lumpy orders, it may be difficult to establish a sufficiently severe deterrence mechanism, since the gain from deviating at the right time may be large, certain and immediate, whereas the losses

([1]) See Case T-35/92, *John Deere* v *Commission*, [1994] ECR II-957, paragraph 78.

([2]) See Commission Decision in Cases IV/31.370 and 31.446, *UK Agricultural Tractor Registration Exchange*, OJ L 68, 13.3.1992, p. 19, paragraph 51 and Case T-35/92, *John Deere* v *Commission*, paragraph 78. It is not necessary that absolute stability be established or fierce competition excluded.

from being punished small and uncertain, and only materialise after some time. The credibility of the deterrence mechanism also depends on whether the other coordinating companies have an incentive to retaliate, determined by their short-term losses from triggering a price war versus their potential long-term gain in case they induce a return to a collusive outcome. For example, companies' ability to retaliate may be reinforced if they are also interrelated by vertical commercial relationships which they can use as a threat of punishment for deviations.

(ii) Characteristics of the information exchange

Strategic information

86. The exchange between competitors of strategic data, that is to say, data that reduces strategic uncertainty in the market, is more likely to be caught by Article 101 than exchanges of other types of information. Sharing of strategic data can give rise to restrictive effects on competition because it reduces the parties' decision-making independence by decreasing their incentives to compete. Strategic information can be related to prices (for example, actual prices, discounts, increases, reductions or rebates), customer lists, production costs, quantities, turnovers, sales, capacities, qualities, marketing plans, risks, investments, technologies and R&D programmes and their results. Generally, information related to prices and quantities is the most strategic, followed by information about costs and demand. However, if companies compete with regard to R&D it is the technology data that may be the most strategic for competition. The strategic usefulness of data also depends on its aggregation and age, as well as the market context and frequency of the exchange.

Market coverage

87. For an information exchange to be likely to have restrictive effects on competition, the companies involved in the exchange have to cover a sufficiently large part of the relevant market. Otherwise, the competitors that are not participating in the information exchange could constrain any anti-competitive behaviour of the companies involved. For example, by pricing below the coordinated price level companies unaffiliated within the information exchange system could threaten the external stability of a collusive outcome.

88. What constitutes 'a sufficiently large part of the market' cannot be defined in the abstract and will depend on the specific facts of each case and the type of information exchange in question. Where, however, an information exchange takes place in the context of another type of horizontal co-operation agreement and does not go beyond what is necessary for its implementation, market coverage below the market share thresholds set out in the relevant chapter of these guidelines, the relevant block exemption regulation ([1]) or the *De Minimis* Notice pertaining to the type of agreement in question will usually not be large enough for the information exchange to give rise to restrictive effects on competition.

Aggregated/individualised data

89. Exchanges of genuinely aggregated data, that is to say, where the recognition of individualised company level information is sufficiently difficult, are much less likely to lead to restrictive effects on competition than exchanges of company level data. Collection and publication of aggregated market data (such as sales data, data on capacities or data on costs of inputs and components) by a trade organisation or market intelligence firm may benefit suppliers and customers alike by allowing them to get a clearer picture of the economic situation of a sector. Such data collection and publication may allow market participants to make better-informed individual choices in order to adapt

([1]) Exchanges of information in the context of an R&D agreement, if they do not exceed what is necessary for implementation of the agreement, can benefit from the safe harbour of 25 % set out in the R&D Block Exemption Regulation. For the Specialisation Block Exemption Regulation, the relevant safe harbour is 20 %.

efficiently their strategy to the market conditions. More generally, unless it takes place in a tight oligopoly, the exchange of aggregated data is unlikely to give rise to restrictive effects on competition. Conversely, the exchange of individualised data facilitates a common understanding on the market and punishment strategies by allowing the coordinating companies to single out a deviator or entrant. Nevertheless, the possibility cannot be excluded that even the exchange of aggregated data may facilitate a collusive outcome in markets with specific characteristics. Namely, members of a very tight and stable oligopoly exchanging aggregated data who detect a market price below a certain level could automatically assume that someone has deviated from the collusive outcome and take market-wide retaliatory steps. In other words, in order to keep collusion stable, companies may not always need to know who deviated, it may be enough to learn that 'someone' deviated.

Age of data

90. The exchange of historic data is unlikely to lead to a collusive outcome as it is unlikely to be indicative of the competitors' future conduct or to provide a common understanding on the market ([1]). Moreover, exchanging historic data is unlikely to facilitate monitoring of deviations because the older the data, the less useful it would be for timely detection of deviations and thus as a credible threat of prompt retaliation ([2]). There is no predetermined threshold when data becomes historic, that is to say, old enough not to pose risks to competition. Whether data is genuinely historic depends on the specific characteristics of the relevant market and in particular the frequency of price re-negotiations in the industry. For example, data can be considered as historic if it is several times older than the average length of contracts in the industry if the latter are indicative of price re-negotiations. Moreover, the threshold when data becomes historic also depends on the data's nature, aggregation, frequency of the exchange, and the characteristics of the relevant market (for example, its stability and transparency).

Frequency of the information exchange

91. Frequent exchanges of information that facilitate both a better common understanding of the market and monitoring of deviations increase the risks of a collusive outcome. In more unstable markets, more frequent exchanges of information may be necessary to facilitate a collusive outcome than in stable markets. In markets with long-term contracts (which are indicative of infrequent price re-negotiations) a less frequent exchange of information would normally be sufficient to achieve a collusive outcome. By contrast, infrequent exchanges would not tend to be sufficient to achieve a collusive outcome in markets with short-term contracts indicative of frequent price re-negotiations ([3]). However, the frequency at which data needs to be exchanged to facilitate a collusive outcome also depends on the nature, age and aggregation of data ([4]).

Public/non-public information

92. In general, exchanges of genuinely public information are unlikely to constitute an infringement of Article 101 ([5]). *Genuinely public information* is information that is generally equally accessible (in terms of costs of access) to all competitors and customers. For information to be genuinely public, obtaining it should not be more costly for customers and companies unaffiliated to the exchange system than for the companies exchanging the information. For this reason, competitors would normally not choose to exchange data that they can collect from the market at equal ease, and hence in practice

([1]) The collection of historic data can also be used to convey a sector association's input to or analysis of a review of public policy.

([2]) For example, in past cases the Commission has considered the exchange of individual data which was more than one year old as historic and as not restrictive of competition within the meaning of Article 101(1), whereas information less than one year old has been considered as recent; Commission Decision in Case IV/31.370, *UK Agricultural Tractor Registration Exchange*, paragraph 50; Commission Decision in Case IV/36.069, *Wirtschaftsvereinigung Stahl*, OJ L 1, 3.1.1998, p. 10, paragraph 17.

([3]) However, infrequent contracts could decrease the likelihood of a sufficiently prompt retaliation.

([4]) However, depending on the structure of the market and the overall context of the exchange, the possibility cannot be excluded that an isolated exchange may constitute a sufficient basis for the participating undertakings to concert their market conduct and thus successfully substitute practical co-operation between them for competition and the risks that that entails; see Case C-8/08, *T-Mobile Netherlands*, paragraph 59.

([5]) Joined Cases T-191/98 and others, *Atlantic Container Line (TACA)*, [2003] ECR II-3275, paragraph 1154. This may not be the case if the exchange underpins a cartel.

exchanges of genuinely public data are unlikely. In contrast, even if the data exchanged between competitors is what is often referred to as being 'in the public domain', it is not genuinely public if the costs involved in collecting the data deter other companies and customers from doing so [1]. A possibility to gather the information in the market, for example to collect it from customers, does not necessarily mean that such information constitutes market data readily accessible to competitors [2].

93. Even if there is public availability of data (for example, information published by regulators), the existence of an additional information exchange by competitors may give rise to restrictive effects on competition if it further reduces strategic uncertainty in the market. In that case, it is the incremental information that could be critical to tip the market balance towards a collusive outcome.

Public/non-public exchange of information

94. An *information exchange* is genuinely public if it makes the exchanged data equally accessible (in terms of costs of access) to all competitors and customers [3]. The fact that information is exchanged in public may decrease the likelihood of a collusive outcome on the market to the extent that non-coordinating companies, potential competitors, as well as costumers may be able to constrain potential restrictive effect on competition [4]. However, the possibility cannot be entirely excluded that even genuinely public exchanges of information may facilitate a collusive outcome in the market.

2.3. **Assessment under Article 101(3)**

2.3.1. *Efficiency gains* [5]

95. Information exchange may lead to efficiency gains. Information about competitors' costs can enable companies to become more efficient if they benchmark their performance against the best practices in the industry and design internal incentive schemes accordingly.

96. Moreover, in certain situations information exchange can help companies allocate production towards high-demand markets (for example, demand information) or low cost companies (for example, cost information). The likelihood of those types of efficiencies depends on market characteristics such as whether companies compete on prices or quantities and the nature of uncertainties on the market. Some forms of information exchanges in this context may allow substantial cost savings where, for example, they reduce unnecessary inventories or enable quicker delivery of perishable products to areas with high demand and their reduction in areas with low demand (see Example 6, paragraph 110).

97. Exchange of consumer data between companies in markets with asymmetric information about consumers can also give rise to efficiencies. For instance, keeping track of the past behaviour of customers in terms of accidents or credit default provides an incentive for consumers to limit their risk exposure. It also makes it possible to detect which consumers carry a lower risk and should benefit from lower prices. In this context, information exchange can also reduce consumer lock-in, thereby inducing stronger competition. This is because information is generally specific to a relationship and consumers would otherwise lose the benefit from that information when switching to another company. Examples of such efficiencies are found in the banking and insurance sectors, which are characterised by frequent exchanges of information about consumer defaults and risk characteristics.

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[1] Moreover, the fact that the parties to the exchange have previously communicated the data to the public (for example through a daily newspaper or on their websites) does not imply that a subsequent non-public exchange would not infringe Article 101.

[2] See Joined Cases T-202/98 and others, *Tate & Lyle* v *Commission*, paragraph 60.

[3] This does not preclude that a database be offered at a lower price to customers which themselves have contributed data to it, as by doing so they normally would have also incurred costs.

[4] Assessing barriers to entry and countervailing 'buyer power' in the market would be relevant for determining whether outsiders to the information exchange system would be able to jeopardise the outcomes expected from coordination. However, increased transparency to consumers may either decrease or increase scope for a collusive outcome because with increased transparency to consumers, as price elasticity of demand is higher, pay-offs from deviation are higher but retaliation is also harsher.

[5] The discussion of potential efficiency gains from information exchange is neither exclusive nor exhaustive.

98. Exchanging past and present data related to market shares may in some situations provide benefits to both companies and consumers by allowing companies to announce it as a signal of quality of their products to consumers. In situations of imperfect information about product quality, consumers often use indirect means to gain information on the relative qualities of products such as price and market shares (for example, consumers use best-selling lists in order to choose their next book).

99. Information exchange that is genuinely public can also benefit consumers by helping them to make a more informed choice (and reducing their search costs). Consumers are most likely to benefit in this way from public exchanges of current data, which are the most relevant for their purchasing decisions. Similarly, public information exchange about current input prices can lower search costs for companies, which would normally benefit consumers through lower final prices. Those types of direct consumer benefits are less likely to be generated by exchanges of future pricing intentions because companies which announce their pricing intentions are likely to revise them before consumers actually purchase based on that information. Consumers generally cannot rely on companies' future intentions when making their consumption plans. However, to some extent, companies may be disciplined not to change the announced future prices before implementation when, for example, they have repeated interactions with consumers and consumers rely on knowing the prices in advance or, for example, when consumers can make advance orders. In those situations, exchanging information related to the future may improve customers' planning of expenditure.

100. Exchanging present and past data is more likely to generate efficiency gains than exchanging information about future intentions. However, in specific circumstances announcing future intentions could also give rise to efficiency gains. For example, companies knowing early the winner of an R&D race could avoid duplicating costly efforts and wasting resources that cannot be recovered [1].

2.3.2. *Indispensability*

101. Restrictions that go beyond what is necessary to achieve the efficiency gains generated by an information exchange do not fulfil the conditions of Article 101(3). For fulfilling the condition of indispensability, the parties will need to prove that the data's subject matter, aggregation, age, confidentiality and frequency, as well as coverage, of the exchange are of the kind that carries the lowest risks indispensable for creating the claimed efficiency gains. Moreover, the exchange should not involve information beyond the variables that are relevant for the attainment of the efficiency gains. For instance, for the purpose of benchmarking, an exchange of individualised data would generally not be indispensable because information aggregated in for example some form of industry ranking could also generate the claimed efficiency gains while carrying a lower risk of leading to a collusive outcome (see Example 4, paragraph 108). Finally, it is generally unlikely that the sharing of individualised data on future intentions is indispensable, especially if it is related to prices and quantities.

102. Similarly, information exchanges that form part of horizontal co-operation agreements are also more likely to fulfil the conditions of Article 101(3) if they do not go beyond what is indispensable for the implementation of the economic purpose of the agreement (for example, sharing technology necessary for an R&D agreement or cost data in the context of a production agreement).

2.3.3. *Pass-on to consumers*

103. Efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects on competition caused by an information exchange. The lower is the market power of the parties involved in the information exchange, the more likely it is that the efficiency gains would be passed on to consumers to an extent that outweighs the restrictive effects on competition.

[1] Such efficiencies need to be weighed against the potential negative effects of, for example, limiting competition for the market which stimulates innovation.

2.3.4. *No elimination of competition*

104. The criteria of Article 101(3) cannot be met if the companies involved in the information exchange are afforded the possibility of eliminating competition in respect of a substantial part of the products concerned.

2.4. **Examples**

105. Exchange of intended future prices as a restriction of competition by object

Example 1

Situation: A trade association of coach companies in country X disseminates individualised information on intended future prices only to the member coach companies. The information contains several elements, such as the intended fare and the route to which the fare applies, the possible restrictions to this fare, such as which consumers can buy it, if advanced payment or minimum stay is required, the period during which tickets can be sold for the given fare (first and last ticket date), and the time during which the ticket with the given fare can be used for travel (first and last travel dates).

Analysis: This information exchange, which is triggered by a decision by an association of undertakings, concerns pricing intentions of competitors. This information exchange is a very efficient tool for reaching a collusive outcome and therefore restricts competition by object. This is because the companies are free to change their own intended prices as announced within the association at any time if they learn that their competitors intend to charge higher prices. This allows the companies to reach a common higher price level without incurring the cost of losing market share. For example, coach Company A can announce today a price increase on the route from city 1 to city 2 for travel as of the following month. Since this information is accessible to all other coach companies, Company A can then wait and see the reaction of its competitors to this price announcement. If a competitor on the same route, say, Company B, matched the price increase, then Company A's announcement would be left unchanged and later would likely become effective. However, if Company B did not match the price increase, then Company A could still revise its fare. The adjustment would continue until the companies converged to an increased anti-competitive price level. This information exchange is unlikely to fulfil the conditions of Article 101(3). The information exchange is only confined to competitors, that is to say, customers of the coach companies do not directly benefit from it.

106. Exchange of current prices with sufficient efficiency gains for consumers

Example 2

Situation: A national tourist office together with the coach companies in small country X agree to disseminate information on current prices of coach tickets through a freely accessible website (in contrast to Example 1, paragraph 105, consumers can already purchase tickets at the prices and conditions which are exchanged, thus they are not intended future prices but present prices of current and future services). The information contains several elements, such as the fare and the route to which the fare is applied, the possible restrictions to this fare, such as which consumers can buy it, if advanced payment or minimum stay is required, and the time during which the ticket with the given fare can be used for travel (first and last travel dates). Coach travel in country X is not in the same relevant market as train and air travel. It is presumed that the relevant market is concentrated, stable and relatively non-complex, and pricing becomes transparent with the information exchange.

Analysis: This information exchange does not constitute a restriction of competition by object. The companies are exchanging current prices rather than intended future prices because they are effectively already selling tickets at these prices (unlike in Example 1, paragraph 105). Therefore, this exchange of information is less likely to constitute an efficient mechanism for reaching a focal point for coordination. Nevertheless, given the market structure and strategic nature of the data, this information exchange is likely to constitute an efficient mechanism for monitoring deviations from a collusive outcome, which would be likely to occur in this type of market setting. Therefore, this information exchange could give rise to restrictive effects on competition within the meaning of Article 101(1). However, to the extent that some restrictive effects on competition could result from the possibility to monitor deviations, it is likely that the efficiency gains stemming from the

information exchange would be passed on to consumers to an extent that outweighs the restrictive effects on competition in both their likelihood and magnitude. Unlike in Example 1, paragraph 105, the information exchange is public and consumers can actually purchase tickets at the prices and conditions that are exchanged. Therefore this information exchange is likely to directly benefit consumers by reducing their search costs and improving choice, and thereby also stimulating price competition. Hence, the conditions of Article 101(3) are likely to be met.

107. Current prices deduced from the information exchanged

Example 3

Situation: The luxury hotels in the capital of country A operate in a tight, non-complex and stable oligopoly, with largely homogenous cost structures, which constitute a separate relevant market from other hotels. They directly exchange individual information about current occupancy rates and revenues. In this case, from the information exchanged the parties can directly deduce their actual current prices.

Analysis: Unless it is a disguised means of exchanging information on future intentions, this exchange of information would not constitute a restriction of competition by object because the hotels exchange present data and not information on intended future prices or quantities. However, the information exchange would give rise to restrictive effects on competition within the meaning of Article 101(1) because knowing the competitors' actual current prices would be likely to facilitate coordination (that is to say, alignment) of companies' competitive behaviour. It would be most likely used to monitor deviations from the collusive outcome. The information exchange increases transparency in the market as even though the hotels normally publish their list prices, they also offer various discounts to the list price resulting from negotiations or for early or group bookings, etc. Therefore, the incremental information that is non-publicly exchanged between the hotels is commercially sensitive, that is to say, strategically useful. This exchange is likely to facilitate a collusive outcome on the market because the parties involved constitute a tight, non-complex and stable oligopoly involved in a long-term competitive relationship (repeated interactions). Moreover, the cost structures of the hotels are largely homogeneous. Finally, neither consumers nor market entry can constrain the incumbents' anti-competitive behaviour as consumers have little buyer power and barriers to entry are high. It is unlikely that in this case the parties would be able to demonstrate any efficiency gains stemming from the information exchange that would be passed on to consumers to an extent that would outweigh the restrictive effects on competition. Therefore it is unlikely that the conditions of Article 101(3) can be met.

108. Benchmarking benefits – criteria of Article 101(3) not fulfilled

Example 4

Situation: Three large companies with a combined market share of 80 % in a stable, non-complex, concentrated market with high barriers to entry, non-publicly and frequently exchange information directly between themselves about a substantial fraction of their individual costs. The companies claim that they do this to benchmark their performance against their competitors and thereby intend to become more efficient.

Analysis: This information exchange does not in principle constitute a restriction of competition by object. Consequently, its effects on the market need to be assessed. Because of the market structure, the fact that the information exchanged relates to a large proportion of the companies' variable costs, the individualised form of presentation of the data, and its large coverage of the relevant market, the information exchange is likely to facilitate a collusive outcome and thereby gives rise to restrictive effects on competition within the meaning of Article 101(1). It is unlikely that the criteria of Article 101(3) are fulfilled because there are less restrictive means to achieve the claimed

efficiency gains, for example by way of a third party collecting, anonymising and aggregating the data in some form of industry ranking. Finally, in this case, since the parties form a very tight, non-complex and stable oligopoly, even the exchange of aggregated data could facilitate a collusive outcome in the market. However, this would be very unlikely if this exchange of information happened in a non-transparent, fragmented, unstable, and complex market.

109. Genuinely public information

Example 5

Situation: The four companies owning all the petrol stations in a large country A exchange current gasoline prices over the telephone. They claim that this information exchange cannot have restrictive effects on competition because the information is public as it is displayed on large display panels at every petrol station.

Analysis: The pricing data exchanged over the telephone is not genuinely public, as in order to obtain the same information in a different way it would be necessary to incur substantial time and transport costs. One would have to travel frequently large distances to collect the prices displayed on the boards of petrol stations spread all over the country. The costs for this are potentially high, so that the information could in practice not be obtained but for the information exchange. Moreover, the exchange is systematic and covers the entire relevant market, which is a tight, non-complex, stable oligopoly. Therefore it is likely to create a climate of mutual certainty as to the competitors' pricing policy and thereby it is likely to facilitate a collusive outcome. Consequently, this information exchange is likely to give rise to restrictive effects on competition within the meaning of Article 101(1).

110. Improved meeting of demand as an efficiency gain

Example 6

Situation: There are five producers of fresh bottled carrot juice in the relevant market. Demand for this product is very unstable and vary from location to location in different points in time. The juice has to be sold and consumed within one day from the date of production. The producers agree to establish an independent market research company that on a daily basis collects current information about unsold juice in each point of sale, which it publishes on its website the following week in a form that is aggregated per point of sale. The published statistics allow producers and retailers to forecast demand and to better position the product. Before the information exchange was put in place, the retailers had reported large quantities of wasted juice and therefore had reduced the quantity of juice purchased from the producers; that is to say, the market was not working efficiently. Consequently, in some periods and areas there were frequent instances of unmet demand. The information exchange system, which allows better forecasting of oversupply and undersupply, has significantly reduced the instances of unmet consumer demand and increased the quantity sold in the market.

Analysis: Even though the market is quite concentrated and the data exchanged is recent and strategic, it is not very likely that this exchange would facilitate a collusive outcome because a collusive outcome would be unlikely to occur in such an unstable market. Even if the exchange creates some risk of giving rise to restrictive effects on competition, the efficiency gains stemming from increasing supply to places with high demand and decreasing supply in places with low demand is likely to offset potential restrictive effects. The information is exchanged in a public and aggregated form, which carries lower anti-competitive risks than if it were non-public and individualised. The information exchange therefore does not go beyond what is necessary to correct the market failure. Therefore, it is likely that this information exchange meets the criteria of Article 101(3).

3. RESEARCH AND DEVELOPMENT AGREEMENTS

3.1. Definition

111. R&D agreements vary in form and scope. They range from outsourcing certain R&D activities to the joint improvement of existing technologies and co-operation concerning the research, development and marketing of completely new products. They may take the form of a co-operation agreement or of a jointly controlled company. This chapter applies to all forms of R&D agreements, including related agreements concerning the production or commercialisation of the R&D results.

3.2. Relevant markets

112. The key to defining the relevant market when assessing the effects of an R&D agreement is to identify those products, technologies or R&D efforts that will act as the main competitive constraints on the parties. At one end of the spectrum of possible situations, innovation may result in a product (or technology) which competes in an existing product (or technology) market. This is, for example, the case with R&D directed towards slight improvements or variations, such as new models of certain products. Here possible effects concern the market for existing products. At the other end of the spectrum, innovation may result in an entirely new product which creates its own new product market (for example, a new vaccine for a previously incurable disease). However, many cases concern situations in between those two extremes, that is to say, situations in which innovation efforts may create products (or technology) which, over time, replace existing ones (for example, CDs which have replaced records). A careful analysis of those situations may have to cover both existing markets and the impact of the agreement on innovation.

Existing product markets

113. Where the co-operation concerns R&D for the improvement of existing products, those existing products and their close substitutes form the relevant market concerned by the co-operation [1].

114. If the R&D efforts aim at a significant change of existing products or even at a new product to replace existing ones, substitution with the existing products may be imperfect or long-term. It may be concluded that the old and the potentially emerging new products do not belong to the same relevant market [2]. The market for existing products may nevertheless be concerned, if the pooling of R&D efforts is likely to result in the coordination of the parties' behaviour as suppliers of existing products, for instance because of the exchange of competitively sensitive information relating to the market for existing products.

115. If the R&D concerns an important component of a final product, not only the market for that component may be relevant for the assessment, but also the existing market for the final product. For instance, if car manufacturers co-operate in R&D related to a new type of engine, the car market may be affected by that R&D co-operation. The market for final products, however, is only relevant for the assessment if the component at which the R&D is aimed is technically or economically a key element of those final products and if the parties to the R&D agreement have market power with respect to the final products.

Existing technology markets

116. R&D co-operation may not only concern products but also technology. When intellectual property rights are marketed separately from the products to which they relate, the relevant technology market has to be defined as well. Technology markets consist of the intellectual property that is licensed and its close substitutes, that is to say, other technologies which customers could use as a substitute.

[1] For market definition, see the Market Definition Notice.

[2] See also Commission Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, OJ C 101, 27.4.2004, p. 2 ('Technology Transfer Guidelines'), paragraph 33.

117. The methodology for defining technology markets follows the same principles as product market definition ([1]). Starting from the technology which is marketed by the parties, those other technologies to which customers could switch in response to a small but non-transitory increase in relative prices need to be identified. Once those technologies are identified, market shares can be calculated by dividing the licensing income generated by the parties by the total licensing income of all licensors.

118. The parties' position in the market for existing technology is a relevant assessment criterion where the R&D co-operation concerns a significant improvement to an existing technology or a new technology that is likely to replace the existing technology. The parties' market shares can, however, only be taken as a starting point for this analysis. In technology markets, particular emphasis must be placed on potential competition. If companies which do not currently license their technology are potential entrants on the technology market they could constrain the ability of the parties to profitably raise the price for their technology. This aspect of the analysis may also be taken into account directly in the calculation of market shares by basing those on the sales of the products incorporating the licensed technology on downstream product markets (see paragraphs 123 to 126).

Competition in innovation (R&D efforts)

119. R&D co-operation may not only affect competition in existing markets, but also competition in innovation and new product markets. This is the case where R&D co-operation concerns the development of new products or technology which either may – if emerging – one day replace existing ones or which are being developed for a new intended use and will therefore not replace existing products but create a completely new demand. The effects on competition in innovation are important in these situations, but can in some cases not be sufficiently assessed by analysing actual or potential competition in existing product/technology markets. In this respect, two scenarios can be distinguished, depending on the nature of the innovative process in a given industry.

120. In the first scenario, which is, for instance, present in the pharmaceutical industry, the process of innovation is structured in such a way that it is possible at an early stage to identify competing R&D poles. Competing R&D poles are R&D efforts directed towards a certain new product or technology, and the substitutes for that R&D, that is to say, R&D aimed at developing substitutable products or technology for those developed by the co-operation and having similar timing. In this case, it can be analysed whether after the agreement there will be a sufficient number of remaining R&D poles. The starting point of the analysis is the R&D of the parties. Then credible competing R&D poles have to be identified. In order to assess the credibility of competing poles, the following aspects have to be taken into account: the nature, scope and size of any other R&D efforts, their access to financial and human resources, know-how/patents, or other specialised assets as well as their timing and their capability to exploit possible results. An R&D pole is not a credible competitor if it cannot be regarded as a close substitute for the parties' R&D effort from the viewpoint of, for instance, access to resources or timing.

121. Besides the direct effect on the innovation itself, the co-operation may also affect a new product market. It will often be difficult to analyse the effects on such a market directly as by its very nature it does not yet exist. The analysis of such markets will therefore often be implicitly incorporated in the analysis of competition in innovation. However, it may be necessary to consider directly the effects on such a market of aspects of the agreement that go beyond the R&D stage. An R&D agreement that includes joint production and commercialisation on the new product market may, for instance, be assessed differently than a pure R&D agreement.

122. In the second scenario, the innovative efforts in an industry are not clearly structured so as to allow the identification of R&D poles. In this situation, in the absence of exceptional circumstances, the Commission would not try to assess the impact of a given R&D co-operation on innovation, but would limit its assessment to existing product and/or technology markets which are related to the R&D co-operation in question.

([1]) See Market Definition Notice; see also Technology Transfer Guidelines, paragraphs 19 *et seq*.

Calculation of market shares

123. The calculation of market shares, both for the purposes of the R&D Block Exemption Regulation and of these guidelines, has to reflect the distinction between existing markets and competition in innovation. At the beginning of an R&D co-operation the reference point is the existing market for products capable of being improved, substituted or replaced by the products under development. If the R&D agreement only aims at improving or refining existing products, that market includes the products directly concerned by the R&D. Market shares can thus be calculated on the basis of the sales value of the existing products.

124. If the R&D aims at replacing an existing product, the new product will, if successful, become a substitute for the existing products. To assess the competitive position of the parties, it is again possible to calculate market shares on the basis of the sales value of the existing products. Consequently, the R&D Block Exemption Regulation bases its exemption of those situations on the market share in the relevant market for the products capable of being improved, substituted or replaced by the contract products ([1]). To fall under the R&D Block Exemption Regulation, that market share may not exceed 25 % ([2]).

125. For technology markets one way to proceed is to calculate market shares on the basis of each technology's share of total licensing income from royalties, representing a technology's share of the market where competing technologies are licensed. However, this may often be a mere theoretical and not very practical way to proceed because of lack of clear information on royalties, the use of royalty free cross-licensing, etc. An alternative approach is to calculate market shares on the technology market on the basis of sales of products or services incorporating the licensed technology on downstream product markets. Under that approach all sales on the relevant product market are taken into account, irrespective of whether the product incorporates a technology that is being licensed ([3]). Also for that market the share may not exceed 25 % (irrespective of the calculation method used) for the benefits of the R&D Block Exemption Regulation to apply.

126. If the R&D aims at developing a product which will create a completely new demand, market shares based on sales cannot be calculated. Only an analysis of the effects of the agreement on competition in innovation is possible. Consequently, the R&D Block Exemption Regulation treats those agreements as agreements between non-competitors and exempts them irrespective of market share for the duration of the joint R&D and an additional period of seven years after the product is first put on the market ([4]). However, the benefit of the block exemption may be withdrawn if the agreement eliminated effective competition in innovation ([5]). After the seven year period, market shares based on sales value can be calculated, and the market share threshold of 25 % applies ([6]).

3.3. **Assessment under Article 101(1)**

3.3.1. *Main competition concerns*

127. R&D co-operation can restrict competition in various ways. First, it may reduce or slow down innovation, leading to fewer or worse products coming to the market later than they otherwise would. Secondly, on product or technology markets the R&D co-operation may reduce significantly competition between the parties outside the scope of the agreement or it may make anti-competitive coordination on those markets likely, thereby leading to higher prices. A foreclosure problem may only arise in the context of co-operation involving at least one player with a significant degree of market power (which does not necessarily amount to dominance) for a key technology and the exclusive exploitation of the results.

([1]) Point (u) of Article 1(1) of the R&D Block Exemption Regulation.
([2]) Article 4(2) of the R&D Block Exemption Regulation.
([3]) See also Technology Transfer Guidelines, paragraph 23.
([4]) Article 4(1) of the R&D Block Exemption Regulation.
([5]) See recitals 19, 20 and 21 in the preamble to the R&D Block Exemption Regulation.
([6]) Article 4(3) of the R&D Block Exemption Regulation.

3.3.2. *Restrictions of competition by object*

128. R&D agreements restrict competition by object if they do not truly concern joint R&D, but serve as a tool to engage in a disguised cartel, that is to say, otherwise prohibited price fixing, output limitation or market allocation. However, an R&D agreement which includes the joint exploitation of possible future results is not necessarily restrictive of competition.

3.3.3. *Restrictive effects on competition*

129. Most R&D agreements do not fall under Article 101(1). First, this can be said for many agreements relating to co-operation in R&D at a rather early stage, far removed from the exploitation of possible results.

130. Moreover, R&D co-operation between non-competitors does generally not give rise to restrictive effects on competition [1]. The competitive relationship between the parties has to be analysed in the context of affected existing markets and/or innovation. If, on the basis of objective factors, the parties are not able to carry out the necessary R&D independently, for instance, due to the limited technical capabilities of the parties, the R&D agreement will normally not have any restrictive effects on competition. This can apply, for example, to companies bringing together complementary skills, technologies and other resources. The issue of potential competition has to be assessed on a realistic basis. For instance, parties cannot be defined as potential competitors simply because the co-operation enables them to carry out the R&D activities. The decisive question is whether each party independently has the necessary means as regards assets, know-how and other resources.

131. Outsourcing of previously captive R&D is a specific form of R&D co-operation. In such a scenario, the R&D is often carried out by specialised companies, research institutes or academic bodies, which are not active in the exploitation of the results. Normally, such agreements are combined with a transfer of know-how and/or an exclusive supply clause concerning the possible results, which, due to the complementary nature of the co-operating parties in such a scenario, do not give rise to restrictive effects on competition within the meaning of Article 101(1).

132. R&D co-operation which does not include the joint exploitation of possible results by means of licensing, production and/or marketing rarely gives rise to restrictive effects on competition within the meaning of Article 101(1). Those pure R&D agreements can only cause a competition problem if competition with respect to innovation is appreciably reduced, leaving only a limited number of credible competing R&D poles.

133. R&D agreements are only likely to give rise to restrictive effects on competition where the parties to the co-operation have market power on the existing markets and/or competition with respect to innovation is appreciably reduced.

134. There is no absolute threshold above which it can be presumed that an R&D agreement creates or maintains market power and thus is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). However, R&D agreements between competitors are covered by the R&D Block Exemption Regulation provided that their combined market share does not exceed 25 % and that the other conditions for the application of the R&D Block Exemption Regulation are fulfilled.

135. Agreements falling outside the R&D Block Exemption Regulation because the combined market share of the parties exceeds 25 % do not necessarily give rise to restrictive effects on competition. However,

[1] R&D co-operation between non-competitors can, however, produce foreclosure effects under Article 101(1) if it relates to an exclusive exploitation of results and if it is concluded between companies, one of which has a significant degree of market power (which does not necessarily amount to dominance) with respect to a key technology.

the stronger the combined position of the parties on existing markets and/or the more competition in innovation is restricted, the more likely it is that the R&D agreement can cause restrictive effects on competition ([1]).

136. If the R&D is directed at the improvement or refinement of existing products or technologies, possible effects concern the relevant market(s) for those existing products or technologies. Effects on prices, output, product quality, product variety or innovation in existing markets are, however, only likely if the parties together have a strong position, entry is difficult and few other innovation activities are identifiable. Furthermore, if the R&D only concerns a relatively minor input of a final product, effects on competition in those final products are, if any, very limited.

137. In general, a distinction has to be made between pure R&D agreements and agreements providing for more comprehensive co-operation involving different stages of the exploitation of results (that is to say, licensing, production or marketing). As set out in paragraph 132, pure R&D agreements will only rarely give rise to restrictive effects on competition within the meaning of Article 101(1). This is in particular true for R&D directed towards a limited improvement of existing products or technologies. If, in such a scenario, the R&D co-operation includes joint exploitation only by means of licensing to third parties, restrictive effects such as foreclosure problems are unlikely. If, however, joint production and/or marketing of the slightly improved products or technologies are included, the effects on competition of the co-operation have to be examined more closely. Restrictive effects on competition in the form of increased prices or reduced output in existing markets are more likely if strong competitors are involved in such a situation.

138. If the R&D is directed at an entirely new product (or technology) which creates its own new market, price and output effects on existing markets are rather unlikely. The analysis has to focus on possible restrictions of innovation concerning, for instance, the quality and variety of possible future products or technologies or the speed of innovation. Those restrictive effects can arise where two or more of the few companies engaged in the development of such a new product start to co-operate at a stage where they are each independently rather near to the launch of the product. Such effects are typically the direct result of the agreement between the parties. Innovation may be restricted even by a pure R&D agreement. In general, however, R&D co-operation concerning entirely new products is unlikely to give rise to restrictive effects on competition unless only a limited number of credible alternative R&D poles exist. This principle does not change significantly if the joint exploitation of the results, even joint marketing, is involved. In those situations the issue of joint exploitation may only give rise to restrictive effects on competition where foreclosure from key technologies plays a role. Those problems would, however, not arise where the parties grant licences that allow third parties to compete effectively.

139. Many R&D agreements will lie somewhere in between the two situations described in paragraphs 137 and 138. They may therefore have effects on innovation as well as repercussions on existing markets. Consequently, both the existing market and the effect on innovation may be of relevance for the assessment with respect to the parties' combined positions, concentration ratios, number of players or innovators and entry conditions. In some cases there can be restrictive effects on competition in the form of increased prices or reduced output, product quality, product variety or innovation in existing markets and in the form of a negative impact on innovation by means of slowing down the development. For instance, if significant competitors on an existing technology market co-operate to develop a new technology which may one day replace existing products that co-operation may slow down the development of the new technology if the parties have market power on the existing market and also a strong position with respect to R&D. A similar effect can occur if the major player in an existing market co-operates with a much smaller or even potential competitor who is just about to emerge with a new product or technology which may endanger the incumbent's position.

([1]) This is without prejudice to the analysis of potential efficiency gains, including those that regularly exist in publicly co-funded R&D.

140. Agreements may also fall outside the R&D Block Exemption Regulation irrespective of the parties' market power. This applies for instance to agreements which unduly restrict access of a party to the results of the R&D co-operation [1]. The R&D Block Exemption Regulation provides for a specific exception to this general rule in the case of academic bodies, research institutes or specialised companies which provide R&D as a service and which are not active in the industrial exploitation of the results of R&D [2]. Nevertheless, agreements falling outside the R&D Block Exemption Regulation and containing exclusive access rights for the purposes of exploitation may, where they fall under Article 101(1), fulfil the criteria of Article 101(3), particularly where exclusive access rights are economically indispensable in view of the market, risks and scale of the investment required to exploit the results of the research and development.

3.4. **Assessment under Article 101(3)**

3.4.1. *Efficiency gains*

141. Many R&D agreements – with or without joint exploitation of possible results – bring about efficiency gains by combining complementary skills and assets, thus resulting in improved or new products and technologies being developed and marketed more rapidly than would otherwise be the case. R&D agreements may also lead to a wider dissemination of knowledge, which may trigger further innovation. R&D agreements may also give rise to cost reductions.

3.4.2. *Indispensability*

142. Restrictions that go beyond what is necessary to achieve the efficiency gains generated by an R&D agreement do not fulfil the criteria of Article 101(3). In particular, the restrictions listed in Article 5 of the R&D Block Exemption Regulation may mean it is less likely that the criteria of Article 101(3) will be found to be met, following an individual assessment. It will therefore generally be necessary for the parties to an R&D agreement to show that such restrictions are indispensable to the co-operation.

3.4.3. *Pass-on to consumers*

143. Efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects on competition caused by the R&D agreement. For example, the introduction of new or improved products on the market must outweigh any price increases or other restrictive effects on competition. In general, it is more likely that an R&D agreement will bring about efficiency gains that benefit consumers if the R&D agreement results in the combination of complementary skills and assets. The parties to an agreement may, for instance, have different research capabilities. If, on the other hand, the parties' skills and assets are very similar, the most important effect of the R&D agreement may be the elimination of part or all of the R&D of one or more of the parties. This would eliminate (fixed) costs for the parties to the agreement but would be unlikely to lead to benefits which would be passed on to consumers. Moreover, the higher the market power of the parties the less likely they are to pass on the efficiency gains to consumers to an extent that would outweigh the restrictive effects on competition.

3.4.4. *No elimination of competition*

144. The criteria of Article 101(3) cannot be met if the parties are afforded the possibility of eliminating competition in respect of a substantial part of the products (or technologies) in question.

3.4.5. *Time of the assessment*

145. The assessment of restrictive agreements under Article 101(3) is made within the actual context in which they occur and on the basis of the facts existing at any given point in time. The assessment is sensitive to material changes in the facts. The exception rule of Article 101(3) applies as long as the four conditions of Article 101(3) are fulfilled and ceases to apply when that is no longer the case. When applying Article 101(3) in accordance with those principles it is necessary to take into account the initial sunk investments made by any of the parties and the time needed and the restraints

[1] See Article 3(2) of the R&D Block Exemption Regulation.
[2] See Article 3(2) of the R&D Block Exemption Regulation.

required to making and recouping an efficiency enhancing investment. Article 101 cannot be applied without taking due account of such *ex ante* investment. The risk facing the parties and the sunk investment that must be made to implement the agreement can thus lead to the agreement falling outside Article 101(1) or fulfilling the conditions of Article 101(3), as the case may be, for the period of time needed to recoup the investment. Should the invention resulting from the investment benefit from any form of exclusivity granted to the parties under rules specific to the protection of intellectual property rights, the recoupment period for such an investment will generally be unlikely to exceed the exclusivity period established under those rules.

146. In some cases the restrictive agreement is an irreversible event. Once the restrictive agreement has been implemented the *ex ante* situation cannot be re-established. In such cases the assessment must be made exclusively on the basis of the facts pertaining at the time of implementation. For instance, in the case of an R&D agreement whereby each party agrees to abandon its respective research project and pool its capabilities with those of another party, it may from an objective point of view be technically and economically impossible to revive a project once it has been abandoned. The assessment of the anti-competitive and pro-competitive effects of the agreement to abandon the individual research projects must therefore be made as of the time of the completion of its implementation. If at that point in time the agreement is compatible with Article 101, for instance because a sufficient number of third parties have competing R&D projects, the parties' agreement to abandon their individual projects remains compatible with Article 101, even if at a later point in time the third party projects fail. However, the prohibition of Article 101 may apply to other parts of the agreement in respect of which the issue of irreversibility does not arise. If, for example, in addition to joint R&D, the agreement provides for joint exploitation, Article 101 may apply to that part of the agreement if, due to subsequent market developments, the agreement gives rise to restrictive effects on competition and does not (any longer) satisfy the conditions of Article 101(3) taking due account of *ex ante* sunk investments.

3.5. **Examples**

147. Impact of joint R&D on innovation markets/new product market

Example 1

Situation: A and B are the two major companies on the Union-wide market for the manufacture of existing electronic components. Both have a market share of 30 %. They have each made significant investments in the R&D necessary to develop miniaturised electronic components and have developed early prototypes. They now agree to pool those R&D efforts by setting up a joint venture to complete the R&D and produce the components, which will be sold back to the parents, who will commercialise them separately. The remainder of the market consists of small companies without sufficient resources to undertake the necessary investments.

Analysis: Miniaturised electronic components, while likely to compete with the existing components in some areas, are essentially a new technology and an analysis must be made of the poles of research destined towards that future market. If the joint venture goes ahead then only one route to the necessary manufacturing technology will exist, whereas it would appear likely that A and B could reach the market individually with separate products. The agreement therefore reduces product variety. The joint production is also likely to directly limit competition between the parties to the agreement and lead them to agree on output levels, quality or other competitively important parameters. This would limit competition even though the parties will commercialise the products independently. The parties could, for instance, limit the output of the joint venture compared to what the parties would have brought to the market if they had decided their output on their own. The joint venture could also charge a high transfer price to the parties, thereby increasing the input costs for the parties which could lead to higher downstream prices. The parties have a large combined market share on the existing downstream market and the remainder of that market is fragmented. This situation is likely to become even more pronounced on the new downstream product market since the smaller competitors cannot invest in the new components. It is therefore quite likely that the joint production will restrict competition.

Furthermore, the market for miniaturised electronic components is in the future likely to develop into a duopoly with a high degree of commonality of costs and possible exchange of commercially sensitive information between the parties. There may therefore also be a serious risk of anti-competitive coordination leading to a collusive outcome in the market. The R&D agreement is therefore likely to give rise to restrictive effects on competition within the meaning of Article 101(1). While the agreement could give rise to efficiency gains in the form of bringing a new technology forward quicker, the parties would face no competition at the R&D level, so their incentives to pursue the new technology at a high pace could be severely reduced. Although some of those concerns could be remedied if the parties committed to license key know-how for manufacturing miniature components to third parties on reasonable terms, it seems unlikely that this could remedy all concerns and fulfil the conditions of Article 101(3).

Example 2

Situation: A small research company (Company A) which does not have its own marketing organisation has discovered and patented a pharmaceutical substance based on new technology that will revolutionise the treatment of a certain disease. Company A enters into an R&D agreement with a large pharmaceutical producer Company B of products that have so far been used for treating the disease. Company B lacks any similar expertise and R&D programme and would not be able to build such expertise within a relevant timeframe. For the existing products Company B has a market share of around 75 % in all Member States, but the patents will expire over the next five years. There exist two other poles of research with other companies at approximately the same stage of development using the same basic new technology. Company B will provide considerable funding and know-how for product development, as well as future access to the market. Company B is granted a licence for the exclusive production and distribution of the resulting product for the duration of the patent. It is expected that the product could be brought to market in five to seven years.

Analysis: The product is likely to belong to a new relevant market. The parties bring complementary resources and skills to the co-operation, and the probability of the product coming to market increases substantially. Although Company B is likely to have considerable market power on the existing market, that market power will be decreasing shortly. The agreement will not lead to a loss in R&D on the part of Company B, as it has no expertise in this area of research, and the existence of other poles of research are likely to eliminate any incentive to reduce R&D efforts. The exploitation rights during the remaining patent period are likely to be necessary for Company B to make the considerable investments needed and Company A has no marketing resources of its own. The agreement is therefore unlikely to give rise to restrictive effects on competition within the meaning of Article 101(1). Even if there were such effects, it is likely that the conditions of Article 101(3) would be fulfilled.

148. Risk of foreclosure

Example 3

Situation: A small research company (Company A) which does not have its own marketing organisation has discovered and patented a new technology that will revolutionise the market for a certain product for which there is a monopoly producer (Company B) worldwide as no competitors can compete with Company B's current technology. There exist two other poles of research with other companies at approximately the same stage of development using the same

basic new technology. Company B will provide considerable funding and know-how for product development, as well as future access to the market. Company B is granted an exclusive licence for the use of the technology for the duration of the patent and commits to funding only the development of Company A's technology.

Analysis: The product is likely to belong to a new relevant market. The parties bring complementary resources and skills to the co-operation, and the probability of the product coming to market increases substantially. However, the fact that Company B commits to Company A's new technology may be likely to lead the two competing poles of research to abandon their projects as it could be difficult to receive continued funding once they have lost the most likely potential customer for their technology. In such a situation no potential competitors would be able to challenge Company B's monopoly position in the future. The foreclosure effect of the agreement would then be likely to be considered to give rise to restrictive effects on competition within the meaning of Article 101(1). In order to benefit from Article 101(3) the parties would have to show that the exclusivity granted would be indispensable to bring the new technology to the market.

Example 4

Situation: Company A has market power on the market of which its blockbuster medicine forms part. A small company (Company B) which is engaged in pharmaceutical R&D and active pharmaceutical ingredient ('API') production has discovered and filed a patent application for a new process that makes it possible to produce the API of Company A's blockbuster in a more economic fashion and continues to develop the process for industrial production. The compound (API) patent of the blockbuster expires in a little less than three years; thereafter there will remain a number of process patents relating to the medicine. Company B considers that the new process developed by it would not infringe the existing process patents of Company A and would allow the production of a generic version of the blockbuster once the API patent has expired. Company B could either produce the product itself or license the process to interested third parties, for example, generic producers or Company A. Before concluding its research and development in this area, Company B enters into an agreement with Company A, in which Company A makes a financial contribution to the R&D project being carried out by Company B on condition that it acquires an exclusive licence for any of Company B's patents related to the R&D project. There exist two other independent poles of research to develop a non-infringing process for the production of the blockbuster medicine, but it is not yet clear that they will reach industrial production.

Analysis: The process covered by Company B's patent application does not allow for the production of a new product. It merely improves an existing production process. Company A has market power on the existing market of which the blockbuster medicine forms part. Whilst that market power would decrease significantly with the actual market entry of generic competitors, the exclusive licence makes the process developed by Company B unavailable to third parties and is thus liable to delay generic entry (not least as the product is still protected by a number of process patents) and, consequently, restricts competition within the meaning of Article 101(1). As Company A and Company B are potential competitors, the R&D Block Exemption Regulation does not apply because Company A's market share on the market of which the blockbuster medicine forms part is above 25 %. The cost savings based on the new production process for Company A are not sufficient to outweigh the restriction of competition. In any event, an exclusive licence is not indispensable to obtain the savings in the production process. Therefore, the agreement is unlikely to fulfil the conditions of Article 101(3).

149. Impact of R&D co-operation on dynamic product and technology markets and the environment

Example 5

Situation: Two engineering companies that produce vehicle components agree to set up a joint venture to combine their R&D efforts to improve the production and performance of an existing

component. The production of that component would also have a positive effect on the environment. Vehicles would consume less fuel and therefore emit less CO_2. The companies pool their existing technology licensing businesses in the area, but will continue to manufacture and sell the components separately. The two companies have market shares in the Union of 15 % and 20 % on the Original Equipment Manufacturer ('OEM') product market. There are two other major competitors together with several in-house research programmes by large vehicle manufacturers. On the world-wide market for the licensing of technology for those products the parties have shares of 20 % and 25 %, measured in terms of revenue generated, and there are two other major technologies. The product life cycle for the component is typically two to three years. In each of the last five years one of the major companies has introduced a new version or upgrade.

Analysis: Since neither company's R&D effort is aimed at a completely new product, the markets to consider are those for the existing components and for the licensing of relevant technology. The parties' combined market share on both the OEM market (35 %) and, in particular, on the technology market (45 %) are quite high. However, the parties will continue to manufacture and sell the components separately. In addition, there are several competing technologies, which are regularly improved. Moreover, the vehicle manufacturers who do not currently license their technology are also potential entrants on the technology market and thus constrain the ability of the parties to profitably raise prices. To the extent that the joint venture has restrictive effects on competition within the meaning of Article 101(1), it is likely that it would fulfil the criteria of Article 101(3). For the assessment under Article 101(3) it would be necessary to take into account that consumers will benefit from a lower consumption of fuel.

4. PRODUCTION AGREEMENTS

4.1. Definition and scope

150. Production agreements vary in form and scope. They can provide that production is carried out by only one party or by two or more parties. Companies can produce jointly by way of a joint venture, that is to say, a jointly controlled company operating one or several production facilities or by looser forms of co-operation in production such as subcontracting agreements where one party (the 'contractor') entrusts to another party (the 'subcontractor') the production of a good.

151. There are different types of subcontracting agreements. Horizontal subcontracting agreements are concluded between companies operating in the same product market irrespective of whether they are actual or potential competitors. Vertical subcontracting agreements are concluded between companies operating at different levels of the market.

152. Horizontal subcontracting agreements comprise unilateral and reciprocal specialisation agreements as well as subcontracting agreements with a view to expanding production. Unilateral specialisation agreements are agreements between two parties which are active on the same product market or markets, by virtue of which one party agrees to fully or partly cease production of certain products or to refrain from producing those products and to purchase them from the other party, which agrees to produce and supply the products. Reciprocal specialisation agreements are agreements between two or more parties which are active on the same products market or markets, by virtue of which two or more parties agree, on a reciprocal basis, to fully or partly cease or refrain from producing certain but different products and to purchase those products from the other parties, which agree to produce and supply them. In the case of subcontracting agreements with a view to expanding production the contractor entrusts the subcontractor with the production of a good, while the contractor does not at the same time cease or limit its own production of the good.

153. These guidelines apply to all forms of joint production agreements and horizontal subcontracting agreements. Subject to certain conditions, joint production agreements as well as unilateral and reciprocal specialisation agreements may benefit from the Specialisation Block Exemption Regulation.

154. Vertical subcontracting agreements are not covered by these guidelines. They fall within the scope of the Guidelines on Vertical Restraints and, subject to certain conditions, may benefit from the Block Exemption Regulation on Vertical Restraints. In addition, they may be covered by the Commission notice of 18 December 1978 concerning its assessment of certain subcontracting agreements in relation to Article 85(1) of the EEC Treaty [1] ('the Subcontracting Notice').

4.2. **Relevant markets**

155. In order to assess the competitive relationship between the co-operating parties, it is necessary first to define the relevant market or markets directly concerned by the co-operation in production, that is to say, the markets to which the products manufactured under the production agreement belong.

156. A production agreement can also have spill-over effects in markets neighbouring the market directly concerned by the co-operation, for instance upstream or downstream to the agreement (the so-called 'spill-over markets') [2]. The spill-over markets are likely to be relevant if the markets are inter-dependent and the parties are in a strong position on the spill-over market.

4.3. **Assessment under Article 101(1)**

4.3.1. *Main competition concerns*

157. Production agreements can lead to a direct limitation of competition between the parties. Production agreements, and in particular production joint ventures, may lead the parties to directly align output levels and quality, the price at which the joint venture sells on its products, or other competitively important parameters. This may restrict competition even if the parties market the products independently.

158. Production agreements may also result in the coordination of the parties' competitive behaviour as suppliers leading to higher prices or reduced output, product quality, product variety or innovation, that is to say, a collusive outcome. This can happen, subject to the parties having market power and the existence of market characteristics conducive to such coordination, in particular when the production agreement increases the parties' commonality of costs (that is to say, the proportion of variable costs which the parties have in common) to a degree which enables them to achieve a collusive outcome, or if the agreement involves an exchange of commercially sensitive information that can lead to a collusive outcome.

159. Production agreements may furthermore lead to anti-competitive foreclosure of third parties in a related market (for example, the downstream market relying on inputs from the market in which the production agreement takes place). For instance, by gaining enough market power, parties engaging in joint production in an upstream market may be able to raise the price of a key component for a market downstream. Thereby, they could use the joint production to raise the costs of their rivals downstream and, ultimately, force them off the market. This would, in turn, increase the parties' market power downstream, which could enable them to sustain prices above the competitive level or otherwise harm consumers. Such competition concerns could materialise irrespective of whether the parties to the agreement are competitors on the market in which the co-operation takes place. However, for this kind of foreclosure to have anti-competitive effects, at least one of the parties must have a strong market position in the market where the risks of foreclosure are assessed.

4.3.2. *Restrictions of competition by object*

160. Generally, agreements which involve price-fixing, limiting output or sharing markets or customers restrict competition by object. However, in the context of production agreements, this does not apply where:

[1] OJ C 1, 3.1.1979, p. 2.
[2] As also referred to in Article 2(4) of the Merger Regulation.

— the parties agree on the output directly concerned by the production agreement (for example, the capacity and production volume of a joint venture or the agreed amount of outsourced products), provided that the other parameters of competition are not eliminated; or

— a production agreement that also provides for the joint distribution of the jointly manufactured products envisages the joint setting of the sales prices for those products, and only those products, provided that that restriction is necessary for producing jointly, meaning that the parties would not otherwise have an incentive to enter into the production agreement in the first place.

161. In these two cases an assessment is required as to whether the agreement gives rise to likely restrictive effects on competition within the meaning of Article 101(1). In both scenarios the agreement on output or prices will not be assessed separately, but in the light of the overall effects of the entire production agreement on the market.

4.3.3. *Restrictive effects on competition*

162. Whether the possible competition concerns that production agreements can give rise to are likely to materialise in a given case depends on the characteristics of the market in which the agreement takes place, as well as on the nature and market coverage of the co-operation and the product it concerns. These variables determine the likely effects of a production agreement on competition and thereby the applicability of Article 101(1).

163. Whether a production agreement is likely to give rise to restrictive effects on competition depends on the situation that would prevail in the absence of the agreement with all its alleged restrictions. Consequently, production agreements between companies which compete on markets on which the co-operation occurs are not likely to have restrictive effects on competition if the co-operation gives rise to a new market, that is to say, if the agreement enables the parties to launch a new product or service, which, on the basis of objective factors, the parties would otherwise not have been able to do, for instance, due to the technical capabilities of the parties.

164. In some industries where production is the main economic activity, even a pure production agreement can in itself eliminate key dimensions of competition, thereby directly limiting competition between the parties to the agreements.

165. Alternatively, a production agreement can lead to a collusive outcome or anti-competitive foreclosure by increasing the companies' market power or their commonality of costs or if it involves the exchange of commercially sensitive information. On the other hand, a direct limitation of competition between the parties, a collusive outcome or anti-competitive foreclosure is not likely to occur if the parties to the agreement do not have market power in the market in which the competition concerns are assessed. It is only market power that can enable them to profitably maintain prices above the competitive level, or profitably maintain output, product quality or variety below what would be dictated by competition.

166. In cases where a company with market power in one market co-operates with a potential entrant, for example, with a supplier of the same product in a neighbouring geographic or product market, the agreement can potentially increase the market power of the incumbent. This can lead to restrictive effects on competition if actual competition in the incumbent's market is already weak and the threat of entry is a major source of competitive constraint.

167. Production agreements which also involve commercialisation functions, such as joint distribution or marketing, carry a higher risk of restrictive effects on competition than pure joint production agreements. Joint commercialisation brings the co-operation closer to the consumer and usually involves the joint setting of prices and sales, that is to say, practices that carry the highest risks for competition. However, joint distribution agreements for products which have been jointly produced are generally less likely to restrict competition than stand-alone joint distribution agreements. Also, a joint distribution agreement that is necessary for the joint production agreement to take place in the first place is less likely to restrict competition than if it were not necessary for the joint production.

Market power

168. A production agreement is unlikely to lead to restrictive effects on competition if the parties to the agreement do not have market power in the market on which a restriction of competition is assessed. The starting point for the analysis of market power is the market share of the parties. This will normally be followed by the concentration ratio and the number of players in the market as well as by other dynamic factors such as potential entry, and changing market shares.

169. Companies are unlikely to have market power below a certain level of market share. Therefore, unilateral or reciprocal specialisation agreements as well as joint production agreements including certain integrated commercialisation functions such as joint distribution are covered by the Specialisation Block Exemption Regulation if they are concluded between parties with a combined market share not exceeding 20 % in the relevant market or markets, provided that the other conditions for the application of the Specialisation Block Exemption Regulation are fulfilled. Moreover, as regards horizontal subcontracting agreements with a view to expanding production, in most cases it is unlikely that market power exists if the parties to the agreement have a combined market share not exceeding 20 %. In any event, if the parties' combined market share does not exceed 20 % it is likely that the conditions of Article 101(3) are fulfilled.

170. However, if the parties' combined market share exceeds 20 %, the restrictive effects have to be analysed as the agreement does not fall within the scope of the Specialisation Block Exemption Regulation or the safe harbour for horizontal subcontracting agreements with a view to expanding production referred to in sentences 3 and 4 of paragraph 169. A moderately higher market share than allowed for in the Specialisation Block Exemption Regulation or the safe harbour referred to in sentences 3 and 4 of paragraph 169 does not necessarily imply a highly concentrated market, which is an important factor in the assessment. A combined market share of the parties of slightly more than 20 % may occur in a market with a moderate concentration. Generally, a production agreement is more likely to lead to restrictive effects on competition in a concentrated market than in a market which is not concentrated. Similarly, a production agreement in a concentrated market may increase the risk of a collusive outcome even if the parties only have a moderate combined market share.

171. Even if the market shares of the parties to the agreement and the market concentration are high, the risks of restrictive effects on competition may still be low if the market is dynamic, that is to say, a market in which entry occurs and market positions change frequently.

172. In the analysis of whether the parties to a production agreement have market power, the number and intensity of links (for example, other co-operation agreements) between the competitors in the market are relevant to the assessment.

173. Factors such as whether the parties to the agreement have high market shares, whether they are close competitors, whether the customers have limited possibilities of switching suppliers, whether competitors are unlikely to increase supply if prices increase, and whether one of the parties to the agreement is an important competitive force, are all relevant for the competitive assessment of the agreement.

Direct limitation of competition between the parties

174. Competition between the parties to a production agreement can be directly limited in various ways. The parties to a production joint venture could, for instance, limit the output of the joint venture compared to what the parties would have brought to the market if each of them had decided their output on their own. If the main product characteristics are determined by the production agreement this could also eliminate the key dimensions of competition between the parties and, ultimately, lead to restrictive effects on competition. Another example would be a joint venture charging a high transfer price to the parties, thereby increasing the input costs for the parties which could lead to higher downstream prices. Competitors may find it profitable to increase their prices as a response, thereby contributing to price increases in the relevant market.

Collusive outcome

175. The likelihood of a collusive outcome depends on the parties' market power as well as the characteristics of the relevant market. A collusive outcome can result in particular (but not only) from commonality of costs or an exchange of information brought about by the production agreement.

176. A production agreement between parties with market power can have restrictive effects on competition if it increases their commonality of costs (that is to say, the proportion of variable costs which the parties have in common) to a level which enables them to collude. The relevant costs are the variable costs of the product with respect to which the parties to the production agreement compete.

177. A production agreement is more likely to lead to a collusive outcome if prior to the agreement the parties already have a high proportion of variable costs in common, as the additional increment (that is to say, the production costs of the product subject to the agreement) can tip the balance towards a collusive outcome. Conversely, if the increment is large, the risk of a collusive outcome may be high even if the initial level of commonality of costs is low.

178. Commonality of costs increases the risk of a collusive outcome only if production costs constitute a large proportion of the variable costs concerned. This is, for instance, not the case where the co-operation concerns products which require costly commercialisation. An example would be new or heterogeneous products requiring expensive marketing or high transport costs.

179. Another scenario where commonality of costs can lead to a collusive outcome could be where the parties agree on the joint production of an intermediate product which accounts for a large proportion of the variable costs of the final product with respect to which the parties compete downstream. The parties could use the production agreement to increase the price of that common important input for their products in the downstream market. This would weaken competition downstream and would be likely to lead to higher final prices. The profit would be shifted from downstream to upstream to be then shared between the parties through the joint venture.

180. Similarly, commonality of costs increases the anti-competitive risks of a horizontal subcontracting agreement where the input which the contractor purchases from the subcontractor accounts for a large proportion of the variable costs of the final product with which the parties compete.

181. Any negative effects arising from the exchange of information will not be assessed separately but in the light of the overall effects of the agreement. A production agreement can give rise to restrictive effects on competition if it involves an exchange of commercially strategic information that can lead to a collusive outcome or anti-competitive foreclosure. Whether the exchange of information in the context of a production agreement is likely to lead to restrictive effects on competition should be assessed according to the guidance given in Chapter 2.

182. If the information exchange does not exceed the sharing of data necessary for the joint production of the goods subject to the production agreement, then even if the information exchange had restrictive effects on competition within the meaning of Article 101(1), the agreement would be more likely to meet the criteria of Article 101(3) than if the exchange went beyond what was necessary for the joint production. In this case the efficiency gains stemming from producing jointly are likely to outweigh the restrictive effects of the coordination of the parties' conduct. Conversely, in the context of a production agreement the sharing of data which is not necessary for producing jointly, for example the exchange of information related to prices and sales, is less likely to fulfil the conditions of Article 101(3).

4.4. **Assessment under Article 101(3)**

4.4.1. *Efficiency gains*

183. Production agreements can be pro-competitive if they provide efficiency gains in the form of cost savings or better production technologies. By producing together companies can save costs that otherwise they would duplicate. They can also produce at lower costs if the co-operation enables them to increase production where marginal costs decline with output, that is to say, by economies of scale. Producing jointly can also help companies to improve product quality if they put together their

complementary skills and know-how. Co-operation can also enable companies to increase product variety, which they could not have afforded, or would not have been able to achieve, otherwise. If joint production allows the parties to increase the number of different types of products, it can also provide cost savings by means of economies of scope.

4.4.2. *Indispensability*

184. Restrictions that go beyond what is necessary to achieve the efficiency gains generated by a production agreement do not fulfil the criteria of Article 101(3). For instance, restrictions imposed in a production agreement on the parties' competitive conduct with regard to output outside the co-operation will normally not be considered to be indispensable. Similarly, setting prices jointly will not be considered indispensable if the production agreement does not also involve joint commercialisation.

4.4.3. *Pass-on to consumers*

185. Efficiency gains attained by indispensable restrictions need to be passed on to consumers in the form of lower prices or better product quality or variety to an extent that outweighs the restrictive effects on competition. Efficiency gains that only benefit the parties or cost savings that are caused by output reduction or market allocation are not sufficient to meet the criteria of Article 101(3). If the parties to the production agreement achieve savings in their variable costs they are more likely to pass them on to consumers than if they reduce their fixed costs. Moreover, the higher the market power of the parties, the less likely they will pass on the efficiency gains to consumers to an extent that would outweigh the restrictive effects on competition.

4.4.4. *No elimination of competition*

186. The criteria of Article 101(3) cannot be met if the parties are afforded the possibility of eliminating competition in respect of a substantial part of the products in question. This has to be analysed in the relevant market to which the products subject to the co-operation belong and in any possible spill-over markets.

4.5. **Examples**

187. Commonality of costs and collusive outcomes

Example 1

Situation: Companies A and B, two suppliers of a product X decide to close their current old production plants and build a larger, modern and more efficient production plant run by a joint venture, which will have a higher capacity than the total capacity of the old plants of Companies A and B. No other such investments are planned by competitors, which are using their facilities at full capacity. Companies A and B have market shares of 20 % and 25 % respectively. Their products are the closest substitutes in a specific segment of the market, which is concentrated. The market is transparent and rather stagnant, there is no entry and the market shares have been stable over time. Production costs constitute a major part of Company A and Company B's variable costs for product X. Commercialisation is a minor economic activity in terms of costs and strategic importance compared to production: marketing costs are low as product X is homogenous and established and transport is not a key driver of competition.

Analysis: If Companies A and B share all or most of their variable costs, this production agreement could lead to a direct limitation of competition between them. It may lead the parties to limit the output of the joint venture compared to what they would have brought to the market if each of them had decided their output on their own. In the light of the capacity constraints of the competitors this reduction output could lead to higher prices.

Even if Companies A and B were not sharing most of their variable costs, but only a significant part thereof, this production agreement could lead to a collusive outcome between Companies A and B, thereby indirectly eliminating competition between the two parties. The likelihood of this depends not only on the issue of commonality of costs (which are high in this case) but also on the characteristics of the relevant market such as, for example, transparency, stability and level of concentration.

In either of the two situations mentioned above, it is likely, in the market configuration of this example, that the production joint venture of Companies A and B would give rise to restrictive effects on competition within the meaning of Article 101(1) on the market of X.

The replacement of two smaller old production plants by the larger, modern and more efficient one may lead the joint venture to increase output at lower prices to the benefits of consumers. However, the production agreement could only meet the criteria of Article 101(3) if the parties provided substantiated evidence that the efficiency gains would be passed on to consumers to such an extent that they would outweigh the restrictive effects on competition.

188. Links between competitors and collusive outcomes

Example 2

Situation: Two suppliers, Companies A and B, form a production joint venture with respect to product Y. Companies A and B each have a 15 % market share on the market for Y. There are 3 other players on the market: Company C with a market share of 30 %, Company D with 25 % and Company E with 15 %. Company B already has a joint production plant with Company D.

Analysis: The market is characterised by very few players and rather symmetric structures. Co-operation between Companies A and B would add an additional link in the market, *de facto* increasing the concentration in the market, as it would also link Company D to Companies A and B. This co-operation is likely to increase the risk of a collusive outcome and thereby likely to give rise to restrictive effects on competition within the meaning of Article 101(1). The criteria of Article 101(3) could only be fulfilled in the presence of significant efficiency gains which are passed on to consumers to such an extent that they would outweigh the restrictive effects on competition.

189. Anti-competitive foreclosure on a downstream market

Example 3

Situation: Companies A and B set up a production joint venture for the intermediate product X which covers their entire production of X. The production costs of X account for 70 % of the variable costs of the final product Y with respect to which Companies A and B compete downstream. Companies A and B each have a share of 20 % on the market for Y, there is limited entry and the market shares have been stable over time. In addition to covering their own demand for X, both Companies A and B each have a market share of 40 % on the market for X. There are high barriers to entry on the market for X and existing producers are operating near full capacity. On the market for Y, there are two other significant suppliers, each with a 15 % market share, and several smaller competitors. This agreement generates economies of scale.

Analysis: By virtue of the production joint venture, Companies A and B would be able to largely control supplies of the essential input X to their competitors in the market for Y. This would give Companies A and B the ability to raise their rivals' costs by artificially increasing the price of X, or by reducing the output. This could foreclose the competitors of Companies A and B in market for Y. Because of the likely anti-competitive foreclosure downstream, this agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). The economies of scale generated by the production joint venture are unlikely to outweigh the restrictive effects on competition and therefore this agreement would most likely not meet the criteria of Article 101(3).

190. Specialisation agreement as market allocation

Example 4

Situation: Companies A and B each manufacture both products X and Y. Company A's market share of X is 30 % and of Y 10 %. B's market share of X is 10 % and of Y 30 %. To obtain economies of scale they conclude a reciprocal specialisation agreement under which Company A will only produce X and Company B only Y. They do not cross-supply the products to each other so that Company A only sells X and Company B sells only Y. The parties claim that by specialising in this way they save costs due to the economies of scale and by focusing on only one product will improve their production technologies, which will lead to better quality products.

Analysis: With regard to its effects on competition in the market, this specialisation agreement is close to a hardcore cartel where parties allocate the market among themselves. Therefore, this agreement restricts competition by object. Because the claimed efficiencies in the form of economies of scale and improving production technology are only linked to the market allocation, they are unlikely to outweigh the restrictive effects, and therefore the agreement would not meet the criteria of Article 101(3). In any event, if Company A or B believes that it would be more efficient to focus on only one product, it can simply take the unilateral decision to only produce X or Y without at the same time agreeing that the other company will focus on producing the respective other product.

The analysis would be different if Companies A and B supplied each other with the product they focus on so that they both continue to sell X and Y. In such a case Companies A and B could still compete on price on both markets, especially if production costs (which become common through the production agreement) did not constitute a major share of the variable costs of their products. The relevant costs in this context are the commercialisation costs. Hence, the specialisation agreement would be unlikely to restrict competition if X and Y were largely heterogeneous products with a very high proportion of marketing and distribution costs (for example, 65–70 % or more of total costs). In such a scenario the risks of a collusive outcome would not be high and the criteria of Article 101(3) may be fulfilled, provided that the efficiency gains would be passed on to consumers to such an extent that they would outweigh the restrictive effects on competition of the agreement.

191. Potential competitors

Example 5

Situation: Company A produces final product X and Company B produces final product Y. X and Y constitute two separate product markets, in which Companies A and B respectively have strong market power. Both companies use Z as an input for their production of X and Y and they both produce Z for captive use only. X is a low added value product for which Z is an essential input (X is quite a simple transformation of Z). Y is a high value added product, for which Z is one of many inputs (Z constitutes a small part of variable costs of Y). Companies A and B agree to jointly produce Z, which generates modest economies of scale.

Analysis: Companies A and B are not actual competitors with regard to X, Y or Z. However, since X is a simple transformation of input Z, it is likely that Company B could easily enter the market for X and thus challenge Company A's position on that market. The joint production agreement with regard to Z might reduce Company B's incentives to do so as the joint production might be used for side payments and limit the probability of Company B selling product X (as Company A is likely to have control over the quantity of Z purchased by Company B from the joint venture). However, the probability of Company B entering the market for X in the absence of the agreement depends on the expected profitability of the entry. As X is a low added value product, entry might not be profitable and thus entry by Company B could be unlikely in the absence of the agreement. Given that Companies A and B already have market power, the agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1) if the agreement does indeed

decrease the likelihood of entry of Company B into Company A's market, that is to say, the market for X. The efficiency gains in the form of economies of scale generated by the agreement are modest and therefore unlikely to outweigh the restrictive effects on competition.

192. Information exchange in a production agreement

Example 6

Situation: Companies A and B with high market power decide to produce together to become more efficient. In the context of this agreement they secretly exchange information about their future prices. The agreement does not cover joint distribution.

Analysis: This information exchange makes a collusive outcome likely and is therefore likely have as its object the restriction of competition within the meaning of Article 101(1). It would be unlikely to meet the criteria of Article 101(3) because the sharing of information about the parties' future prices is not indispensable for producing jointly and attaining the corresponding cost savings.

193. Swaps and information exchange

Example 7

Situation: Companies A and B both produce Z, a commodity chemical. Z is a homogenous product which is manufactured according to a European standard which does not allow for any product variations. Production costs are a significant cost factor regarding Z. Company A has a market share of 20 % and Company B of 25 % on the Union-wide market for Z. There are four other manufacturers on the market for Z, with respective market shares of 20 %, 15 %, 10 % and 10 %. The production plant of Company A is located in Member State X in northern Europe whereas the production plant of Company B is located in Member State Y in southern Europe. Even though the majority of Company A's customers are located in northern Europe, Company A also has a number of customers in southern Europe. The majority of Company B's customers are in southern Europe, although it also has a number of customers located in northern Europe. Currently, Company A provides its southern European customers with Z manufactured in its production plant in Member State X and transports it to southern Europe by truck. Similarly, Company B provides its northern European customers with Z manufactured in Member State Y and transports it to northern Europe by truck. Transport costs are quite high, but not so high as to make the deliveries by Company A to southern Europe and Company B to northern Europe unprofitable. Transport costs from Member State X to southern Europe are lower than from Member State Y to northern Europe.

Companies A and B decide that it would be more efficient if Company A stopped transporting Z from Member State X to southern Europe and if Company B stopped transporting the Z from Member State Y to northern Europe although, at the same time, they are keen on retaining their customers. To do so, Companies A and B intend to enter into a swap agreement which allows them to purchase an agreed annual quantity of Z from the other party's plant with a view to selling the purchased Z to those of their customers which are located closer to the other party's plant. In order to calculate a purchase price which does not favour one party over the other and which takes due account of the parties' different production costs and different savings on transport costs, and in order to ensure that both parties can achieve an appropriate margin, they agree to disclose to each other their main costs with regard to Z (that is to say, production costs and transport costs).

Analysis: The fact that Companies A and B – who are competitors – swap parts of their production does not in itself give rise to competition concerns. However, the envisaged swap agreement between Companies A and B provides for the exchange of both parties' production and transport costs with regard to Z. Moreover, Companies A and B have a strong combined market position in a fairly concentrated market for a homogenous commodity product. Therefore, due to the extensive information exchange on a key parameter of competition with regard to Z, it is

likely that the swap agreement between Companies A and B will give rise to restrictive effects on competition within the meaning of Article 101(1) as it can lead to a collusive outcome. Even though the agreement will give rise to significant efficiency gains in the form of cost savings for the parties, the restrictions on competition generated by the agreement are not indispensable for their attainment. The parties could achieve similar cost savings by agreeing on a price formula which does not entail the disclosure of their production and transport costs. Consequently, in its current form the swap agreement does not fulfil the criteria of Article 101(3).

5. PURCHASING AGREEMENTS

5.1. Definition

194. This chapter focuses on agreements concerning the joint purchase of products. Joint purchasing can be carried out by a jointly controlled company, by a company in which many other companies hold non-controlling stakes, by a contractual arrangement or by even looser forms of co-operation (collectively referred to as 'joint purchasing arrangements'). Joint purchasing arrangements usually aim at the creation of buying power which can lead to lower prices or better quality products or services for consumers. However, buying power may, under certain circumstances, also give rise to competition concerns.

195. Joint purchasing arrangements may involve both horizontal and vertical agreements. In these cases a two-step analysis is necessary. First, the horizontal agreements between the companies engaging in joint purchasing have to be assessed according to the principles described in these guidelines. If that assessment leads to the conclusion that the joint purchasing arrangement does not give rise to competition concerns, a further assessment will be necessary to examine the relevant vertical agreements. The latter assessment will follow the rules of the Block Exemption Regulation on Vertical Restraints and the Guidelines on Vertical Restraints.

196. A common form of joint purchasing arrangement is an 'alliance', that is to say an association of undertakings formed by a group of retailers for the joint purchasing of products. Horizontal agreements concluded between the members of the alliance or decisions adopted by the alliance first have to be assessed as a horizontal co-operation agreement according to these guidelines. Only if that assessment does not reveal any competition concerns does it become relevant to assess the relevant vertical agreements between the alliance and an individual member thereof and between the alliance and suppliers. Those agreements are covered – subject to certain conditions – by the Block Exemption Regulation on Vertical Restraints. Vertical agreements not covered by that Block Exemption Regulation are not presumed to be illegal but require individual examination.

5.2. Relevant markets

197. There are two markets which may be affected by joint purchasing arrangements. First, the market or markets with which the joint purchasing arrangement is directly concerned, that is to say, the relevant purchasing market or markets. Secondly, the selling market or markets, that is to say, the market or markets downstream where the parties to the joint purchasing arrangement are active as sellers.

198. The definition of relevant purchasing markets follows the principles described in the Market Definition Notice and is based on the concept of substitutability to identify competitive constraints. The only difference from the definition of 'selling markets' is that substitutability has to be defined from the viewpoint of supply and not from the viewpoint of demand. In other words, the suppliers' alternatives are decisive in identifying the competitive constraints on purchasers. Those alternatives could be analysed, for instance, by examining the suppliers' reaction to a small but non-transitory price decrease. Once the market is defined, the market share can be calculated as the percentage of the purchases by the parties out of the total sales of the purchased product or products in the relevant market.

199. If the parties are, in addition, competitors on one or more selling markets, those markets are also relevant for the assessment. The selling markets have to be defined by applying the methodology described in the Market Definition Notice.

5.3. **Assessment under Article 101(1)**

5.3.1. *Main competition concerns*

200. Joint purchasing arrangements may lead to restrictive effects on competition on the purchasing and/or downstream selling market or markets, such as increased prices, reduced output, product quality or variety, or innovation, market allocation, or anti-competitive foreclosure of other possible purchasers.

201. If downstream competitors purchase a significant part of their products together, their incentives for price competition on the selling market or markets may be considerably reduced. If the parties have a significant degree of market power (which does not necessarily amount to dominance) on the selling market or markets, the lower purchase prices achieved by the joint purchasing arrangement are likely not to be passed on to consumers.

202. If the parties have a significant degree of market power on the purchasing market (buying power) there is a risk that they may force suppliers to reduce the range or quality of products they produce, which may bring about restrictive effects on competition such as quality reductions, lessening of innovation efforts, or ultimately sub-optimal supply.

203. Buying power of the parties to the joint purchasing arrangement could be used to foreclose competing purchasers by limiting their access to efficient suppliers. This is most likely if there are a limited number of suppliers and there are barriers to entry on the supply side of the upstream market.

204. In general, however, joint purchasing arrangements are less likely to give rise to competition concerns when the parties do not have market power on the selling market or markets.

5.3.2. *Restrictions of competition by object*

205. Joint purchasing arrangements restrict competition by object if they do not truly concern joint purchasing, but serve as a tool to engage in a disguised cartel, that is to say, otherwise prohibited price fixing, output limitation or market allocation.

206. Agreements which involve the fixing of purchase prices can have the object of restricting competition within the meaning of Article 101(1) ([1]). However, this does not apply where the parties to a joint purchasing arrangement agree on the purchasing prices the joint purchasing arrangement may pay to its suppliers for the products subject to the supply contract. In that case an assessment is required as to whether the agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). In both scenarios the agreement on purchase prices will not be assessed separately, but in the light of the overall effects of the purchasing agreement on the market.

5.3.3. *Restrictive effects on competition*

207. Joint purchasing arrangements which do not have as their object the restriction of competition must be analysed in their legal and economic context with regard to their actual and likely effects on competition. The analysis of the restrictive effects on competition generated by a joint purchasing arrangement must cover the negative effects on both the purchasing and the selling markets.

Market power

208. There is no absolute threshold above which it can be presumed that the parties to a joint purchasing arrangement have market power so that the joint purchasing arrangement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). However, in most cases it is unlikely that market power exists if the parties to the joint purchasing arrangement have a combined market share not exceeding 15 % on the purchasing market or markets as well as a combined market share not exceeding 15 % on the selling market or markets. In any event, if the parties' combined market shares do not exceed 15 % on both the purchasing and the selling market or markets, it is likely that the conditions of Article 101(3) are fulfilled.

([1]) See Article 101(1)(a); Joined Cases T-217/03 and T-245/03, *French Beef*, paragraphs 83 *et seq.*; Case C-8/08, *T-Mobile Netherlands,* paragraph 37.

209. A market share above that threshold in one or both markets does not automatically indicate that the joint purchasing arrangement is likely to give rise to restrictive effects on competition. A joint purchasing arrangement which does not fall within that safe harbour requires a detailed assessment of its effects on the market involving, but not limited to, factors such as market concentration and possible countervailing power of strong suppliers.

210. Buying power may, under certain circumstances, cause restrictive effects on competition. Anti-competitive buying power is likely to arise if a joint purchasing arrangement accounts for a sufficiently large proportion of the total volume of a purchasing market so that access to the market may be foreclosed to competing purchasers. A high degree of buying power may indirectly affect the output, quality and variety of products on the selling market.

211. In the analysis of whether the parties to a joint purchasing arrangement have buying power, the number and intensity of links (for example, other purchasing agreements) between the competitors in the market are relevant.

212. If, however, competing purchasers co-operate who are not active on the same relevant selling market (for example, retailers which are active in different geographic markets and cannot be regarded as potential competitors), the joint purchasing arrangement is unlikely to have restrictive effects on competition unless the parties have a position in the purchasing markets that is likely to be used to harm the competitive position of other players in their respective selling markets.

Collusive outcome

213. Joint purchasing arrangements may lead to a collusive outcome if they facilitate the coordination of the parties' behaviour on the selling market. This can be the case if the parties achieve a high degree of commonality of costs through joint purchasing, provided the parties have market power and the market characteristics are conducive to coordination.

214. Restrictive effects on competition are more likely if the parties to the joint purchasing arrangement have a significant proportion of their variable costs in the relevant downstream market in common. This is, for instance, the case if retailers, which are active in the same relevant retail market or markets, jointly purchase a significant amount of the products they offer for resale. It may also be the case if competing manufacturers and sellers of a final product jointly purchase a high proportion of their input together.

215. The implementation of a joint purchasing arrangement may require the exchange of commercially sensitive information such as purchase prices and volumes. The exchange of such information may facilitate coordination with regard to sales prices and output and thus lead to a collusive outcome on the selling markets. Spill-over effects from the exchange of commercially sensitive information can, for example, be minimised where data is collated by a joint purchasing arrangement which does not pass on the information to the parties thereto.

216. Any negative effects arising from the exchange of information will not be assessed separately but in the light of the overall effects of the agreement. Whether the exchange of information in the context of a joint purchasing arrangement is likely to lead to restrictive effects on competition should be assessed according to the guidance given in Chapter 2. If the information exchange does not exceed the sharing of data necessary for the joint purchasing of the products by the parties to the joint purchasing arrangement, then even if the information exchange has restrictive effects on competition within the meaning of Article 101(1), the agreement is more likely to meet the criteria of Article 101(3) than if the exchange goes beyond what was necessary for the joint purchasing.

5.4. **Assessment under Article 101(3)**

5.4.1. *Efficiency gains*

217. Joint purchasing arrangements can give rise to significant efficiency gains. In particular, they can lead to cost savings such as lower purchase prices or reduced transaction, transportation and storage costs, thereby facilitating economies of scale. Moreover, joint purchasing arrangements may give rise to qualitative efficiency gains by leading suppliers to innovate and introduce new or improved products on the markets.

5.4.2. *Indispensability*

218. Restrictions that go beyond what is necessary to achieve the efficiency gains generated by a purchasing agreement do not meet the criteria of Article 101(3). An obligation to purchase exclusively through the co-operation may, in certain cases, be indispensable to achieve the necessary volume for the realisation of economies of scale. However, such an obligation has to be assessed in the context of the individual case.

5.4.3. *Pass-on to consumers*

219. Efficiency gains, such as cost efficiencies or qualitative efficiencies in the form of the introduction of new or improved products on the market, attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects of competition caused by the joint purchasing arrangement. Hence, cost savings or other efficiencies that only benefit the parties to the joint purchasing arrangement will not suffice. Cost savings need to be passed on to consumers, that is to say, the parties' customers. To take a notable example, this pass-on may occur through lower prices on the selling markets. Lower purchasing prices resulting from the mere exercise of buying power are not likely to be passed on to consumers if the purchasers together have market power on the selling markets, and thus do not meet the criteria of Article 101(3). Moreover, the higher the market power of the parties on the selling market or markets the less likely they will pass on the efficiency gains to consumers to an extent that would outweigh the restrictive effects on competition.

5.4.4. *No elimination of competition*

220. The criteria of Article 101(3) cannot be fulfilled if the parties are afforded the possibility of eliminating competition in respect of a substantial part of the products in question. That assessment has to cover both purchasing and selling markets.

5.5. **Examples**

221. Joint purchasing by small companies with moderate combined market shares

Example 1

Situation: 150 small retailers conclude an agreement to form a joint purchasing organisation. They are obliged to purchase a minimum volume through the organisation, which accounts for roughly 50 % of each retailer's total costs. The retailers can purchase more than the minimum volume through the organisation, and they may also purchase outside the co-operation. They have a combined market share of 23 % on both the purchasing and the selling markets. Company A and Company B are their two large competitors. Company A has a 25 % share on both the purchasing and selling markets, Company B 35 %. There are no barriers which would prevent the remaining smaller competitors from also forming a purchasing group. The 150 retailers achieve substantial cost savings by virtue of purchasing jointly through the purchasing organisation.

Analysis: The retailers have a moderate market position on the purchasing and the selling markets. Furthermore, the co-operation brings about some economies of scale. Even though the retailers achieve a high degree of commonality of costs, they are unlikely to have market power on the selling market due to the market presence of Companies A and B, which are both individually larger than the joint purchasing organisation. Consequently, the retailers are unlikely to coordinate their behaviour and reach a collusive outcome. The formation of the joint purchasing organisation is therefore unlikely to give rise to restrictive effects on competition within the meaning of Article 101(1).

222. Commonality of costs and market power on the selling market

Example 2

Situation: Two supermarket chains conclude an agreement to jointly purchase products which account for roughly 80 % of their variable costs. On the relevant purchasing markets for the

different categories of products the parties have combined market shares between 25 % and 40 %. On the relevant selling market they have a combined market share of 60 %. There are four other significant retailers each with a 10 % market share. Market entry is not likely.

Analysis: It is likely that this purchasing agreement would give the parties the ability to coordinate their behaviour on the selling market, thereby leading to a collusive outcome. The parties have market power on the selling market and the purchasing agreement gives rise to a significant commonality of costs. Moreover, market entry is unlikely. The incentive for the parties to coordinate their behaviour would be reinforced if their cost structures were already similar prior to concluding the agreement. Moreover, similar margins of the parties would further increase the risk of a collusive outcome. This agreement also creates the risk that by the parties' withholding demand and, consequently, as a result of reduced quantity, downstream selling prices would increase. Hence, the purchasing agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). Even though the agreement is very likely to give rise to efficiency gains in the form of cost savings, due to the parties' significant market power on the selling market, these are unlikely to be passed on to consumers to an extent that would outweigh the restrictive effects on competition. Therefore, the purchasing agreement is unlikely to fulfil the criteria of Article 101(3).

223. Parties active in different geographic markets

Example 3

Situation: Six large retailers, which are each based in a different Member State, form a purchasing group to buy several branded durum wheat flour-based products jointly. The parties are allowed to purchase other similar branded products outside the co-operation. Moreover, five of them also offer similar private label products. The members of the purchasing group have a combined market share of approximately 22 % on the relevant purchasing market, which is Union-wide. In the purchasing market there are three other large players of similar size. Each of the parties to the purchasing group has a market share between 20 % and 30 % on the national selling markets on which they are active. None of them is active in a Member State where another member of the group is active. The parties are not potential entrants to each other's markets.

Analysis: The purchasing group will be able to compete with the other existing major players on the purchasing market. The selling markets are much smaller (in turnover and geographic scope) than the Union-wide purchasing market and in those markets some of the members of the group may have market power. Even if the members of the purchasing group have a combined market share of more than 15 % on the purchasing market, the parties are unlikely to coordinate their conduct and collude on the selling markets since they are neither actual nor potential competitors on the downstream markets. Consequently, the purchasing group is not likely to give rise to restrictive effects on competition within the meaning of Article 101(1).

224. Information exchange

Example 4

Situation: Three competing manufacturers A, B and C entrust an independent joint purchasing organisation with the purchase of product Z, which is an intermediary product used by the three parties for their production of the final product X. The costs of Z are not a significant cost factor for the production of X. The joint purchasing organisation does not compete with the parties on the selling market for X. All information necessary for the purchases (for example quality specifications, quantities, delivery dates, maximum purchase prices) is only disclosed to the joint purchasing organisation, not to the other parties. The joint purchasing organisation agrees the purchasing prices with the suppliers. A, B and C have a combined market share of 30 % on each of the purchasing and selling markets. They have six competitors in the purchasing and selling markets, two of which have a market share of 20 %.

Analysis: Since there is no direct information exchange between the parties, the transfer of the information necessary for the purchases to the joint purchasing organisation is unlikely to lead to a collusive outcome. Consequently, the exchange of information is unlikely to give rise to restrictive effects on competition within the meaning of Article 101(1).

6. AGREEMENTS ON COMMERCIALISATION

6.1. Definition

225. Commercialisation agreements involve co-operation between competitors in the selling, distribution or promotion of their substitute products. This type of agreement can have widely varying scope, depending on the commercialisation functions which are covered by the co-operation. At one end of the spectrum, joint selling agreements may lead to a joint determination of all commercial aspects related to the sale of the product, including price. At the other end, there are more limited agreements that only address one specific commercialisation function, such as distribution, after-sales service, or advertising.

226. An important category of those more limited agreements is distribution agreements. The Block Exemption Regulation on Vertical Restraints and Guidelines on Vertical Restraints generally cover distribution agreements unless the parties to the agreement are actual or potential competitors. If the parties are competitors, the Block Exemption Regulation on Vertical Restraints only covers non-reciprocal vertical agreements between competitors, if (a) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level or, (b) the supplier is a provider of services at several levels of trade, while the buyer provides its goods or services at the retail level and does not provide competing services at the level of trade where it purchases the contract services ([1]).

227. If competitors agree to distribute their substitute products on a reciprocal basis (in particular if they do so on different geographic markets) there is a possibility in certain cases that the agreements have as their object or effect the partitioning of markets between the parties or that they lead to a collusive outcome. The same can be true for non-reciprocal agreements between competitors. Reciprocal agreements and non-reciprocal agreements between competitors thus have first to be assessed according to the principles set out in this Chapter. If that assessment leads to the conclusion that co-operation between competitors in the area of distribution would in principle be acceptable, a further assessment will be necessary to examine the vertical restraints included in such agreements. That second step of the assessment should be based on the principles set out in the Guidelines on Vertical Restraints.

228. A further distinction should be drawn between agreements where the parties agree only on joint commercialisation and agreements where the commercialisation is related to another type of co-operation upstream, such as joint production or joint purchasing. When analysing commercialisation agreements combining different stages of co-operation it is necessary to determine the centre of gravity of the co-operation in accordance with paragraphs 13 and 14.

6.2. Relevant markets

229. To assess the competitive relationship between the parties, the relevant product and geographic market or markets directly concerned by the co-operation (that is to say, the market or markets to which the products subject to the agreement belong) have to be defined. As a commercialisation agreement in one market may also affect the competitive behaviour of the parties in a neighbouring market which is closely related to the market directly concerned by the co-operation, any such neighbouring market also needs to be defined. The neighbouring market may be horizontally or vertically related to the market where the co-operation takes place.

([1]) Article 2(4) of the Block Exemption Regulation on Vertical Restraints.

6.3. **Assessment under Article 101(1)**

6.3.1. *Main competition concerns*

230. Commercialisation agreements can lead to restrictions of competition in several ways. First, and most obviously, commercialisation agreements may lead to price fixing.

231. Secondly, commercialisation agreements may also facilitate output limitation, because the parties may decide on the volume of products to be put on the market, therefore restricting supply.

232. Thirdly, commercialisation agreements may become a means for the parties to divide the markets or to allocate orders or customers, for example in cases where the parties' production plants are located in different geographic markets or when the agreements are reciprocal.

233. Finally, commercialisation agreements may also lead to an exchange of strategic information relating to aspects within or outside the scope of the co-operation or to commonality of costs – in particular with regard to agreements not encompassing price fixing – which may result in a collusive outcome.

6.3.2. *Restrictions of competition by object*

234. Price fixing is one of the major competition concerns arising from commercialisation agreements between competitors. Agreements limited to joint selling generally have the object of coordinating the pricing policy of competing manufacturers or service providers. Such agreements may not only eliminate price competition between the parties on substitute products but may also restrict the total volume of products to be delivered by the parties within the framework of a system for allocating orders. Such agreements are therefore likely to restrict competition by object.

235. That assessment does not change if the agreement is non-exclusive (that is to say, where the parties are free to sell individually outside the agreement), as long as it can be concluded that the agreement will lead to an overall coordination of the prices charged by the parties.

236. Another specific competition concern related to distribution arrangements between parties which are active in different geographic markets is that they can be an instrument of market partitioning. If the parties use a reciprocal distribution agreement to distribute each other's products in order to eliminate actual or potential competition between them by deliberately allocating markets or customers, the agreement is likely to have as its object a restriction of competition. If the agreement is not reciprocal, the risk of market partitioning is less pronounced. It is necessary, however, to assess whether the non-reciprocal agreement constitutes the basis for a mutual understanding to avoid entering each other's markets.

6.3.3. *Restrictive effects on competition*

237. A commercialisation agreement is normally not likely to give rise to competition concerns if it is objectively necessary to allow one party to enter a market it could not have entered individually or with a more limited number of parties than are effectively taking part in the co-operation, for example, because of the costs involved. A specific application of this principle would be consortia arrangements that allow the companies involved to participate in projects that they would not be able to undertake individually. As the parties to the consortia arrangement are therefore not potential competitors for implementing the project, there is no restriction of competition within the meaning of Article 101(1).

238. Similarly, not all reciprocal distribution agreements have as their object a restriction of competition. Depending on the facts of the case at hand, some reciprocal distribution agreements may, nevertheless, have restrictive effects on competition. The key issue in assessing an agreement of this type is whether the agreement in question is objectively necessary for the parties to enter each other's markets. If it is,

the agreement does not create competition problems of a horizontal nature. However, if the agreement reduces the decision-making independence of one of the parties with regard to entering the other parties' market or markets by limiting its incentives to do so, it is likely to give rise to restrictive effects on competition. The same reasoning applies to non-reciprocal agreements, where the risk of restrictive effects on competition is, however, less pronounced.

239. Moreover, a distribution agreement can have restrictive effects on competition if it contains vertical restraints, such as restrictions on passive sales, resale price maintenance, etc.

Market power

240. Commercialisation agreements between competitors can only have restrictive effects on competition if the parties have some degree of market power. In most cases, it is unlikely that market power exists if the parties to the agreement have a combined market share not exceeding 15 %. In any event, if the parties' combined market share does not exceed 15 % it is likely that the conditions of Article 101(3) are fulfilled.

241. If the parties' combined market share is greater than 15 %, their agreement will fall outside the safe harbour of paragraph 240 and thus the likely impact of the joint commercialisation agreement on the market must be assessed.

Collusive outcome

242. A joint commercialisation agreement that does not involve price fixing is also likely to give rise to restrictive effects on competition if it increases the parties' commonality of variable costs to a level which is likely to lead to a collusive outcome. This is likely to be the case for a joint commercialisation agreement if prior to the agreement the parties already have a high proportion of their variable costs in common as the additional increment (that is to say, the commercialisation costs of the product subject to the agreement) can tip the balance towards a collusive outcome. Conversely, if the increment is large, the risk of a collusive outcome may be high even if the initial level of commonality of costs is low.

243. The likelihood of a collusive outcome depends on the parties' market power and the characteristics of the relevant market. Commonality of costs can only increase the risk of a collusive outcome if the parties have market power and if the commercialisation costs constitute a large proportion of the variable costs related to the products concerned. This is, for example, not the case for homogeneous products for which the highest cost factor is production. However, commonality of commercialisation costs increases the risk of a collusive outcome if the commercialisation agreement concerns products which entail costly commercialisation, for example, high distribution or marketing costs. Consequently, joint advertising or joint promotion agreements can also give rise to restrictive effects on competition if those costs constitute a significant cost factor.

244. Joint commercialisation generally involves the exchange of sensitive commercial information, particularly on marketing strategy and pricing. In most commercialisation agreements, some degree of information exchange is required in order to implement the agreement. It is therefore necessary to verify whether the information exchange can give rise to a collusive outcome with regard to the parties' activities within and outside the co-operation. Any negative effects arising from the exchange of information will not be assessed separately but in the light of the overall effects of the agreement.

245. For example, where the parties to a joint advertising agreement exchange pricing information, this may lead to a collusive outcome with regard to the sale of the jointly advertised products. In any event, the exchange of such information in the context of a joint advertising agreement goes beyond what would be necessary to implement that agreement. The likely restrictive effects on competition of information exchange in the context of commercialisation agreements will depend on the characteristics of the market and the data shared, and should be assessed in the light of the guidance given in Chapter 2.

6.4. **Assessment under Article 101(3)**

6.4.1. *Efficiency gains*

246. Commercialisation agreements can give rise to significant efficiency gains. The efficiencies to be taken into account when assessing whether a commercialisation agreement fulfils the criteria of Article 101(3) will depend on the nature of the activity and the parties to the co-operation. Price fixing can generally not be justified, unless it is indispensable for the integration of other marketing functions, and this integration will generate substantial efficiencies. Joint distribution can generate significant efficiencies, stemming from economies of scale or scope, especially for smaller producers.

247. In addition, the efficiency gains must not be savings which result only from the elimination of costs that are inherently part of competition, but must result from the integration of economic activities. A reduction of transport cost which is only a result of customer allocation without any integration of the logistical system can therefore not be regarded as an efficiency gain within the meaning of Article 101(3).

248. Efficiency gains must be demonstrated by the parties to the agreement. An important element in this respect would be the contribution by the parties of significant capital, technology, or other assets. Cost savings through reduced duplication of resources and facilities can also be accepted. However, if the joint commercialisation represents no more than a sales agency without any investment, it is likely to be a disguised cartel and as such unlikely to fulfil the conditions of Article 101(3).

6.4.2. *Indispensability*

249. Restrictions that go beyond what is necessary to achieve the efficiency gains generated by a commercialisation agreement do not fulfil the criteria of Article 101(3). The question of indispensability is especially important for those agreements involving price fixing or market allocation, which can only under exceptional circumstances be considered indispensable.

6.4.3. *Pass-on to consumers*

250. Efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects on competition caused by the commercialisation agreement. This can happen in the form of lower prices or better product quality or variety. The higher the market power of the parties, however, the less likely it is that efficiency gains will be passed on to consumers to an extent that outweighs the restrictive effects on competition. Where the parties have a combined market share of below 15 %, it is likely that any demonstrated efficiency gains generated by the agreement will be sufficiently passed on to consumers.

6.4.4. *No elimination of competition*

251. The criteria of Article 101(3) cannot be fulfilled if the parties are afforded the possibility of eliminating competition in respect of a substantial part of the products in question. This has to be analysed in the relevant market to which the products subject to the co-operation belong and in possible spill-over markets.

6.5. **Examples**

252. Joint commercialisation necessary to enter a market

Example 1

Situation: Four companies providing laundry services in a large city close to the border of another Member State, each with a 3 % market share of the overall laundry market in that city, agree to create a joint marketing arm for the selling of laundry services to institutional customers (that is to say, hotels, hospitals and offices), whilst keeping their independence and freedom to compete for local, individual clients. In view of the new segment of demand (the institutional customers) they develop a common brand name, a common price and common standard terms including, inter alia, a maximum period of 24 hours before deliveries and schedules for delivery. They set up a common

call centre where institutional clients can request their collection and/or delivery service. They hire a receptionist (for the call centre) and several drivers. They further invest in vans for dispatching, and in brand promotion, to increase their visibility. The agreement does not fully reduce their individual infrastructure costs (since they are keeping their own premises and still compete with each other for the individual local clients), but it increases their economies of scale and allows them to offer a more comprehensive service to other types of clients, which includes longer opening hours and dispatching to a wider geographic coverage. In order to ensure the viability of the project, it is indispensable that all four of them enter into the agreement. The market is very fragmented, with no individual competitor having more than 15 % market share.

Analysis: Although the joint market share of the parties is below 15 %, the fact that the agreement involves price fixing means that Article 101(1) could apply. However, the parties would not have been in a position to enter the market for providing laundry services to institutional customers, either individually or in co-operation with a fewer number of parties than the four currently taking part in the agreement. As such, the agreement would not create competition concerns, irrespective of the price-fixing restriction, which in this case can be considered as indispensable to the promotion of the common brand and the success of the project.

253. Commercialisation agreement by more parties than necessary to enter a market

Example 2

Situation: The same facts as in Example 1, paragraph 252, apply with one main difference: in order to ensure the viability of the project, the agreement could have been implemented by only three of the parties (instead of the four actually taking part in the co-operation).

Analysis: Although the joint market share of the parties is below 15 %, the fact that the agreement involves price fixing and could have been carried out by fewer than the four parties means that Article 101(1) applies. The agreement thus needs to be assessed under Article 101(3). The agreement gives rise to efficiency gains as the parties are now able to offer improved services for a new category of customers on a larger scale (which they would not otherwise have been able to service individually). In the light of the parties' combined market share of below 15 %, it is likely that they will sufficiently pass-on any efficiency gains to consumers. It is further necessary to consider whether the restrictions imposed by the agreement are indispensable to achieve the efficiencies and whether the agreement eliminates competition. Given that the aim of the agreement is to provide a more comprehensive service (including dispatch, which was not offered before) to an additional category of customers, under a single brand with common standard terms, the price fixing can be considered as indispensable to the promotion of the common brand and, consequently, the success of the project and the resulting efficiencies. Additionally, taking into account the market fragmentation, the agreement will not eliminate competition. The fact that there are four parties to the agreement (instead of the three that would have been strictly necessary) allows for increased capacity and contributes to simultaneously fulfilling the demand of several institutional customers in compliance with the standard terms (that is to say, meeting maximum delivery time terms). As such, the efficiency gains are likely to outweigh the restrictive effects arising from the reduction of competition between the parties and the agreement is likely to fulfil the conditions of Article 101(3).

254. Joint internet platform

Example 3

Situation: A number of small specialty shops throughout a Member State join an electronic web-based platform for the promotion, sale and delivery of gift fruit baskets. There are a number of competing web-based platforms. By means of a monthly fee, they share the running costs of the platform and jointly invest in brand promotion. Through the webpage, where a wide range of different types of gift baskets are offered, customers order (and pay for) the type of gift basket they

want to be delivered. The order is then allocated to the specialty shop closest to the address of delivery. The shop individually bears the costs of composing the gift basket and delivering it to the client. It reaps 90 % of the final price, which is set by the web-based platform and uniformly applies to all participating specialty shops, whilst the remaining 10 % is used for the common promotion and the running costs of the web-based platform. Apart from the payment of the monthly fee, there are no further restrictions for specialty shops to join the platform, throughout the national territory. Moreover, specialty shops having their own company website are also able to (and in some cases do) sell gift fruit baskets on the internet under their own name and thus can still compete among themselves outside the co-operation. Customers purchasing over the web-based platform are guaranteed same day delivery of the fruit baskets and they can also choose a delivery time convenient to them.

Analysis: Although the agreement is of a limited nature, since it only covers the joint selling of a particular type of product through a specific marketing channel (the web-based platform), since it involves price-fixing, it is likely to restrict competition by object. The agreement therefore needs to be assessed under Article 101(3). The agreement gives rise to efficiency gains such as greater choice and higher quality service and the reduction of search costs, which benefit consumers and are likely to outweigh the restrictive effects on competition the agreement brings about. Given that the specialty stores taking part in the co-operation are still able to operate individually and to compete one with another, both through their shops and the internet, the price-fixing restriction could be considered as indispensable for the promotion of the product (since when buying through the web-based platform consumers do not know where they are buying the gift basket from and do not want to deal with a multitude of different prices) and the ensuing efficiency gains. In the absence of other restrictions, the agreement fulfils the criteria of Article 101(3). Moreover, as other competing web-based platforms exist and the parties continue to compete with each other, through their shops or over the internet, competition will not be eliminated.

255. Sales joint venture

Example 4

Situation: Companies A and B, located in two different Member States, produce bicycle tyres. They have a combined market share of 14 % on the Union-wide market for bicycle tyres. They decide to set up a (non full-function) sales joint venture for marketing the tyres to bicycle producers and agree to sell all their production through the joint venture. The production and transport infrastructure remains separate within each party. The parties claim considerable efficiency gains stem from the agreement. Such gains mainly relate to increased economies of scale, being able to fulfil the demands of their existing and potential new customers and better competing with imported tyres produced in third countries. The joint venture negotiates the prices and allocates orders to the closest production plant, as a way to rationalise transport costs when further delivering to the customer.

Analysis: Even though the combined market share of the parties is below 15 %, the agreement falls under Article 101(1). It restricts competition by object since it involves customer allocation and the setting of prices by the joint venture. The claimed efficiencies deriving from the agreement do not result from the integration of economic activities or from common investment. The joint venture would have a very limited scope and would only serve as an interface for allocating orders to the production plants. It is therefore unlikely that any efficiency gains would be passed on to consumers to such an extent that they would outweigh the restrictive effects on competition brought about by the agreement. Thus, the conditions of Article 101(3) would not be fulfilled.

256. Non-poaching clause in agreement on outsourcing of services

Example 5

Situation: Companies A and B are competing providers of cleaning services for commercial premises. Both have a market share of 15 %. There are several other competitors with market shares between 10 and 15 %. A has taken the (unilateral) decision to only focus on large customers in the future as servicing large and small customers has proved to require a somewhat different organisation of the work. Consequently, Company A has decided to no longer enter into contracts with new small customers. In addition, Companies A and B enter into an outsourcing agreement whereby Company B would directly provide cleaning services to Company A's existing small customers (which represent 1/3 of its customer base). At the same time, Company A is keen not to lose the customer relationship with those small customers. Hence, Company A will continue to keep its contractual relationships with the small customers but the direct provision of the cleaning services will be done by Company B. In order to implement the outsourcing agreement, Company A will necessarily need to provide Company B with the identities of Company A's small customers which are subject to the agreement. As Company A is afraid that Company B may try to poach those customers by offering cheaper direct services (thereby bypassing Company A), Company A insists that the outsourcing agreement contain a 'non-poaching clause'. According to that clause, Company B may not contact the small customers falling under the outsourcing agreements with a view to providing direct services to them. In addition, Companies A and B agree that Company B may not even provide direct services to those customers if Company B is approached by them. Without the 'non-poaching clause' Company A would not enter into an outsourcing agreement with Company B or any other company.

Analysis: The outsourcing agreement removes Company B as an independent supplier of cleaning services for Company A's small customers as they will no longer be able to enter into a direct contractual relationship with Company B. However, those customers only represent 1/3 of Company A's customer base, that is to say, 5 % of the market. They will still be able to turn to Company A and Company B's competitors, which represent 70 % of the market. Hence, the outsourcing agreement will not enable Company A to profitably raise the prices charged to the customers subject to the outsourcing agreement. In addition, the outsourcing agreement is not likely to give rise to a collusive outcome as Companies A and B only have a combined market share of 30 % and they are faced with several competitors that have market shares similar to Company A's and Company B's individual market shares. Moreover, the fact that servicing large and small customers is somewhat different minimises the risk of spill-over effects from the outsourcing agreement to Company A's and Company B's behaviour when competing for large customers. Consequently, the outsourcing agreement is not likely to give rise to restrictive effects on competition within the meaning of Article 101(1).

7. STANDARDISATION AGREEMENTS

7.1. Definition

Standardisation agreements

257. Standardisation agreements have as their primary objective the definition of technical or quality requirements with which current or future products, production processes, services or methods may comply [1]. Standardisation agreements can cover various issues, such as standardisation of different grades or sizes of a particular product or technical specifications in product or services markets where compatibility and interoperability with other products or systems is essential. The terms of access to a particular quality mark or for approval by a regulatory body can also be regarded as a standard. Agreements setting out standards on the environmental performance of products or production processes are also covered by this chapter.

[1] Standardisation can take different forms, ranging from the adoption of consensus based standards by the recognised European or national standards bodies, through consortia and fora, to agreements between independent companies.

258. The preparation and production of technical standards as part of the execution of public powers are not covered by these guidelines ([1]). The European standardisation bodies recognised under Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations and on rules on Information Society services ([2]) are subject to competition law to the extent that they can be considered to be an undertaking or an association of undertakings within the meaning of Articles 101 and 102 ([3]). Standards related to the provision of professional services, such as rules of admission to a liberal profession, are not covered by these guidelines.

Standard terms

259. In certain industries companies use standard terms and conditions of sale or purchase elaborated by a trade association or directly by the competing companies ('standard terms') ([4]). Such standard terms are covered by these guidelines to the extent that they establish standard conditions of sale or purchase of goods or services between competitors and consumers (and not the conditions of sale or purchase between competitors) for substitute products. When such standard terms are widely used within an industry, the conditions of purchase or sale used in the industry may become *de facto* aligned ([5]). Examples of industries in which standard terms play an important role are the banking (for example, bank account terms) and insurance sectors.

260. Standard terms elaborated individually by a company solely for its own use when contracting with its suppliers or customers are not horizontal agreements and are therefore not covered by these guidelines.

7.2. **Relevant markets**

261. Standardisation agreements may produce their effects on four possible markets, which will be defined according to the Market Definition Notice. First, standard-setting may have an impact on the product or service market or markets to which the standard or standards relates. Second, where the standard-setting involves the selection of technology and where the rights to intellectual property are marketed separately from the products to which they relate, the standard can have effects on the relevant technology market ([6]). Third, the market for standard-setting may be affected if different standard-setting bodies or agreements exist. Fourth, where relevant, a distinct market for testing and certification may be affected by standard-setting.

262. As regards standard terms, the effects are, in general, felt on the downstream market where the companies using the standard terms compete by selling their product to their customers.

7.3. **Assessment under Article 101(1)**

7.3.1. *Main competition concerns*

Standardisation agreements

263. Standardisation agreements usually produce significant positive economic effects ([7]), for example by promoting economic interpenetration on the internal market and encouraging the development of new and improved products or markets and improved supply conditions. Standards thus normally

([1]) See Case C-113/07, *SELEX*, [2009] ECR I-2207, paragraph 92.
([2]) OJ L 204, 21.7.1998, p. 37.
([3]) See judgment of 12 May 2010 in Case T-432/05, *EMC Development AB* v. *Commission*, not yet reported.
([4]) Such standard terms might cover only a very small part of the clauses contained in the final contract or a large part thereof.
([5]) This refers to a situation where (legally non-binding) standard terms in practice are used by most of the industry and/or for most aspects of the product/service thus leading to a limitation or even lack of consumer choice.
([6]) See Chapter 3 on R&D agreements.
([7]) See also paragraph 308.

increase competition and lower output and sales costs, benefiting economies as a whole. Standards may maintain and enhance quality, provide information and ensure interoperability and compatibility (thus increasing value for consumers).

264. Standard-setting can, however, in specific circumstances, also give rise to restrictive effects on competition by potentially restricting price competition and limiting or controlling production, markets, innovation or technical development. This can occur through three main channels, namely reduction in price competition, foreclosure of innovative technologies and exclusion of, or discrimination against, certain companies by prevention of effective access to the standard.

265. First, if companies were to engage in anti-competitive discussions in the context of standard-setting, this could reduce or eliminate price competition in the markets concerned, thereby facilitating a collusive outcome on the market ([1]).

266. Second, standards that set detailed technical specifications for a product or service may limit technical development and innovation. While a standard is being developed, alternative technologies can compete for inclusion in the standard. Once one technology has been chosen and the standard has been set, competing technologies and companies may face a barrier to entry and may potentially be excluded from the market. In addition, standards requiring that a particular technology is used exclusively for a standard or preventing the development of other technologies by obliging the members of the standard-setting organisation to exclusively use a particular standard, may lead to the same effect. The risk of limitation of innovation is increased if one or more companies are unjustifiably excluded from the standard-setting process.

267. In the context of standards involving intellectual property rights ('IPR') ([2]), three main groups of companies with different interests in standard-setting can be distinguished in the abstract ([3]). First, there are upstream-only companies that solely develop and market technologies. Their only source of income is licensing revenue and their incentive is to maximise their royalties. Secondly, there are downstream-only companies that solely manufacture products or offer services based on technologies developed by others and do not hold relevant IPR. Royalties represent a cost for them, and not a source of revenue, and their incentive is to reduce or avoid royalties. Finally, there are vertically integrated companies that both develop technology and sell products. They have mixed incentives. On the one hand, they can draw licensing revenue from their IPR. On the other hand, they may have to pay royalties to other companies holding IPR essential to the standard. They might therefore cross-license their own essential IPR in exchange for essential IPR held by other companies.

268. Third, standardisation may lead to anti-competitive results by preventing certain companies from obtaining effective access to the results of the standard-setting process (that is to say, the specification and/or the essential IPR for implementing the standard). If a company is either completely prevented from obtaining access to the result of the standard, or is only granted access on prohibitive or discriminatory terms, there is a risk of an anti-competitive effect. A system where potentially relevant IPR is disclosed up-front may increase the likelihood of effective access being granted to the standard since it allows the participants to identify which technologies are covered by IPR and which are not. This enables the participants to both factor in the potential effect on the final price of the result of the standard (for example choosing a technology without IPR is likely to have a positive effect on the final price) and to verify with the IPR holder whether they would be willing to license if their technology is included in the standard.

([1]) Depending on the circle of participants in the standard-setting process, restrictions can occur either on the supplier or on the purchaser side of the market for the standardised product.

([2]) In the context of this chapter IPR in particular refers to patent(s) (excluding non-published patent applications). However, in case any other type of IPR in practice gives the IPR holder control over the use of the standard the same principles should be applied.

([3]) In practice, many companies use a mix of these business models.

269. Intellectual property laws and competition laws share the same objectives [1] of promoting innovation and enhancing consumer welfare. IPR promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. IPR are therefore in general pro-competitive. However, by virtue of its IPR, a participant holding IPR essential for implementing the standard, could, in the specific context of standard-setting, also acquire control over the use of a standard. When the standard constitutes a barrier to entry, the company could thereby control the product or service market to which the standard relates. This in turn could allow companies to behave in anti-competitive ways, for example by 'holding-up' users after the adoption of the standard either by refusing to license the necessary IPR or by extracting excess rents by way of excessive [2] royalty fees thereby preventing effective access to the standard. However, even if the establishment of a standard can create or increase the market power of IPR holders possessing IPR essential to the standard, there is no presumption that holding or exercising IPR essential to a standard equates to the possession or exercise of market power. The question of market power can only be assessed on a case by case basis.

Standard terms

270. Standard terms can give rise to restrictive effects on competition by limiting product choice and innovation. If a large part of an industry adopts the standard terms and chooses not to deviate from them in individual cases (or only deviates from them in exceptional cases of strong buyer-power), customers might have no option other than to accept the conditions in the standard terms. However, the risk of limiting choice and innovation is only likely in cases where the standard terms define the scope of the end-product. As regards classical consumer goods, standard terms of sale generally do not limit innovation of the actual product or product quality and variety.

271. In addition, depending on their content, standard terms might risk affecting the commercial conditions of the final product. In particular, there is a serious risk that standard terms relating to price would restrict price competition.

272. Moreover, if the standard terms become industry practice, access to them might be vital for entry into the market. In such cases, refusing access to the standard terms could risk causing anti-competitive foreclosure. As long as the standard terms remain effectively open for use for anyone that wishes to have access to them, they are unlikely to give rise to anti-competitive foreclosure.

7.3.2. *Restrictions of competition by object*

Standardisation agreements

273. Agreements that use a standard as part of a broader restrictive agreement aimed at excluding actual or potential competitors restrict competition by object. For instance, an agreement whereby a national association of manufacturers sets a standard and puts pressure on third parties not to market products that do not comply with the standard or where the producers of the incumbent product collude to exclude new technology from an already existing standard [3] would fall into this category.

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[1] See Technology Transfer Guidelines, paragraph 7.

[2] High royalty fees can only be qualified as excessive if the conditions for an abuse of a dominant position as set out in Article 102 of the Treaty and the case-law of the Court of Justice of the European Union are fulfilled. See for example Case 27/76, *United Brands*, [1978] ECR 207.

[3] See for example Commission Decision in Case IV/35.691, *Pre-insulated pipes*, OJ L 24, 30.1.1999, p. 1, where part of the infringement of Article 101 consisted in 'using norms and standards in order to prevent or delay the introduction of new technology which would result in price reductions' (paragraph 147).

274. Any agreements to reduce competition by using the disclosure of most restrictive licensing terms prior to the adoption of a standard as a cover to jointly fix prices either of downstream products or of substitute IPR or technology will constitute restrictions of competition by object [1].

Standard terms

275. Agreements that use standard terms as part of a broader restrictive agreement aimed at excluding actual or potential competitors also restrict competition by object. An example would be where a trade association does not allow a new entrant access to its standards terms, the use of which is vital to ensure entry to the market.

276. Any standard terms containing provisions which directly influence the prices charged to customers (that is to say, recommended prices, rebates, etc.) would constitute a restriction of competition by object.

7.3.3. *Restrictive effects on competition*

Standardisation agreements

Agreements normally not restrictive of competition

277. Standardisation agreements which do not restrict competition by object must be analysed in their legal and economic context with regard to their actual and likely effect on competition. In the absence of market power [2], a standardisation agreement is not capable of producing restrictive effects on competition. Therefore, restrictive effects are most unlikely in a situation where there is effective competition between a number of voluntary standards.

278. For those standard-setting agreements which risk creating market power, paragraphs 280 to 286 set out the conditions under which such agreements would normally fall outside the scope of Article 101(1).

279. The non-fulfilment of any or all of the principles set out in this section will not lead to any presumption of a restriction of competition within Article 101(1). However, it will necessitate a self-assessment to establish whether the agreement falls under Article 101(1) and, if so, if the conditions of Article 101(3) are fulfilled. In this context, it is recognised that there exist different models for standard-setting and that competition within and between those models is a positive aspect of a market economy. Therefore, standard-setting organisations remain entirely free to put in place rules and procedures that do not violate competition rules whilst being different to those described in paragraphs 280 to 286.

280. Where participation in standard-setting is **unrestricted** and the procedure for adopting the standard in question is **transparent**, standardisation agreements which contain **no obligation to comply** [3] with the standard and provide **access to the standard on fair, reasonable and non-discriminatory terms** will normally not restrict competition within the meaning of Article 101(1).

281. In particular, to ensure **unrestricted participation** the rules of the standard-setting organisation would need to guarantee that all competitors in the market or markets affected by the standard can participate in the process leading to the selection of the standard. The standard-setting organisations would also need to have objective and non-discriminatory procedures for allocating voting rights as well as, if relevant, objective criteria for selecting the technology to be included in the standard.

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[1] This paragraph should not prevent unilateral ex ante disclosures of most restrictive licensing terms as described in paragraph 299. It also does not prevent patent pools created in accordance with the principles set out in the Technology Transfer Guidelines or the decision to license IPR essential to a standard on royalty-free terms as set out in this Chapter.

[2] See by analogy paragraph 39 *et seq*. As regards market shares see also paragraph 296.

[3] See also paragraph 293 in this regard.

282. With respect to **transparency**, the relevant standard-setting organisation would need to have procedures which allow stakeholders to effectively inform themselves of upcoming, on-going and finalised standardisation work in good time at each stage of the development of the standard.

283. Furthermore, the standard-setting organisation's rules would need to ensure effective **access to the standard on fair, reasonable and non discriminatory terms** [1].

284. In the case of a standard involving IPR, **a clear and balanced IPR policy** [2], **adapted to the particular industry** and the needs of the standard-setting organisation in question, increases the likelihood that the implementers of the standard will be granted effective access to the standards elaborated by that standard-setting organisation.

285. In order to ensure effective access to the standard, the IPR policy would need to require participants wishing to have their IPR included in the standard to provide an irrevocable commitment in writing to offer to license their essential IPR to all third parties on fair, reasonable and non-discriminatory terms ('**FRAND commitment**') [3]. That commitment should be given prior to the adoption of the standard. At the same time, the IPR policy should allow IPR holders to exclude specified technology from the standard-setting process and thereby from the commitment to offer to license, providing that exclusion takes place at an early stage in the development of the standard. To ensure the effectiveness of the FRAND commitment, there would also need to be a requirement on all participating IPR holders who provide such a commitment to ensure that any company to which the IPR owner transfers its IPR (including the right to license that IPR) is bound by that commitment, for example through a contractual clause between buyer and seller.

286. Moreover, the IPR policy would need to require **good faith disclosure**, by participants, of their IPR that might be essential for the implementation of the standard under development. This would enable the industry to make an informed choice of technology and thereby assist in achieving the goal of effective access to the standard. Such a disclosure obligation could be based on ongoing disclosure as the standard develops and on reasonable endeavours to identify IPR reading on the potential standard [4]. It is also sufficient if the participant declares that it is likely to have IPR claims over a particular technology (without identifying specific IPR claims or applications for IPR). Since the risks with regard to effective access are not the same in the case of a standard-setting organisation with a royalty-free standards policy, IPR disclosure would not be relevant in that context.

FRAND Commitments

287. FRAND commitments are designed to ensure that essential IPR protected technology incorporated in a standard is accessible to the users of that standard on fair, reasonable and non-discriminatory terms and conditions. In particular, FRAND commitments can prevent IPR holders from making the implementation of a standard difficult by refusing to license or by requesting unfair or unreasonable fees (in other words excessive fees) after the industry has been locked-in to the standard or by charging discriminatory royalty fees.

288. Compliance with Article 101 by the standard-setting organisation does not require the standard-setting organisation to verify whether licensing terms of participants fulfil the FRAND commitment. Participants will have to assess for themselves whether the licensing terms and in particular the fees they charge fulfil the FRAND commitment. Therefore, when deciding whether to commit to FRAND for a particular IPR, participants will need to anticipate the implications of the FRAND commitment, notably on their ability to freely set the level of their fees.

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[1] For example effective access should be granted to the specification of the standard.
[2] As specified in paragraphs 285 and 286.
[3] It should be noted that FRAND can also cover royalty-free licensing.
[4] To obtain the sought after result a good faith disclosure does not need to go as far as to require participants to compare their IPR against the potential standard and issue a statement positively concluding that they have no IPR reading on the potential standard.

289. In case of a dispute, the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR [1]. In general, there are various methods available to make this assessment. In principle, cost-based methods are not well adapted to this context because of the difficulty in assessing the costs attributable to the development of a particular patent or groups of patents. Instead, it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (*ex ante*) with those charged after the industry has been locked in (*ex post*). This assumes that the comparison can be made in a consistent and reliable manner [2].

290. Another method could be to obtain an independent expert assessment of the objective centrality and essentiality to the standard at issue of the relevant IPR portfolio. In an appropriate case, it may also be possible to refer to *ex ante* disclosures of licensing terms in the context of a specific standard-setting process. This also assumes that the comparison can be made in a consistent and reliable manner. The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates. These guidelines do not seek to provide an exhaustive list of appropriate methods to assess whether the royalty fees are excessive.

291. However, it should be emphasised that nothing in these Guidelines prejudices the possibility for parties to resolve their disputes about the level of FRAND royalty rates by having recourse to the competent civil or commercial courts.

Effects based assessment for standardisation agreements

292. The assessment of each standardisation agreement must take into account the likely effects of the standard on the markets concerned. The following considerations apply to all standardisation agreements that depart from the principles as set out in paragraphs 280 to 286.

293. Whether standardisation agreements may give rise to restrictive effects on competition may depend on whether the members of a standard-setting organisation remain **free to develop alternative standards or products** that do not comply with the agreed standard [3]. For example, if the standard-setting agreement binds the members to only produce products in compliance with the standard, the risk of a likely negative effect on competition is significantly increased and could in certain circumstances give rise to a restriction of competition by object [4]. In the same vein, standards only covering minor aspects or parts of the end-product are less likely to lead to competition concerns than more comprehensive standards.

294. The assessment whether the agreement restricts competition will also focus on **access to the standard**. Where the result of a standard (that is to say, the specification of how to comply with the standard and, if relevant, the essential IPR for implementing the standard) is not at all accessible, or only accessible on discriminatory terms, for members or third parties (that is to say, non-members of the relevant standard-setting organisation) this may discriminate or foreclose or segment markets according to their geographic scope of application and thereby is likely to restrict competition. However, in the case of several competing standards or in the case of effective competition between the standardised solution and non-standardised solution, a limitation of access may not produce restrictive effects on competition.

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[1] See Case 27/76, *United Brands*, paragraph 250; see also Case C-385/07 P, *Der Grüne Punkt – Duales System Deutschland GmbH*, [2009] ECR I-6155, paragraph 142.

[2] See Case 395/87, *Ministère public* v *Jean-Louis Tournier*, [1989] ECR 2521, paragraph 38; Joined Cases 110/88, 241/88 and 242/88, *Francois Lucazeau* v *SACEM*, [1989] ECR 2811, paragraph 33.

[3] See Commission Decision in Case IV/29/151, *Philips/VCR*, OJ L 47, 18.2.1978, p. 42, paragraph 23: 'As these standards were for the manufacture of VCR equipment, the parties were obliged to manufacture and distribute only cassettes and recorders conforming to the VCR system licensed by Philips. They were prohibited from changing to manufacturing and distributing other video cassette systems … This constituted a restriction of competition under Article 85(1)(b)'.

[4] See Commission Decision in Case IV/29/151, *Philips/VCR*, paragraph 23.

295. If **participation in the standard-setting process** is open in the sense that it allows all competitors (and/or stakeholders) in the market affected by the standard to take part in choosing and elaborating the standard, this will lower the risks of a likely restrictive effect on competition by not excluding certain companies from the ability to influence the choice and elaboration of the standard ([1]). The greater the likely market impact of the standard and the wider its potential fields of application, the more important it is to allow equal access to the standard-setting process. However, if the facts at hand show that there is competition between several such standards and standard-setting organisations (and it is not necessary that the whole industry applies the same standards) there may be no restrictive effects on competition. Also, if in the absence of a limitation on the number of participants it would not have been possible to adopt the standard, the agreement would not be likely to lead to any restrictive effect on competition under Article 101(1) ([2]). In certain situations the potential negative effects of restricted participation may be removed or at least lessened by ensuring that stakeholders are **kept informed and consulted** on the work in progress ([3]). The more transparent the procedure for adopting the standard, the more likely it is that the adopted standard will take into account the interests of all stakeholders.

296. To assess the effects of a standard-setting agreement, the **market shares of the goods or services based on the standard** should be taken into account. It might not always be possible to assess with any certainty at an early stage whether the standard will in practice be adopted by a large part of the industry or whether it will only be a standard used by a marginal part of the relevant industry. In many cases the relevant market shares of the companies having participated in developing the standard could be used as a proxy for estimating the likely market share of the standard (since the companies participating in setting the standard would in most cases have an interest in implementing the standard) ([4]). However, as the effectiveness of standardisation agreements is often proportional to the share of the industry involved in setting and/or applying the standard, high market shares held by the parties in the market or markets affected by the standard will not necessarily lead to the conclusion that the standard is likely to give rise to restrictive effects on competition.

297. Any standard-setting agreement which clearly **discriminates** against any of the participating or potential members could lead to a restriction of competition. For example, if a standard-setting organisation explicitly excludes upstream only companies (that is to say, companies not active on the downstream production market), this could lead to an exclusion of potentially better technologies.

298. As regards standard-setting agreements with **different types of IPR disclosure models** from the ones described in paragraph 286, it would have to be assessed on a case by case basis whether the disclosure model in question (for example a disclosure model not requiring but only encouraging IPR disclosure) guarantees effective access to the standard. In other words, it needs to be assessed whether, in the specific context, an informed choice between technologies and associated IPR is in practice not prevented by the IPR disclosure model.

299. Finally, standard-setting agreements providing for **ex ante disclosures of most restrictive licensing terms**, will not, in principle, restrict competition within the meaning of Article 101(1). In that regard, it is important that parties involved in the selection of a standard be fully informed not only as to the available technical options and the associated IPR, but also as to the likely cost of that IPR. Therefore, should a standard-setting organisation's IPR policy choose to provide for IPR holders to individually

([1]) In Commission Decision in Case IV/31.458, *X/Open Group*, OJ L 35, 6.2.1987, p. 36, the Commission considered that even if the standards adopted were made public, the restricted membership policy had the effect of preventing non-members from influencing the results of the work of the group and from getting the know-how and technical understanding relating to the standards which the members were likely to acquire. In addition, non-members could not, in contrast to the members, implement the standard before it was adopted (see paragraph 32). The agreement was therefore in these circumstances seen to constitute a restriction under Article 101(1).

([2]) Or if the adoption of the standard would have been heavily delayed by an inefficient process, any initial restriction could be outweighed by efficiencies to be considered under Article 101(3).

([3]) See Commission Decision of 14 October 2009 in Case 39.416, *Ship Classification*. The Decision can be found at: http://ec.europa.eu/competition/antitrust/cases/index/by_nr_78.html#i39_416

([4]) See paragraph 261.

disclose their most restrictive licensing terms, including the maximum royalty rates they would charge, prior to the adoption of the standard, this will normally not lead to a restriction of competition within the meaning of Article 101(1) ([1]). Such unilateral ex ante disclosures of most restrictive licensing terms would be one way to enable the standard-setting organisation to take an informed decision based on the disadvantages and advantages of different alternative technologies, not only from a technical perspective but also from a pricing perspective.

Standard terms

300. The establishment and use of standard terms must be assessed in the appropriate economic context and in the light of the situation on the relevant market in order to determine whether the standard terms at issue are likely to give rise to restrictive effects on competition.

301. As long as participation in the actual establishment of standard terms is **unrestricted** for the competitors in the relevant market (either by participation in the trade association or directly), and the established standard terms are **non-binding** and **effectively accessible** for anyone, such agreements are not likely to give rise to restrictive effects on competition (subject to the caveats set out in paragraphs 303, 304, 305 and 307).

302. Effectively accessible and non-binding standard terms for the sale of consumer goods or services (on the presumption that they have no effect on price) thus generally do not have any restrictive effect on competition since they are unlikely to lead to any negative effect on product quality, product variety or innovation. There are, however, two general exceptions where a more in-depth assessment would be required.

303. Firstly, standard terms for the sale of consumer goods or services where the standard terms define the scope of the product sold to the customer, and where therefore the risk of limiting product choice is more significant, could give rise to restrictive effects on competition within the meaning of Article 101(1) where their common application is likely to result in a *de facto* alignment. This could be the case when the widespread use of the standard terms *de facto* leads to a limitation of innovation and product variety. For instance, this may arise where standard terms in insurance contracts limit the customer's practical choice of key elements of the contract, such as the standard risks covered. Even if the use of the standard terms is not compulsory, they might undermine the incentives of the competitors to compete on product diversification.

304. When assessing whether there is a risk that the standard terms are likely to have restrictive effects by way of a limitation of product choice, factors such as existing competition on the market should be taken into account. For example if there is a large number of smaller competitors, the risk of a limitation of product choice would seem to be less than if there are only a few bigger competitors ([2]). The market shares of the companies participating in the establishment of the standard terms might also give a certain indication of the likelihood of uptake of the standard terms or of the likelihood that the standard terms will be used by a large part of the market. However, in this respect, it is not only relevant to analyse whether the standard terms elaborated are likely to be used by a large part of the market, but also whether the standard terms only cover part of the product or the whole product (the less extensive the standard terms, the less likely that they will lead, overall, to a limitation of product choice). Moreover, in cases where in the absence of the establishment of the standard terms it would not have been possible to offer a certain product, there would not be likely to be any restrictive effect on competition within the meaning of Article 101(1). In that scenario, product choice is increased rather than decreased by the establishment of the standard terms.

([1]) Any unilateral ex ante disclosures of most restrictive licensing terms should not serve as a cover to jointly fix prices either of downstream products or of substitute IPR/technologies which is, as outlined in paragraph 274, a restriction of competition by object.

([2]) If previous experience with standard terms on the relevant market shows that the standard terms did not lead to lessened competition on product differentiation, this might also be an indication that the same type of standard terms elaborated for a neighbouring product will not lead to a restrictive effect on competition.

305. Secondly, even if the standard terms do not define the actual scope of the end-product they might be a decisive part of the transaction with the customer for other reasons. An example would be online shopping where customer confidence is essential (for example, in the use of safe payment systems, a proper description of the products, clear and transparent pricing rules, flexibility of the return policy, etc). As it is difficult for customers to make a clear assessment of all those elements, they tend to favour widespread practices and standard terms regarding those elements could therefore become a *de facto* standard with which companies would need to comply to sell in the market. Even though non-binding, those standard terms would become a *de facto* standard, the effects of which are very close to a binding standard and need to be analysed accordingly.

306. If the use of standard terms is binding, there is a need to assess their impact on product quality, product variety and innovation (in particular if the standard terms are binding on the entire market).

307. Moreover, should the standard terms (binding or non-binding) contain any terms which are likely to have a negative effect on competition relating to prices (for example terms defining the type of rebates to be given), they would be likely to give rise to restrictive effects on competition within the meaning of Article 101(1).

7.4. **Assessment under Article 101(3)**

7.4.1. *Efficiency gains*

Standardisation agreements

308. Standardisation agreements frequently give rise to significant efficiency gains. For example, Union wide standards may facilitate market integration and allow companies to market their goods and services in all Member States, leading to increased consumer choice and decreasing prices. Standards which establish technical interoperability and compatibility often encourage competition on the merits between technologies from different companies and help prevent lock-in to one particular supplier. Furthermore, standards may reduce transaction costs for sellers and buyers. Standards on, for instance, quality, safety and environmental aspects of a product may also facilitate consumer choice and can lead to increased product quality. Standards also play an important role for innovation. They can reduce the time it takes to bring a new technology to the market and facilitate innovation by allowing companies to build on top of agreed solutions.

309. To achieve those efficiency gains in the case of standardisation agreements, the information necessary to apply the standard must be effectively available to those wishing to enter the market [1].

310. Dissemination of a standard can be enhanced by marks or logos certifying compliance thereby providing certainty to customers. Agreements for testing and certification go beyond the primary objective of defining the standard and would normally constitute a distinct agreement and market.

311. While the effects on innovation must be analysed on a case-by-case basis, standards creating compatibility on a horizontal level between different technology platforms are considered to be likely to give rise to efficiency gains.

Standard terms

312. The use of standard terms can entail economic benefits such as making it easier for customers to compare the conditions offered and thus facilitate switching between companies. Standard terms might also lead to efficiency gains in the form of savings in transaction costs and, in certain sectors (in particular where the contracts are of a complex legal structure), facilitate entry. Standard terms may also increase legal certainty for the contract parties.

313. The higher the number of competitors on the market, the greater the efficiency gain of facilitating the comparison of conditions offered.

[1] See Commission Decision in Case IV/31.458, *X/Open Group*, paragraph 42: 'The Commission considers that the willingness of the Group to make available the results as quickly as possible is an essential element in its decision to grant an exemption'.

7.4.2. *Indispensability*

314. Restrictions that go beyond what is necessary to achieve the efficiency gains that can be generated by a standardisation agreement or standard terms do not fulfil the criteria of Article 101(3).

Standardisation agreements

315. The assessment of each standardisation agreement must take into account its likely effect on the markets concerned, on the one hand, and the scope of restrictions that possibly go beyond the objective of achieving efficiencies, on the other ([1]).

316. Participation in standard-setting should normally be open to all competitors in the market or markets affected by the standard unless the parties demonstrate significant inefficiencies of such participation or recognised procedures are foreseen for the collective representation of interests ([2]).

317. As a general rule standardisation agreements should cover no more than what is necessary to ensure their aims, whether this is technical interoperability and compatibility or a certain level of quality. In cases where having only one technological solution would benefit consumers or the economy at large that standard should, be set on a non-discriminatory basis. Technology neutral standards can, in certain circumstances, lead to larger efficiency gains. Including substitute IPR ([3]) as essential parts of a standard while at the same time forcing the users of the standard to pay for more IPR than technically necessary would go beyond what is necessary to achieve any identified efficiency gains. In the same vein, including substitute IPR as essential parts of a standard and limiting the use of that technology to that particular standard (that is to say, exclusive use) could limit inter-technology competition and would not be necessary to achieve the efficiencies identified.

318. Restrictions in a standardisation agreement making a standard binding and obligatory for the industry are in principle not indispensable.

319. In a similar vein, standardisation agreements that entrust certain bodies with the exclusive right to test compliance with the standard go beyond the primary objective of defining the standard and may also restrict competition. The exclusivity can, however, be justified for a certain period of time, for example by the need to recoup significant start-up costs ([4]). The standardisation agreement should in that case include adequate safeguards to mitigate possible risks to competition resulting from exclusivity. This concerns, inter alia, the certification fee which needs to be reasonable and proportionate to the cost of the compliance testing.

([1]) In Case IV/29/151, *Philips/VCR*, compliance with the VCR standards led to the exclusion of other, perhaps better systems. Such exclusion was particularly serious in view of the pre-eminent market position enjoyed by Philips '… [R]restrictions were imposed upon the parties which were not indispensable to the attainment of these improvements. The compatibility of VCR video cassettes with the machines made by other manufacturers would have been ensured even if the latter had to accept no more than an obligation to observe the VCR standards when manufacturing VCR equipment' (paragraph 31).

([2]) See Commission Decision in Case IV/31.458, *X/Open Group*, paragraph 45: '[T]he aims of the Group could not be achieved if any company willing to commit itself to the Group objectives had a right to become a member. This would create practical and logistical difficulties for the management of the work and possibly prevent appropriate proposals being passed.' See also Commission Decision of 14 October 2009 in Case 39.416, *Ship Classification*, paragraph 36: 'the Commitments strike an appropriate balance between maintaining demanding criteria for membership of IACS on the one hand, and removing unnecessary barriers to membership of IACS on the other hand. The new criteria will ensure that only technically competent CSs are eligible to become member of IACS, thus preventing that the efficiency and quality of IACS' work is unduly impaired by too lenient requirements for participation in IACS. At the same time, the new criteria will not hinder CSs, who are technically competent and willing to do so from joining IACS'.

([3]) Technology which is regarded by users or licensees as interchangeable with or substitutable for another technology, by reason of the characteristics and intended use of the technologies.

([4]) In this context see Commission Decision in Cases IV/34.179, 34.202, 216, *Dutch Cranes (SCK and FNK)*, OJ L 312, 23.12.1995, p. 79, paragraph 23: 'The ban on calling on firms not certified by SCK as sub-contractors restricts the freedom of action of certified firms. Whether a ban can be regarded as preventing, restricting or distorting competition within the meaning of Article 85(1) must be judged in the legal and economic context. If such a ban is associated with a certification system which is completely open, independent and transparent and provides for the acceptance of equivalent guarantees from other systems, it may be argued that it has no restrictive effects on competition but is simply aimed at fully guaranteeing the quality of the certified goods or services'.

Standard terms

320. It is generally not justified to make standard terms binding and obligatory for the industry or the members of the trade association that established them. The possibility cannot, however, be ruled out that making standard terms binding may, in a specific case, be indispensable to the attainment of the efficiency gains generated by them.

7.4.3. *Pass-on to consumers*

Standardisation agreements

321. Efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects on competition caused by a standardisation agreement or by standard terms. A relevant part of the analysis of likely pass-on to consumers is which procedures are used to guarantee that the interests of the users of standards and end consumers are protected. Where standards facilitate technical interoperability and compatibility or competition between new and already existing products, services and processes, it can be presumed that the standard will benefit consumers.

Standard terms

322. Both the risk of restrictive effects on competition and the likelihood of efficiency gains increase with the companies' market shares and the extent to which the standard terms are used. Hence, it is not possible to provide any general 'safe harbour' within which there is no risk of restrictive effects on competition or which would allow the presumption that efficiency gains will be passed on to consumers to an extent that outweighs the restrictive effects on competition.

323. However, certain efficiency gains generated by standard terms, such as increased comparability of the offers on the market, facilitated switching between providers, and legal certainty of the clauses set out in the standard terms, are necessarily beneficial for the consumers. As regards other possible efficiency gains, such as lower transaction costs, it is necessary to make an assessment on a case-by-case basis and in the relevant economic context whether these are likely to be passed on to consumers.

7.4.4. *No elimination of competition*

324. Whether a standardisation agreement affords the parties the possibility of eliminating competition depends on the various sources of competition in the market, the level of competitive constraint that they impose on the parties and the impact of the agreement on that competitive constraint. While market shares are relevant for that analysis, the magnitude of remaining sources of actual competition cannot be assessed exclusively on the basis of market share except in cases where a standard becomes a *de facto* industry standard [1]. In the latter case competition may be eliminated if third parties are foreclosed from effective access to the standard. Standard terms used by a majority of the industry might create a *de facto* industry standard and thus raise the same concerns. However, if the standard or the standard terms only concern a limited part of the product or service, competition is not likely to be eliminated.

7.5. **Examples**

325. Setting standards competitors cannot satisfy

Example 1

Situation: A standard-setting organisation sets and publishes safety standards that are widely used by the relevant industry. Most competitors of the industry take part in the setting of the standard. Prior to the adoption of the standard, a new entrant has developed a product which is technically equivalent in terms of the performance and functional requirements and which is recognised by the technical committee of the standard-setting organisation. However, the technical specifications of the safety standard are, without any objective justification, drawn up in such a way as to not allow for this or other new products to comply with the standard.

[1] *De facto* standardisation refers to a situation where a (legally non-binding) standard, is, in practice, used by most of the industry.

Analysis: This standardisation agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1) and is unlikely to meet the criteria of Article 101(3). The members of the standards development organisation have, without any objective justification, set the standard in such a way that products of their competitors which are based on other technological solutions cannot satisfy it, even though they have equivalent performance. Hence, this standard, which has not been set on a non-discriminatory basis, will reduce or prevent innovation and product variety. It is unlikely that the way the standard is drafted will lead to greater efficiency gains than a neutral one.

326. Non-binding and transparent standard covering a large part of the market

Example 2

Situation: A number of consumer electronics manufacturers with substantial market shares agree to develop a new standard for a product to follow up the DVD.

Analysis: Provided that (a) the manufacturers remain free to produce other new products which do not conform to the new standard, (b) participation in the standard-setting is unrestricted and transparent, and (c) the standardisation agreement does not otherwise restrict competition, Article 101(1) is not likely to be infringed. If the parties agreed to only manufacture products which conform to the new standard, the agreement would limit technical development, reduce innovation and prevent the parties from selling different products, thereby creating restrictive effects on competition within the meaning of Article 101(1).

327. Standardisation agreement without IPR disclosure

Example 3

Situation: A private standard-setting organisation active in standardisation in the ICT (information and communication technology) sector has an IPR policy which neither requires nor encourages disclosures of IPR which could be essential for the future standard. The standard-setting organisation took the conscious decision not to include such an obligation in particular considering that in general all technologies potentially relevant for the future standard are covered by many IPR. Therefore the standard-setting organisation considered that an IPR disclosure obligation would, on the one hand, not lead to the benefit of enabling the participants to choose a solution with no or little IPR and, on the other, would lead to additional costs in analysing whether the IPR would be potentially essential for the future standard. However, the IPR policy of the standard-setting organisation requires all participants to make a commitment to license any IPR that might read on the future standard on FRAND terms. The IPR policy allows for opt-outs if there is specific IPR that an IPR holder wishes to put outside the blanket licensing commitment. In this particular industry there are several competing private standard-setting organisations. Participation in the standard-setting organisation is open to anyone active in the industry.

Analysis: In many cases an IPR disclosure obligation would be pro-competitive by increasing competition between technologies ex ante. In general, such an obligation allows the members of a standard-setting organisation to factor in the amount of IPR reading on a particular technology when deciding between competing technologies (or even to, if possible, choose a technology which is not covered by IPR). The amount of IPR reading on a technology will often have a direct impact on the cost of access to the standard. However, in this particular context, all available technologies seem to be covered by IPR, and even many IPR. Therefore, any IPR disclosure would not have the positive effect of enabling the members to factor in the amount of IPR when choosing technology since regardless of what technology is chosen, it can be presumed that there is IPR reading on that

technology. IPR disclosure would be unlikely to contribute to guaranteeing effective access to the standard which in this scenario is sufficiently guaranteed by the blanket commitment to license any IPR that might read on the future standard on FRAND terms. On the contrary, an IPR disclosure obligation might in this context lead to additional costs for the participants. The absence of IPR disclosure might also, in those circumstances, lead to a quicker adoption of the standard which might be important if there are several competing standard-setting organisations. It follows that the agreement is unlikely to give rise to any negative effects on competition within the meaning of Article 101(1).

328. Standards in the insurance sector

Example 4

Situation: A group of insurance companies comes together to agree non-binding standards for the installation of certain security devices (that is to say, components and equipment designed for loss prevention and reduction and systems formed from such elements). The non-binding standards set by the insurance companies (a) are agreed in order to address a specific need and to assist insurers to manage risk and offer risk-appropriate premiums; (b) are discussed with the installers (or their representatives) and their views are taken on board prior to finalisation of the standards; (c) are published by the relevant insurance association on a dedicated section of its website so that any installer or other interested party can access them easily.

Analysis: The process for setting these standards is transparent and allows for the participation of interested parties. In addition, the result is easily accessible on a reasonable and non-discriminatory basis for anyone that wishes to have access to it. Provided that the standard does not have negative effects on the downstream market (for example by excluding certain installers through very specific and unjustified requirements for installations) it is not likely to lead to restrictive effects on competition. However, even if the standards led to restrictive effects on competition, the conditions set out in Article 101(3) would seem to be fulfilled. The standards would assist insurers in analysing to what extent such installation systems reduce relevant risk and prevent losses so that they can manage risks and offer risk-appropriate premiums. Subject to the caveat regarding the downstream market, they would also be more efficient for installers, allowing them to comply with one set of standards for all insurance companies rather than be tested by every insurance company separately. They could also make it easier for consumers to switch between insurers. In addition, they could be beneficial for smaller insurers who may not have the capacity to test separately. As regards the other conditions of Article 101(3), it seems that the non-binding standards do not go beyond what is necessary to achieve the efficiencies in question, that benefits would be passed on to the consumers (some would even be directly beneficial for the consumers) and that the restrictions would not lead to an elimination of competition.

329. Environmental standards

Example 5

Situation: Almost all producers of washing machines agree, with the encouragement of a public body, to no longer manufacture products which do not comply with certain environmental criteria (for example, energy efficiency). Together, the parties hold 90 % of the market. The products which will be thus phased out of the market account for a significant proportion of total sales. They will be replaced by more environmentally friendly, but also more expensive products. Furthermore, the agreement indirectly reduces the output of third parties (for example, electric utilities and suppliers of components incorporated in the products phased out). Without the agreement, the parties would not have shifted their production and marketing efforts to the more environmentally friendly products.

Analysis: The agreement grants the parties control of individual production and concerns an appreciable proportion of their sales and total output, whilst also reducing third parties' output. Product variety, which is partly focused on the environmental characteristics of the product, is reduced and prices will probably rise. Therefore, the agreement is likely to give rise to restrictive effects on competition within the meaning of Article 101(1). The involvement of the public

authority is irrelevant for that assessment. However, newer, more environmentally friendly products are more technically advanced, offering qualitative efficiencies in the form of more washing machine programmes which can be used by consumers. Furthermore, there are cost efficiencies for the purchasers of the washing machines resulting from lower running costs in the form of reduced consumption of water, electricity and soap. Those cost efficiencies are realised on markets which are different from the relevant market of the agreement. Nevertheless, those efficiencies may be taken into account as the markets on which the restrictive effects on competition and the efficiency gains arise are related and the group of consumers affected by the restriction and the efficiency gains is substantially the same. The efficiency gains outweigh the restrictive effects on competition in the form of increased costs. Other alternatives to the agreement are shown to be less certain and less cost-effective in delivering the same net benefits. Various technical means are economically available to the parties in order to manufacture washing machines which do comply with the environmental characteristics agreed upon and competition will still take place for other product characteristics. Therefore, the criteria of Article 101(3) would appear to be fulfilled.

330. Government encouraged standardisation

Example 6

Situation: In response to the findings of research into the recommended levels of fat in certain processed food conducted by a government-funded think tank in one Member State, several major manufacturers of the processed foods in the same Member State agree, through formal discussions at an industry trade association, to set recommended fat levels for the products. Together, the parties represent 70 % of sales of the products within the Member State. The parties' initiative will be supported by a national advertising campaign funded by the think tank highlighting the dangers of a high fat content in processed foods.

Analysis: Although the fat levels are recommendations and therefore voluntary, as a result of the wide publicity resulting from the national advertising campaign, the recommended fat levels are likely to be implemented by all manufacturers of the processed foods in the Member State. It is therefore likely to become a *de facto* maximum fat level in the processed foods. Consumer choice across the product markets could therefore be reduced. However, the parties will be able to continue to compete with regard to a number of other characteristics of the products, such as price, product size, quality, taste, other nutritional and salt content, balance of ingredients, and branding. Moreover, competition regarding the fat levels in the product offering may increase where parties seek to offer products with the lowest levels. The agreement is therefore unlikely to give rise to restrictive effects on competition within the meaning of Article 101(1).

331. Open standardisation of product packaging

Example 7

Situation: The major manufacturers of a fast-moving consumer product in a competitive market in a Member State – as well as manufacturers and distributors in other Member States who sell the product into the Member State ('importers') – agree with the major packaging suppliers to develop and implement a voluntary initiative to standardise the size and shape of the packaging of the product sold in that Member State. There is currently a wide variation in packaging sizes and materials within and across the Member States. This reflects the fact that the packaging does not represent a high proportion of total production costs and that switching costs for packaging producers are not significant. There is no actual or pending European standard for the packaging. The agreement has been entered into by the parties voluntarily in response to pressure from the Member State's government to meet environmental targets. Together, the manufacturers and importers represent 85 % of sales of the product within the Member State. The voluntary initiative will give rise to a uniform-sized product for sale within the Member State that uses less packaging material, occupies less shelf space, has lower transport and packaging costs, and is more environmentally friendly through reduced packaging waste. It also reduces the recycling costs of producers.

The standard does not specify that particular types of packaging materials must be used. The specifications of the standard have been agreed between manufacturers and importers in an open and transparent manner, with the draft specifications having been published for open consultation on an industry website in a timely manner prior to adoption. The final specifications adopted are also published on an industry trade association website that is freely accessible to any potential entrants, even if they are not members of the trade association.

Analysis: Although the agreement is voluntary, the standard is likely to become a *de facto* industry practice because the parties together represent a high proportion of the market for the product in the Member State and retailers are also being encouraged by the government to reduce packaging waste. As such, the agreement could in theory create barriers to entry and give rise to potential anti-competitive foreclosure effects in the Member State market. This would in particular be a risk for importers of the product in question who may need to repackage the product to meet the *de facto* standard in order to sell in the Member State if the pack size used in other Member States does not meet the standard. However, significant barriers to entry and foreclosure are unlikely to occur in practice because (a) the agreement is voluntary, (b) the standard has been agreed with major importers in an open and transparent manner, (c) switching costs are low, and (d) the technical details of the standard are accessible to new entrants, importers and all packaging suppliers. In particular, importers will have been aware of potential changes to packaging at an early stage of development and will have had the opportunity through the open consultation on the draft standards to put forward their views before the standard was eventually adopted. The agreement therefore may not give rise to restrictive effects on competition within the meaning of Article 101(1).

In any event, it is likely that the conditions of Article 101(3) will be fulfilled in this case: (i) the agreement will give rise to quantitative efficiencies through lower transport and packaging costs, (ii) the prevailing conditions of competition on the market are such that these costs reductions are likely to be passed on to consumers, (iii) the agreement includes only the minimum restrictions necessary to achieve the packaging standard and is unlikely to result in significant foreclosure effects and (iv) competition will not be eliminated in a substantial part of the products in question.

332. Closed standardisation of product packaging

Example 8

Situation: The situation is the same as in Example 7, paragraph 331, except the standard is agreed only between manufacturers of the fast-moving consumer product located within the Member State (who represent 65 % of the sales of the product in the Member State), there was no open consultation on the specifications adopted (which include detailed standards on the type of packaging material that must be used) and the specifications of the voluntary standard are not published. This resulted in higher switching costs for producers in other Member States than for domestic producers.

Analysis: Similar to Example 7, paragraph 331, although the agreement is voluntary, it is very likely to become *de facto* standard industry practice since retailers are also being encouraged by the government to reduce packaging waste and the domestic manufacturers account for 65 % of sales of the product within the Member State. The fact that relevant producers in other Member States were not consulted resulted in the adoption of a standard which imposes higher switching costs on them compared to domestic producers. The agreement may therefore create barriers to entry and give rise to potential anti-competitive foreclosure effects on packaging suppliers, new entrants and importers – all of whom were not involved in the standard-setting process – as they may need to repackage the product to meet the *de facto* standard in order to sell in the Member State if the pack size used in other Member States does not meet the standard.

Unlike in Example 7, paragraph 331, the standardisation process has not been carried out in an open and transparent manner. In particular, new entrants, importers and packaging suppliers have not been given the opportunity to comment on the proposed standard and may not even be aware of it until a late stage, creating the possibility that they may not be able to change their production methods or switch suppliers quickly and effectively. Moreover, new entrants, importers and

packaging suppliers may not be able to compete if the standard is unknown or difficult to comply with. Of particular relevance here is the fact that the standard includes detailed specifications on the packaging materials to be used which, because of the closed nature of the consultation and the standard, importers and new entrants will struggle to comply with. The agreement may therefore restrict competition within the meaning of Article 101(1). This conclusion is not affected by the fact the agreement has been entered into in order to meet underlying environmental targets agreed with the Member State's government.

It is unlikely that the conditions of Article 101(3) will be fulfilled in this case. Although the agreement will give rise to similar quantitative efficiencies as arise under Example 7, paragraph 331, the closed and private nature of the standardisation agreement and the non-published detailed standard on the type of packaging material that must be used are unlikely to be indispensable to achieving the efficiencies under the agreement.

333. Non-binding and open standard terms used for contracts with end-users

Example 9

Situation: A trade association for electricity distributors establishes non-binding standard terms for the supply of electricity to end-users. The establishment of the standard terms is made in a transparent and non-discriminatory manner. The standard terms cover issues such as the specification of the point of consumption, the location of the connection point and the connection voltage, provisions on service reliability as well as the procedure for settling the accounts between the parties to the contract (for example, what happens if the customer does not provide the supplier with the readings of the measurement devices). The standard terms do not cover any issues relating to prices, that is to say, they contain no recommended prices or other clauses related to price. Any company active within the sector is free to use the standard terms as it sees fit. About 80 % of the contracts concluded with end-users in the relevant market are based on these standard terms.

Analysis: These standard terms are not likely to give rise to restrictive effects on competition within the meaning of Article 101(1). Even if they have become industry practice, they do not seem to have any appreciable negative impact on prices, product quality or variety.

334. Standard terms used for contracts between companies

Example 10

Situation: Construction companies in a certain Member State come together to establish non-binding and open standard terms and conditions for use by a contractor when submitting a quotation for construction work to a client. A form of quotation is included together with terms and conditions suitable for building or construction. Together, the documents create the construction contract. Clauses cover such matters as contract formation, general obligations of the contractor and the client and non-price related payment conditions (for example, a provision specifying the contractor's right to give notice to suspend the work for non-payment), insurance, duration, handover and defects, limitation of liability, termination, etc. In contrast to Example 9, paragraph 333, these standard terms would often be used between companies, one active upstream and one active downstream.

Analysis: These standard terms are not likely to have restrictive effects on competition within the meaning of Article 101(1). There would normally not be any significant limitation in the customer's choice of the end-product, namely the construction work. Other restrictive effects on competition do not seem likely. Indeed, several of the clauses above (handover and defects, termination, etc.) would often be regulated by law.

335. Standard terms facilitating the comparison of different companies' products

Example 11

Situation: A national association for the insurance sector distributes non-binding standard policy conditions for house insurance contracts. The conditions give no indication of the level of insurance premiums, the amount of the cover or the excesses payable by the insured. They do not impose comprehensive cover including risks to which a significant number of policyholders are not simultaneously exposed and do not require the policyholders to obtain cover from the same insurer for different risks. While the majority of insurance companies use standard policy conditions, not all their contracts contain the same conditions as they are adapted to each client's individual needs and therefore there is no *de facto* standardisation of insurance products offered to consumers. The standard policy conditions enable consumers and consumer organisations to compare the policies offered by the different insurers. A consumer association is involved in the process of laying down the standard policy conditions. They are also available for use by new entrants, on a non-discriminatory basis.

Analysis: These standard policy conditions relate to the composition of the final insurance product. If the market conditions and other factors would show that there might be a risk of limitation in product variety as a result of insurance companies using such standard policy conditions, it is likely that such possible limitation would be outweighed by efficiencies such as facilitation of comparison by consumers of conditions offered by insurance companies. Those comparisons in turn facilitate switching between insurance companies and thus enhance competition. Furthermore the switching of providers, as well as market entry by competitors, constitutes an advantage for consumers. The fact that the consumer association has participated in the process could, in certain instances, increase the likelihood of those efficiencies which do not automatically benefit the consumers being passed on. The standard policy conditions are also likely to reduce transaction costs and facilitate entry for insurers on a different geographic and/or product markets. Moreover, the restrictions do not seem to go beyond what is necessary to achieve the identified efficiencies and competition would not be eliminated. Consequently, the criteria of Article 101(3) are likely to be fulfilled.

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Guidelines on Vertical Restraints

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Guidelines on Vertical Restraints

(Text with EEA relevance)

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I. INTRODUCTION

1. Purpose of the Guidelines

(1) These Guidelines set out the principles for the assessment of vertical agreements under Article 101 of the Treaty on the Functioning of the European Union (hereinafter "the Treaty").[1] Article 1(1)(a) of Commission Regulation (EU) **[insert new Regulation number]** on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices[2] (hereinafter referred to as the "Block Exemption Regulation") (see paragraphs 24 to 46) defines the term "vertical agreement". These Guidelines are without prejudice to the possible parallel application of Article 102 of the Treaty to vertical agreements. The Guidelines are structured in the following way:

- Section II (paragraphs 8 to 22) describes vertical agreements which generally fall outside Article 101(1);
- Section III (paragraphs 23 to 73) clarifies the conditions for the application of the Block Exemption Regulation;
- Section IV (paragraphs 74 to 85) describes the principles concerning the withdrawal of the block exemption and the disapplication of the Block Exemption Regulation;
- Section V (paragraphs 86 to 95) gives guidance on how to define the relevant market and calculate the market shares;
- Section VI (paragraphs 96 to 229) describes the general framework of analysis and the enforcement policy of the Commission in individual cases concerning vertical agreements.

(2) Throughout these Guidelines the analysis applies to both goods and services, although certain vertical restraints are mainly used in the distribution of goods. Similarly, vertical agreements can be concluded for intermediate and final goods and services. Unless otherwise stated, the analysis and arguments in the text apply to all types of goods and services and to all levels of trade. Thus, the term "products" includes both goods and services. The terms "supplier" and "buyer" are used for all levels of trade. The Block Exemption Regulation and Guidelines do not apply to agreements with final consumers where the latter are not undertakings, since Article 101 only applies to agreements between undertakings.

(3) By issuing these Guidelines the Commission aims to help companies to make their own assessment of vertical agreements under the EU competition rules. The standards set forth in these Guidelines cannot be applied mechanically, but must be applied with due consideration for the specific circumstances of each case. Each case must be evaluated in the light of its own facts.

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[1] These Guidelines replace the Commission Notice – Guidelines on Vertical Restraints, OJ C 291, 13.10.2000, p. 1-44.

[2] Reference New Block Exemption Regulation

(4) These Guidelines are without prejudice to the case-law of the General Court and the Court of Justice of the European Union about the application of Article 101 to vertical agreements. The Commission will continue to monitor the operation of the Regulation and Guidelines based on market information from stakeholders and national competition authorities and may revise this notice in the light of future developments and of evolving insight.

2. Applicability of Article 101 to vertical agreements

(5) Article 101 applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition ("vertical restraints")[3]. Article 101 provides a legal framework for the assessment of vertical restraints, which takes into consideration the distinction between anti-competitive and pro-competitive effects. Article 101(1) prohibits those agreements which appreciably restrict or distort competition, while Article 101(3) exempts those agreements which confer sufficient benefits to outweigh the anti-competitive effects.[4]

(6) For most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels. Vertical restraints are generally less harmful than horizontal restraints and may provide substantial scope for efficiencies.

(7) The objective of Article 101 is to ensure that undertakings do not use agreements – in this context, vertical agreements – to restrict competition on the market to the detriment of consumers. Assessing vertical restraints is also important in the context of the wider objective of achieving an integrated internal market. Market integration enhances competition in the European Union. Companies should not be allowed to recreate private barriers between Member States where State barriers have been successfully abolished.

II. VERTICAL AGREEMENTS WHICH GENERALLY FALL OUTSIDE ARTICLE 101(1)

1. Agreements of minor importance and SMEs

(8) Agreements that are not capable of appreciably affecting trade between Member States or of appreciably restricting competition by object or effect are not caught by Article 101(1). The Block Exemption Regulation applies only to agreements falling within the scope of application of Article 101(1). These Guidelines are without prejudice to the application of the present or any future "*de minimis"* notice[5].

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3 See *inter alia* judgment of the Court of Justice in Joined Cases 56/64 and 58/64 Grundig-Consten v Commission [1966] ECR 299; Case 56/65 Technique Minière v Machinenbau Ulm [1966] ECR 235; and of the General Court in Case T-77/92 Parker Pen v Commission [1994] ECR II 549.

4 See Communication from the Commission - Notice – Guidelines on the application of Article 81(3) of the Treaty, OJ C 101, 27.4.2004, p. 97-118, for the Commission's general methodology and interpretation of the conditions for applying Article 101(1) (previously 81(1)) and in particular Article 101(3) (previously 81(3)).

5 See Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community *("de minimis"*), OJ C 368, 22.12.2001, p.13-15

(9) Subject to the conditions set out in the "*de minimis"* notice concerning hardcore restrictions and cumulative effect issues, vertical agreements entered into by non-competing undertakings whose individual market share on the relevant market does not exceed 15% are generally considered to fall outside the scope of Article 101(1)[6]. There is no presumption that vertical agreements concluded by undertakings having more than 15% market share automatically infringe Article 101(1). Agreements between undertakings whose market share exceeds the 15% threshold may still not have an appreciable effect on trade between Member States or may not constitute an appreciable restriction of competition[7]. Such agreements need to be assessed in their legal and economic context. The criteria for the assessment of individual agreements are set out in paragraphs 96 to 229.

(10) As regards hardcore restrictions referred to in the "*de minimis"* notice, Article 101(1) may apply below the 15% threshold, provided that there is an appreciable effect on trade between Member States and on competition. The applicable case-law of the Court of Justice and the General Court is relevant in this respect.[8] Reference is also made to the possible need to assess positive and negative effects of hardcore restrictions as described in particular in paragraph 47 of the Guidelines.

(11) In addition, the Commission considers that, subject to cumulative effect and hardcore restrictions, vertical agreements between small and medium-sized undertakings as defined in the Annex to Commission Recommendation 2003/361/EC[9] are rarely capable of appreciably affecting trade between Member States or of appreciably restricting competition within the meaning of Article 101(1), and therefore generally fall outside the scope of Article 101(1). In cases where such agreements nonetheless meet the conditions for the application of Article 101(1), the Commission will normally refrain from opening proceedings for lack of sufficient interest for the European Union unless those undertakings collectively or individually hold a dominant position in a substantial part of the internal market.

2. Agency agreements

(i) Definition of agency agreements

(12) An agent is a legal or physical person vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the:

- purchase of goods or services by the principal, or
- sale of goods or services supplied by the principal.

(13) The determining factor in defining an agency agreement for the application of Article 101(1) is the financial or commercial risk borne by the agent in relation to the activities for

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6 For agreements between competing undertakings the "*de minimis"* market share threshold is 10% for their collective market share on each affected relevant market

7 See judgment of the General Court in Case T-7/93 Langnese-Iglo v Commission [1995] ECR II-1533, paragraph 98.

8 See judgments of the Court of Justice in Case 5/69 Völk v Vervaecke [1969] ECR 295; Case 1/71 Cadillon v Höss [1971] ECR 351 and Case C-306/96 Javico v Yves Saint Laurent [1998] ECR I-1983, paragraphs 16 and 17.

9 OJ L 124/36, 20.05.2003

which he has been appointed as an agent by the principal[10]. In this respect it is not material for the assessment whether the agent acts for one or several principals. Neither is material for this assessment the qualification given to their agreement by the parties or national legislation.

(14) There are three types of financial or commercial risk that are material to the definition of an agency agreement for the application of Article 101(1). First there are the contract-specific risks which are directly related to the contracts concluded and/or negotiated by the agent on behalf of the principal, such as financing of stocks. Secondly, there are the risks related to market-specific investments. These are investments specifically required for the type of activity for which the agent has been appointed by the principal, i.e. which are required to enable the agent to conclude and/or negotiate this type of contract. Such investments are usually sunk, which means that upon leaving that particular field of activity the investment cannot be used for other activities or sold other than at a significant loss. Thirdly, there are the risks related to other activities undertaken in the same product market, to the extent that the principal requires the agent to undertake such activities, but not as an agent on behalf of the principal but for its own risk.

(15) For the purposes of applying Article 101(1) the agreement will be qualified as an agency agreement if the agent does not bear any, or bears only insignificant, risks in relation to the contracts concluded and/or negotiated on behalf of the principal, in relation to market-specific investments for that field of activity, and in relation to other activities required by the principal to be undertaken in the same product market. However, risks that are related to the activity of providing agency services in general, such as the risk of the agent's income being dependent upon his success as an agent or general investments in for instance premises or personnel, are not material to this assessment.

(16) For the purpose of applying Article 101(1) an agreement will thus generally be considered an agency agreement where property in the contract goods bought or sold does not vest in the agent, or the agent does not himself supply the contract services and where the agent:

– does not contribute to the costs relating to the supply/purchase of the contract goods or services, including the costs of transporting the goods. This does not preclude the agent from carrying out the transport service, provided that the costs are covered by the principal;

– does not maintain at his own cost or risk stocks of the contract goods, including the costs of financing the stocks and the costs of loss of stocks and can return unsold goods to the principal without charge, unless the agent is liable for fault (for example, by failing to comply with reasonable security measures to avoid loss of stocks);

– does not undertake responsibility towards third parties for damage caused by the product sold (product liability), unless, as agent, he is liable for fault in this respect;

[10] See judgments in Case T-325/01, 15 September 2005, Daimler Chrysler v. Commission; Case C-217/05, 14 December 2006, Confederación Espanola de Empresarios de Estaciones de Servicio v CEPSA and Case C-279/06, 11 September 2008, CEPSA Estaciones de Servicio SA v. LV Tobar e Hijos SL.

– does not take responsibility for customers' non-performance of the contract, with the exception of the loss of the agent's commission, unless the agent is liable for fault (for example, by failing to comply with reasonable security or anti-theft measures or failing to comply with reasonable measures to report theft to the principal or police or to communicate to the principal all necessary information available to him on the customer's financial reliability);

– is not, directly or indirectly, obliged to invest in sales promotion, such as contributions to the advertising budgets of the principal;

– does not make market-specific investments in equipment, premises or training of personnel, such as for example the petrol storage tank in the case of petrol retailing or specific software to sell insurance policies in case of insurance agents, unless these costs are fully reimbursed by the principal;

– does not undertake other activities within the same product market required by the principal, unless these activities are fully reimbursed by the principal.

(17) This list is not exhaustive. However, where the agent incurs one or more of the above risks or costs, the agreement between agent and principal will not be qualified as an agency agreement. The question of risk must be assessed on a case-by-case basis, and with regard to the economic reality of the situation rather than the legal form. For practical reasons, the risk analysis may start with the assessment of the contract-specific risks. If contract-specific risks are incurred by the agent, this will be enough to conclude that the agent is an independent distributor. On the contrary, if the agent does not incur contract-specific risks, then it will be necessary to continue further the analysis by assessing the risks related to market-specific investments. Finally, if the agent does not incur any contract-specific risks and risks related to market-specific investments, the risks related to other required activities within the same product market may have to be considered.

(ii) The application of Article 101(1) to agency agreements

(18) In the case of agency agreements as defined above, the selling or purchasing function of the agent forms part of the principal's activities. Since the principal bears the commercial and financial risks related to the selling and purchasing of the contract goods and services all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 101(1). The following obligations on the agent's part will be considered to form an inherent part of an agency agreement, as each of them relates to the ability of the principal to fix the scope of activity of the agent in relation to the contract goods or services, which is essential if the principal is to take the risks and therefore to be in a position to determine the commercial strategy:

– limitations on the territory in which the agent may sell these goods or services;

– limitations on the customers to whom the agent may sell these goods or services;

– the prices and conditions at which the agent must sell or purchase these goods or services.

(19) In addition to governing the conditions of sale or purchase of the contract goods or services by the agent on behalf of the principal, agency agreements often contain provisions

which concern the relationship between the agent and the principal. In particular, they may contain a provision preventing the principal from appointing other agents in respect of a given type of transaction, customer or territory (exclusive agency provisions) and/or a provision preventing the agent from acting as an agent or distributor of undertakings which compete with the principal (single branding provisions). Since the agent is a separate undertaking from the principal, the provisions which concern the relationship between the agent and the principal may infringe Article 101(1). Exclusive agency provisions will in general not lead to anti-competitive effects. However, single branding provisions and post-term non-compete provisions, which concern inter-brand competition, may infringe Article 101(1) if they lead to or contribute to a (cumulative) foreclosure effect on the relevant market where the contract goods or services are sold or purchased (see in particular Section VI.2.1). Such provisions may benefit from the Block Exemption Regulation, in particular when the conditions provided in Article 5 thereof are fulfilled. They can also be individually justified by efficiencies under Article 101(3) as for instance described below in paragraphs 144-148.

(20) An agency agreement may also fall within the scope of Article 101(1), even if the principal bears all the relevant financial and commercial risks, where it facilitates collusion. This could for instance be the case when a number of principals use the same agents while collectively excluding others from using these agents, or when they use the agents to collude on marketing strategy or to exchange sensitive market information between the principals.

(21) Where the agent bears one or more of the relevant risks as described in paragraph 16, the agreement between agent and principal does not constitute an agency agreement for the purpose of applying Article 101(1). In that situation the agent will be treated as an independent undertaking and the agreement between agent and principal will be subject to Article 101(1) as any other vertical agreement.

3. Subcontracting agreements

(22) Subcontracting concerns a contractor providing technology or equipment to a subcontractor who undertakes to produce certain products on the basis thereof (exclusively) for the contractor. Subcontracting is covered by the Commission's Notice concerning the assessment of certain subcontracting agreements in relation to Article 81(1) of the Treaty (currently Article 101)[11]. According to this notice, which remains applicable, subcontracting agreements whereby the subcontractor undertakes to produce certain products exclusively for the contractor generally fall outside Article 101(1) provided that the technology or equipment is necessary to enable the subcontractor to produce the products. However, other restrictions imposed on the subcontractor such as the obligation not to conduct or exploit his own research and development or not to produce in general for third parties may be caught by Article 101[12].

III. APPLICATION OF THE BLOCK EXEMPTION REGULATION

1. Safe harbour created by the Block Exemption Regulation

(23) For most vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels. Provided that they do not contain hardcore

[11] OJ C 1, 3.1.1979, p. 2.

[12] See paragraph 3 of the subcontracting notice.

restrictions of competition, which are restrictions of competition by object, the Block Exemption Regulation creates a presumption of legality for vertical agreements depending on the market share of the supplier and the buyer. Pursuant to Article 3 of the Block Exemption Regulation, it is the supplier's market share on the market where it sells the contract goods or services and the buyer's market share on the market where it purchases the contract goods or services which determine the applicability of the block exemption. In order for the block exemption to apply, the supplier's and the buyer's market share must each be 30 % or less. Section V of these Guidelines provides guidance on how to define the relevant market and calculate the market shares. Above the market share threshold of 30 %, there is no presumption that vertical agreements are caught by Article 101(1) or fail to satisfy the conditions of Article 101(3) but there is also no presumption that vertical agreements falling within the scope of Article 101(1) will usually satisfy the conditions of Article 101(3).

2. Scope of the Block Exemption Regulation

(i) Definition of vertical agreements

(24) Article 1(1)(a) of the Block Exemption Regulation defines a "vertical agreement" as "an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services".

(25) There are four main elements in this definition:

– The Block Exemption Regulation applies to agreements and concerted practices. The Block Exemption Regulation does not apply to unilateral conduct of the undertakings concerned. Such unilateral conduct can fall within the scope of Article 102 of the Treaty which prohibits abuses of a dominant position. For there to be an agreement within the meaning of Article 101 it is sufficient that the parties have expressed their joint intention to conduct themselves on the market in a specific way. The form in which that intention is expressed is irrelevant as long as it constitutes a faithful expression of the parties' intention. In case there is no explicit agreement expressing the concurrence of wills, the Commission will have to prove that the unilateral policy of one party receives the acquiescence of the other party. For vertical agreements, there are two ways in which acquiescence with a particular unilateral policy can be established. First, the acquiescence can be deduced from the powers conferred upon the parties in a general agreement drawn up in advance. If the clauses of the agreement drawn up in advance provide for or authorise a party to adopt subsequently a specific unilateral policy which will be binding on the other party, the acquiescence of that policy by the other party can be established on the basis thereof[13]. Secondly, in the absence of such an explicit acquiescence, the Commission can show the existence of tacit acquiescence. For that it is necessary to show first that one party requires explicitly or implicitly the cooperation of the other party for the implementation of its unilateral policy and second that the other party complied with that requirement by implementing that unilateral policy in practice[14]. For instance, if after a supplier's announcement of a unilateral reduction of supplies in

[13] Case C-74/04 P, 13 July 2006, Commission v. Volkswagen AG

[14] Case T-41/96, 26 October 2000, Bayer AG v. Commission

order to prevent parallel trade, distributors reduce immediately their orders and stop engaging in parallel trade, then those distributors tacitly acquiesce to the supplier's unilateral policy. This can however not be concluded if the distributors continue to engage in parallel trade or try to find new ways to engage in parallel trade. Similarly, for vertical agreements, tacit acquiescence may be deduced from the level of coercion exerted by a party to impose its unilateral policy on the other party or parties to the agreement in combination with the number of distributors who are actually implementing in practice the unilateral policy of the supplier. For instance, a system of monitoring and penalties, set up by a supplier to penalise those distributors who do not comply with its unilateral policy, points to tacit acquiescence with the supplier's unilateral policy if this system allows the supplier to implement in practice its policy. The two ways of establishing acquiescence described above can be used jointly;

– The agreement or concerted practice is between two or more undertakings. Vertical agreements with final consumers not operating as an undertaking are not covered by the Block Exemption Regulation. More generally, agreements with final consumers do not fall under Article 101(1), as that article applies only to agreements between undertakings, decisions by associations of undertakings and concerted practices of undertakings. This is without prejudice to the possible application of Article 102;

– The agreement or concerted practice is between undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain. This means for instance that one undertaking produces a raw material which the other undertaking uses as an input, or that the first is a manufacturer, the second a wholesaler and the third a retailer. This does not preclude an undertaking from being active at more than one level of the production or distribution chain;

– The agreements or concerted practices relate to the conditions under which the parties to the agreement, the supplier and the buyer, "may purchase, sell or resell certain goods or services". This reflects the purpose of the Block Exemption Regulation to cover purchase and distribution agreements. These are agreements which concern the conditions for the purchase, sale or resale of the goods or services supplied by the supplier and/or which concern the conditions for the sale by the buyer of the goods or services which incorporate these goods or services. For the application of the Block Exemption Regulation both the goods or services supplied by the supplier and the resulting goods or services are considered to be contract goods or services. Vertical agreements relating to all final and intermediate goods and services are covered. The only exception is the automobile sector, as long as this sector remains covered by a specific block exemption such as that granted by Commission Regulation (EC) No 1400/2002[15] or its successor. The goods or services provided by the supplier may be resold by the buyer or may be used as an input by the buyer to produce his own goods or services.

(26) The Block Exemption Regulation also applies to goods sold and purchased for renting to third parties. However, rent and lease agreements as such are not covered, as no good or service is being sold by the supplier to the buyer. More generally, the Block Exemption Regulation does not cover restrictions or obligations that do not relate to the conditions of

[15] OJ L 203, 31.7.2002, p. 30.

purchase, sale and resale, such as an obligation preventing parties from carrying out independent research and development which the parties may have included in an otherwise vertical agreement. In addition, Article 2(2) to (5) directly or indirectly excludes certain vertical agreements from the application of the Block Exemption Regulation.

(ii) Vertical agreements between competitors

(27) Article 2(4) of the Block Exemption Regulation explicitly excludes from its application "vertical agreements entered into between competing undertakings". Vertical agreements between competitors are dealt with, as regards possible collusion effects, in the Guidelines on the applicability of Article 101 to horizontal cooperation agreements[16]. However, the vertical aspects of such agreements need to be assessed under these Guidelines. Article 1(1)(c) of the Block Exemption Regulation defines a competing undertaking as "an actual or potential competitor". Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, absent the agreement, in case of a small but permanent increase in relative prices it is likely that this first company, within a short period of time normally not longer than 1 year, would undertake the necessary additional investments or other necessary switching costs to enter the relevant market on which the other company is active. This assessment has to be based on realistic grounds; the mere theoretical possibility of entering a market is not sufficient[17]. A distributor who provides specifications to a manufacturer to produce particular goods under the distributor's brand name is not to be considered a manufacturer of such own-brand goods.

(28) Article 2(4) of the Block Exemption Regulation contains two exceptions to the general exclusion of vertical agreements between competitors. These exceptions concern non-reciprocal agreements. Non-reciprocal agreements between competitors are covered by the Block Exemption Regulation where (1) the supplier is a manufacturer and distributor of goods, while the buyer is only a distributor and not also a competing undertaking at the manufacturing level, or (2) the supplier is a provider of services operating at several levels of trade, while the buyer operates at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services. The first exception covers situations of dual distribution, i.e. the manufacturer of particular goods also acts as a distributor of the goods in competition with independent distributors of his goods. In case of dual distribution it is considered that in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing or retail level. The second exception covers similar situations of dual distribution, but in this case for services, when the supplier is also a provider of products at the retail level where the buyer operates.

(iii) Associations of retailers

(29) Article 2(2) of the Block Exemption Regulation includes in its application vertical agreements entered into by an association of undertakings which fulfils certain conditions and thereby excludes from the Block Exemption Regulation vertical agreements entered into by

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16 OJ C 3 of 06.01.2001. A revision of these Guidelines is forthcoming.

17 See Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5, at paragraphs 20 to 24, the Commission's Thirteenth Report on Competition Policy, point 55, and Commission Decision 90/410/EEC in Case No IV/32.009 — Elopak/Metal Box-Odin, OJ L 209, 8.8.1990, p. 15.

all other associations. Vertical agreements entered into between an association and its members, or between an association and its suppliers, are covered by the Block Exemption Regulation only if all the members are retailers of goods (not services) and if each individual member of the association has a turnover not exceeding EUR 50 million. Retailers are distributors reselling goods to final consumers. Where only a limited number of the members of the association have a turnover exceeding the EUR 50 million threshold and where these members together represent less than 15% of the collective turnover of all the members combined, this will normally not change the assessment under Article 101.

(30) An association of undertakings may involve both horizontal and vertical agreements. The horizontal agreements have to be assessed according to the principles set out in the Guidelines on the applicability of Article 101 to horizontal cooperation agreements. If this assessment leads to the conclusion that a cooperation between undertakings in the area of purchasing or selling is acceptable, a further assessment will be necessary to examine the vertical agreements concluded by the association with its suppliers or its individual members. The latter assessment will follow the rules of the Block Exemption Regulation and these Guidelines. For instance, horizontal agreements concluded between the members of the association or decisions adopted by the association, such as the decision to require the members to purchase from the association or the decision to allocate exclusive territories to the members have to be assessed first as a horizontal agreement. Only if this assessment is positive does it become relevant to assess the vertical agreements between the association and individual members or between the association and suppliers.

(iv) Vertical agreements containing provisions on intellectual property rights (IPRs)

(31) Article 2(3) of the Block Exemption Regulation includes in its application vertical agreements containing certain provisions relating to the assignment of IPRs to or use of IPRs by the buyer and thereby excludes from the Block Exemption Regulation all other vertical agreements containing IPR provisions. The Block Exemption Regulation applies to vertical agreements containing IPR provisions when five conditions are fulfilled:

– The IPR provisions must be part of a vertical agreement, i.e. an agreement with conditions under which the parties may purchase, sell or resell certain goods or services;

– The IPRs must be assigned to, or licensed for use by, the buyer;

– The IPR provisions must not constitute the primary object of the agreement;

– The IPR provisions must be directly related to the use, sale or resale of goods or services by the buyer or his customers. In the case of franchising where marketing forms the object of the exploitation of the IPRs, the goods or services are distributed by the master franchisee or the franchisees;

– The IPR provisions, in relation to the contract goods or services, must not contain restrictions of competition having the same object as vertical restraints which are not exempted under the Block Exemption Regulation.

(32) These conditions ensure that the Block Exemption Regulation applies to vertical agreements where the use, sale or resale of goods or services can be performed more effectively because IPRs are assigned to or licensed for use by the buyer. In other words,

restrictions concerning the assignment or use of IPRs can be covered when the main object of the agreement is the purchase or distribution of goods or services.

(33) The first condition makes clear that the context in which the IPRs are provided is an agreement to purchase or distribute goods or an agreement to purchase or provide services and not an agreement concerning the assignment or licensing of IPRs for the manufacture of goods, nor a pure licensing agreement. The Block Exemption Regulation does not cover for instance:

– agreements where a party provides another party with a recipe and licenses the other party to produce a drink with this recipe;

– agreements under which one party provides another party with a mould or master copy and licenses the other party to produce and distribute copies;

– the pure licence of a trade mark or sign for the purposes of merchandising;

– sponsorship contracts concerning the right to advertise oneself as being an official sponsor of an event;

– copyright licensing such as broadcasting contracts concerning the right to record and/or broadcast an event.

(34) The second condition makes clear that the Block Exemption Regulation does not apply when the IPRs are provided by the buyer to the supplier, no matter whether the IPRs concern the manner of manufacture or of distribution. An agreement relating to the transfer of IPRs to the supplier and containing possible restrictions on the sales made by the supplier is not covered by the Block Exemption Regulation. This means in particular that subcontracting involving the transfer of know-how to a subcontractor[18] does not fall within the scope of application of the Block Exemption Regulation (see also paragraph 22 above). However, vertical agreements under which the buyer provides only specifications to the supplier which describe the goods or services to be supplied are covered by the Block Exemption Regulation.

(35) The third condition makes clear that in order to be covered by the Block Exemption Regulation the primary object of the agreement must not be the assignment or licensing of IPRs. The primary object must be the purchase, sale or resale of goods or services and the IPR provisions must serve the implementation of the vertical agreement.

(36) The fourth condition requires that the IPR provisions facilitate the use, sale or resale of goods or services by the buyer or his customers. The goods or services for use or resale are usually supplied by the licensor but may also be purchased by the licensee from a third supplier. The IPR provisions will normally concern the marketing of goods or services. This is for instance the case in a franchise agreement where the franchisor sells to the franchisee goods for resale and in addition licenses the franchisee to use his trade mark and know-how to market the goods. Also covered is the case where the supplier of a concentrated extract licenses the buyer to dilute and bottle the extract before selling it as a drink.

(37) The fifth condition signifies in particular that the IPR provisions should not have the same object as any of the hardcore restrictions listed in Article 4 of the Block Exemption

[18] See Notice on subcontracting, OJ C 1, 3.1.1979, p. 2.

Regulation or any of the restrictions excluded from the coverage of the Block Exemption Regulation by Article 5 (see paragraphs 47 to 69).

(38) Intellectual property rights which may be considered to serve the implementation of vertical agreements within the meaning of Article 2(3) of the Block Exemption Regulation generally concern three main areas: trade marks, copyright and know-how.

Trade mark

(39) A trade mark licence to a distributor may be related to the distribution of the licensor's products in a particular territory. If it is an exclusive licence, the agreement amounts to exclusive distribution.

Copyright

(40) Resellers of goods covered by copyright (books, software, etc.) may be obliged by the copyright holder only to resell under the condition that the buyer, whether another reseller or the end user, shall not infringe the copyright. Such obligations on the reseller, to the extent that they fall under Article 101(1) at all, are covered by the Block Exemption Regulation.

(41) Agreements, under which hard copies of software are supplied for resale and where the reseller does not acquire a licence to any rights over the software but only has the right to resell the hard copies, are to be regarded as agreements for the supply of goods for resale for the purpose of the Block Exemption Regulation. Under this form of distribution the licence of the software only takes place between the copyright owner and the user of the software. This may take the form of a "shrink wrap" licence, i.e. a set of conditions included in the package of the hard copy which the end user is deemed to accept by opening the package.

(42) Buyers of hardware incorporating software protected by copyright may be obliged by the copyright holder not to infringe the copyright, for example not to make copies and resell the software or not to make copies and use the software in combination with other hardware. Such use-restrictions, to the extent that they fall within Article 101(1) at all, are covered by the Block Exemption Regulation.

Know-how

(43) Franchise agreements, with the exception of industrial franchise agreements, are the most obvious example where know-how for marketing purposes is communicated to the buyer.[19] Franchise agreements contain licences of intellectual property rights relating to trade marks or signs and know-how for the use and distribution of goods or the provision of services. In addition to the licence of IPR, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance, such as procurement services, training, advice on real estate, financial planning etc. The licence and the assistance are integral components of the business method being franchised.

(44) Licensing contained in franchise agreements is covered by the Block Exemption Regulation if all five conditions listed in paragraph 31 are fulfilled. This is usually the case, as under most franchise agreements, including master franchise agreements, the franchisor

[19] Paragraphs 43-45 apply by analogy to other types of distribution agreements which involve the transfer of substantial know-how from supplier to buyer.

provides goods and/or services, in particular commercial or technical assistance services, to the franchisee. The IPRs help the franchisee to resell the products supplied by the franchisor or by a supplier designated by the franchisor or to use those products and sell the resulting goods or services. Where the franchise agreement only or primarily concerns licensing of IPRs, such an agreement is not covered by the Block Exemption Regulation, but the Commission will, as a general rule, apply to it the principles set out in this Block Exemption Regulation and these Guidelines.

(45) The following IPR-related obligations are generally considered to be necessary to protect the franchisor's intellectual property rights and are, if these obligations fall under Article 101(1), also covered by the Block Exemption Regulation:

(a) an obligation on the franchisee not to engage, directly or indirectly, in any similar business;

(b) an obligation on the franchisee not to acquire financial interests in the capital of a competing undertaking such as would give the franchisee the power to influence the economic conduct of such undertaking;

(c) an obligation on the franchisee not to disclose to third parties the know-how provided by the franchisor as long as this know-how is not in the public domain;

(d) an obligation on the franchisee to communicate to the franchisor any experience gained in exploiting the franchise and to grant it, and other franchisees, a non-exclusive licence for the know-how resulting from that experience;

(e) an obligation on the franchisee to inform the franchisor of infringements of licensed intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers;

(f) an obligation on the franchisee not to use know-how licensed by the franchisor for purposes other than the exploitation of the franchise;

(g) an obligation on the franchisee not to assign the rights and obligations under the franchise agreement without the franchisor's consent.

(v) Relationship to other block exemption regulations

(46) Article 2(5) states that the Block Exemption Regulation does "not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation, unless otherwise provided for in such a regulation". This means that the Block Exemption Regulation does not apply to vertical agreements covered by Commission Regulation (EC) No 772/2004[20] on technology transfer, Commission Regulation (EC) No 1400/2002[21] for car distribution or Regulations (EC) No 2658/2000[22] and (EC) No

[20] Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, OJ L 123, 27.04.2004, p. 11-17

[21] Commission Regulation 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector, OJ L 203, 31.7.2002, p. 30

[22] Commission Regulation (EC) No 2658/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements, OJ L 304, 05.12.2000, p. 3

2659/2000[23] exempting vertical agreements concluded in connection with horizontal agreements, or any future regulations of that kind, unless otherwise provided for in such a regulation.

3. Hardcore restrictions under the Block Exemption Regulation

(47) The Block Exemption Regulation contains in Article 4 a list of hardcore restrictions which lead to the exclusion of the whole vertical agreement from the scope of application of the Block Exemption Regulation.[24] Including such a hardcore restriction in an agreement gives rise to the presumption that the agreement falls within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply. However, undertakings have the possibility to demonstrate pro-competitive effects under Article 101(3) in an individual case.[25] 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 101(3) are fulfilled, this will require the Commission to effectively assess the likely negative impact on competition before making the ultimate assessment of whether the conditions of Article 101(3) are fulfilled.[26]

(48) The hardcore restriction set out in Article 4(a) of the Block Exemption Regulation concerns resale price maintenance (RPM), that is agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer. In the case of contractual provisions or concerted practices that directly establish the resale price, the restriction is clear cut. However, RPM can also be achieved through indirect means. Examples of the latter are an agreement fixing the distribution margin, fixing the maximum level of discount the distributor can grant from a prescribed price level, making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level, linking the prescribed resale price to the resale prices of competitors, threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level. Direct or indirect means of achieving price fixing can be made more effective when combined with measures to identify price-cutting distributors, such as the implementation of a price monitoring system, or the obligation on retailers to report other members of the distribution network who deviate from the standard price level. Similarly, direct or indirect price fixing can be made more effective when combined with measures which may reduce the buyer's incentive to lower the resale price, such as the supplier printing a recommended resale price on the product or the supplier obliging the buyer to apply a most-

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23 Commission Regulation (EC) No 2659/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of research and development agreements OJ L 304, 05.12.2000, p. 7

24 This list of hardcore restrictions applies to vertical agreements concerning trade within the Community. In so far as vertical agreements concern exports outside the Community or imports/re-imports from outside the Community see the judgment in Case C-306/96 Javico v Yves Saint Laurent [1998] ECR I. In that judgment the ECJ held in paragraph 20 that "an agreement in which the reseller gives to the producer an undertaking that he will sell the contractual products on a market outside the Community cannot be regarded as having the object of appreciably restricting competition within the common market or as being capable of affecting, as such, trade between Member States."

25 See in particular paragraphs 106 to 109 describing in general possible efficiencies related to vertical restraints and Section VI.2.2.10 on resale price restrictions. See for general guidance on this the Guidelines on the application of Article 81(3) of the Treaty, cited in note 4

26 Although, in legal terms, these are two distinct steps, they may in practice be an iterative process where the parties and Commission in several steps enhance and improve their respective arguments.

favoured-customer clause. The same indirect means and the same "supportive" measures can be used to make maximum or recommended prices work as RPM. However, the use of a particular supportive measure or the provision of a list of recommended prices or maximum prices by the supplier to the buyer is not considered in itself as leading to RPM.

(49) In the case of agency agreements, the principal normally establishes the sales price, as the agent does not become the owner of the goods. However, where such an agreement cannot be qualified as an agency agreement for the purposes of applying Article 101(1) (see paragraphs 12 to 21) an obligation preventing or restricting the agent from sharing his commission, fixed or variable, with the customer would be a hardcore restriction under Article 4(a) of the Block Exemption Regulation. In order to avoid including this hardcore restriction in the agreement, the agent should thus be left free to lower the effective price paid by the customer without reducing the income for the principal[27].

(50) The hardcore restriction set out in Article 4(b) of the Block Exemption Regulation concerns agreements or concerted practices that have as their direct or indirect object the restriction of sales by a buyer party to the agreement or its customers, in as far as those restrictions relate to the territory into which or the customers to whom the buyer or its customers may sell the contract goods or services. This hardcore restriction relates to market partitioning by territory or by customer group. That may be the result of direct obligations, such as the obligation not to sell to certain customers or to customers in certain territories or the obligation to refer orders from these customers to other distributors. It may also result from indirect measures aimed at inducing the distributor not to sell to such customers, such as refusal or reduction of bonuses or discounts, termination of supply, reduction of supplied volumes or limitation of supplied volumes to the demand within the allocated territory or customer group, threat of contract termination, requiring a higher price for products to be exported, limiting the proportion of sales that can be exported or profit pass-over obligations. It may further result from the supplier not providing a Union-wide guarantee service under which normally all distributors are obliged to provide the guarantee service and are reimbursed for this service by the supplier, even in relation to products sold by other distributors into their territory[28]. These practices are even more likely to be viewed as a restriction of the buyer's sales when used in conjunction with the implementation by the supplier of a monitoring system aimed at verifying the effective destination of the supplied goods, e.g. the use of differentiated labels or serial numbers. However, obligations on the reseller relating to the display of the supplier's brand name are not classified as hardcore. As Article 4(b) only concerns restrictions of sales by the buyer or its customers, this implies that restrictions of the supplier’s sales are also not a hardcore restriction, subject to what is said below regarding sales of spare parts in the context of Article 4(e) of the Block Exemption Regulation. Article 4(b) applies without prejudice to a restriction on the buyer's place of establishment. Thus, the benefit of the Block Exemption Regulation is not lost if it is agreed that the buyer will restrict its distribution outlet(s) and warehouse(s) to a particular address, place or territory.

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[27] See, for instance, Commission Decision 91/562/EEC in Case No IV/32.737 — Eirpage, OJ L 306, 7.11.1991, p. 22, in particular point (6).

[28] If the supplier decides not to reimburse its distributors for services rendered under the Union-wide guarantee, it may be agreed with these distributors that a distributor which makes a sale outside its allocated territory, will have to pay the distributor appointed in the territory of destination a fee based on the cost of the services (to be) carried out including a reasonable profit margin. This type of scheme may not be seen as a restriction of the distributors' sales outside their territory (see the judgment in Case T-67/01, 13 January 2004, JCB Service v. Commission).

(51) There are four exceptions to the hardcore restriction in Article 4(b) of the Block Exemption Regulation. The first exception in Article 4(b)(i) allows a supplier to restrict active sales by a buyer party to the agreement to a territory or a customer group which has been allocated exclusively to another buyer or which the supplier has reserved to itself. A territory or customer group is exclusively allocated when the supplier agrees to sell his product only to one distributor for distribution in a particular territory or to a particular customer group and the exclusive distributor is protected against active selling into his territory or to his customer group by all the other buyers of the supplier inside the Union, irrespective of sales by the supplier. The supplier is allowed to combine the allocation of an exclusive territory and an exclusive customer group by for instance appointing an exclusive distributor for a particular customer group in a certain territory. This protection of exclusively allocated territories or customer groups must, however, permit passive sales to such territories or customer groups. For the application of Article 4(b) of the Block Exemption Regulation, the Commission interprets «active» and «passive» sales as follows:

– «Active» sales mean actively approaching individual customers by for instance direct mail, including the sending of unsolicited e-mails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory.

– «Passive» sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion that reaches customers in other distributors' (exclusive) territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in one's own territory, are passive sales. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' (exclusive) territories or customer groups.

(52) The internet is a powerful tool to reach more and different customers than will be reached when only more traditional sales methods are used and this is why certain restrictions on the use of the internet are dealt with as (re)sales restrictions. In principle, every distributor must be allowed to use the internet to sell products. In general, having a website is considered a form of passive selling, since it is a reasonable way to allow customers to reach the distributor. The fact that it may have effects outside one's own territory or customer group results from the technology, i.e. the easy access from everywhere. If a customer visits the web site of a distributor and contacts the distributor and if such contact leads to a sale, including delivery, then that is considered passive selling. The same holds if a customer opts to be kept (automatically) informed by the distributor and this leads to a sale. On their own the language options used on the website or in the communication are considered a part of passive selling. The Commission thus regards for instance the following as hardcore restrictions of passive selling in view of the capability of these restrictions to limit the distributor to reach more and different customers:

– agreeing that the (exclusive) distributor shall prevent customers located in another (exclusive) territory to view its website or shall put on its website automatic re-

routing of customers to the manufacturer's or other (exclusive) distributors' websites. This does not exclude agreeing that the distributor's website in addition offers a number of links to websites of other distributors and/or the supplier;

– agreeing that the (exclusive) distributor shall terminate consumers' transactions over the internet once their credit card data reveal an address that is not within the distributor's (exclusive) territory;

– agreeing that the distributor shall limit its proportion of overall sales made over the internet. 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 56). 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;

– agreeing that the distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line. This does not exclude the supplier agreeing with the buyer a fixed fee (i.e. not a variable fee where the sum increases with the realised off-line turnover as this would amount indirectly to dual pricing) to support the latter's off-line or online sales efforts.

(53) A restriction on the use of the internet by distributors party to the agreement is compatible with the Block Exemption Regulation to the extent that promotion on the internet or use of the internet would lead to active selling into, for instance, other distributors' exclusive territories or customer groups. The Commission considers online advertisement specifically addressed to certain customers a form of active selling to these customers. For instance, territory based banners on third party websites are a form of active sales into the territory where these banners are shown. In general, efforts to be found specifically in a certain territory or by a certain customer group is active selling into that territory or to that customer group. For instance, paying a search engine or online advertisement provider to have advertisement displayed specifically to users in a particular territory is active selling into that territory.

(54) Notwithstanding what has been said before, under the block exemption the supplier may require quality standards for the use of the internet site to resell his goods, just as the supplier may require quality standards for a shop or for selling by catalogue or for advertising and promotion in general. This may be relevant in particular for selective distribution. Under the block exemption the supplier may for instance require its distributors to have one or more brick and mortar shops or showrooms as a condition for becoming a member of its distribution system. Subsequent changes to such a condition are also possible under the block exemption, except if these changes have as their object to directly or indirectly limit the online sales by the distributors. Similarly, a supplier may require that its distributors use third party platforms to distribute the contract products only in accordance with the standards and conditions agreed between the supplier and its distributors for the distributors' use of the internet. For instance, where the distributor's website is hosted by a third party platform, the supplier may require that customers do not visit the distributor's website through a site carrying the name or logo of the third party platform.

(55) There are three other exceptions to the hardcore restriction set out in Article 4(b) of the Block Exemption Regulation. All three exceptions allow for the restriction of both active and passive sales. Under the first exception it is permissible to restrict a wholesaler from selling to end users, which allows a supplier to keep the wholesale and retail level of trade separate. This exception also covers allowing the wholesaler to sell to certain end users, for instance bigger end users, while not allowing sales to (all) other end users. The second exception allows a supplier to restrict an appointed distributor in a selective distribution system from selling, at any level of trade, to unauthorised distributors located in any territory where the system is currently operated or where the supplier does not yet sell the contract products (referred to as "the territory reserved by the supplier to operate that system" in Article 4(b)(iii)). The third exception allows a supplier to restrict a buyer of components, to whom the components are supplied for incorporation, from reselling them to competitors of the supplier. The term "component" includes any intermediate goods and the term "incorporation" refers to the use of any input to produce goods.

(56) The hardcore restriction set out in Article 4(c) of the Block Exemption Regulation excludes the restriction of active or passive sales to end users, whether professional end users or final consumers, by members of a selective distribution network, without prejudice to the possibility of prohibiting a member of the network from operating out of an unauthorised place of establishment. This means that dealers in a selective distribution system, as defined in Article 1(1)(e) of the Block Exemption Regulation, cannot be restricted in the users or purchasing agents acting on behalf of these users to whom they may sell, except to protect an exclusive distribution system operated elsewhere (see paragraph 51 above). Within a selective distribution system the dealers should be free to sell, both actively and passively, to all end users, also with the help of the internet. Therefore, the Commission regards as a hardcore restriction any obligations which dissuade appointed dealers from using the internet to reach more and different customers by imposing criteria for online sales which are not overall equivalent to the criteria imposed for the sales from the brick and mortar shop. This does not mean that the criteria imposed for online sales must be identical to those imposed for off-line sales, but rather that they should pursue the same objectives and achieve comparable results and that the difference between the criteria must be justified by the different nature of these two distribution modes. This can be illustrated with the following examples. In order to prevent sales to unauthorised dealers, a supplier can require its selected dealers not to sell to an individual end user more than a given quantity of contract products. This requirement may have to be stricter for online sales if it is easier for an unauthorised dealer to obtain those products by using the internet. Similarly, it may have to be stricter for off-line sales if it is easier to obtain them from a brick and mortar shop. In order to ensure timely delivery of contract products, for offline sales a supplier may impose that the products be delivered instantly. Whereas an identical requirement cannot be imposed for online sales, the supplier may specify certain practicable delivery times for these sales. For online sales specific requirements may have to be formulated for an online after-sales help desk, for covering the costs of customers returning the product and for applying secure payment systems.

(57) This also means that within the territory where the supplier operates selective distribution, this system may not be combined with exclusive distribution as that would lead to a restriction of active or passive selling by the dealers, with the exception that restrictions can be imposed on the dealer's ability to determine the location of his business premises. Selected dealers may be prevented from running their business from different premises or from opening a new outlet in a different location. In this context, the use by a distributor of its own website cannot be assimilated to the opening of a new outlet in a different location. If the

dealer's outlet is mobile ("shop on wheels"), an area may be defined outside which the mobile outlet cannot be operated. In addition, the supplier may commit itself to supplying only one dealer or a limited number of dealers in a particular part of the territory where the selective distribution system is applied.

(58) The hardcore restriction set out in Article 4(d) of the Block Exemption Regulation concerns the restriction of cross-supplies between appointed distributors within a selective distribution system. This means that an agreement or concerted practice may not have as its direct or indirect object to prevent or restrict the active or passive selling of the contract products between the selected distributors. Selected distributors must remain free to purchase the contract products from other appointed distributors within the network, operating either at the same or at a different level of trade. This means that selective distribution cannot be combined with vertical restraints aimed at forcing distributors to purchase the contract products exclusively from a given source. It also means that within a selective distribution network no restrictions can be imposed on appointed wholesalers as regards their sales of the product to appointed retailers.

(59) The hardcore restriction set out in Article 4(e) of the Block Exemption Regulation concerns agreements that prevent or restrict end-users, independent repairers and service providers from obtaining spare parts directly from the manufacturer of these spare parts. An agreement between a manufacturer of spare parts and a buyer who incorporates these parts into his own products (original equipment manufacturer (OEM)), may not, either directly or indirectly, prevent or restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers. Indirect restrictions may arise in particular when the supplier of the spare parts is restricted in supplying technical information and special equipment which are necessary for the use of spare parts by users, independent repairers or service providers. However, the agreement may place restrictions on the supply of the spare parts to the repairers or service providers entrusted by the original equipment manufacturer with the repair or servicing of its own goods. In other words, the original equipment manufacturer may require its own repair and service network to buy the spare parts from it.

4. Individual cases of hardcore sales restrictions that may fall outside Article 101(1) or may fulfil the conditions of article 101(3)

(60) Hardcore restrictions may exceptionally be objectively necessary for the existence of an agreement of a particular type or nature[29] and fall outside Article 101(1), such as when necessary to align on a public ban on selling dangerous substances to certain customers for reasons of safety or health. In addition, undertakings have the possibility to plead an efficiency defence under Article 101(3) in an individual case. This section provides some examples for (re)sales restrictions, whereas for RPM this is dealt with in section VI.2.10.

(61) A distributor which will be the first to sell a new brand or the first to sell an existing brand on a new market, thereby ensuring a genuine entry in the relevant market, may have to commit substantial investments to start up and/or develop the new market where there was previously no demand for that type of product in general or for that type of product from that producer. Such expenses may often be sunk and in such circumstances it could well be the case that the distributor would not enter into the distribution agreement without protection for

[29] See paragraph 18 of the Communication from the Commission - Notice – Guidelines on the application of Article 81(3) of the Treaty, OJ C 101, 27.4.2004, p. 97-118.

a certain period of time against (active and) passive sales into its territory or to its customer group by other distributors. For instance, where a manufacturer established in a particular national market enters another national market and introduces its products with the help of an exclusive distributor and where this distributor needs to invest in launching and establishing the brand in this new market. Where substantial investments by the distributor to start up and/or develop the new market are necessary, restrictions of passive sales by other distributors into such a territory or to such a customer group which are necessary for the distributor to recoup these investments generally fall outside Article 101(1) during the first two years that this distributor is selling the contract goods or services in that territory or to that customer group, even though such hardcore restrictions are in general presumed to fall within Article 101(1).

(62) In the case of genuine testing of a new product in a limited territory or with a limited customer group and in the case of a staggered introduction of a new product, the distributors appointed to sell the new product on the test market or to participate in the first round(s) of the staggered introduction can be restricted in their active selling outside the test market or the market(s) where the product is first introduced without being caught by Article 101(1) for the period necessary for the testing or introduction of the product.

(63) In the case of a selective distribution system cross supplies between appointed distributors must normally remain free (see paragraph 58 above). However, if appointed wholesalers located in different territories have to invest in promotional activities in 'their' territories to support the sales by appointed retailers and it is not practical to agree by contract effective promotion requirements, restrictions on active sales by the wholesalers to appointed retailers in other wholesalers' territories to overcome possible free riding may in an individual case fulfil the conditions of Article 101(3).

(64) In general, agreeing that a distributor shall pay a higher price for products intended to be resold by the distributor online than for products intended to be resold off-line is a hardcore restriction (see paragraph 52 above). However, in a particular case where a manufacturer agrees such dual pricing with its distributors, charging more for sales to be made on-line, because sales on-line lead to substantially higher costs for the manufacturer than sales made off-line, for instance because the latter are normally including home installation by the distributor while the former are not and therewith lead to more customer complaints and warranty claims to the manufacturer, the agreement may fulfil the conditions of Article 101(3). In that context, the Commission will also investigate to what extent the restriction is likely to limit internet sales and hinder the distributor to reach more and different customers.

5. Excluded restrictions under the Block Exemption Regulation

(65) Article 5 of the Block Exemption Regulation excludes certain obligations from the coverage of the Block Exemption Regulation even though the market share threshold is not exceeded. However, the Block Exemption Regulation continues to apply to the remaining part of the vertical agreement if that part is severable from the non-exempted obligations.

(66) The first exclusion is provided in Article 5(1)(a) of the Block Exemption Regulation and concerns non-compete obligations. Non-compete obligations are arrangements that result in the buyer purchasing from the supplier or from another undertaking designated by the supplier more than 80 % of the buyer's total purchases of the contract goods and services and their substitutes during the previous year (see the definition in Article 1(1)(d) of the Block

Exemption Regulation), thereby preventing the buyer from purchasing competing goods or services or limiting such purchases to less than 20 % of total purchases. Where, in the first year after entering in the agreement, for the year preceding the conclusion of the contract no relevant purchasing data for the buyer are available, the buyer's best estimate of his annual total requirements may be used. Such non-compete obligations are not covered by the Block Exemption Regulation when their duration is indefinite or exceeds five years. Non-compete obligations that are tacitly renewable beyond a period of five years are also not covered by the Block Exemption Regulation (see Article 5(1) last subparagraph). In general, non-compete obligations are covered when their duration is limited to five years or less and no obstacles exist that hinder the buyer from effectively terminating the non-compete obligation at the end of the five year period. If for instance the agreement provides for a five-year non-compete obligation and the supplier provides a loan to the buyer, the repayment of that loan should not hinder the buyer from effectively terminating the non-compete obligation at the end of the five-year period. Similarly, when the supplier provides the buyer with equipment which is not relationship-specific, the buyer should have the possibility to take over the equipment at its market asset value at the end of the non-compete obligation.

(67) The five-year duration limit does not apply when the goods or services are resold by the buyer "from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer". In such cases the non-compete obligation may be of the same duration as the period of occupancy of the point of sale by the buyer (Article 5(2) of the Block Exemption Regulation). The reason for this exception is that it is normally unreasonable to expect a supplier to allow competing products to be sold from premises and land owned by the supplier without his permission. By analogy, the same principles apply where the buyer operates from a mobile outlet (shop on wheels) owned by the supplier or leased by the supplier from third parties not connected with the buyer. Artificial ownership constructions, such as a transfer by the distributor of its proprietary rights over the land and premises to the supplier for only a limited period, intended to avoid the five-year limit cannot benefit from this exception.

(68) The second exclusion from the block exemption is provided for in Article 5(1)(b) of the Block Exemption Regulation and concerns post term non-compete obligations on the buyer. Such obligations are normally not covered by the Block Exemption Regulation, unless the obligation is indispensable to protect know-how transferred by the supplier to the buyer, is limited to the point of sale from which the buyer has operated during the contract period, and is limited to a maximum period of one year (see Article 5(2)). According to the definition in Article 1(1)(g) of the Block Exemption Regulation the know-how needs to be "substantial", meaning "that the know-how includes information which is significant and useful to the buyer for the use, sale or resale of the contract goods or services".

(69) The third exclusion from the block exemption is provided for in Article 5(1)(c) of the Block Exemption Regulation and concerns the sale of competing goods in a selective distribution system. The Block Exemption Regulation covers the combination of selective distribution with a non-compete obligation, obliging the dealers not to resell competing brands in general. However, if the supplier prevents his appointed dealers, either directly or indirectly, from buying products for resale from specific competing suppliers, such an obligation cannot enjoy the benefit of the Block Exemption Regulation. The objective of the exclusion of this obligation is to avoid a situation whereby a number of suppliers using the same selective distribution outlets prevent one specific competitor or certain specific

competitors from using these outlets to distribute their products (foreclosure of a competing supplier which would be a form of collective boycott)[30].

6. Severability

(70) The Block Exemption Regulation exempts vertical agreements on condition that no hardcore restriction, as set out in Article 4, is contained in or practised with the vertical agreement. If there are one or more hardcore restrictions, the benefit of the Block Exemption Regulation is lost for the entire vertical agreement. There is no severability for hardcore restrictions.

(71) The rule of severability does apply, however, to the excluded restrictions set out in Article 5 of the Block Exemption Regulation. Therefore, the benefit of the block exemption is only lost in relation to that part of the vertical agreement which does not comply with the conditions set out in Article 5.

7. Portfolio of products distributed through the same distribution system

(72) Where a supplier uses the same distribution agreement to distribute several goods/services some of these may, in view of the market share threshold, be covered by the Block Exemption Regulation while others may not. In that case, the Block Exemption Regulation applies to those goods and services for which the conditions of application are fulfilled.

(73) In respect of the goods or services which are not covered by the Block Exemption Regulation, the ordinary rules of competition apply, which means:

– there is no block exemption but also no presumption of illegality;

– if there is an infringement of Article 101(1) which is not exemptable, consideration may be given to whether there are appropriate remedies to solve the competition problem within the existing distribution system;

– if there are no such appropriate remedies, the supplier concerned will have to make other distribution arrangements.

This situation can also arise where Article 102 applies in respect of some products but not in respect of others.

IV. WITHDRAWAL OF THE BLOCK EXEMPTION AND DISAPPLICATION OF THE BLOCK EXEMPTION REGULATION

1. Withdrawal procedure

(74) The presumption of legality conferred by the Block Exemption Regulation may be withdrawn if a vertical agreement, considered either in isolation or in conjunction with similar

[30] An example of indirect measures having such exclusionary effects can be found in Commission Decision 92/428/EEC in Case No IV/33.542 — Parfum Givenchy (OJ L 236, 19.8.1992, p. 11).

agreements enforced by competing suppliers or buyers, comes within the scope of Article 101(1) and does not fulfil all the conditions of Article 101(3).

(75) The conditions of Article 101(3) may in particular not be fulfilled when access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar vertical agreements practised by competing suppliers or buyers. Parallel networks of vertical agreements are to be regarded as similar if they contain restraints producing similar effects on the market. Such a situation may arise for example when, on a given market, certain suppliers practise purely qualitative selective distribution while other suppliers practise quantitative selective distribution. Such a situation may also arise when, on a given market, the cumulative use of qualitative criteria forecloses more efficient distributors. In such circumstances, the assessment must take account of the anti-competitive effects attributable to each individual network of agreements. Where appropriate, withdrawal may concern only a particular qualitative criterion or only the quantitative limitations imposed on the number of authorised distributors.

(76) Responsibility for an anti-competitive cumulative effect can only be attributed to those undertakings which make an appreciable contribution to it. Agreements entered into by undertakings whose contribution to the cumulative effect is insignificant do not fall under the prohibition provided for in Article 101(1)[31] and are therefore not subject to the withdrawal mechanism. The assessment of such a contribution will be made in accordance with the criteria set out in paragraphs 128 to 229.

(77) Where the withdrawal procedure is applied, the Commission bears the burden of proof that the agreement falls within the scope of Article 101(1) and that the agreement does not fulfil one or several of the conditions of Article 101(3). A withdrawal decision can only have ex nunc effect, which means that the exempted status of the agreements concerned will not be affected until the date at which the withdrawal becomes effective.

(78) As referred to in recital 14 of the Block Exemption Regulation, the competition authority of a Member State may withdraw the benefit of the Block Exemption Regulation in respect of vertical agreements whose anti-competitive effects are felt in the territory of the Member State concerned or a part thereof, which has all the characteristics of a distinct geographic market. The Commission has the exclusive power to withdraw the benefit of the Block Exemption Regulation in respect of vertical agreements restricting competition on a relevant geographic market which is wider than the territory of a single Member State. When the territory of a single Member State, or a part thereof, constitutes the relevant geographic market, the Commission and the Member State concerned have concurrent competence for withdrawal.

2. Disapplication of the Block Exemption Regulation

(79) Article 6 of the Block Exemption Regulation enables the Commission to exclude from the scope of the Block Exemption Regulation, by means of regulation, parallel networks of similar vertical restraints where these cover more than 50 % of a relevant market. Such a measure is not addressed to individual undertakings but concerns all undertakings whose agreements are defined in the regulation disapplying the Block Exemption Regulation.

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[31] Judgment of the Court of Justice of 28 February 1991 in Case C-234/89, *Stergios Delimitis v Henninger Bräu AG*

(80) Whereas the withdrawal of the benefit of the Block Exemption Regulation implies the adoption of a decision establishing an infringement of Article 101 by an individual company, the effect of a regulation under Article 6 is merely to remove, in respect of the restraints and the markets concerned, the benefit of the application of the Block Exemption Regulation and to restore the full application of Article 101(1) and (3). Following the adoption of a regulation declaring the Block Exemption Regulation inapplicable in respect of certain vertical restraints on a particular market, the criteria developed by the relevant case-law of the Court of Justice and the General Court and by notices and previous decisions adopted by the Commission will guide the application of Article 101 to individual agreements. Where appropriate, the Commission will take a decision in an individual case, which can provide guidance to all the undertakings operating on the market concerned.

(81) For the purpose of calculating the 50 % market coverage ratio, account must be taken of each individual network of vertical agreements containing restraints, or combinations of restraints, producing similar effects on the market. Article 6 does not entail an obligation on the part of the Commission to act where the 50 % market-coverage ratio is exceeded. In general, disapplication is appropriate when it is likely that access to the relevant market or competition therein is appreciably restricted. This may occur in particular when parallel networks of selective distribution covering more than 50 % of a market are liable to foreclose the market by using selection criteria which are not required by the nature of the relevant goods or which discriminate against certain forms of distribution capable of selling such goods.

(82) In assessing the need to apply Article 6, the Commission will consider whether individual withdrawal would be a more appropriate remedy. This may depend, in particular, on the number of competing undertakings contributing to a cumulative effect on a market or the number of affected geographic markets within the Community.

(83) Any regulation adopted under Article 6 must clearly set out its scope. This means, first, that the Commission must define the relevant product and geographic market(s) and, secondly, that it must identify the type of vertical restraint in respect of which the Block Exemption Regulation will no longer apply. As regards the latter aspect, the Commission may modulate the scope of its regulation according to the competition concern which it intends to address. For instance, while all parallel networks of single-branding type arrangements shall be taken into account in view of establishing the 50 % market coverage ratio, the Commission may nevertheless restrict the scope of the disapplication regulation only to non-compete obligations exceeding a certain duration. Thus, agreements of a shorter duration or of a less restrictive nature might be left unaffected, in consideration of the lesser degree of foreclosure attributable to such restraints. Similarly, when on a particular market selective distribution is practised in combination with additional restraints such as non-compete or quantity-forcing on the buyer, the disapplication regulation may concern only such additional restraints. Where appropriate, the Commission may also provide guidance by specifying the market share level which, in the specific market context, may be regarded as insufficient to bring about a significant contribution by an individual undertaking to the cumulative effect.

(84) Pursuant to Regulation No 19/65 of the Council[32], the Commission will have to set a transitional period of not less than six months before a regulation disapplying the Block

[32] OJ 36, 6.3.1965, p.533/65. Regulation as amended by Council Regulation (EC) No 1215/1999 (OJ L 148, 15.6.1999, p. 1) and Council Regulation (EC) No 1/2003 (OJ L 1, 4.1.2003, p. 1).

Exemption Regulation becomes applicable. This should allow the undertakings concerned to adapt their agreements to take account of the regulation disapplying the Block Exemption Regulation.

(85) A regulation disapplying the Block Exemption Regulation will not affect the exempted status of the agreements concerned for the period preceding its entry into force.

V. MARKET DEFINITION AND MARKET SHARE CALCULATION

1. Commission Notice on definition of the relevant market

(86) The Commission Notice on definition of the relevant market for the purposes of Community competition law[33] provides guidance on the rules, criteria and evidence which the Commission uses when considering market definition issues. That Notice will not be further explained in these Guidelines and should serve as the basis for market definition issues. These Guidelines will only deal with specific issues that arise in the context of vertical restraints and that are not dealt with in the general notice on market definition.

2. The relevant market for calculating the 30 % market share threshold under the Block Exemption Regulation

(87) Under Article 3 of the Block Exemption Regulation, the market share of both the supplier and the buyer are decisive to determine if the block exemption applies. In order for the block exemption to apply, the market share of the supplier on the market where it sells the contract products to the buyer, and the market share of the buyer on the market where it purchases the contract products, must each be 30 % or less. For agreements between small and medium-sized undertakings it is in general not necessary to calculate market shares (see paragraph 11).

(88) In order to calculate an undertaking’s market share, it is necessary to determine the relevant market where that undertaking sells respectively purchases the contract products. For this, the relevant product market and the relevant geographic market must be defined. The relevant product market comprises any goods or services which are regarded by the buyers as interchangeable, by reason of their characteristics, prices and intended use. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of relevant goods or services, in which the conditions of competition are sufficiently homogeneous, and which can be distinguished from neighbouring geographic areas because, in particular, conditions of competition are appreciably different in those areas.

(89) The product market depends in the first place on substitutability from the buyers' perspective. When the supplied product is used as an input to produce other products and is generally not recognisable in the final product, the product market is normally defined by the direct buyers' preferences. The customers of the buyers will normally not have a strong preference concerning the inputs used by the buyers. Usually the vertical restraints agreed between the supplier and buyer of the input only relate to the sale and purchase of the intermediate product and not to the sale of the resulting product. In the case of distribution of final goods, what are substitutes for the direct buyers will normally be influenced or determined by the preferences of the final consumers. A distributor, as reseller, cannot ignore

[33] OJ C 372, 9.12.1997, p. 5.

the preferences of final consumers when he purchases final goods. In addition, at the distribution level the vertical restraints usually concern not only the sale of products between supplier and buyer, but also their resale. As different distribution formats usually compete, markets are in general not defined by the form of distribution that is applied. Where suppliers generally sell a portfolio of products, the entire portfolio may determine the product market when the portfolios and not the individual products are regarded as substitutes by the buyers. As distributors are professional buyers, the geographic wholesale market is usually wider than the retail market, where the product is resold to final consumers. Often, this will lead to the definition of national or wider wholesale markets. But also retail markets may be wider than the final consumers' search area in case of homogeneous market conditions and overlapping local or regional catchment areas.

(90) Where a vertical agreement involves three parties, each operating at a different level of trade, each party's market share must be 30% or less in order for the block exemption to apply. As specified in Article 3(2) of the Block Exemption Regulation, where in a multi party agreement an undertaking buys the contract goods or services from one undertaking party to the agreement and sells the contract goods or services to another undertaking party to the agreement, the block exemption applies only if its market share does not exceed the 30% threshold both as a buyer and a supplier. If for instance, in an agreement between a manufacturer, a wholesaler (or association of retailers) and a retailer, a non-compete obligation is agreed, then the market shares of the manufacturer and the wholesaler (or association of retailers) on their respective downstream markets must not exceed 30% and the market share of the wholesaler (or association of retailers) and the retailer must not exceed 30% on their respective purchase markets in order to benefit from the block exemption.

(91) Where a supplier produces both original equipment and the repair or replacement parts for this equipment, the supplier will often be the only or the major supplier on the after-market for the repair and replacement parts. This may also arise where the supplier (OEM supplier) subcontracts the manufacturing of the repair or replacement parts. The relevant market for application of the Block Exemption Regulation may be the original equipment market including the spare parts or a separate original equipment market and after-market depending on the circumstances of the case, such as the effects of the restrictions involved, the lifetime of the equipment and importance of the repair or replacement costs[34]. In practice, the issue to decide is whether a significant proportion of buyers make their choice taking into account the lifetime costs of the product. If so, this indicates there is one market for the original equipment and spare parts combined.

(92) Where the vertical agreement, in addition to the supply of the contract goods, also contains IPR provisions — such as a provision concerning the use of the supplier's trademark — which help the buyer to market the contract goods, the supplier's market share on the market where he sells the contract goods is relevant for the application of the Block Exemption Regulation. Where a franchisor does not supply goods to be resold but provides a bundle of services and goods combined with IPR provisions which together form the business method being franchised, the franchisor needs to take account of his market share as a

[34] See for example Pelikan/Kyocera in XXV Report on Competition Policy, point 87, and Commission Decision 91/595/EEC in Case No IV/M.12 — Varta/Bosch, OJ L 320, 22.11.1991, p. 26, Commission Decision in Case No IV/M.1094 — Caterpillar/Perkins Engines, OJ C 94, 28.3.1998, p. 23, and Commission Decision in Case No IV/M.768 — Lucas/Varity, OJ C 266, 13.9.1996, p. 6. See also point 56 of the Commission Notice on the definition of relevant market for the purposes of Community competition law.

provider of a business method. For that purpose, the franchisor needs to calculate his market share on the market where the business method is exploited, which is the market where the franchisees exploit the business method to provide goods or services to end users. The franchisor must base his market share on the value of the goods or services supplied by his franchisees on this market. On such a market the competitors may be providers of other franchised business methods but also suppliers of substitutable goods or services not applying franchising. For instance, without prejudice to the definition of such market, if there was a market for fast-food services, a franchisor operating on such a market would need to calculate his market share on the basis of the relevant sales figures of his franchisees on this market.

3. Calculation of market shares under the Block Exemption Regulation

(93) The calculation of market shares needs to be based in principle on value figures. Where value figures are not available substantiated estimates can be made. Such estimates may be based on other reliable market information such as volume figures (see Article 7(a) of the Block Exemption Regulation).

(94) In-house production, that is production of an intermediate product for own use, may be very important in a competition analysis as one of the competitive constraints or to accentuate the market position of a company. However, for the purpose of market definition and the calculation of market share for intermediate goods and services, in-house production will not be taken into account.

(95) However, in the case of dual distribution of final goods, i.e. where a producer of final goods also acts as a distributor on the market, the market definition and market share calculation need to include sales of their own goods made by the producers through their vertically integrated distributors and agents (see Article 7(c) of the Block Exemption Regulation). "Integrated distributors" are connected undertakings within the meaning of Article 1(2) of the Block Exemption Regulation.[35]

VI. ENFORCEMENT POLICY IN INDIVIDUAL CASES

1. The framework of analysis

(96) Outside the scope of the block exemption it is relevant to examine whether in the individual case the agreement is caught by Article 101(1) and if so whether the conditions of Article 101(3) are satisfied. Provided that they do not contain restrictions of competition by object and in particular hardcore restrictions of competition, there is no presumption that vertical agreements falling outside the block exemption because the market share threshold is exceeded are caught by Article 101(1) or fail to satisfy the conditions of Article 101(3). Individual assessment of the likely effects of the agreement is required. Companies are encouraged to do their own assessment. Agreements that either do not restrict competition within the meaning of Article 101(1) or which fulfil the conditions of Article 101(3) are valid and enforceable. Pursuant to Article 1(2) of Regulation 1/2003 no notification needs to be made to benefit from an individual exemption under Article 101(3). In the case of an individual examination by the Commission, the latter will bear the burden of proof that the agreement in question infringes Article 101(1). The undertakings claiming the benefit of

[35] For these market definition and market share calculation purposes it is not relevant whether the integrated distributor sells in addition products of competitors.

Article 101(3) bear the burden of proving that the conditions of that paragraph are fulfilled. When likely anti-competitive effects are demonstrated, undertakings may substantiate efficiency claims and explain why a certain distribution system is indispensable to bring likely benefits to consumers without eliminating competition, before the Commission decides whether the agreement satisfies the conditions of Article 101(3).

(97) The assessment of whether a vertical agreement has the effect of restricting competition will be made by comparing the actual or likely future situation in the relevant market with the vertical restraints in place with the situation that would prevail in the absence of the vertical restraints in the agreement. In the assessment of individual cases, the Commission will take, as appropriate, both actual and likely effects into account. For vertical agreements to be restrictive of competition by effect they must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation, or the variety or quality of goods and services can be expected with a reasonable degree of probability. The likely negative effects on competition must be appreciable[36]. Appreciable anticompetitive effects are likely to occur when at least one of the parties has or obtains some degree of market power and the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power. Market power is the ability to maintain prices above competitive levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time. The degree of market power normally required for a finding of an infringement under Article 101(1) is less than the degree of market power required for a finding of dominance under Article 102.

(98) Vertical restraints are generally less harmful than horizontal restraints. The main reason for being less concerned about a vertical restraint than a horizontal restraint lies in the fact that the latter may concern an agreement between competitors producing identical or substitutable goods or services. In such horizontal relationships the exercise of market power by one company (higher price of its product) may benefit its competitors. This may provide an incentive to competitors to induce each other to behave anti-competitively. In vertical relationships the product of the one is the input for the other, in other words the activities of the parties to the agreement are complementary to each other. This means that the exercise of market power by either the upstream or downstream company would normally hurt the demand for the product of the other. The companies involved in the agreement therefore usually have an incentive to prevent the exercise of market power by the other.

(99) However, this self-restraining character should not be over-estimated. When a company has no market power it can only try to increase its profits by optimising its manufacturing and distribution processes, with or without the help of vertical restraints. More in general, because of the complementary role of the parties to a vertical agreement in getting a product to the market, vertical restraints may provide substantial scope for efficiencies. However, when an undertaking does have market power it can also try to increase its profits at the expense of its direct competitors by raising their costs and at the expense of its buyers and ultimately consumers by trying to appropriate some of their surplus. This can happen when the upstream and downstream company share the extra profits or when one of the two uses vertical restraints to appropriate all the extra profits.

[36] See Section II.1.

1.1. Negative effects of vertical restraints

(100) The negative effects on the market that may result from vertical restraints which EU competition law aims at preventing are the following:

(i) anticompetitive foreclosure of other suppliers or other buyers by raising barriers to entry or expansion;

(ii) softening of competition between the supplier and its competitors and/or facilitation of collusion amongst these suppliers, often referred to as reduction of inter-brand competition[37];

(iii) softening of competition between the buyer and its competitors and/or facilitation of collusion amongst these competitors, often referred to as reduction of intra-brand competition if it concerns distributors' competition on the basis of the brand or product of the same supplier;

(iv) the creation of obstacles to market integration, including, above all, limitations on the possibilities for consumers to purchase goods or services in any Member State they may choose.

(101) Foreclosure, softening of competition and collusion at the manufacturers' level may harm consumers in particular by increasing the wholesale prices of the products, limiting the choice of products, lowering their quality or reducing the level of product innovation. Foreclosure, softening of competition and collusion at the distributors' level may harm consumers in particular by increasing the retail prices of the products, limiting the choice of price-service combinations and distribution formats, lowering the availability and quality of retail services and reducing the level of innovation of distribution.

(102) In a market where individual distributors distribute the brand(s) of only one supplier, a reduction of competition between the distributors of the same brand will lead to a reduction of intra-brand competition between these distributors, but may not have a negative effect on competition between distributors in general. In such a case, if inter-brand competition is fierce, it is unlikely that a reduction of intra-brand competition will have negative effects for consumers.

(103) Exclusive arrangements are generally worse for competition than non-exclusive arrangements. Exclusive dealing makes, by the express language of the contract or its practical effects, one party fulfil all or practically all its requirements from another party. For instance, under a non-compete obligation the buyer purchases only one brand. Quantity forcing, on the other hand, leaves the buyer some scope to purchase competing goods. The degree of foreclosure may therefore be less with quantity forcing.

(104) Vertical restraints agreed for non-branded goods and services are in general less harmful than restraints affecting the distribution of branded goods and services. Branding tends to increase product differentiation and reduce substitutability of the product, leading to a reduced elasticity of demand and an increased possibility to raise price. The distinction between branded and non-branded goods or services will often coincide with the distinction between intermediate goods and services and final goods and services.

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[37] By collusion is meant both explicit collusion and tacit collusion (conscious parallel behaviour).

(105) In general, a combination of vertical restraints aggravates their negative effects. However, certain combinations of vertical restraints are better for competition than their use in isolation from each other. For instance, in an exclusive distribution system, the distributor may be tempted to increase the price of the products as intra-brand competition has been reduced. The use of quantity forcing or the setting of a maximum resale price may limit such price increases. Possible negative effects of vertical restraints are reinforced when several suppliers and their buyers organise their trade in a similar way, leading to so-called cumulative effects.

1.2. Positive effects of vertical restraints

(106) It is important to recognise that vertical restraints may have positive effects by, in particular, promoting non-price competition and improved quality of services. When a company has no market power, it can only try to increase its profits by optimising its manufacturing or distribution processes. In a number of situations vertical restraints may be helpful in this respect since the usual arm's length dealings between supplier and buyer, determining only price and quantity of a certain transaction, can lead to a sub-optimal level of investments and sales.

(107) While trying to give a fair overview of the various justifications for vertical restraints, these Guidelines do not claim to be complete or exhaustive. The following reasons may justify the application of certain vertical restraints:

(1) To "solve a "free-rider" problem". One distributor may free-ride on the promotion efforts of another distributor. This type of problem is most common at the wholesale and retail level. Exclusive distribution or similar restrictions may be helpful in avoiding such free-riding. Free-riding can also occur between suppliers, for instance where one invests in promotion at the buyer's premises, in general at the retail level, that may also attract customers for its competitors. Non-compete type restraints can help to overcome this situation of free-riding[38].

For there to be a problem, there needs to be a real free-rider issue. Free-riding between buyers can only occur on pre-sales services and other promotional activities, but not on after-sales services for which the distributor can charge its customers individually. The product will usually need to be relatively new or technically complex or the reputation of the product must be a major determinant of its demand, as the customer may otherwise very well know what he or she wants, based on past purchases. And the product must be of a reasonably high value as it is otherwise not attractive for a customer to go to one shop for information and to another to buy. Lastly, it must not be practical for the supplier to impose on all buyers, by contract, effective promotion or service requirements.

Free-riding between suppliers is also restricted to specific situations, namely to cases where the promotion takes place at the buyer's premises and is generic, not brand specific.

[38] Whether consumers actually overall benefit from extra promotional efforts depends on whether the extra promotion informs and convinces and thus benefits many new customers or mainly reaches customers who already know what they want to buy and for whom the extra promotion only or mainly implies a price increase.

(2) To "open up or enter new markets". Where a manufacturer wants to enter a new geographic market, for instance by exporting to another country for the first time, this may involve special "first time investments" by the distributor to establish the brand in the market. In order to persuade a local distributor to make these investments it may be necessary to provide territorial protection to the distributor so that he can recoup these investments by temporarily charging a higher price. Distributors based in other markets should then be restrained for a limited period from selling in the new market (see also paragraph 61 in Section III.3). This is a special case of the free-rider problem described under point (1).

(3) The "certification free-rider issue". In some sectors, certain retailers have a reputation for stocking only "quality" products. In such a case, selling through these retailers may be vital for the introduction of a new product. If the manufacturer cannot initially limit his sales to the premium stores, he runs the risk of being de-listed and the product introduction may fail. This means that there may be a reason for allowing for a limited duration a restriction such as exclusive distribution or selective distribution. It must be enough to guarantee introduction of the new product but not so long as to hinder large-scale dissemination. Such benefits are more likely with "experience" goods or complex goods that represent a relatively large purchase for the final consumer.

(4) The so-called "hold-up problem". Sometimes there are client-specific investments to be made by either the supplier or the buyer, such as in special equipment or training. For instance, a component manufacturer that has to build new machines and tools in order to satisfy a particular requirement of one of his customers. The investor may not commit the necessary investments before particular supply arrangements are fixed.

However, as in the other free-riding examples, there are a number of conditions that have to be met before the risk of under-investment is real or significant. Firstly, the investment must be relationship-specific. An investment made by the supplier is considered to be relationship-specific when, after termination of the contract, it cannot be used by the supplier to supply other customers and can only be sold at a significant loss. An investment made by the buyer is considered to be relationship-specific when, after termination of the contract, it cannot be used by the buyer to purchase and/or use products supplied by other suppliers and can only be sold at a significant loss. An investment is thus relationship-specific because for instance it can only be used to produce a brand-specific component or to store a particular brand and thus cannot be used profitably to produce or resell alternatives. Secondly, it must be a long-term investment that is not recouped in the short run. And thirdly, the investment must be asymmetric i.e. one party to the contract invests more than the other party. When these conditions are met, there is usually a good reason to have a vertical restraint for the duration it takes to depreciate the investment. The appropriate vertical restraint will be of the non-compete type or quantity-forcing type when the investment is made by the supplier and of the exclusive distribution, exclusive customer allocation or exclusive supply type when the investment is made by the buyer.

(5) The "specific hold-up problem that may arise in the case of transfer of substantial know-how". The know-how, once provided, cannot be taken back and the provider of the know-how may not want it to be used for or by his competitors. In as far as the

know-how was not readily available to the buyer, is substantial and indispensable for the operation of the agreement, such a transfer may justify a non-compete type of restriction. This would normally fall outside Article 101(1).

(6) The “vertical externality issue”. A retailer may not gain all the benefits of its action taken to improve sales; some may go to the manufacturer. For every extra unit a retailer sells by lowering its resale price or by increasing its sales effort, the manufacturer benefits if its wholesale price exceeds its marginal production costs. Thus, there may be a positive externality bestowed on the manufacturer by such retailer’s actions and from the manufacturer’s perspective the retailer may be pricing too high and/or making too little sales efforts. The negative externality of too high pricing by the retailer is sometimes called the “double marginalisation problem” and it can be avoided by imposing a maximum resale price on the retailer. To increase the retailer’s sales efforts selective distribution, exclusive distribution or similar restrictions may be helpful[39].

(7) "Economies of scale in distribution". In order to have scale economies exploited and thereby see a lower retail price for his product, the manufacturer may want to concentrate the resale of his products on a limited number of distributors. For this he could use exclusive distribution, quantity forcing in the form of a minimum purchasing requirement, selective distribution containing such a requirement or exclusive sourcing.

(8) "Capital market imperfections". The usual providers of capital (banks, equity markets) may provide capital sub-optimally when they have imperfect information on the quality of the borrower or there is an inadequate basis to secure the loan. The buyer or supplier may have better information and be able, through an exclusive relationship, to obtain extra security for his investment. Where the supplier provides the loan to the buyer this may lead to non-compete or quantity forcing on the buyer. Where the buyer provides the loan to the supplier this may be the reason for having exclusive supply or quantity forcing on the supplier.

(9) "Uniformity and quality standardisation". A vertical restraint may help to create a brand image by imposing a certain measure of uniformity and quality standardisation on the distributors, thereby increasing the attractiveness of the product to the final consumer and increasing its sales. This can for instance be found in selective distribution and franchising.

(108) The nine situations mentioned in paragraph 107 make clear that under certain conditions vertical agreements are likely to help realise efficiencies and the development of new markets and that this may offset possible negative effects. The case is in general strongest for vertical restraints of a limited duration which help the introduction of new complex products or protect relationship-specific investments. A vertical restraint is sometimes necessary for as long as the supplier sells his product to the buyer (see in particular the situations described in paragraph 107, points (1), (5), (6), (7) and (9).

(109) There is a large measure of substitutability between the different vertical restraints. This means that the same inefficiency problem can be solved by different vertical restraints. For

[39] See however footnote 38.

instance, economies of scale in distribution may possibly be achieved by using exclusive distribution, selective distribution, quantity forcing or exclusive sourcing. This is important as the negative effects on competition may differ between the various vertical restraints. This plays a role when indispensability is discussed under Article 101(3).

1.3. Methodology of analysis

(110) The assessment of a vertical restraint involves in general the following four steps:[40]

(1) First, the undertakings involved need to establish the market shares of the supplier and the buyer on the market where they respectively sell and purchase the contract products.

(2) If the relevant market share of the supplier and the buyer each do not exceed the 30 % threshold, the vertical agreement is covered by the Block Exemption Regulation, subject to the hardcore restrictions and conditions set out in that regulation.

(3) If the relevant market share is above the 30 % threshold for supplier and/or buyer, it is necessary to assess whether the vertical agreement falls within Article 101(1).

(4) If the vertical agreement falls within Article 101(1), it is necessary to examine whether it fulfils the conditions for exemption under Article 101(3).

1.3.1. Relevant factors for the assessment under Article 101(1)

(111) In assessing cases above the market share threshold of 30 %, the Commission will make a full competition analysis. The following factors are in particular relevant to establish whether a vertical agreement brings about an appreciable restriction of competition under Article 101(1):

(a) nature of the agreement;

(b) market position of the parties

(c) market position of competitors;

(d) market position of buyers of the contract products;

(e) entry barriers;

(f) maturity of the market;

(g) level of trade;

(h) nature of the product;

(i) other factors.

[40] These steps are not intended to present a legal reasoning that the Commission should follow in this order to take a decision.

(112) The importance of individual factors may vary from case to case and depends on all other factors. For instance, a high market share of the parties is usually a good indicator of market power, but in the case of low entry barriers it may not be indicative of market power. It is therefore not possible to provide firm rules on the importance of the individual factors. However the following can be said:

(113) Vertical agreements can take many shapes and forms. It is therefore important to analyse the nature of the agreement in terms of the restraints that it contains, their duration and the percentage of total sales on the market affected by the restraints. It may be necessary to go beyond the express terms of the agreement. The existence of implicit restraints may be derived from the way in which the agreement is implemented by the parties and the incentives that they face.

(114) The market position of the parties provides an indication of the degree of market power, if any, possessed by the supplier, the buyer or both. The higher their market share, the greater their market power is likely to be. This is particularly so where the market share reflects cost advantages or other competitive advantages vis-à-vis competitors. These competitive advantages may for instance result from being a first mover in the market (having the best site, etc.), from holding essential patents or having superior technology, from being the brand leader or having a superior portfolio.

(115) The same indicators, that is market share and possible competitive advantages, are used to assess the market position of competitors. The stronger the competitors are and the greater their number, the less risk there is that the parties will be able to individually exercise market power and foreclose the market or soften competition. It is also relevant to consider whether there are effective and timely counterstrategies that competitors would be likely to deploy. However, if the number of competitors becomes rather small and their market position (size, costs, R&D potential, etc.) is rather similar, this market structure may increase the risk of collusion. Fluctuating or rapidly changing market shares are in general an indication of intense competition.

(116) The market position of customers of the parties provides an indication of whether or not one or more of these customers possess buyer power. The first indicator of buyer power is the market share of the customer on the purchase market. This share reflects the importance of its demand for possible suppliers. Other indicators focus on the position of the customer on its resale market, including characteristics such as a wide geographic spread of its outlets, own brands including private labels and its brand image amongst final consumers. In some circumstances buyer power may prevent the parties from exercising market power and thereby solve a competition problem that would otherwise have existed. This is particularly so when strong customers have the capacity and incentive to bring new sources of supply on to the market in the case of a small but permanent increase in relative prices. Where the strong customers merely extract favourable terms for themselves or simply pass on any price increase to their customers, their position is not preventing the exercise of market power by the parties.

(117) Entry barriers are measured by the extent to which incumbent companies can increase their price above the competitive level without attracting new entry. In the absence of entry barriers, easy and quick entry would render price increases unprofitable. When effective entry, preventing or eroding the exercise of market power, is likely to occur within one or two years, entry barriers can, as a general rule, be said to be low. Entry barriers may result from a wide variety of factors such as economies of scale and scope, government regulations,

especially where they establish exclusive rights, state aid, import tariffs, intellectual property rights, ownership of resources where the supply is limited due to for instance natural limitations[41], essential facilities, a first mover advantage and brand loyalty of consumers created by strong advertising over a period of time. Vertical restraints and vertical integration may also work as an entry barrier by making access more difficult and foreclosing (potential) competitors. Entry barriers may be present at only the supplier or buyer level or at both levels. The question whether certain of these factors should be described as entry barriers depends particularly on whether they entail sunk costs. Sunk costs are those costs that have to be incurred to enter or be active on a market but that are lost when the market is exited. Advertising costs to build consumer loyalty are normally sunk costs, unless an exiting firm could either sell its brand name or use it somewhere else without a loss. The more costs are sunk, the more potential entrants have to weigh the risks of entering the market and the more credibly incumbents can threaten that they will match new competition, as sunk costs make it costly for incumbents to leave the market. If, for instance, distributors are tied to a manufacturer via a non-compete obligation, the foreclosing effect will be more significant if setting up its own distributors will impose sunk costs on the potential entrant. In general, entry requires sunk costs, sometimes minor and sometimes major. Therefore, actual competition is in general more effective and will weigh more heavily in the assessment of a case than potential competition.

(118) A mature market is a market that has existed for some time, where the technology used is well known and widespread and not changing very much, where there are no major brand innovations and in which demand is relatively stable or declining. In such a market negative effects are more likely than in more dynamic markets.

(119) The level of trade is linked to the distinction between intermediate and final goods and services. Intermediate goods and services are sold to undertakings for use as an input to produce other goods or services and are generally not recognisable in the final goods or services. The buyers of intermediate products are usually well-informed customers, able to assess quality and therefore less reliant on brand and image. Final goods are, directly or indirectly, sold to final consumers who often rely more on brand and image. As distributors (retailers, wholesalers) have to respond to the demand of final consumers, competition may suffer more when distributors are foreclosed from selling one or a number of brands than when buyers of intermediate products are prevented from buying competing products from certain sources of supply.

(120) The nature of the product plays a role in particular for final products in assessing both the likely negative and the likely positive effects. When assessing the likely negative effects, it is important whether the products on the market are more homogeneous or heterogeneous, whether the product is expensive, taking up a large part of the consumer's budget, or is inexpensive and whether the product is a one-off purchase or repeatedly purchased. In general, when the product is more heterogeneous, less expensive and resembles more a one-off purchase, vertical restraints are more likely to have negative effects.

(121) In the assessment of particular restraints other factors may have to be taken into account. Among these factors can be the cumulative effect, i.e. the coverage of the market by similar agreements of others, whether the agreement is "imposed" (mainly one party is subject

[41] See Commission Decision 97/26/EC (Case No IV/M.619 — Gencor/Lonrho), (OJ L 11, 14.1.1997, p. 30).

to the restrictions or obligations) or "agreed" (both parties accept restrictions or obligations), the regulatory environment and behaviour that may indicate or facilitate collusion like price leadership, pre-announced price changes and discussions on the "right" price, price rigidity in response to excess capacity, price discrimination and past collusive behaviour.

1.3.2. Relevant factors for the assessment under Article 101(3)

(122) Restrictive vertical agreements may also produce pro-competitive effects in the form of efficiencies, which may outweigh their anti-competitive effects. This assessment takes place within the framework of Article 101(3), which contains an exception from the prohibition rule of Article 101(1). For this exception to be applicable the vertical agreement must produce objective economic benefits, the restrictions on competition must be indispensable to attain the efficiencies, consumers must receive a fair share of the efficiency gains, and the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned.[42]

(123) The assessment of restrictive agreements under Article 101(3) is made within the actual context in which they occur[43] and on the basis of the facts existing at any given point in time. The assessment is sensitive to material changes in the facts. The exception rule of Article 101(3) applies as long as the four conditions are fulfilled and ceases to apply when that is no longer the case[44]. When applying Article 101(3) in accordance with these principles it is necessary to take into account the investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment.

(124) The first condition of Article 101(3) requires an assessment of what are the objective benefits in terms of efficiencies produced by the agreement. In this respect, vertical agreements often have the potential to help realise efficiencies, as explained in Section VI.1.2, by improving the way in which the parties conduct their complementary activities.

(125) In the application of the indispensability test contained in Article 101(3) the Commission will in particular examine whether individual restrictions make it possible to perform the production, purchase and/or (re)sale of the contract products more efficiently than would have been the case in the absence of the restriction concerned. In making this assessment the market conditions and the realities facing the parties must be taken into account. Undertakings invoking the benefit of Article 101(3) are not required to consider hypothetical and theoretical alternatives. They must, however, explain and demonstrate why seemingly realistic and significantly less restrictive alternatives would be significantly less efficient. If the application of what appears to be a commercially realistic and less restrictive alternative would lead to a significant loss of efficiencies, the restriction in question is treated as indispensable.

(126) The condition that consumers must receive a fair share of the benefits implies that consumers of the products purchased and/or (re) sold under the vertical agreement must at least be compensated for the negative effects of the agreement[45]. This means that the

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42 See the Guidelines on the application of Article 81(3) of the Treaty, cited in note 4.

43 See Joined Cases 25/84 and 26/84, *Ford*, [1985] ECR 2725.

44 See in this respect for example Commission Decision in *TPS* (OJ L 90, 2.4.1999, p. 6). Similarly, the prohibition of Article 101(1) also only applies as long as the agreement has a restrictive object or restrictive effects.

45 See paragraph 85 of the Guidelines on the application of Article 81(3) of the Treaty, cited in note 4.

efficiency gains must fully off-set the likely negative impact on prices, output and other relevant factors caused by the agreement.

(127) The last condition of Article 101(3), according to which the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products concerned, presupposes an analysis of remaining competitive pressures on the market and the impact of the agreement on such sources of competition. In the application of the last condition of Article 101(3) the relationship between Article 101(3) and Article 102 must be taken into account. According to settled case law, the application of Article 101(3) cannot prevent the application of Article 102[46]. Moreover, since Articles 101 and 102 both pursue the aim of maintaining effective competition on the market, consistency requires that Article 101(3) be interpreted as precluding any application of the exception rule to restrictive agreements that constitute an abuse of a dominant position[47]. The vertical agreement may not eliminate effective competition, by removing all or most existing sources of actual or potential competition. Rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the form of innovation. In its absence the dominant undertaking will lack adequate incentives to continue to create and pass on efficiency gains. Where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains. A restrictive agreement which maintains, creates or strengthens a market position approaching that of a monopoly can normally not be justified on the grounds that it also creates efficiency gains.

2. Analysis of specific vertical restraints

(128) The most common vertical restraints and combinations of vertical restraints are analysed below following the framework of analysis developed in paragraphs 96 to 127. There are other restraints and combinations for which no direct guidance is provided here. They will however be treated according to the same principles and with the same emphasis on the effect on the market.

2.1. Single branding

(129) Under the heading of "single branding" come those agreements which have as their main element that the buyer is obliged or induced to concentrate his orders for a particular type of product with one supplier. This component can be found amongst others in non-compete and quantity-forcing on the buyer. A non-compete arrangement is based on an obligation or incentive scheme which makes the buyer purchase more than 80% of his requirements on a particular market from only one supplier. It does not mean that the buyer can only buy directly from the supplier, but that the buyer will not buy and resell or incorporate competing goods or services. Quantity-forcing on the buyer is a weaker form of non-compete, where incentives or obligations agreed between the supplier and the buyer make the latter concentrate his purchases to a large extent with one supplier. Quantity-forcing may

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[46] See Joined Cases C-395/96 P and C-396/96 P, *Compagnie Maritime Belge*, [2000] ECR I-1365, paragraph 130. Similarly, the application of Article 101(3) does not prevent the application of the Treaty rules on the free movement of goods, services, persons and capital. These provisions are in certain circumstances applicable to agreements, decisions and concerted practices within the meaning of Article 101(1), see to that effect Case C-309/99, *Wouters*, [2002] ECR I-1577, paragraph 120.

[47] See in this respect Case T-51/89, *Tetra Pak* (I), [1990] ECR II-309. See also paragraph 106 of the Guidelines on the application of Article 81(3) of the Treaty cited in note 4 above.

for example take the form of minimum purchase requirements, stocking requirements or non-linear pricing, such as conditional rebate schemes or a two-part tariff (fixed fee plus a price per unit). A so-called "English clause", requiring the buyer to report any better offer and allowing him only to accept such an offer when the supplier does not match it, can be expected to have the same effect as a single branding obligation, especially when the buyer has to reveal who makes the better offer.

(130) The possible competition risks of single branding are foreclosure of the market to competing suppliers and potential suppliers, softening of competition and facilitation of collusion between suppliers in case of cumulative use and, where the buyer is a retailer selling to final consumers, a loss of in-store inter-brand competition. All these restrictive effects have a direct impact on inter-brand competition.

(131) Single branding is exempted by the Block Exemption Regulation when the supplier's and buyer's market share each do not exceed 30 % and subject to a limitation in time of five years for the non-compete obligation. Above the market share threshold or beyond the time limit of five years, the following guidance is provided for the assessment of individual cases.

(132) The capacity for single branding obligations of one specific supplier to result in anticompetitive foreclosure arises in particular where, without the obligations, an important competitive constraint is exercised by competitors who either are not yet present in the market at the time the obligations are concluded, or who are not in a position to compete for the full supply of the customers. Competitors may not be able to compete for an individual customer's entire demand because the supplier in question is an unavoidable trading partner at least for part of the demand on the market, for instance because its brand is a 'must stock item' preferred by many final consumers or because the capacity constraints on the other suppliers are such that a part of demand can only be provided for by the supplier in question[48]. The "market position of the supplier" is thus of main importance to assess possible anti-competitive effects of single branding obligations.

(133) If competitors can compete on equal terms for each individual customer's entire demand, single branding obligations of one specific supplier are generally unlikely to hamper effective competition unless the switching of supplier by customers is rendered difficult due to the duration and market coverage of the single branding obligations. The higher his tied market share, i.e. the part of his market share sold under a single branding obligation, the more significant foreclosure is likely to be. Similarly, the longer the duration of the single branding obligations, the more significant foreclosure is likely to be. Single branding obligations shorter than one year entered into by non-dominant companies are in general not considered to give rise to appreciable anti-competitive effects or net negative effects. Single branding obligations between one and five years entered into by non-dominant companies usually require a proper balancing of pro- and anti-competitive effects, while single branding obligations exceeding five years are for most types of investments not considered necessary to achieve the claimed efficiencies or the efficiencies are not sufficient to outweigh their foreclosure effect. Single branding obligations are more likely to result in anti-competitive foreclosure when entered into by dominant companies.

(134) In assessing the supplier's market power, the "market position of his competitors" is important. As long as the competitors are sufficiently numerous and strong, no appreciable

[48] Case T-65/98 *Van den Bergh Foods* v *Commission* [2003] ECR II-4653, paragraphs 104 and 156

anti-competitive effects can be expected. Foreclosure of competitors is not very likely where they have similar market positions and can offer similarly attractive products. In such a case foreclosure may however occur for potential entrants when a number of major suppliers enter into single branding contracts with a significant number of buyers on the relevant market (cumulative effect situation). This is also a situation where single branding agreements may facilitate collusion between competing suppliers. If individually these suppliers are covered by the Block Exemption Regulation, a withdrawal of the block exemption may be necessary to deal with such a negative cumulative effect. A tied market share of less than 5 % is not considered in general to contribute significantly to a cumulative foreclosure effect.

(135) In cases where the market share of the largest supplier is below 30 % and the market share of the five largest suppliers is below 50 %, there is unlikely to be a single or a cumulative anti-competitive effect situation. If a potential entrant cannot penetrate the market profitably, this is likely to be due to factors other than single branding obligations, such as consumer preferences.

(136) "Entry barriers" are important to establish whether there is anticompetitive foreclosure. Wherever it is relatively easy for competing suppliers to create new buyers or find alternative buyers for their product, foreclosure is unlikely to be a real problem. However, there are often entry barriers, both at the manufacturing and at the distribution level.

(137) "Countervailing power" is relevant, as powerful buyers will not easily allow themselves to be cut off from the supply of competing goods or services. More generally, in order to convince customers to accept single branding, the supplier may have to compensate them, in whole or in part, for the loss in competition resulting from the exclusivity. Where such compensation is given, it may be in the individual interest of a customer to enter into a single branding obligation with the supplier. But it would be wrong to conclude automatically from this that all single branding obligations, taken together, are overall beneficial for customers in that market and for the final consumers. It is in particular unlikely that consumers as a whole will benefit if there are many customers and the single branding obligations, taken together, have the effect of preventing the entry or expansion of competing undertakings.

(138) Lastly, "the level of trade" is relevant. Anticompetitive foreclosure is less likely in case of an intermediate product. When the supplier of an intermediate product is not dominant, the competing suppliers still have a substantial part of demand that is "free". Below the level of dominance an anticompetitive foreclosure effect may however arise in a cumulative effect situation. A cumulative anticompetitive effect is unlikely to arise as long as less than 50 % of the market is tied.

(139) Where the agreement concerns the supply of a final product at the wholesale level, the question whether a competition problem is likely to arise depends in large part on the type of wholesaling and the entry barriers at the wholesale level. There is no real risk of anticompetitive foreclosure if competing manufacturers can easily establish their own wholesaling operation. Whether entry barriers are low depends in part on the type of wholesaling, i.e. whether or not wholesalers can operate efficiently with only the product concerned by the agreement (for example ice cream) or whether it is more efficient to trade in a whole range of products (for example frozen foodstuffs). In the latter case, it is not efficient for a manufacturer selling only one product to set up its own wholesaling operation. In that case anti-competitive effects may arise. In addition, cumulative effect problems may arise if several suppliers tie most of the available wholesalers.

(140) For final products, foreclosure is in general more likely to occur at the retail level, given the significant entry barriers for most manufacturers to start retail outlets just for their own products. In addition, it is at the retail level that single branding agreements may lead to reduced in-store inter-brand competition. It is for these reasons that for final products at the retail level, significant anti-competitive effects may start to arise, taking into account all other relevant factors, if a non-dominant supplier ties 30 % or more of the relevant market. For a dominant company, even a modest tied market share may already lead to significant anti-competitive effects.

(141) At the retail level a cumulative foreclosure effect may also arise. When all suppliers have market shares below 30 % a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is less than 40 % and withdrawal of the block exemption is therefore unlikely. This figure may be higher when other factors like the number of competitors, entry barriers etc. are taken into account. When not all companies have market shares below the threshold of the Block Exemption Regulation but none is dominant, a cumulative anticompetitive foreclosure effect is unlikely if the total tied market share is below 30 %.

(142) Where the buyer operates from premises and land owned by the supplier or leased by the supplier from a third party not connected with the buyer, the possibility of imposing effective remedies for a possible foreclosure effect will be limited. In that case intervention by the Commission below the level of dominance is unlikely.

(143) In certain sectors the selling of more than one brand from a single site may be difficult, in which case a foreclosure problem can better be remedied by limiting the effective duration of contracts.

(144) Where appreciable anti-competitive effects are established, the question of a possible exemption under Article 101(3) arises. For non-compete obligations, the efficiencies described in paragraph 107, points 1 (free riding between suppliers), 4, 5 (hold-up problems) and 8 (capital market imperfections) may be particularly relevant.

(145) In the case of an efficiency as described in paragraph 107, points 1, 4 and 8, quantity forcing on the buyer could possibly be a less restrictive alternative. A non-compete obligation may be the only viable way to achieve an efficiency as described in paragraph 107, point 5 (hold-up problem related to the transfer of know-how).

(146) In the case of a relationship-specific investment made by the supplier (see efficiency 4 in paragraph 107), a non-compete or quantity forcing agreement for the period of depreciation of the investment will in general fulfil the conditions of Article 101(3). In the case of high relationship-specific investments, a non-compete obligation exceeding five years may be justified. A relationship-specific investment could, for instance, be the installation or adaptation of equipment by the supplier when this equipment can be used afterwards only to produce components for a particular buyer. General or market-specific investments in (extra) capacity are normally not relationship-specific investments. However, where a supplier creates new capacity specifically linked to the operations of a particular buyer, for instance a company producing metal cans which creates new capacity to produce cans on the premises of or next to the canning facility of a food producer, this new capacity may only be economically viable when producing for this particular customer, in which case the investment would be considered to be relationship-specific.

(147) Where the supplier provides the buyer with a loan or provides the buyer with equipment which is not relationship-specific, this in itself is normally not sufficient to justify the exemption of an anticompetitive foreclosure effect on the market. In case of capital market imperfection, it may be more efficient for the supplier of a product than for a bank to provide a loan (see efficiency 8 in paragraph 107). However, in such a case the loan should be provided in the least restrictive way and the buyer should thus in general not be prevented from terminating the obligation and repaying the outstanding part of the loan at any point in time and without payment of any penalty.

(148) The transfer of substantial know-how (efficiency 5 in paragraph 107) usually justifies a non-compete obligation for the whole duration of the supply agreement, as for example in the context of franchising.

(149) Example of non-compete

The market leader in a national market for an impulse consumer product, with a market share of 40 %, sells most of its products (90 %) through tied retailers (tied market share 36 %). The agreements oblige the retailers to purchase only from the market leader for at least four years. The market leader is especially strongly represented in the more densely populated areas like the capital. Its competitors, 10 in number, of which some are only locally available, all have much smaller market shares, the biggest having 12 %. These 10 competitors together supply another 10 % of the market via tied outlets. There is strong brand and product differentiation in the market. The market leader has the strongest brands. It is the only one with regular national advertising campaigns. It provides its tied retailers with special stocking cabinets for its product.

The result on the market is that in total 46 % (36 % + 10 %) of the market is foreclosed to potential entrants and to incumbents not having tied outlets. Potential entrants find entry even more difficult in the densely populated areas where foreclosure is even higher, although it is there that they would prefer to enter the market. In addition, owing to the strong brand and product differentiation and the high search costs relative to the price of the product, the absence of in-store inter-brand competition leads to an extra welfare loss for consumers. The possible efficiencies of the outlet exclusivity, which the market leader claims result from reduced transport costs and a possible hold-up problem concerning the stocking cabinets, are limited and do not outweigh the negative effects on competition. The efficiencies are limited, as the transport costs are linked to quantity and not exclusivity and the stocking cabinets do not contain special know-how and are not brand specific. Accordingly, it is unlikely that the conditions of Article 101(3) are fulfilled.

(150) Example of quantity forcing

A producer X with a 40 % market share sells 80 % of its products through contracts which specify that the reseller is required to purchase at least 75 % of its requirements for that type of product from X. In return X is offering financing and equipment at favourable rates. The contracts have a duration of five years in which repayment of the loan is foreseen in equal instalments. However, after the first two years buyers have the possibility to terminate the contract with a six-month notice period if they repay the outstanding loan and take over the equipment at its market asset value. At the end of the five-year period the equipment becomes the property of the buyer. Most of the competing producers are small, twelve in total with the biggest having a market share of 20 %, and engage in similar contracts with different durations. The producers with market shares below 10 % often have contracts with longer

durations and with less generous termination clauses. The contracts of producer X leave 25 % of requirements free to be supplied by competitors. In the last three years, two new producers have entered the market and gained a combined market share of around 8 %, partly by taking over the loans of a number of resellers in return for contracts with these resellers.

Producer X's tied market share is 24 % (0,75 × 0,80 × 40 %). The other producers' tied market share is around 25 %. Therefore, in total around 49 % of the market is foreclosed to potential entrants and to incumbents not having tied outlets for at least the first two years of the supply contracts. The market shows that the resellers often have difficulty in obtaining loans from banks and are too small in general to obtain capital through other means like the issuing of shares. In addition, producer X is able to demonstrate that concentrating his sales on a limited number of resellers allows him to plan his sales better and to save transport costs. In the light of the efficiencies on the one hand and the 25 % non-tied part in the contracts of producer X, the real possibility for early termination of the contract, the recent entry of new producers and the fact that around half the resellers are not tied on the other hand, the quantity forcing of 75 % applied by producer X is likely to fulfil the conditions of Article 101(3).

2.2. Exclusive distribution

(151) In an exclusive distribution agreement the supplier agrees to sell his products only to one distributor for resale in a particular territory. At the same time the distributor is usually limited in his active selling into other (exclusively allocated) territories. The possible competition risks are mainly reduced intra-brand competition and market partitioning, which may in particular facilitate price discrimination. When most or all of the suppliers apply exclusive distribution this may soften competition and facilitate collusion, both at the suppliers' and distributors' level. Lastly, exclusive distribution may lead to foreclosure of other distributors and therewith reduce competition at that level.

(152) Exclusive distribution is exempted by the Block Exemption Regulation when both the supplier's and buyer's market share each do not exceed 30 %, even if combined with other non-hardcore vertical restraints, such as a non-compete obligation limited to five years, quantity forcing or exclusive purchasing. A combination of exclusive distribution and selective distribution is only exempted by the Block Exemption Regulation if active selling in other territories is not restricted. Above the 30 % market share threshold, the following guidance is provided for the assessment of exclusive distribution in individual cases.

(153) The market position of the supplier and his competitors is of major importance, as the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the "position of the supplier", the more serious is the loss of intra-brand competition. Above the 30 % market share threshold there may be a risk of a significant reduction of intra-brand competition. In order to fulfil the conditions of Article 101(3), the loss of intra-brand competition may need to be balanced with real efficiencies.

(154) The "position of the competitors" can have a dual significance. Strong competitors will generally mean that the reduction in intra-brand competition is outweighed by sufficient inter-brand competition. However, if the number of competitors becomes rather small and their market position is rather similar in terms of market share, capacity and distribution network, there is a risk of collusion and/or softening of competition. The loss of intra-brand competition can increase this risk, especially when several suppliers operate similar distribution systems. Multiple exclusive dealerships, i.e. when different suppliers appoint the same exclusive distributor in a given territory, may further increase the risk of collusion

and/or softening of competition. If a dealer is granted the exclusive right to distribute two or more important competing products in the same territory, inter-brand competition may be substantially restricted for those brands. The higher the cumulative market share of the brands distributed by the exclusive multiple brand dealers, the higher the risk of collusion and/or softening of competition and the more inter-brand competition will be reduced. If a retailer is the exclusive distributor for a number of brands this may have as result that if one producer cuts the wholesale price for its brand, the exclusive retailer will not be eager to transmit this price cut to the final consumer as it would reduce its sales and profits made with the other brands. Hence, compared to the situation without multiple exclusive dealerships, producers have a reduced interest in entering into price competition with one another. Such cumulative effect situations may be a reason to withdraw the benefit of the Block Exemption Regulation when the market shares of the suppliers and buyers are below the threshold of the Block Exemption Regulation.

(155) "Entry barriers" that may hinder suppliers from creating new distributors or finding alternative distributors are less important in assessing the possible anti-competitive effects of exclusive distribution. Foreclosure of other suppliers does not arise as long as exclusive distribution is not combined with single branding.

(156) Foreclosure of other distributors is not a problem if the supplier which operates the exclusive distribution system appoints a high number of exclusive distributors in the same market and these exclusive distributors are not restricted in selling to other non-appointed distributors. Foreclosure of other distributors may however become a problem where there is "buying power" and market power downstream, in particular in the case of very large territories where the exclusive distributor becomes the exclusive buyer for a whole market. An example would be a supermarket chain which becomes the only distributor of a leading brand on a national food retail market. The foreclosure of other distributors may be aggravated in the case of multiple exclusive dealership.

(157) "Buying power" may also increase the risk of collusion on the buyers' side when the exclusive distribution arrangements are imposed by important buyers, possibly located in different territories, on one or several suppliers.

(158) "Maturity of the market" is important, as loss of intra-brand competition and price discrimination may be a serious problem in a mature market but may be less relevant in a market with growing demand, changing technologies and changing market positions.

(159) "The level of trade" is important as the possible negative effects may differ between the wholesale and retail level. Exclusive distribution is mainly applied in the distribution of final goods and services. A loss of intra-brand competition is especially likely at the retail level if coupled with large territories, since final consumers may be confronted with little possibility of choosing between a high price/high service and a low price/low service distributor for an important brand.

(160) A manufacturer which chooses a wholesaler to be his exclusive distributor will normally do so for a larger territory, such as a whole Member State. As long as the wholesaler can sell the products without limitation to downstream retailers there are not likely to be appreciable anti-competitive effects. A possible loss of intra-brand competition at the wholesale level may be easily outweighed by efficiencies obtained in logistics, promotion etc., especially when the manufacturer is based in a different country. The possible risks for inter-brand competition of multiple exclusive dealerships are however higher at the wholesale

than at the retail level. If one wholesaler becomes the exclusive distributor for a significant number of suppliers, this may not only reduce competition between these brands but may also lead to foreclosure at the wholesale level of trade.

(161) As said above, foreclosure of other suppliers does not arise as long as exclusive distribution is not combined with single branding. But even when exclusive distribution is combined with single branding anticompetitive foreclosure of other suppliers is unlikely, except possibly when the single branding is applied to a dense network of exclusive distributors with small territories or in case of a cumulative effect. This may necessitate application of the principles set out above on single branding. However, when the combination does not lead to significant foreclosure, the combination of exclusive distribution and single branding may be pro-competitive by increasing the incentive for the exclusive distributor to focus his efforts on the particular brand. Therefore, in the absence of such a foreclosure effect, the combination of exclusive distribution with non-compete may very well fulfil the conditions of Article 101(3) for the whole duration of the agreement, particularly at the wholesale level.

(162) The combination of exclusive distribution with exclusive sourcing increases the possible competition risks of reduced intra-brand competition and market partitioning which may in particular facilitate price discrimination. Exclusive distribution already limits arbitrage by customers, as it limits the number of distributors and usually also restricts the distributors in their freedom of active selling. Exclusive sourcing, requiring the exclusive distributors to buy their supplies for the particular brand directly from the manufacturer, eliminates in addition possible arbitrage by the exclusive distributors, who are prevented from buying from other distributors in the system. This enhances the possibilities for the supplier to limit intra-brand competition while applying dissimilar conditions of sale to the detriment of consumers, unless the combination allows the creation of efficiencies leading to lower prices to all final consumers.

(163) The "nature of the product" is not very relevant to assessing the possible anti-competitive effects of exclusive distribution. It is, however, relevant when the issue of possible efficiencies is discussed, that is after an appreciable anti-competitive effect is established.

(164) Exclusive distribution may lead to efficiencies, especially where investments by the distributors are required to protect or build up the brand image. In general, the case for efficiencies is strongest for new products, for complex products, for products whose qualities are difficult to judge before consumption (so-called experience products) or of which the qualities are difficult to judge even after consumption (so-called credence products). In addition, exclusive distribution may lead to savings in logistic costs due to economies of scale in transport and distribution.

(165) Example of exclusive distribution at the wholesale level

In the market for a consumer durable, A is the market leader. A sells its product through exclusive wholesalers. Territories for the wholesalers correspond to the entire Member State for small Member States, and to a region for larger Member States. These exclusive distributors take care of sales to all the retailers in their territories. They do not sell to final consumers. The wholesalers are in charge of promotion in their markets. This includes sponsoring of local events, but also explaining and promoting the new products to the retailers in their territories. Technology and product innovation are evolving fairly quickly on this

market, and pre-sale service to retailers and to final consumers plays an important role. The wholesalers are not required to purchase all their requirements of the brand of supplier A from the producer himself, and arbitrage by wholesalers or retailers is practicable because the transport costs are relatively low compared to the value of the product. The wholesalers are not under a non-compete obligation. Retailers also sell a number of brands of competing suppliers, and there are no exclusive or selective distribution agreements at the retail level. On the European market of sales to wholesalers A has around 50 % market share. Its market share on the various national retail markets varies between 40 % and 60 %. A has between 6 and 10 competitors on every national market: B, C and D are its biggest competitors and are also present on each national market, with market shares varying between 20 % and 5 %. The remaining producers are national producers, with smaller market shares. B, C and D have similar distribution networks, whereas the local producers tend to sell their products directly to retailers.

On the wholesale market described above, the risk of reduced intra-brand competition and price discrimination is low. Arbitrage is not hindered, and the absence of intra-brand competition is not very relevant at the wholesale level. At the retail level neither intra- nor inter-brand competition are hindered. Moreover, inter-brand competition is largely unaffected by the exclusive arrangements at the wholesale level. This makes it likely, even if anti-competitive effects exist, that also the conditions of Article 101(3) are fulfilled.

(166) Example of multiple exclusive dealerships in an oligopolistic market

In a national market for a final product, there are four market leaders, who each have a market share of around 20 %. These four market leaders sell their product through exclusive distributors at the retail level. Retailers are given an exclusive territory which corresponds to the town in which they are located or a district of the town for large towns. In most territories, the four market leaders happen to appoint the same exclusive retailer ("multiple dealership"), often centrally located and rather specialised in the product. The remaining 20 % of the national market is composed of small local producers, the largest of these producers having a market share of 5 % on the national market. These local producers sell their products in general through other retailers, in particular because the exclusive distributors of the four largest suppliers show in general little interest in selling less well-known and cheaper brands. There is strong brand and product differentiation on the market. The four market leaders have large national advertising campaigns and strong brand images, whereas the fringe producers do not advertise their products at the national level. The market is rather mature, with stable demand and no major product and technological innovation. The product is relatively simple.

In such an oligopolistic market, there is a risk of collusion between the four market leaders. This risk is increased through multiple dealerships. Intra-brand competition is limited by the territorial exclusivity. Competition between the four leading brands is reduced at the retail level, since one retailer fixes the price of all four brands in each territory. The multiple dealership implies that, if one producer cuts the price for its brand, the retailer will not be eager to transmit this price cut to the final consumer as it would reduce its sales and profits made with the other brands. Hence, producers have a reduced interest in entering into price competition with one another. Inter-brand price competition exists mainly with the low brand image goods of the fringe producers. The possible efficiency arguments for (joint) exclusive distributors are limited, as the product is relatively simple, the resale does not require any specific investments or training and advertising is mainly carried out at the level of the producers.

Even though each of the market leaders has a market share below the threshold, the conditions of Article 101(3) may not be fulfilled and withdrawal of the block exemption may be necessary for the agreements concluded with distributors whose market share is below 30% in the procurement market.

(167) Example of exclusive distribution combined with exclusive sourcing

Manufacturer A is the European market leader for a bulky consumer durable, with a market share of between 40 % and 60 % in most national retail markets. In Member States where it has a high market share it has less competitors with much smaller market shares. The competitors are present on only one or two national markets. A's long time policy is to sell its product through its national subsidiaries to exclusive distributors at the retail level, which are not allowed to sell actively into each other's territories. These distributors are thereby incentivised to promote the product and provide pre-sales services. Recently the retailers are in addition obliged to purchase manufacturer A's products exclusively from the national subsidiary of manufacturer A in their own country. The retailers selling the brand of manufacturer A are the main resellers of that type of product in their territory. They handle competing brands, but with varying degrees of success and enthusiasm. Since the introduction of exclusive sourcing A applies price differences of 10 % to 15 % between markets with higher prices in the markets where it has less competition. The markets are relatively stable on the demand and the supply side, and there are no significant technological changes.

In the high price markets, the loss of intra-brand competition results not only from the territorial exclusivity at the retail level but is aggravated by the exclusive sourcing obligation imposed on the retailers. The exclusive sourcing obligation helps to keep markets and territories separate by making arbitrage between the exclusive retailers, the main resellers of that type of product, impossible. The exclusive retailers also cannot sell actively into each other's territory and in practice tend to avoid delivering outside their own territory. This has rendered price discrimination possible, without having led to a significant increase in total sales. Arbitrage by consumers or independent traders is limited due to the bulkiness of the product.

While the possible efficiency arguments for appointing exclusive distributors may be convincing, in particular because of the incentivising of retailers, the possible efficiency arguments for the combination of exclusive distribution and exclusive sourcing, and in particular the possible efficiency arguments for exclusive sourcing, linked mainly to economies of scale in transport, are unlikely to outweigh the negative effect of price discrimination and reduced intra-brand competition. Consequently, it is unlikely that the conditions of Article 101(3) are fulfilled.

2.3. Exclusive customer allocation

(168) In an exclusive customer allocation agreement, the supplier agrees to sell his products only to one distributor for resale to a particular group of customers. At the same time, the distributor is usually limited in his active selling to other (exclusively allocated) groups of customers. The Block Exemption Regulation does not limit the way an exclusive customer group can be defined; it could for instance be a particular type of customers defined by their occupation but also a list of specific customers selected on the basis of one or more objective criteria. The possible competition risks are mainly reduced intra-brand competition and market partitioning, which may in particular facilitate price discrimination. When most or all of the suppliers apply exclusive customer allocation, this may soften competition and

facilitate collusion, both at the suppliers' and the distributors' level. Lastly, exclusive customer allocation may lead to foreclosure of other distributors and therewith reduce competition at that level.

(169) Exclusive customer allocation is exempted by the Block Exemption Regulation when both the supplier's and buyer's market share does not exceed the 30 % market share threshold, even if combined with other non-hardcore vertical restraints such as non-compete, quantity-forcing or exclusive sourcing. A combination of exclusive customer allocation and selective distribution is normally hardcore, as active selling to end-users by the appointed distributors is usually not left free. Above the 30 % market share threshold, the guidance provided in paragraphs 151 to 167 applies mutatis mutandis to the assessment of exclusive customer allocation, subject to the following specific remarks.

(170) The allocation of customers normally makes arbitrage by the customers more difficult. In addition, as each appointed distributor has his own class of customers, non-appointed distributors not falling within such a class may find it difficult to obtain the product. This will reduce possible arbitrage by non-appointed distributors.

(171) Exclusive customer allocation is mainly applied to intermediate products and at the wholesale level when it concerns final products, where customer groups with different specific requirements concerning the product can be distinguished.

(172) Exclusive customer allocation may lead to efficiencies, especially when the distributors are required to make investments in for instance specific equipment, skills or know-how to adapt to the requirements of their group of customers. The depreciation period of these investments indicates the justified duration of an exclusive customer allocation system. In general the case is strongest for new or complex products and for products requiring adaptation to the needs of the individual customer. Identifiable differentiated needs are more likely for intermediate products, that is products sold to different types of professional buyers. Allocation of final consumers is unlikely to lead to efficiencies.

(173) Example of exclusive customer allocation

A company has developed a sophisticated sprinkler installation. The company has currently a market share of 40 % on the market for sprinkler installations. When it started selling the sophisticated sprinkler it had a market share of 20 % with an older product. The installation of the new type of sprinkler depends on the type of building that it is installed in and on the use of the building (office, chemical plant, hospital etc.). The company has appointed a number of distributors to sell and install the sprinkler installation. Each distributor needed to train its employees for the general and specific requirements of installing the sprinkler installation for a particular class of customers. To ensure that distributors would specialise, the company assigned to each distributor an exclusive class of customers and prohibited active sales to each others' exclusive customer classes. After five years, all the exclusive distributors will be allowed to sell actively to all classes of customers, thereby ending the system of exclusive customer allocation. The supplier may then also start selling to new distributors. The market is quite dynamic, with two recent entries and a number of technological developments. Competitors, with market shares between 25 % and 5 %, are also upgrading their products.

As the exclusivity is of limited duration and helps to ensure that the distributors may recoup their investments and concentrate their sales efforts first on a certain class of customers in

order to learn the trade, and as the possible anti-competitive effects seem limited in a dynamic market, the conditions of Article 101(3) are likely to be fulfilled.

2.4. Selective distribution

(174) Selective distribution agreements, like exclusive distribution agreements, restrict on the one hand the number of authorised distributors and on the other the possibilities of resale. The difference with exclusive distribution is that the restriction of the number of dealers does not depend on the number of territories but on selection criteria linked in the first place to the nature of the product. Another difference with exclusive distribution is that the restriction on resale is not a restriction on active selling to a territory but a restriction on any sales to non-authorised distributors, leaving only appointed dealers and final customers as possible buyers. Selective distribution is almost always used to distribute branded final products.

(175) The possible competition risks are a reduction in intra-brand competition and, especially in case of cumulative effect, foreclosure of certain type(s) of distributors and softening of competition and facilitation of collusion between suppliers or buyers. To assess the possible anti-competitive effects of selective distribution under Article 101(1), a distinction needs to be made between purely qualitative selective distribution and quantitative selective distribution. Purely qualitative selective distribution selects dealers only on the basis of objective criteria required by the nature of the product such as training of sales personnel, the service provided at the point of sale, a certain range of the products being sold etc[49]. The application of such criteria does not put a direct limit on the number of dealers. Purely qualitative selective distribution is in general considered to fall outside Article 101(1) for lack of anti-competitive effects, provided that three conditions are satisfied. First, the nature of the product in question must necessitate a selective distribution system, in the sense that such a system must constitute a legitimate requirement, having regard to the nature of the product concerned, to preserve its quality and ensure its proper use. Secondly, resellers must be chosen on the basis of objective criteria of a qualitative nature which are laid down uniformly for all and made available to all potential resellers and are not applied in a discriminatory manner. Thirdly, the criteria laid down must not go beyond what is necessary[50]. Quantitative selective distribution adds further criteria for selection that more directly limit the potential number of dealers by, for instance, requiring minimum or maximum sales, by fixing the number of dealers, etc.

(176) Qualitative and quantitative selective distribution is exempted by the Block Exemption Regulation as long as the market share of both supplier and buyer each do not exceed 30 %, even if combined with other non-hardcore vertical restraints, such as non-compete or exclusive distribution, provided active selling by the authorised distributors to each other and to end users is not restricted. The Block Exemption Regulation exempts selective distribution regardless of the nature of the product concerned and regardless of the nature of the selection criteria. However, where the characteristics of the product[51] do not require selective

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49 See for example judgment of the General Court in Case T-88/92 Groupement d'achat Édouard Leclerc v Commission [1996] ECR II-1961.

50 See judgments of the Court of Justice in Case 31/80 L'Oréal v PVBA [1980] ECR 3775, paragraphs 15 and 16; Case 26/76 Metro I [1977] ECR 1875, paragraphs 20 and 21; Case 107/82 AEG [1983] ECR 3151, paragraph 35; and of the General Court in Case T-19/91 Vichy v Commission [1992] ECR II-415, paragraph 65.

51 See for example judgments of the General Court in Case T-19/92, *Groupement d'achat Edouard Leclerc v Commission* [1996] ECR II-1851, paragraphs 112 to 123; Case T-88/92 *Groupement d'achat Edouard Leclerc v Commission* [1996] ECR II-1961, paragraphs 106 to 117, and the case law referred to in the preceding footnote.

distribution or do not require the applied criteria, such as for instance the requirement for distributors to have one or more brick and mortar shops or to provide specific services, such a distribution system does not generally bring about sufficient efficiency enhancing effects to counterbalance a significant reduction in intra-brand competition. If appreciable anti-competitive effects occur, the benefit of the Block Exemption Regulation is likely to be withdrawn. In addition, the following guidance is provided for the assessment of selective distribution in individual cases which are not covered by the Block Exemption Regulation or in the case of cumulative effects resulting from parallel networks of selective distribution.

(177) The market position of the supplier and his competitors is of central importance in assessing possible anti-competitive effects, as the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the position of the supplier, the more problematic is the loss of intra-brand competition. Another important factor is the number of selective distribution networks present in the same market. Where selective distribution is applied by only one supplier in the market, quantitative selective distribution does not normally create net negative effects provided that the contract goods, having regard to their nature, require the use of a selective distribution system and on condition that the selection criteria applied are necessary to ensure efficient distribution of the goods in question. The reality, however, seems to be that selective distribution is often applied by a number of the suppliers in a given market.

(178) The position of competitors can have a dual significance and plays in particular a role in case of a cumulative effect. Strong competitors will mean in general that the reduction in intra-brand competition is easily outweighed by sufficient inter-brand competition. However, when a majority of the main suppliers apply selective distribution there will be a significant loss of intra-brand competition and possible foreclosure of certain types of distributors as well as an increased risk of collusion between those major suppliers. The risk of foreclosure of more efficient distributors has always been greater with selective distribution than with exclusive distribution, given the restriction on sales to non-authorised dealers in selective distribution. This is designed to give selective distribution systems a closed character, making it impossible for non-authorised dealers to obtain supplies. This makes selective distribution particularly well suited to avoid pressure by price discounters (whether offline or online-only distributors) on the margins of the manufacturer, as well as on the margins of the authorised dealers. Foreclosure of such distribution formats, whether resulting from the cumulative application of selective distribution or from the application by a single supplier with a market share exceeding 30%, reduces the possibilities for consumers to take advantage of the specific benefits offered by these formats such as lower prices, more transparency and wider access.

(179) Where the Block Exemption Regulation applies to individual networks of selective distribution, withdrawal of the block exemption or disapplication of the Block Exemption Regulation may be considered in case of cumulative effects. However, a cumulative effect problem is unlikely to arise when the share of the market covered by selective distribution is below 50 %. Also, no problem is likely to arise where the market coverage ratio exceeds 50 %, but the aggregate market share of the five largest suppliers (CR5) is below 50 %. Where both the CR5 and the share of the market covered by selective distribution exceed 50 %, the assessment may vary depending on whether or not all five largest suppliers apply selective distribution. The stronger the position of the competitors not applying selective distribution, the less likely the foreclosure of other distributors. If all five largest suppliers apply selective distribution, competition concerns may in particular arise with respect to those agreements that apply quantitative selection criteria by directly limiting the number of authorised dealers or that apply qualitative criteria, such as a requirement to have one or more

brick and mortar shops or to provide specific services, which forecloses certain distribution formats. The conditions of Article 101(3) are in general unlikely to be fulfilled if the selective distribution systems at issue prevent access to the market by new distributors capable of adequately selling the products in question, especially price discounters or online-only distributors offering lower prices to consumers, thereby limiting distribution to the advantage of certain existing channels and to the detriment of final consumers. More indirect forms of quantitative selective distribution, resulting for instance from the combination of purely qualitative selection criteria with the requirement imposed on the dealers to achieve a minimum amount of annual purchases, are less likely to produce net negative effects, if such an amount does not represent a significant proportion of the dealer's total turnover achieved with the type of products in question and it does not go beyond what is necessary for the supplier to recoup his relationship-specific investment and/or realise economies of scale in distribution. As regards individual contributions, a supplier with a market share of less than 5 % is in general not considered to contribute significantly to a cumulative effect.

(180) "Entry barriers" are mainly of interest in the case of foreclosure of the market to non-authorised dealers. In general entry barriers will be considerable as selective distribution is usually applied by manufacturers of branded products. It will in general take time and considerable investment for excluded retailers to launch their own brands or obtain competitive supplies elsewhere.

(181) "Buying power" may increase the risk of collusion between dealers and thus appreciably change the analysis of possible anti-competitive effects of selective distribution. Foreclosure of the market to more efficient retailers may especially result where a strong dealer organisation imposes selection criteria on the supplier aimed at limiting distribution to the advantage of its members.

(182) Article 5(1)(c) of the Block Exemption Regulation provides that the supplier may not impose an obligation causing the authorised dealers, either directly or indirectly, not to sell the brands of particular competing suppliers. This condition aims specifically at avoiding horizontal collusion to exclude particular brands through the creation of a selective club of brands by the leading suppliers. This kind of obligation is unlikely to be exemptable when the CR5 is equal to or above 50 %, unless none of the suppliers imposing such an obligation belongs to the five largest suppliers in the market.

(183) Foreclosure of other suppliers is normally not a problem as long as other suppliers can use the same distributors, i.e. as long as the selective distribution system is not combined with single branding. In the case of a dense network of authorised distributors or in the case of a cumulative effect, the combination of selective distribution and a non-compete obligation may pose a risk of foreclosure to other suppliers. In that case the principles set out above on single branding apply. Where selective distribution is not combined with a non-compete obligation, foreclosure of the market to competing suppliers may still be a problem when the leading suppliers apply not only purely qualitative selection criteria, but impose on their dealers certain additional obligations such as the obligation to reserve a minimum shelf-space for their products or to ensure that the sales of their products by the dealer achieve a minimum percentage of the dealer's total turnover. Such a problem is unlikely to arise if the share of the market covered by selective distribution is below 50 % or, where this coverage ratio is exceeded, if the market share of the five largest suppliers is below 50 %.

(184) Maturity of the market is important, as loss of intra-brand competition and possible foreclosure of suppliers or dealers may be a serious problem in a mature market but is less

relevant in a market with growing demand, changing technologies and changing market positions.

(185) Selective distribution may be efficient when it leads to savings in logistical costs due to economies of scale in transport and this may happen irrespective of the nature of the product (efficiency 7 in paragraph 107). However, this is usually only a marginal efficiency in selective distribution systems. To help solve a free-rider problem between the distributors (efficiency 1 in paragraph 107) or to help create a brand image (efficiency 9 in paragraph 107), the nature of the product is very relevant. In general the case is strongest for new products, for complex products, for products of which the qualities are difficult to judge before consumption (so-called experience products) or of which the qualities are difficult to judge even after consumption (so-called credence products). The combination of selective distribution with a location clause, protecting an appointed dealer against other appointed dealers opening up a shop in its vicinity, may in particular fulfil the conditions of Article 101(3) if the combination is indispensable to protect substantial and relationship-specific investments made by the authorised dealer (efficiency 4 in paragraph 107).

(186) To ensure that the least anti-competitive restraint is chosen, it is relevant to see whether the same efficiencies can be obtained at a comparable cost by for instance service requirements alone.

(187) Example of quantitative selective distribution:

In a market for consumer durables, the market leader (brand A) with a market share of 35 %, sells its product to final consumers through a selective distribution network. There are several criteria for admission to the network: the shop must employ trained staff and provide pre-sales services, there must be a specialised area in the shop devoted to the sales of the product and similar hi-tech products, and the shop is required to sell a wide range of models of the supplier and to display them in an attractive manner. Moreover, the number of admissible retailers in the network is directly limited through the establishment of a maximum number of retailers per number of inhabitants in each province or urban area. Manufacturer A has 6 competitors in this market. Its largest competitors, B, C and D, have market shares of respectively 25, 15 and 10 %, whilst the other producers have smaller market shares. A is the only manufacturer to use selective distribution. The selective distributors of brand A always handle a few competing brands. However, competing brands are also widely sold in shops which are not member of A's selective distribution network. Channels of distribution are various: for instance, brands B and C are sold in most of A's selected shops, but also in other shops providing a high quality service and in hypermarkets. Brand D is mainly sold in high service shops. Technology is evolving quite rapidly in this market, and the main suppliers maintain a strong quality image for their products through advertising.

In this market, the coverage ratio of selective distribution is 35 %. Inter-brand competition is not directly affected by the selective distribution system of A. Intra-brand competition for brand A may be reduced, but consumers have access to low service/low price retailers for brands B and C, which have a comparable quality image to brand A. Moreover, access to high service retailers for other brands is not foreclosed, since there is no limitation on the capacity of selected distributors to sell competing brands, and the quantitative limitation on the number of retailers for brand A leaves other high service retailers free to distribute competing brands. In this case, in view of the service requirements and the efficiencies these are likely to provide and the limited effect on intra-brand competition the conditions of Article 101(3) are likely to be fulfilled.

(188) Example of selective distribution with cumulative effects:

On a market for a particular sports article, there are seven manufacturers, whose respective market shares are: 25 %, 20 %, 15 %, 15 %, 10 %, 8 % and 7 %. The five largest manufacturers distribute their products through quantitative selective distribution, whilst the two smallest use different types of distribution systems, which results in a coverage ratio of selective distribution of 85 %. The criteria for access to the selective distribution networks are remarkably uniform amongst manufacturers: the distributors are required to have one or more brick and mortar shops, these shops are required to have trained personnel and to provide pre-sale services, there must be a specialised area in the shop devoted to the sales of the article and a minimum size for this area is specified. The shop is required to sell a wide range of the brand in question and to display the article in an attractive manner, the shop must be located in a commercial street, and this type of article must represent at least 30 % of the total turnover of the shop. In general, the same dealer is appointed selective distributor for all five brands. The two brands which do not use selective distribution usually sell through less specialised retailers with lower service levels. The market is stable, both on the supply and on the demand side, and there is strong brand image and product differentiation. The five market leaders have strong brand images, acquired through advertising and sponsoring, whereas the two smaller manufacturers have a strategy of cheaper products, with no strong brand image.

In this market, access by general price discounters and online-only distributors to the five leading brands is denied. Indeed, the requirement that this type of article represents at least 30 % of the activity of the dealers and the criteria on presentation and pre-sales services rule out most price discounters from the network of authorised dealers. The requirement to have one or more brick and mortar shops excludes online-only distributors from the network. As a consequence, consumers have no choice but to buy the five leading brands in high service/high price shops. This leads to reduced inter-brand competition between the five leading brands. The fact that the two smallest brands can be bought in low service/low price shops does not compensate for this, because the brand image of the five market leaders is much better. Inter-brand competition is also limited through multiple dealership. Even though there exists some degree of intra-brand competition and the number of retailers is not directly limited, the criteria for admission are strict enough to lead to a small number of retailers for the five leading brands in each territory.

The efficiencies associated with these quantitative selective distribution systems are low: the product is not very complex and does not justify a particularly high service. Unless the manufacturers can prove that there are clear efficiencies linked to their network of selective distribution, it is probable that the block exemption will have to be withdrawn because of its cumulative effects resulting in less choice and higher prices for consumers.

2.5. Franchising

(189) Franchise agreements contain licences of intellectual property rights relating in particular to trade marks or signs and know-how for the use and distribution of goods or services. In addition to the licence of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance. The licence and the assistance are integral components of the business method being franchised. The franchisor is in general paid a franchise fee by the franchisee for the use of the particular business method. Franchising may enable the franchisor to establish, with limited investments, a uniform network for the distribution of his products. In addition to the provision of the business method, franchise agreements usually contain a combination of different vertical restraints

concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.

(190) The coverage by the Block Exemption Regulation of the licensing of IPRs contained in franchise agreements is dealt with in paragraphs 24 to 46. As for the vertical restraints on the purchase, sale and resale of goods and services within a franchising arrangement, such as selective distribution, non-compete or exclusive distribution, the Block Exemption Regulation applies up to the 30 % market share threshold[52]. The guidance provided earlier in respect of these types of restraints applies also to franchising, subject to the following specific remarks:

1) The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or are indispensable to protect the know-how and that the vertical restraints fulfil the conditions of Article 101(3).

2) A non-compete obligation on the goods or services purchased by the franchisee falls outside Article 101(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 101(1), as long as it does not exceed the duration of the franchise agreement itself.

(191) Example of franchising:

A manufacturer has developed a new format for selling sweets in so-called fun shops where the sweets can be coloured specially on demand from the consumer. The manufacturer of the sweets has also developed the machines to colour the sweets. The manufacturer also produces the colouring liquids. The quality and freshness of the liquid is of vital importance to producing good sweets. The manufacturer made a success of its sweets through a number of own retail outlets all operating under the same trade name and with the uniform fun image (style of lay-out of the shops, common advertising etc.). In order to expand sales the manufacturer started a franchising system. The franchisees are obliged to buy the sweets, liquid and colouring machine from the manufacturer, to have the same image and operate under the trade name, pay a franchise fee, contribute to common advertising and ensure the confidentiality of the operating manual prepared by the franchisor. In addition, the franchisees are only allowed to sell from the agreed premises, are only allowed to sell to end users or other franchisees and are not allowed to sell other sweets. The franchisor is obliged not to appoint another franchisee nor operate a retail outlet himself in a given contract territory. The franchisor is also under the obligation to update and further develop its products, the business outlook and the operating manual and make these improvements available to all retail franchisees. The franchise agreements are concluded for a duration of 10 years.

Sweet retailers buy their sweets on a national market from either national producers that cater for national tastes or from wholesalers which import sweets from foreign producers in addition to selling products from national producers. On this market the franchisor's products compete with other brands of sweets. The franchisor has a market share of 30 % on the market for sweets sold to retailers. Competition comes from a number of national and international brands, sometimes produced by large diversified food companies. There are many potential points of sale of sweets in the form of tobacconists, general food retailers,

[52] See also paragraphs 86 to 95, in particular paragraph 92.

cafeterias and specialised sweet shops. On the market for machines for colouring food the franchisor's market share is below 10 %.

Most of the obligations contained in the franchise agreements can be assessed as being necessary to protect the intellectual property rights or maintain the common identity and reputation of the franchised network and fall outside Article 101(1). The restrictions on selling (contract territory and selective distribution) provide an incentive to the franchisees to invest in the colouring machine and the franchise concept and, if not necessary for, at least help to maintain the common identity, thereby offsetting the loss of intra-brand competition. The non-compete clause excluding other brands of sweets from the shops for the full duration of the agreements does allow the franchisor to keep the outlets uniform and prevent competitors from benefiting from its trade name. It does not lead to any serious foreclosure in view of the great number of potential outlets available to other sweet producers. The franchise agreements of this franchisor are likely to fulfil the conditions for exemption under Article 101(3) in as far as the obligations contained therein fall under Article 101(1).

2.6. Exclusive supply

(192) Under the heading of exclusive supply come those agreements that have as their main element that the supplier is obliged or induced to sell the contract products only or mainly to one buyer, in general or for a particular use. This may take the form of an exclusive supply obligation, restricting the supplier to sell to only one buyer for the purposes of resale or a particular use, but may for instance also take the form of quantity forcing on the supplier, where incentives are agreed between the supplier and buyer which make the former concentrate its sales mainly with one buyer. For intermediate goods or services, exclusive supply is often referred to as industrial supply.

(193) Exclusive supply is exempted by the Block Exemption Regulation when both the supplier's and buyer's market share does not exceed 30 %, even if combined with other non-hardcore vertical restraints such as non-compete. Above the market share threshold the following guidance is provided for the assessment of exclusive supply in individual cases.

(194) The main competition risk of exclusive supply is anticompetitive foreclosure of other buyers. There is a similarity with the possible effects of exclusive distribution, in particular when the exclusive distributor becomes the exclusive buyer for a whole market (see Section VI.2.2 above, in particular paragraph 156). The market share of the buyer on the upstream purchase market is obviously important for assessing the ability of the buyer to "impose" exclusive supply which forecloses other buyers from access to supplies. The importance of the buyer on the downstream market is however the factor which determines whether a competition problem may arise. If the buyer has no market power downstream, then no appreciable negative effects for consumers can be expected. Negative effects may arise when the market share of the buyer on the downstream supply market as well as the upstream purchase market exceeds 30 %. Where the market share of the buyer on the upstream market does not exceed 30 %, significant foreclosure effects may still result, especially when the market share of the buyer on his downstream market exceeds 30 % and the exclusive supply relates to a particular use of the contract products. Where a company is dominant on the downstream market, any obligation to supply the products only or mainly to the dominant buyer may easily have significant anti-competitive effects.

(195) It is not only the market position of the buyer on the upstream and downstream market that is important but also the extent to and the duration for which he applies an exclusive

supply obligation. The higher the tied supply share, and the longer the duration of the exclusive supply, the more significant the foreclosure is likely to be. Exclusive supply agreements shorter than five years entered into by non-dominant companies usually require a balancing of pro- and anti-competitive effects, while agreements lasting longer than five years are for most types of investments not considered necessary to achieve the claimed efficiencies or the efficiencies are not sufficient to outweigh the foreclosure effect of such long-term exclusive supply agreements.

(196) The market position of the competing buyers on the upstream market is important as it is only likely that competing buyers will be foreclosed for anti-competitive reasons, i.e. to increase their costs, if they are significantly smaller than the foreclosing buyer. Foreclosure of competing buyers is not very likely where these competitors have similar buying power and can offer the suppliers similar sales possibilities. In such a case, foreclosure could only occur for potential entrants, who may not be able to secure supplies when a number of major buyers all enter into exclusive supply contracts with the majority of suppliers on the market. Such a cumulative effect may lead to withdrawal of the benefit of the Block Exemption Regulation.

(197) Entry barriers at the supplier level are relevant to establishing whether there is real foreclosure. In as far as it is efficient for competing buyers to provide the goods or services themselves via upstream vertical integration, foreclosure is unlikely to be a real problem. However, often there are significant entry barriers.

(198) Countervailing power of suppliers is relevant, as important suppliers will not easily allow themselves to be cut off from alternative buyers. Foreclosure is therefore mainly a risk in the case of weak suppliers and strong buyers. In the case of strong suppliers the exclusive supply may be found in combination with non-compete. The combination with non-compete brings in the rules developed for single branding. Where there are relationship-specific investments involved on both sides (hold-up problem) the combination of exclusive supply and non-compete i.e. reciprocal exclusivity in industrial supply agreements may often be justified, in particular below the level of dominance.

(199) Lastly, the level of trade and the nature of the product are relevant for foreclosure. Anticompetitive foreclosure is less likely in the case of an intermediate product or where the product is homogeneous. Firstly, a foreclosed manufacturer that uses a certain input usually has more flexibility to respond to the demand of his customers than the wholesaler/retailer has in responding to the demand of the final consumer for whom brands may play an important role. Secondly, the loss of a possible source of supply matters less for the foreclosed buyers in the case of homogeneous products than in the case of a heterogeneous product with different grades and qualities. For final branded products or differentiated intermediate products where there are entry barriers, exclusive supply may have appreciable anti-competitive effects where the competing buyers are relatively small compared to the foreclosing buyer, even if the latter is not dominant on the downstream market.

(200) Efficiencies can be expected in the case of a hold-up problem (paragraph 107, points 4 and 5), and this is more likely for intermediate products than for final products. Other efficiencies are less likely. Possible economies of scale in distribution (paragraph 107, point 7) do not seem likely to justify exclusive supply.

(201) In the case of a hold-up problem and even more so in the case of economies of scale in distribution, quantity forcing on the supplier, such as minimum supply requirements, could well be a less restrictive alternative.

(202) Example of exclusive supply:

On a market for a certain type of components (intermediate product market) supplier A agrees with buyer B to develop, with his own know-how and considerable investment in new machines and with the help of specifications supplied by buyer B, a different version of the component. B will have to make considerable investments to incorporate the new component. It is agreed that A will supply the new product only to buyer B for a period of five years from the date of first entry on the market. B is obliged to buy the new product only from A for the same period of five years. Both A and B can continue to sell and buy respectively other versions of the component elsewhere. The market share of buyer B on the upstream component market and on the downstream final goods market is 40 %. The market share of the component supplier is 35 %. There are two other component suppliers with around 20-25 % market share and a number of small suppliers.

Given the considerable investments, the agreement is likely to fulfil the conditions of Article 101(3) in view of the efficiencies and the limited foreclosure effect. Other buyers are foreclosed from a particular version of a product of a supplier with 35 % market share and there are other component suppliers that could develop similar new products. The foreclosure of part of buyer B's demand to other suppliers is limited to maximum 40 % of the market.

2.7. Upfront access payments

(203) Upfront access payments are fixed fees that suppliers pay to distributors in the framework of a vertical relationship at the beginning of a relevant period, in order to get access to their distribution network and remunerate services provided to the suppliers by the retailers. This category includes various practices such as slotting allowances[53], the so called pay-to-stay fees[54], payments to have access to a distributor's promotion campaigns etc. Upfront access payments are block exempted when both the supplier's and buyer's market share does not exceed 30%. Above the market share threshold the following guidance is provided for the assessment of upfront access payments in individual cases.

(204) Upfront access payments may sometimes result in anticompetitive foreclosure of other distributors if such payments induce the supplier to channel its products through only one or a limited number of distributors. A high fee may make that a supplier wants to channel a substantial volume of its sales through this distributor in order to cover the costs of the fee. In this case, upfront access payments may have the same downstream foreclosure effect as an exclusive supply type of obligation. The assessment of this negative effect is made by analogy to the assessment of exclusive supply obligations (in particular paragraphs 194-199).

(205) Exceptionally, upfront access payments may also result in anticompetitive foreclosure of other suppliers, if the widespread use of upfront access payments increases barriers to entry for small entrants. The assessment of this possible negative effect is made by analogy to the assessment of single branding obligations (in particular paragraphs 132-141).

(206) In addition to possible foreclosure effects, upfront access payments may soften competition and facilitate collusion between distributors. Upfront access payments are likely to increase the price charged by the supplier for the contract products since the supplier must

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53 Fixed fees that manufacturers pay to retailers in order to get access to their shelf space

54 Lump sum payments made to ensure the continued presence of an existing product on the shelf for some further period

cover the expense of those payments. Higher supply prices may reduce the incentive of the retailers to compete on price on the downstream market, while the profits of distributors are increased as a result of the access payments. Such reduction of competition between distributors through the cumulative use of upfront access payments normally requires the distribution market to be highly concentrated.

(207) However, the use of upfront access payments may in many cases contribute to an efficient allocation of shelf space for new products. Distributors often have less information than suppliers on the potential for success of new products to be introduced on the market and, as a result, the amount of products to be stocked may be sub-optimal. Upfront access payments may be used to reduce this asymmetry in information between suppliers and distributors by explicitly allowing suppliers to compete for shelf space. The distributor may thus receive a signal of which products are most likely to be successful since a supplier would normally agree to pay an upfront access fee if he estimates a low probability of failure of the product introduction.

(208) Furthermore, due to the asymmetry in information mentioned above, suppliers may have incentives to free-ride on distributors' promotional efforts in order to introduce sub-optimal products. If a product is not successful, the distributors will pay part of the costs of the product failure. The use of upfront access fees may prevent such free riding by shifting the risk of product failure back to the suppliers, thereby contributing to an optimal rate of product introductions.

2.8. Category Management Agreements

(209) Category management agreements are agreements by which, within a distribution agreement, the distributor entrusts the supplier (the "category captain") with the marketing of a category of products including in general not only the supplier's products, but also the products of its competitors. The category captain may thus have an influence on for instance the product placement and product promotion in the shop and product selection for the shop. Category management agreements are block exempted when both the supplier's and buyer's market share does not exceed 30%. Above the market share threshold the following guidance is provided for the assessment of category management agreements in individual cases.

(210) While in most cases category management agreements will not be problematic, they may sometimes distort competition between suppliers, and finally result in anticompetitive foreclosure of other suppliers, if the category captain is able, due to its influence over the marketing decisions of the distributor, to limit or disadvantage the distribution of products of competing suppliers. While in most cases the distributor may not have an interest in limiting its choice of products, when the distributor also sells competing products under its own brand (private labels), the distributor may also have incentives to exclude certain suppliers, in particular intermediate range products. The assessment of this upstream foreclosure effect is made by analogy to the assessment of single branding obligations (in particular paragraphs 132-141) by addressing issues like the market coverage of these agreements, the market position of competing suppliers and the possible cumulative use of such agreements.

(211) In addition, category management agreements may facilitate collusion between distributors when the same supplier serves as a category captain for all or most of the competing distributors in a market and provides these distributors with a common point of reference for their marketing decisions.

(212) Category management may also facilitate collusion between suppliers through increased opportunities to exchange via retailers sensitive market information, such as for instance information related to future pricing, promotional plans or advertising campaigns[55].

(213) However, the use of category management agreements may also lead to efficiencies. Category management agreements may allow distributors to have access to the supplier's marketing expertise for a certain group of products and to achieve economies of scale as they ensure that the optimal quantity of products is presented timely and directly on the shelves. As category management is based on customers' habits, category management agreements may lead to higher customer satisfaction as they help to better meet demand expectations. In general, the higher the inter-brand competition and the lower consumers' switching costs, the greater the economic benefits achieved through category management.

2.9. Tying

(214) Tying refers to situations where customers that purchase one product (the tying product) are required also to purchase another distinct product (the tied product) from the same supplier or someone designated by the latter. Tying may constitute an abuse within the meaning of Article 102[56]. Tying may also constitute a vertical restraint falling under Article 101 where it results in a single branding type of obligation (see paragraphs 129 to 150) for the tied product. Only the latter situation is dealt with in these Guidelines.

(215) Whether products will be considered to be distinct depends on customer demand. Two products are distinct if, in the absence of the tying, a substantial number of customers would purchase or would have purchased the tying product without also buying the tied product from the same supplier, thereby allowing stand-alone production for both the tying and the tied product[57]. Evidence that two products are distinct could include direct evidence that, when given a choice, customers purchase the tying and the tied products separately from different sources of supply, or indirect evidence, such as the presence on the market of undertakings specialised in the manufacture or sale of the tied product without the tying product[58], or evidence indicating that undertakings with little market power, particularly in competitive markets, tend not to tie or not to bundle such products. For instance, since customers want to buy shoes with laces and it is not practicable for distributors to lace new shoes with the laces of their choice, it has become commercial usage for shoe manufacturers to supply shoes with laces. Therefore, the sale of shoes with laces is not a tying practice.

(216) Tying may lead to anticompetitive foreclosure effects in the tied market, the tying market, or both at the same time. The foreclosure effect depends on the tied percentage of total sales on the market of the tied product. On the question of what can be considered appreciable foreclosure under Article 101(1), the analysis for single branding can be applied. Tying means that there is at least a form of quantity-forcing on the buyer in respect of the tied product. Where in addition a non-compete obligation is agreed in respect of the tied product,

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55 Direct information exchange between competitors is not covered by the Block Exemption Regulation, see Article 2(4) and paragraphs 27-28.

56 Judgment of the Court of Justice in Case C-333/94 P Tetrapak v Commission [1996] ECR I-5951, paragraph 37. See also Communication from the Commission – Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7-20.

57 Case T-201/04 *Microsoft* v *Commission* [2007] ECR II-3601, paragraphs 917, 921 and 922

58 Case T-30/89 *Hilti* v *Commission* [1991] ECR II-1439, paragraph 67

this increases the possible foreclosure effect on the market of the tied product. The tying may lead to less competition for customers interested in buying the tied product, but not the tying product. If there is not a sufficient number of customers who will buy the tied product alone to sustain competitors of the supplier in the tied market, the tying can lead to those customers facing higher prices. If the tied product is an important complementary product for customers of the tying product, a reduction of alternative suppliers of the tied product and hence a reduced availability of that product can make entry to the tying market alone more difficult.

(217) Tying may also directly lead to supra-competitive prices, especially in three situations. Firstly, if the tying and the tied product can be used in variable proportions as inputs to a production process, customers may react to an increase in price for the tying product by increasing their demand for the tied product while decreasing their demand for the tying product. By tying the two products the supplier may seek to avoid this substitution and as a result be able to raise its prices. Secondly, when the tying allows price discrimination according to the use the customer makes of the tying product, for example the tying of ink cartridges to the sale of photocopying machines (metering). Thirdly, when in the case of long-term contracts or in the case of after-markets with original equipment with a long replacement time, it becomes difficult for the customers to calculate the consequences of the tying.

(218) Tying is block exempted when the market share of the supplier, on both the market of the tied product and the market of the tying product, and the market share of the buyer, on the relevant upstream markets, do not exceed 30 %. It may be combined with other non-hardcore vertical restraints such as non-compete or quantity forcing in respect of the tying product, or exclusive sourcing. Above the market share threshold the following guidance is provided for the assessment of tying in individual cases.

(219) The market position of the supplier on the market of the tying product is obviously of main importance to assess possible anti-competitive effects. In general this type of agreement is imposed by the supplier. The importance of the supplier on the market of the tying product is the main reason why a buyer may find it difficult to refuse a tying obligation.

(220) To assess the supplier's market power, the market position of his competitors on the market of the tying product is important. As long as his competitors are sufficiently numerous and strong, no anti-competitive effects can be expected, as buyers have sufficient alternatives to purchase the tying product without the tied product, unless other suppliers are applying similar tying. In addition, entry barriers on the market of the tying product are relevant to establish the market position of the supplier. When tying is combined with a non-compete obligation in respect of the tying product, this considerably strengthens the position of the supplier.

(221) Buying power is relevant, as important buyers will not easily be forced to accept tying without obtaining at least part of the possible efficiencies. Tying not based on efficiency is therefore mainly a risk where buyers do not have significant buying power.

(222) Where appreciable anti-competitive effects are established, the question whether the conditions of Article 101(3) are fulfilled arises. Tying obligations may help to produce efficiencies arising from joint production or joint distribution. Where the tied product is not produced by the supplier, an efficiency may also arise from the supplier buying large quantities of the tied product. For tying to fulfil the conditions of Article 101(3), it must, however, be shown that at least part of these cost reductions are passed on to the consumer, which is normally not the case when the retailer is able to obtain, on a regular basis, supplies

of the same or equivalent products on the same or better conditions than those offered by the supplier which applies the tying practice. Another efficiency may exist where tying helps to ensure a certain uniformity and quality standardisation (see efficiency in point 9 of paragraph 107). However, it needs to be demonstrated that the positive effects cannot be realised equally efficiently by requiring the buyer to use or resell products satisfying minimum quality standards, without requiring the buyer to purchase these from the supplier or someone designated by the latter. The requirements concerning minimum quality standards would not normally fall within Article 101(1). Where the supplier of the tying product imposes on the buyer the suppliers from which the buyer must purchase the tied product, for instance because the formulation of minimum quality standards is not possible, this may also fall outside Article 101(1), especially where the supplier of the tying product does not derive a direct (financial) benefit from designating the suppliers of the tied product.

2.10. Resale price restrictions

(223) As explained in section III.3, resale price maintenance (RPM), that is agreements or concerted practices having as their direct or indirect object the establishment of a fixed or minimum resale price or a fixed or minimum price level to be observed by the buyer, are treated as a hardcore restriction. Including RPM in an agreement gives rise to the presumption that the agreement restricts competition and thus falls within Article 101(1). It also gives rise to the presumption that the agreement is unlikely to fulfil the conditions of Article 101(3), for which reason the block exemption does not apply. However, undertakings have the possibility to plead an efficiency defence under Article 101(3) in an individual case. It is incumbent on the parties to substantiate that likely efficiencies result from including RPM in their agreement and demonstrate that all the conditions of Article 101(3) are fulfilled. It then falls to the Commission to effectively assess the likely negative effects on competition and consumers before deciding whether the conditions of Article 101(3) are fulfilled.

(224) RPM may restrict competition in a number of ways. Firstly, RPM may facilitate collusion between suppliers by enhancing price transparency in the market, thereby making it easier to detect whether a supplier deviates from the collusive equilibrium by cutting its price. RPM also undermines the incentive for the supplier to cut its price to its distributors, as the fixed resale price will prevent it from benefiting from expanded sales. This negative effect is in particular plausible if the market is prone to collusive outcomes, for instance if the manufacturers form a tight oligopoly, and a significant part of the market is covered by RPM agreements. Secondly, by eliminating intra-brand price competition, RPM may also facilitate collusion between the buyers, i.e. at the distribution level. Strong or well organised distributors may be able to force/convince one or more suppliers to fix their resale price above the competitive level and thereby help them to reach or stabilise a collusive equilibrium. This loss of price competition seems especially problematic when the RPM is inspired by the buyers, whose collective horizontal interests can be expected to work out negatively for consumers. Thirdly, RPM may more in general soften competition between manufacturers and/or between retailers, in particular when manufacturers use the same distributors to distribute their products and RPM is applied by all or many of them. Fourthly, the immediate effect of RPM will be that all or certain distributors are prevented from lowering their sales price for that particular brand. In other words, the direct effect of RPM is a price increase. Fifthly, RPM may lower the pressure on the margin of the manufacturer, in particular where the manufacturer has a commitment problem, i.e. where he has an interest in lowering the price charged to subsequent distributors. In such a situation, the manufacturer may prefer to agree to RPM, so as to help it to commit not to lower the price for subsequent distributors and to reduce the pressure on its own margin. Sixthly, RPM may be implemented by a

manufacturer with market power to foreclose smaller rivals. The increased margin that RPM may offer distributors, may entice the latter to favour the particular brand over rival brands when advising customers, even where such advice is not in the interest of these customers, or not to sell these rival brands at all. Lastly, RPM may reduce dynamism and innovation at the distribution level. By preventing price competition between different distributors, RPM may prevent more efficient retailers from entering the market and/or acquiring sufficient scale with low prices. It also may prevent or hinder the entry and expansion of distribution formats based on low prices, such as price discounters.

(225) However, RPM may not only restrict competition but may also, in particular where it is supplier driven, lead to efficiencies, which will be assessed under Article 101(3). Most notably, where a manufacturer introduces a new product, RPM may be helpful during the introductory period of expanding demand to induce distributors to better take into account the manufacturer's interest to promote the product. RPM may provide the distributors with the means to increase sales efforts and if the distributors in this market are under competitive pressure this may induce them to expand overall demand for the product and make the launch of the product a success, also for the benefit of consumers.[59] Similarly, fixed resale prices, and not just maximum resale prices, may be necessary to organise in a franchise system or similar distribution system applying a uniform distribution format a coordinated short term low price campaign (2 to 6 weeks in most cases) which will also benefit the consumers. In some situations, the extra margin provided by RPM may allow retailers to provide (additional) pre-sales services, in particular in case of experience or complex products. If enough customers take advantage from such services to make their choice but then purchase at a lower price with retailers that do not provide such services (and hence do not incur these costs), high-service retailers may reduce or eliminate these services that enhance the demand for the supplier's product. RPM may help to prevent such free-riding at the distribution level. The parties will have to convincingly demonstrate that the RPM agreement can be expected to not only provide the means but also the incentive to overcome possible free riding between retailers on these services and that the pre-sales services overall benefit consumers as part of the demonstration that all the conditions of Article 101(3) are fulfilled.

(226) The practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price is covered by the Block Exemption Regulation when the market share of each of the parties to the agreement does not exceed the 30 % threshold, provided it does not amount to a minimum or fixed sale price as a result of pressure from, or incentives offered by, any of the parties. For cases above the market share threshold and for cases of withdrawal of the block exemption the following guidance is provided.

(227) The possible competition risk of maximum and recommended prices is that they will work as a focal point for the resellers and might be followed by most or all of them and/or that maximum or recommended prices may soften competition or facilitate collusion between suppliers.

(228) An important factor for assessing possible anti-competitive effects of maximum or recommended resale prices is the market position of the supplier. The stronger the market position of the supplier, the higher the risk that a maximum resale price or a recommended resale price leads to a more or less uniform application of that price level by the resellers,

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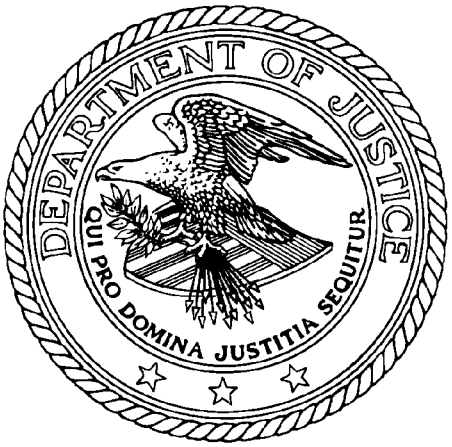
[59] This assumes that it is not practical for the supplier to impose on all buyers by contract effective promotion requirements, see also paragraph 107, point (1), above.

because they may use it as a focal point. They may find it difficult to deviate from what they perceive to be the preferred resale price proposed by such an important supplier on the market.

(229) Where appreciable anti-competitive effects are established for maximum or recommended resale prices, the question of a possible exemption under Article 101(3) arises. For maximum resale prices, the efficiency described in paragraph 107, point 6 (avoiding double marginalisation), may be particularly relevant. A maximum resale price may also help to ensure that the brand in question competes more forcefully with other brands, including own label products, distributed by the same distributor.

Antitrust Guidelines for Collaborations Among Competitors





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ANTITRUST GUIDELINES FOR
COLLABORATIONS AMONG COMPETITORS

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ANTITRUST GUIDELINES FOR
COLLABORATIONS AMONG COMPETITORS

PREAMBLE

In order to compete in modern markets, competitors sometimes need to collaborate. Competitive forces are driving firms toward complex collaborations to achieve goals such as expanding into foreign markets, funding expensive innovation efforts, and lowering production and other costs.

Such collaborations often are not only benign but procompetitive. Indeed, in the last two decades, the federal antitrust agencies have brought relatively few civil cases against competitor collaborations. Nevertheless, a perception that antitrust laws are skeptical about agreements among actual or potential competitors may deter the development of procompetitive collaborations.[1]

To provide guidance to business people, the Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") (collectively, "the Agencies") previously issued guidelines addressing several special circumstances in which antitrust issues related to competitor collaborations may arise.[2] But none of these Guidelines represents a general statement of the Agencies' analytical approach to competitor collaborations. The increasing varieties and use of competitor collaborations have yielded requests for improved clarity regarding their treatment under the antitrust laws.

The new *Antitrust Guidelines for Collaborations among Competitors* ("*Competitor Collaboration Guidelines*") are intended to explain how the Agencies analyze certain antitrust issues raised by collaborations among competitors. Competitor collaborations and the market circumstances in which they operate vary widely. No set of guidelines can provide specific

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[1] Congress has protected certain collaborations from full antitrust liability by passing the National Cooperative Research Act of 1984 ("NCRA") and the National Cooperative Research and Production Act of 1993 ("NCRPA") (codified together at 15 U.S.C. § § 4301-06).

[2] The *Statements of Antitrust Enforcement Policy in Health Care* ("*Health Care Statements*") outline the Agencies' approach to certain health care collaborations, among other things. The *Antitrust Guidelines for the Licensing of Intellectual Property* ("*Intellectual Property Guidelines*") outline the Agencies' enforcement policy with respect to intellectual property licensing agreements among competitors, among other things. The *1992* DOJ/FTC *Horizontal Merger Guidelines*, as amended in 1997 ("*Horizontal Merger Guidelines"*), outline the Agencies' approach to horizontal mergers and acquisitions, and certain competitor collaborations.

answers to every antitrust question that might arise from a competitor collaboration. These Guidelines describe an analytical framework to assist businesses in assessing the likelihood of an antitrust challenge to a collaboration with one or more competitors. They should enable businesses to evaluate proposed transactions with greater understanding of possible antitrust implications, thus encouraging procompetitive collaborations, deterring collaborations likely to harm competition and consumers, and facilitating the Agencies' investigations of collaborations.

SECTION 1: PURPOSE, DEFINITIONS, AND OVERVIEW

1.1 Purpose and Definitions

These Guidelines state the antitrust enforcement policy of the Agencies with respect to competitor collaborations. By stating their general policy, the Agencies hope to assist businesses in assessing whether the Agencies will challenge a competitor collaboration or any of the agreements of which it is comprised.[3] However, these Guidelines cannot remove judgment and discretion in antitrust law enforcement. The Agencies evaluate each case in light of its own facts and apply the analytical framework set forth in these Guidelines reasonably and flexibly.[4]

A "competitor collaboration" comprises a set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom.[5] "Competitors" encompasses both actual and potential competitors.[6] Competitor collaborations involve one or more business activities, such as research and development ("R&D"), production, marketing, distribution, sales or purchasing. Information sharing and various trade association activities also may take place through competitor

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[3] These Guidelines neither describe how the Agencies litigate cases nor assign burdens of proof or production.

[4] The analytical framework set forth in these Guidelines is consistent with the analytical frameworks in the *Health Care Statements* and the *Intellectual Property Guidelines*, which remain in effect to address issues in their special contexts.

[5] These Guidelines take into account neither the possible effects of competitor collaborations in foreclosing or limiting competition by rivals not participating in a collaboration nor the possible anticompetitive effects of standard setting in the context of competitor collaborations. Nevertheless, these effects may be of concern to the Agencies and may prompt enforcement actions.

[6] Firms also may be in a buyer-seller or other relationship, but that does not eliminate the need to examine the competitor relationship, if present. A firm is treated as a potential competitor if there is evidence that entry by that firm is reasonably probable in the absence of the relevant agreement, or that competitively significant decisions by actual competitors are constrained by concerns that anticompetitive conduct likely would induce the firm to enter.

collaborations.

These Guidelines use the terms "anticompetitive harm," "procompetitive benefit," and "overall competitive effect" in analyzing the competitive effects of agreements among competitors. All of these terms include actual and likely competitive effects. The Guidelines use the term "anticompetitive harm" to refer to an agreement's adverse competitive consequences, without taking account of offsetting procompetitive benefits. Conversely, the term "procompetitive benefit" refers to an agreement's favorable competitive consequences, without taking account of its anticompetitive harm. The terms "overall competitive effect" or "competitive effect" are used in discussing the combination of an agreement's anticompetitive harm and procompetitive benefit.

1.2 Overview of Analytical Framework

Two types of analysis are used by the Supreme Court to determine the lawfulness of an agreement among competitors: per se and rule of reason.[7] Certain types of agreements are so likely to harm competition and to have no significant procompetitive benefit that they do not warrant the time and expense required for particularized inquiry into their effects. Once identified, such agreements are challenged as per se unlawful.[8] All other agreements are evaluated under the rule of reason, which involves a factual inquiry into an agreement's overall competitive effect. As the Supreme Court has explained, rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances.[9]

This overview briefly sets forth questions and factors that the Agencies assess in analyzing an agreement among competitors. The rest of the Guidelines should be consulted for the detailed definitions and discussion that underlie this analysis.

Agreements Challenged as Per Se Illegal. Agreements of a type that always or almost always tends to raise price or to reduce output are per se illegal. The Agencies challenge such agreements, once identified, as per se illegal. Types of agreements that have been held per se illegal include agreements among competitors to fix prices or output, rig bids, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce. The courts conclusively presume such agreements, once identified, to be illegal, without inquiring into their claimed business purposes, anticompetitive harms, procompetitive benefits, or overall competitive effects. The Department of Justice prosecutes participants in hard-core cartel agreements criminally.

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[7] *See* National Soc'y of Prof'l. Eng'rs v. United States, 435 U.S. 679, 692 (1978).

[8] *See* FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 432-36 (1990).

[9] *See* California Dental Ass'n v. FTC, 119 S. Ct. 1604, 1617-18 (1999); FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 459-61 (1986); National Collegiate Athletic Ass'n v. Board of Regents of the Univ. of Okla., 468 U.S. 85, 104-13 (1984).

Agreements Analyzed under the Rule of Reason. Agreements not challenged as per se illegal are analyzed under the rule of reason to determine their overall competitive effect. These include agreements of a type that otherwise might be considered per se illegal, provided they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity.

Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.

Rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances. The Agencies focus on only those factors, and undertake only that factual inquiry, necessary to make a sound determination of the overall competitive effect of the relevant agreement. Ordinarily, however, no one factor is dispositive in the analysis.

The Agencies' analysis begins with an examination of the nature of the relevant agreement. As part of this examination, the Agencies ask about the business purpose of the agreement and examine whether the agreement, if already in operation, has caused anticompetitive harm. In some cases, the nature of the agreement and the absence of market power together may demonstrate the absence of anticompetitive harm. In such cases, the Agencies do not challenge the agreement. Alternatively, where the likelihood of anticompetitive harm is evident from the nature of the agreement, or anticompetitive harm has resulted from an agreement already in operation, then, absent overriding benefits that could offset the anticompetitive harm, the Agencies challenge such agreements without a detailed market analysis.

If the initial examination of the nature of the agreement indicates possible competitive concerns, but the agreement is not one that would be challenged without a detailed market analysis, the Agencies analyze the agreement in greater depth. The Agencies typically define relevant markets and calculate market shares and concentration as an initial step in assessing whether the agreement may create or increase market power or facilitate its exercise. The Agencies examine the extent to which the participants and the collaboration have the ability and incentive to compete independently. The Agencies also evaluate other market circumstances, e.g. entry, that may foster or prevent anticompetitive harms.

If the examination of these factors indicates no potential for anticompetitive harm, the Agencies end the investigation without considering procompetitive benefits. If investigation indicates anticompetitive harm, the Agencies examine whether the relevant agreement is reasonably necessary to achieve procompetitive benefits that likely would offset anticompetitive harms.

1.3 Competitor Collaborations Distinguished from Mergers

The competitive effects from competitor collaborations may differ from those of mergers due to a number of factors. Most mergers completely end competition between the merging parties in the relevant market(s). By contrast, most competitor collaborations preserve some form of competition among the participants. This remaining competition may reduce competitive concerns, but also may raise questions about whether participants have agreed to anticompetitive restraints on the remaining competition.

Mergers are designed to be permanent, while competitor collaborations are more typically of limited duration. Thus, participants in a collaboration typically remain potential competitors, even if they are not actual competitors for certain purposes (*e.g.*, R&D) during the collaboration. The potential for future competition between participants in a collaboration requires antitrust scrutiny different from that required for mergers.

Nonetheless, in some cases, competitor collaborations have competitive effects identical to those that would arise if the participants merged in whole or in part. The Agencies treat a competitor collaboration as a horizontal merger in a relevant market and analyze the collaboration pursuant to the *Horizontal Merger Guidelines* if appropriate, which ordinarily is when: (a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a sufficiently limited period[10] by its own specific and express terms.[11] Effects of the collaboration on competition in other markets are analyzed as appropriate under these Guidelines or other applicable precedent. *See* Example 1.[12]

SECTION 2: GENERAL PRINCIPLES FOR EVALUATING AGREEMENTS AMONG COMPETITORS

2.1 Potential Procompetitive Benefits

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[10] In general, the Agencies use ten years as a term indicating sufficient permanence to justify treatment of a competitor collaboration as analogous to a merger. The length of this term may vary, however, depending on industry-specific circumstances, such as technology life cycles.

[11] This definition, however, does not determine obligations arising under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.

[12] Examples illustrating this and other points set forth in these Guidelines are included in the Appendix.

The Agencies recognize that consumers may benefit from competitor collaborations in a variety of ways. For example, a competitor collaboration may enable participants to offer goods or services that are cheaper, more valuable to consumers, or brought to market faster than would be possible absent the collaboration. A collaboration may allow its participants to better use existing assets, or may provide incentives for them to make output-enhancing investments that would not occur absent the collaboration. The potential efficiencies from competitor collaborations may be achieved through a variety of contractual arrangements including joint ventures, trade or professional associations, licensing arrangements, or strategic alliances.

Efficiency gains from competitor collaborations often stem from combinations of different capabilities or resources. For example, one participant may have special technical expertise that usefully complements another participant's manufacturing process, allowing the latter participant to lower its production cost or improve the quality of its product. In other instances, a collaboration may facilitate the attainment of scale or scope economies beyond the reach of any single participant. For example, two firms may be able to combine their research or marketing activities to lower their cost of bringing their products to market, or reduce the time needed to develop and begin commercial sales of new products. Consumers may benefit from these collaborations as the participants are able to lower prices, improve quality, or bring new products to market faster.

2.2 Potential Anticompetitive Harms

Competitor collaborations may harm competition and consumers by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement. Such effects may arise through a variety of mechanisms. Among other things, agreements may limit independent decision making or combine the control of or financial interests in production, key assets, or decisions regarding price, output, or other competitively sensitive variables, or may otherwise reduce the participants' ability or incentive to compete independently.

Competitor collaborations also may facilitate explicit or tacit collusion through facilitating practices such as the exchange or disclosure of competitively sensitive information or through increased market concentration. Such collusion may involve the relevant market in which the collaboration operates or another market in which the participants in the collaboration are actual or potential competitors.

2.3 Analysis of the Overall Collaboration and the Agreements of Which It Consists

A competitor collaboration comprises a set of one or more agreements, other than merger agreements, between or among competitors to engage in economic activity, and the economic activity resulting therefrom. In general, the Agencies assess the competitive effects of the overall

collaboration and any individual agreement or set of agreements within the collaboration that may harm competition. For purposes of these Guidelines, the phrase "relevant agreement" refers to whichever of these three – the overall collaboration, an individual agreement, or a set of agreements – the evaluating Agency is assessing. Two or more agreements are assessed together if their procompetitive benefits or anticompetitive harms are so intertwined that they cannot meaningfully be isolated and attributed to any individual agreement. *See* Example 2.

2.4 Competitive Effects Are Assessed as of the Time of Possible Harm to Competition

The competitive effects of a relevant agreement may change over time, depending on changes in circumstances such as internal reorganization, adoption of new agreements as part of the collaboration, addition or departure of participants, new market conditions, or changes in market share. The Agencies assess the competitive effects of a relevant agreement as of the time of possible harm to competition, whether at formation of the collaboration or at a later time, as appropriate. *See* Example 3. However, an assessment after a collaboration has been formed is sensitive to the reasonable expectations of participants whose significant sunk cost investments in reliance on the relevant agreement were made before it became anticompetitive.

SECTION 3: ANALYTICAL FRAMEWORK FOR EVALUATING AGREEMENTS AMONG COMPETITORS

3.1 Introduction

Section 3 sets forth the analytical framework that the Agencies use to evaluate the competitive effects of a competitor collaboration and the agreements of which it consists. Certain types of agreements are so likely to be harmful to competition and to have no significant benefits that they do not warrant the time and expense required for particularized inquiry into their effects.[13] Once identified, such agreements are challenged as per se illegal.[14]

Agreements not challenged as per se illegal are analyzed under the rule of reason. Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. Under the rule of reason, the central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement. Given the great variety of competitor collaborations, rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances. Rule of reason analysis focuses on only those factors, and undertakes only the degree of factual inquiry, necessary to assess accurately the overall competitive effect of the

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[13] *See* Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 n.16 (1977).

[14] *See Superior Court Trial Lawyers Ass'n*, 493 U.S. at 432-36.

relevant agreement.[15]

3.2 Agreements Challenged as Per Se Illegal

Agreements of a type that always or almost always tends to raise price or reduce output are per se illegal.[16] The Agencies challenge such agreements, once identified, as per se illegal. Typically these are agreements not to compete on price or output. Types of agreements that have been held per se illegal include agreements among competitors to fix prices or output, rig bids, or share or divide markets by allocating customers, suppliers, territories or lines of commerce.[17] The courts conclusively presume such agreements, once identified, to be illegal, without inquiring into their claimed business purposes, anticompetitive harms, procompetitive benefits, or overall competitive effects. The Department of Justice prosecutes participants in hard-core cartel agreements criminally.

If, however, participants in an efficiency-enhancing integration of economic activity enter into an agreement that is reasonably related to the integration and reasonably necessary to achieve its procompetitive benefits, the Agencies analyze the agreement under the rule of reason, even if it is of a type that might otherwise be considered per se illegal.[18] *See* Example 4. In an efficiency-enhancing integration, participants collaborate to perform or cause to be performed (by a joint venture entity created by the collaboration or by one or more participants or by a third party acting on behalf of other participants) one or more business functions, such as production, distribution, marketing, purchasing or R&D, and thereby benefit, or potentially benefit, consumers by expanding output, reducing price, or enhancing quality, service, or innovation. Participants in an efficiency-enhancing integration typically combine, by contract or otherwise, significant capital, technology, or other complementary assets to achieve procompetitive benefits that the participants could not achieve separately. The mere coordination of decisions on price, output, customers, territories, and the like is not integration, and cost savings without integration are not a basis for avoiding per se condemnation. The integration must be of a type that plausibly would generate procompetitive benefits cognizable under the efficiencies analysis set forth in Section 3.36 below. Such procompetitive benefits may enhance the participants' ability or incentives to compete and thus may offset an agreement's anticompetitive tendencies. *See* Examples 5 through 7.

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[15] *See California Dental Ass'n*, 119 S. Ct. at 1617-18; *Indiana Fed'n of Dentists*, 476 U.S. at 459-61; *NCAA*, 468 U.S. at 104-13.

[16] *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 19-20 (1979).

[17] *See, e.g.*, Palmer v. BRG of Georgia, Inc., 498 U.S. 46 (1990) (market allocation); United States v. Trenton Potteries Co., 273 U.S. 392 (1927) (price fixing).

[18] *See* Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 339 n.7, 356-57 (1982) (finding no integration).

An agreement may be "reasonably necessary" without being essential. However, if the participants could achieve an equivalent or comparable efficiency-enhancing integration through practical, significantly less restrictive means, then the Agencies conclude that the agreement is not reasonably necessary.[19] In making this assessment, except in unusual circumstances, the Agencies consider whether practical, significantly less restrictive means were reasonably available when the agreement was entered into, but do not search for a theoretically less restrictive alternative that was not practical given the business realities.

Before accepting a claim that an agreement is reasonably necessary to achieve procompetitive benefits from an integration of economic activity, the Agencies undertake a limited factual inquiry to evaluate the claim.[20] Such an inquiry may reveal that efficiencies from an agreement that are possible in theory are not plausible in the context of the particular collaboration. Some claims – such as those premised on the notion that competition itself is unreasonable – are insufficient as a matter of law,[21] and others may be implausible on their face. In any case, labeling an arrangement a "joint venture" will not protect what is merely a device to raise price or restrict output;[22] the nature of the conduct, not its designation, is determinative.

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[19] *See id.* at 352-53 (observing that even if a maximum fee schedule for physicians' services were desirable, it was not necessary that the schedule be established by physicians rather than by insurers); *Broadcast Music*, 441 U.S. at 20-21 (setting of price "necessary" for the blanket license).

[20] *See Maricopa*, 457 U.S. at 352-53, 356-57 (scrutinizing the defendant medical foundations for indicia of integration and evaluating the record evidence regarding less restrictive alternatives).

[21] *See Indiana Fed'n of Dentists*, 476 U.S. at 463-64; *NCAA*, 468 U.S. at 116-17; *Prof'l. Eng'rs*, 435 U.S. at 693-96. Other claims, such as an absence of market power, are no defense to per se illegality. *See Superior Court Trial Lawyers Ass'n*, 493 U.S. at 434-36; United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224-26 & n.59 (1940).

[22] *See* Timken Roller Bearing Co. v. United States, 341 U.S. 593, 598 (1951).

3.3 Agreements Analyzed under the Rule of Reason

Agreements not challenged as per se illegal are analyzed under the rule of reason to determine their overall competitive effect. Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.[23]

Rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances.[24] The Agencies focus on only those factors, and undertake only that factual inquiry, necessary to make a sound determination of the overall competitive effect of the relevant agreement. Ordinarily, however, no one factor is dispositive in the analysis.

Under the rule of reason, the Agencies' analysis begins with an examination of the nature of the relevant agreement, since the nature of the agreement determines the types of anticompetitive harms that may be of concern. As part of this examination, the Agencies ask about the business purpose of the agreement and examine whether the agreement, if already in operation, has caused anticompetitive harm.[25] If the nature of the agreement and the absence of market power[26] together demonstrate the absence of anticompetitive harm, the Agencies do not challenge the agreement. *See* Example 8. Alternatively, where the likelihood of anticompetitive harm is evident from the nature of the agreement,[27] or anticompetitive harm has resulted from an agreement

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[23] In addition, concerns may arise where an agreement increases the ability or incentive of buyers to exercise monopsony power. *See infra* Section 3.31(a).

[24] *See California Dental Ass'n* , 119 S. Ct. at 1612-13, 1617 ("What is required . . . is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint."); *NCAA*, 468 U.S. 109 n.39 ("the rule of reason can sometimes be applied in the twinkling of an eye") (quoting Phillip E. Areeda, *The "Rule of Reason" in Antitrust Analysis: General Issues* 37-38 (Federal Judicial Center, June 1981)).

[25] *See* Board of Trade of the City of Chicago v. United States, 246 U.S. 231, 238 (1918).

[26] That market power is absent may be determined without defining a relevant market. For example, if no market power is likely under any plausible market definition, it does not matter which one is correct. Alternatively, easy entry may indicate an absence of market power.

[27] *See California Dental Ass'n*, 119 S. Ct. at 1612-13, 1617 (an "obvious anticompetitive effect" would warrant quick condemnation); *Indiana Fed'n of Dentists*, 476 U.S. at 459; *NCAA*, 468 U.S. at 104, 106-10.

already in operation,[28] then, absent overriding benefits that could offset the anticompetitive harm, the Agencies challenge such agreements without a detailed market analysis.[29]

If the initial examination of the nature of the agreement indicates possible competitive concerns, but the agreement is not one that would be challenged without a detailed market analysis, the Agencies analyze the agreement in greater depth. The Agencies typically define relevant markets and calculate market shares and concentration as an initial step in assessing whether the agreement may create or increase market power[30] or facilitate its exercise and thus poses risks to competition.[31] The Agencies examine factors relevant to the extent to which the participants and the collaboration have the ability and incentive to compete independently, such as whether an agreement is exclusive or non-exclusive and its duration.[32] The Agencies also evaluate whether entry would be timely, likely, and sufficient to deter or counteract any anticompetitive harms. In addition, the Agencies assess any other market circumstances that may foster or impede anticompetitive harms.

If the examination of these factors indicates no potential for anticompetitive harm, the Agencies end the investigation without considering procompetitive benefits. If investigation indicates anticompetitive harm, the Agencies examine whether the relevant agreement is reasonably

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[28] *See Indiana Fed'n of Dentists*, 476 U.S. at 460-61 ("Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects, such as a reduction of output,' can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'") (quoting 7 Phillip E. Areeda, *Antitrust Law* ¶ 1511, at 424 (1986)); *NCAA*, 468 U.S. at 104-08, 110 n.42.

[29] *See Indiana Fed'n of Dentists*, 476 U.S. at 459-60 (condemning without "detailed market analysis" an agreement to limit competition by withholding x-rays from patients' insurers after finding no competitive justification).

[30] Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time. Sellers also may exercise market power with respect to significant competitive dimensions other than price, such as quality, service, or innovation. Market power to a buyer is the ability profitably to depress the price paid for a product below the competitive level for a significant period of time and thereby depress output.

[31] *See* Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 464 (1992).

[32] *Compare NCAA*, 468 U.S. at 113-15, 119-20 (noting that colleges were not permitted to televise their own games without restraint), *with Broadcast Music*, 441 U.S. at 23-24 (finding no legal or practical impediment to individual licenses).

necessary to achieve procompetitive benefits that likely would offset anticompetitive harms.[33]

3.31 Nature of the Relevant Agreement: Business Purpose, Operation in the Marketplace and Possible Competitive Concerns

The nature of the agreement is relevant to whether it may cause anticompetitive harm. For example, by limiting independent decision making or combining control over or financial interests in production, key assets, or decisions on price, output, or other competitively sensitive variables, an agreement may create or increase market power or facilitate its exercise by the collaboration, its participants, or both. An agreement to limit independent decision making or to combine control or financial interests may reduce the ability or incentive to compete independently. An agreement also may increase the likelihood of an exercise of market power by facilitating explicit or tacit collusion,[34] either through facilitating practices such as an exchange of competitively sensitive information or through increased market concentration.

In examining the nature of the relevant agreement, the Agencies take into account inferences about business purposes for the agreement that can be drawn from objective facts. The Agencies also consider evidence of the subjective intent of the participants to the extent that it sheds light on competitive effects.[35] The Agencies do not undertake a full analysis of procompetitive benefits pursuant to Section 3.36 below, however, unless an anticompetitive harm appears likely. The Agencies also examine whether an agreement already in operation has caused anticompetitive harm.[36] Anticompetitive harm may be observed, for example, if a competitor collaboration successfully mandates new, anticompetitive conduct or successfully eliminates procompetitive pre-collaboration conduct, such as withholding services that were desired by consumers when offered in a competitive market. If anticompetitive harm is found, examination of market power ordinarily is not required. In some cases, however, a determination of anticompetitive harm may be informed by consideration of market power.

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[33] *See NCAA*, 468 U.S. at 113-15 (rejecting efficiency claims when production was limited, not enhanced); *Prof'l. Eng'rs*, 435 U.S. at 696 (dictum) (distinguishing restraints that promote competition from those that eliminate competition); *Chicago Bd. of Trade*, 246 U.S. at 238 (same).

[34] As used in these Guidelines, "collusion" is not limited to conduct that involves an agreement under the antitrust laws.

[35] Anticompetitive intent alone does not establish an antitrust violation, and procompetitive intent does not preclude a violation. *See, e.g., Chicago Bd. of Trade*, 246 U.S. at 238. But extrinsic evidence of intent may aid in evaluating market power, the likelihood of anticompetitive harm, and claimed procompetitive justifications where an agreement's effects are otherwise ambiguous.

[36] *See id.*

The following sections illustrate competitive concerns that may arise from the nature of particular types of competitor collaborations. This list is not exhaustive. In addition, where these sections address agreements of a type that otherwise might be considered per se illegal, such as agreements on price, the discussion assumes that the agreements already have been determined to be subject to rule of reason analysis because they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity. *See supra* Section 3.2.

3.31(a) Relevant Agreements that Limit Independent Decision Making or Combine Control or Financial Interests

The following is intended to illustrate but not exhaust the types of agreements that might harm competition by eliminating independent decision making or combining control or financial interests.

Production Collaborations. Competitor collaborations may involve agreements jointly to produce a product sold to others or used by the participants as an input. Such agreements are often procompetitive.[37] Participants may combine complementary technologies, know-how, or other assets to enable the collaboration to produce a good more efficiently or to produce a good that no one participant alone could produce. However, production collaborations may involve agreements on the level of output or the use of key assets, or on the price at which the product will be marketed by the collaboration, or on other competitively significant variables, such as quality, service, or promotional strategies, that can result in anticompetitive harm. Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making or by combining in the collaboration, or in certain participants, the control over some or all production or key assets or decisions about key competitive variables that otherwise would be controlled independently.[38] Such agreements could reduce individual participants' control over assets necessary to compete and thereby reduce their ability to compete independently, combine financial interests in ways that undermine incentives to compete

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[37] The *NCRPA* accords rule of reason treatment to certain production collaborations. However, the statute permits per se challenges, in appropriate circumstances, to a variety of activities, including agreements to jointly market the goods or services produced or to limit the participants' independent sale of goods or services produced outside the collaboration. *NCRPA*, 15 U.S.C. §§ 4301-02.

[38] For example, where output resulting from a collaboration is transferred to participants for independent marketing, anticompetitive harm could result if that output is restricted or if the transfer takes place at a supracompetitive price. Such conduct could raise participants' marginal costs through inflated per-unit charges on the transfer of the collaboration's output. Anticompetitive harm could occur even if there is vigorous competition among collaboration participants in the output market, since all the participants would have paid the same inflated transfer price.

independently, or both.

Marketing Collaborations. Competitor collaborations may involve agreements jointly to sell, distribute, or promote goods or services that are either jointly or individually produced. Such agreements may be procompetitive, for example, where a combination of complementary assets enables products more quickly and efficiently to reach the marketplace. However, marketing collaborations may involve agreements on price, output, or other competitively significant variables, or on the use of competitively significant assets, such as an extensive distribution network, that can result in anticompetitive harm. Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making; by combining in the collaboration, or in certain participants, control over competitively significant assets or decisions about competitively significant variables that otherwise would be controlled independently; or by combining financial interests in ways that undermine incentives to compete independently. For example, joint promotion might reduce or eliminate comparative advertising, thus harming competition by restricting information to consumers on price and other competitively significant variables.

Buying Collaborations. Competitor collaborations may involve agreements jointly to purchase necessary inputs. Many such agreements do not raise antitrust concerns and indeed may be procompetitive. Purchasing collaborations, for example, may enable participants to centralize ordering, to combine warehousing or distribution functions more efficiently, or to achieve other efficiencies. However, such agreements can create or increase market power (which, in the case of buyers, is called "monopsony power") or facilitate its exercise by increasing the ability or incentive to drive the price of the purchased product, and thereby depress output, below what likely would prevail in the absence of the relevant agreement. Buying collaborations also may facilitate collusion by standardizing participants' costs or by enhancing the ability to project or monitor a participant's output level through knowledge of its input purchases.

Research & Development Collaborations. Competitor collaborations may involve agreements to engage in joint research and development ("R&D"). Most such agreements are procompetitive, and they typically are analyzed under the rule of reason.[39] Through the combination of complementary assets, technology, or know-how, an R&D collaboration may enable participants more quickly or more efficiently to research and develop new or improved goods, services, or production processes. Joint R&D agreements, however, can create or increase market power or facilitate its exercise by limiting independent decision making or by combining in the collaboration, or in certain participants, control over competitively significant assets or all or a portion of participants' individual competitive R&D efforts. Although R&D collaborations also may facilitate tacit collusion on R&D efforts, achieving, monitoring, and punishing departures from collusion is sometimes difficult in the R&D context.

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[39] Aspects of the antitrust analysis of competitor collaborations involving R&D are governed by provisions of the *NCRPA*, 15 U.S.C. §§ 4301-02.

An exercise of market power may injure consumers by reducing innovation below the level that otherwise would prevail, leading to fewer or no products for consumers to choose from, lower quality products, or products that reach consumers more slowly than they otherwise would. An exercise of market power also may injure consumers by reducing the number of independent competitors in the market for the goods, services, or production processes derived from the R&D collaboration, leading to higher prices or reduced output, quality, or service. A central question is whether the agreement increases the ability or incentive anticompetitively to reduce R&D efforts pursued independently or through the collaboration, for example, by slowing the pace at which R&D efforts are pursued. Other considerations being equal, R&D agreements are more likely to raise competitive concerns when the collaboration or its participants already possess a secure source of market power over an existing product and the new R&D efforts might cannibalize their supracompetitive earnings. In addition, anticompetitive harm generally is more likely when R&D competition is confined to firms with specialized characteristics or assets, such as intellectual property, or when a regulatory approval process limits the ability of late-comers to catch up with competitors already engaged in the R&D.

3.31(b) Relevant Agreements that May Facilitate Collusion

Each of the types of competitor collaborations outlined above can facilitate collusion. Competitor collaborations may provide an opportunity for participants to discuss and agree on anticompetitive terms, or otherwise to collude anticompetitively, as well as a greater ability to detect and punish deviations that would undermine the collusion. Certain marketing, production, and buying collaborations, for example, may provide opportunities for their participants to collude on price, output, customers, territories, or other competitively sensitive variables. R&D collaborations, however, may be less likely to facilitate collusion regarding R&D activities since R&D often is conducted in secret, and it thus may be difficult to monitor an agreement to coordinate R&D. In addition, collaborations can increase concentration in a relevant market and thus increase the likelihood of collusion among all firms, including the collaboration and its participants.

Agreements that facilitate collusion sometimes involve the exchange or disclosure of information. The Agencies recognize that the sharing of information among competitors may be procompetitive and is often reasonably necessary to achieve the procompetitive benefits of certain collaborations; for example, sharing certain technology, know-how, or other intellectual property may be essential to achieve the procompetitive benefits of an R&D collaboration. Nevertheless, in some cases, the sharing of information related to a market in which the collaboration operates or in which the participants are actual or potential competitors may increase the likelihood of collusion on matters such as price, output, or other competitively sensitive variables. The competitive concern depends on the nature of the information shared. Other things being equal, the sharing of information relating to price, output, costs, or strategic planning is more likely to raise competitive concern than the sharing of information relating to less competitively sensitive variables. Similarly, other things being equal, the sharing of information on current operating and future business plans is more likely to raise concerns than the sharing of historical information.

Finally, other things being equal, the sharing of individual company data is more likely to raise concern than the sharing of aggregated data that does not permit recipients to identify individual firm data.

3.32 Relevant Markets Affected by the Collaboration

The Agencies typically identify and assess competitive effects in all of the relevant product and geographic markets in which competition may be affected by a competitor collaboration, although in some cases it may be possible to assess competitive effects directly without defining a particular relevant market(s). Markets affected by a competitor collaboration include all markets in which the economic integration of the participants' operations occurs or in which the collaboration operates or will operate,[40] and may also include additional markets in which any participant is an actual or potential competitor.[41]

3.32(a) Goods Markets

In general, for goods[42] markets affected by a competitor collaboration, the Agencies approach relevant market definition as described in Section 1 of the *Horizontal Merger Guidelines.* To determine the relevant market, the Agencies generally consider the likely reaction of buyers to a price increase and typically ask, among other things, how buyers would respond to increases over prevailing price levels. However, when circumstances strongly suggest that the prevailing price exceeds what likely would have prevailed absent the relevant agreement, the Agencies use a price more reflective of the price that likely would have prevailed. Once a market has been defined, market shares are assigned both to firms currently in the relevant market and to firms that are able to make "uncommitted" supply responses. *See* Sections 1.31 and 1.32 of the *Horizontal Merger Guidelines*.

3.32(b) Technology Markets

When rights to intellectual property are marketed separately from the products in which they are used, the Agencies may define technology markets in assessing the competitive effects of a competitor collaboration that includes an agreement to license intellectual property. Technology markets consist of the intellectual property that is licensed and its close substitutes;

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[40] For example, where a production joint venture buys inputs from an upstream market to incorporate in products to be sold in a downstream market, both upstream and downstream markets may be "markets affected by a competitor collaboration."

[41] Participation in the collaboration may change the participants' behavior in this third category of markets, for example, by altering incentives and available information, or by providing an opportunity to form additional agreements among participants.

[42] The term "goods" also includes services.

that is, the technologies or goods that are close enough substitutes significantly to constrain the exercise of market power with respect to the intellectual property that is licensed. The Agencies approach the definition of a relevant technology market and the measurement of market share as described in Section 3.2.2 of the *Intellectual Property Guidelines.*

3.32(c) Research and Development: Innovation Markets

In many cases, an agreement's competitive effects on innovation are analyzed as a separate competitive effect in a relevant goods market. However, if a competitor collaboration may have competitive effects on innovation that cannot be adequately addressed through the analysis of goods or technology markets, the Agencies may define and analyze an innovation market as described in Section 3.2.3 of the *Intellectual Property Guidelines.* An innovation market consists of the research and development directed to particular new or improved goods or processes and the close substitutes for that research and development. The Agencies define an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms.

3.33 Market Shares and Market Concentration

Market share and market concentration affect the likelihood that the relevant agreement will create or increase market power or facilitate its exercise. The creation, increase, or facilitation of market power will likely increase the ability and incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.

Other things being equal, market share affects the extent to which participants or the collaboration must restrict their own output in order to achieve anticompetitive effects in a relevant market. The smaller the percentage of total supply that a firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable. In assessing whether an agreement may cause anticompetitive harm, the Agencies typically calculate the market shares of the participants and of the collaboration.[43] The Agencies assign a range of market shares to the collaboration. The high end of that range is the sum of the market shares of the collaboration and its participants. The low end is the share of the collaboration in isolation. In general, the Agencies approach the calculation of market share as set forth in Section 1.4 of the *Horizontal Merger Guidelines.*

Other things being equal, market concentration affects the difficulties and costs of achieving and

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[43] When the competitive concern is that a limitation on independent decision making or a combination of control or financial interests may yield an anticompetitive reduction of research and development, the Agencies typically frame their inquiries more generally, looking to the strength, scope, and number of competing R&D efforts and their close substitutes. *See supra* Sections 3.31(a) and 3.32(c).

enforcing collusion in a relevant market. Accordingly, in assessing whether an agreement may increase the likelihood of collusion, the Agencies calculate market concentration. In general, the Agencies approach the calculation of market concentration as set forth in Section 1.5 of the *Horizontal Merger Guidelines*, ascribing to the competitor collaboration the same range of market shares described above.

Market share and market concentration provide only a starting point for evaluating the competitive effect of the relevant agreement. The Agencies also examine other factors outlined in the *Horizontal Merger Guidelines* as set forth below:

The Agencies consider whether factors such as those discussed in Section 1.52 of the *Horizontal Merger Guidelines* indicate that market share and concentration data overstate or understate the likely competitive significance of participants and their collaboration.

In assessing whether anticompetitive harm may arise from an agreement that combines control over or financial interests in assets or otherwise limits independent decision making, the Agencies consider whether factors such as those discussed in Section 2.2 of the *Horizontal Merger Guidelines* suggest that anticompetitive harm is more or less likely.

In assessing whether anticompetitive harms may arise from an agreement that may increase the likelihood of collusion, the Agencies consider whether factors such as those discussed in Section 2.1 of the *Horizontal Merger Guidelines* suggest that anticompetitive harm is more or less likely.

In evaluating the significance of market share and market concentration data and interpreting the range of market shares ascribed to the collaboration, the Agencies also examine factors beyond those set forth in the *Horizontal Merger Guidelines*. The following section describes which factors are relevant and the issues that the Agencies examine in evaluating those factors.

3.34 Factors Relevant to the Ability and Incentive of the Participants and the Collaboration to Compete

Competitor collaborations sometimes do not end competition among the participants and the collaboration. Participants may continue to compete against each other and their collaboration, either through separate, independent business operations or through membership in other collaborations. Collaborations may be managed by decision makers independent of the individual participants. Control over key competitive variables may remain outside the collaboration, such as where participants independently market and set prices for the collaboration's output.

Sometimes, however, competition among the participants and the collaboration may be restrained through explicit contractual terms or through financial or other provisions that reduce or eliminate the incentive to compete. The Agencies look to the competitive benefits and harms of the relevant agreement, not merely the formal terms of agreements among the participants.

Where the nature of the agreement and market share and market concentration data reveal a likelihood of anticompetitive harm, the Agencies more closely examine the extent to which the participants and the collaboration have the ability and incentive to compete independent of each other. The Agencies are likely to focus on six factors: (a) the extent to which the relevant agreement is non-exclusive in that participants are likely to continue to compete independently outside the collaboration in the market in which the collaboration operates; (b) the extent to which participants retain independent control of assets necessary to compete; (c) the nature and extent of participants' financial interests in the collaboration or in each other; (d) the control of the collaboration's competitively significant decision making; (e) the likelihood of anticompetitive information sharing; and (f) the duration of the collaboration.

Each of these factors is discussed in further detail below. Consideration of these factors may reduce or increase competitive concern. The analysis necessarily is flexible: the relevance and significance of each factor depends upon the facts and circumstances of each case, and any additional factors pertinent under the circumstances are considered. For example, when an agreement is examined subsequent to formation of the collaboration, the Agencies also examine factual evidence concerning participants' actual conduct.

3.34(a) Exclusivity

The Agencies consider whether, to what extent, and in what manner the relevant agreement permits participants to continue to compete against each other and their collaboration, either through separate, independent business operations or through membership in other collaborations. The Agencies inquire whether a collaboration is non-exclusive in fact as well as in name and consider any costs or other impediments to competing with the collaboration. In assessing exclusivity when an agreement already is in operation, the Agencies examine whether, to what extent, and in what manner participants actually have continued to compete against each other and the collaboration. In general, competitive concern likely is reduced to the extent that participants actually have continued to compete, either through separate, independent business operations or through membership in other collaborations, or are permitted to do so.

3.34(b) Control over Assets

The Agencies ask whether the relevant agreement requires participants to contribute to the collaboration significant assets that previously have enabled or likely would enable participants to be effective independent competitors in markets affected by the collaboration. If such resources must be contributed to the collaboration and are specialized in that they cannot readily be replaced, the participants may have lost all or some of their ability to compete against each other and their collaboration, even if they retain the contractual right to do so.[44] In general, the greater

[44] For example, if participants in a production collaboration must contribute most of their productive capacity to the collaboration, the collaboration may impair the ability of its participants to remain effective independent competitors regardless of the terms of the agreement.

the contribution of specialized assets to the collaboration that is required, the less the participants may be relied upon to provide independent competition.

3.34(c) Financial Interests in the Collaboration or in Other Participants

The Agencies assess each participant's financial interest in the collaboration and its potential impact on the participant's incentive to compete independently with the collaboration. The potential impact may vary depending on the size and nature of the financial interest (e.g., whether the financial interest is debt or equity). In general, the greater the financial interest in the collaboration, the less likely is the participant to compete with the collaboration.[45] The Agencies also assess direct equity investments between or among the participants. Such investments may reduce the incentives of the participants to compete with each other. In either case, the analysis is sensitive to the level of financial interest in the collaboration or in another participant relative to the level of the participant's investment in its independent business operations in the markets affected by the collaboration.

3.34(d) Control of the Collaboration's Competitively Significant Decision Making

The Agencies consider the manner in which a collaboration is organized and governed in assessing the extent to which participants and their collaboration have the ability and incentive to compete independently. Thus, the Agencies consider the extent to which the collaboration's governance structure enables the collaboration to act as an independent decision maker. For example, the Agencies ask whether participants are allowed to appoint members of a board of directors for the collaboration, if incorporated, or otherwise to exercise significant control over the operations of the collaboration. In general, the collaboration is less likely to compete independently as participants gain greater control over the collaboration's price, output, and other competitively significant decisions.[46]

To the extent that the collaboration's decision making is subject to the participants' control, the Agencies consider whether that control could be exercised jointly. Joint control over the collaboration's price and output levels could create or increase market power and raise competitive concerns. Depending on the nature of the collaboration, competitive concern also may arise due to joint control over other competitively significant decisions, such as the level and

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[45] Similarly, a collaboration's financial interest in a participant may diminish the collaboration's incentive to compete with that participant.

[46] Control may diverge from financial interests. For example, a small equity investment may be coupled with a right to veto large capital expenditures and, thereby, to effectively limit output. The Agencies examine a collaboration's actual governance structure in assessing issues of control.

scope of R&D efforts and investment. In contrast, to the extent that participants independently set the price and quantity [47] of their share of a collaboration's output and independently control other competitively significant decisions, an agreement's likely anticompetitive harm is reduced.[48]

3.34(e) Likelihood of Anticompetitive Information Sharing

The Agencies evaluate the extent to which competitively sensitive information concerning markets affected by the collaboration likely would be disclosed. This likelihood depends on, among other things, the nature of the collaboration, its organization and governance, and safeguards implemented to prevent or minimize such disclosure. For example, participants might refrain from assigning marketing personnel to an R&D collaboration, or, in a marketing collaboration, participants might limit access to competitively sensitive information regarding their respective operations to only certain individuals or to an independent third party. Similarly, a buying collaboration might use an independent third party to handle negotiations in which its participants' input requirements or other competitively sensitive information could be revealed. In general, it is less likely that the collaboration will facilitate collusion on competitively sensitive variables if appropriate safeguards governing information sharing are in place.

3.34(f) Duration of the Collaboration

The Agencies consider the duration of the collaboration in assessing whether participants retain the ability and incentive to compete against each other and their collaboration. In general, the shorter the duration, the more likely participants are to compete against each other and their collaboration.

3.35 Entry

Easy entry may deter or prevent profitably maintaining price above, or output, quality, service or innovation below, what likely would prevail in the absence of the relevant agreement. Where the nature of the agreement and market share and concentration data suggest a likelihood of anticompetitive harm that is not sufficiently mitigated by any continuing competition identified

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[47] Even if prices to consumers are set independently, anticompetitive harms may still occur if participants jointly set the collaboration's level of output. For example, participants may effectively coordinate price increases by reducing the collaboration's level of output and collecting their profits through high transfer prices, *i.e.*, through the amounts that participants contribute to the collaboration in exchange for each unit of the collaboration's output. Where a transfer price is determined by reference to an objective measure not under the control of the participants, (*e.g.*, average price in a different unconcentrated geographic market), competitive concern may be less likely.

[48] Anticompetitive harm also is less likely if individual participants may independently increase the overall output of the collaboration.

through the analysis in Section 3.34, the Agencies inquire whether entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the anticompetitive harm of concern. If so, the relevant agreement ordinarily requires no further analysis.

As a general matter, the Agencies assess timeliness, likelihood, and sufficiency of committed entry under principles set forth in Section 3 of the *Horizontal Merger Guidelines*.[49] However, unlike mergers, competitor collaborations often restrict only certain business activities, while preserving competition among participants in other respects, and they may be designed to terminate after a limited duration. Consequently, the extent to which an agreement creates and enables identification of opportunities that would induce entry and the conditions under which ease of entry may deter or counteract anticompetitive harms may be more complex and less direct than for mergers and will vary somewhat according to the nature of the relevant agreement. For example, the likelihood of entry may be affected by what potential entrants believe about the probable duration of an anticompetitive agreement. Other things being equal, the shorter the anticipated duration of an anticompetitive agreement, the smaller the profit opportunities for potential entrants, and the lower the likelihood that it will induce committed entry. Examples of other differences are set forth below.

For certain collaborations, sufficiency of entry may be affected by the possibility that entrants will participate in the anticompetitive agreement. To the extent that such participation raises the amount of entry needed to deter or counteract anticompetitive harms, and assets required for entry are not adequately available for entrants to respond fully to their sales opportunities, or otherwise renders entry inadequate in magnitude, character or scope, sufficient entry may be more difficult to achieve.[50]

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[49] Committed entry is defined as new competition that requires expenditure of significant sunk costs of entry and exit. *See* Section 3.0 of the *Horizontal Merger Guidelines*.

[50] Under the same principles applied to production and marketing collaborations, the exercise of monopsony power by a buying collaboration may be deterred or counteracted by the entry of new purchasers. To the extent that collaborators reduce their purchases, they may create an opportunity for new buyers to make purchases without forcing the price of the input above pre-relevant agreement levels. Committed purchasing entry, defined as new purchasing competition that requires expenditure of significant sunk costs of entry and exit — such as a new steel factory built in response to a reduction in the price of iron ore — is analyzed under principles analogous to those articulated in Section 3 of the *Horizontal Merger Guidelines*. Under that analysis, the Agencies assess whether a monopsonistic price reduction is likely to attract committed purchasing entry, profitable at pre-relevant agreement prices, that would not have occurred before the relevant agreement at those same prices. (Uncommitted new buyers are identified as participants in the relevant market if their demand responses to a price decrease are likely to occur within one year and without the expenditure of significant sunk costs of entry and exit. *See id*. at Sections 1.32 and 1.41.)

In the context of research and development collaborations, widespread availability of R&D capabilities and the large gains that may accrue to successful innovators often suggest a high likelihood that entry will deter or counteract anticompetitive reductions of R&D efforts. Nonetheless, such conditions do not always pertain, and the Agencies ask whether entry may deter or counteract anticompetitive R&D reductions, taking into account the likelihood, timeliness, and sufficiency of entry.

To be timely, entry must be sufficiently prompt to deter or counteract such harms. The Agencies evaluate the likelihood of entry based on the extent to which potential entrants have (1) core competencies (and the ability to acquire any necessary specialized assets) that give them the ability to enter into competing R&D and (2) incentives to enter into competing R&D. The sufficiency of entry depends on whether the character and scope of the entrants' R&D efforts are close enough to the reduced R&D efforts to be likely to achieve similar innovations in the same time frame or otherwise to render a collaborative reduction of R&D unprofitable.

3.36 Identifying Procompetitive Benefits of the Collaboration

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, as explained above, competitor collaborations have the potential to generate significant efficiencies that benefit consumers in a variety of ways. For example, a competitor collaboration may enable firms to offer goods or services that are cheaper, more valuable to consumers, or brought to market faster than would otherwise be possible. Efficiency gains from competitor collaborations often stem from combinations of different capabilities or resources. *See supra* Section 2.1. Indeed, the primary benefit of competitor collaborations to the economy is their potential to generate such efficiencies.

Efficiencies generated through a competitor collaboration can enhance the ability and incentive of the collaboration and its participants to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, through collaboration, competitors may be able to produce an input more efficiently than any one participant could individually; such collaboration-generated efficiencies may enhance competition by permitting two or more ineffective (*e.g.*, high cost) participants to become more effective, lower cost competitors. Even when efficiencies generated through a competitor collaboration enhance the collaboration's or the participants' ability to compete, however, a competitor collaboration may have other effects that may lessen competition and ultimately may make the relevant agreement anticompetitive.

If the Agencies conclude that the relevant agreement has caused, or is likely to cause, anticompetitive harm, they consider whether the agreement is reasonably necessary to achieve "cognizable efficiencies." "Cognizable efficiencies" are efficiencies that have been verified by the Agencies, that do not arise from anticompetitive reductions in output or service, and that cannot be achieved through practical, significantly less restrictive means. *See infra* Sections 3.36(a) and 3.36(b). Cognizable efficiencies are assessed net of costs produced by the competitor collaboration or incurred in achieving those efficiencies.

3.36(a) Cognizable Efficiencies Must Be Verifiable and Potentially Procompetitive

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the collaboration's participants. The participants must substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency; how and when each would be achieved; any costs of doing so; how each would enhance the collaboration's or its participants' ability and incentive to compete; and why the relevant agreement is reasonably necessary to achieve the claimed efficiencies (*see* Section 3.36 (b)). Efficiency claims are not considered if they are vague or speculative or otherwise cannot be verified by reasonable means.

Moreover, cognizable efficiencies must be potentially procompetitive. Some asserted efficiencies, such as those premised on the notion that competition itself is unreasonable, are insufficient as a matter of law. Similarly, cost savings that arise from anticompetitive output or service reductions are not treated as cognizable efficiencies. *See* Example 9.

3.36(b) Reasonable Necessity and Less Restrictive Alternatives

The Agencies consider only those efficiencies for which the relevant agreement is reasonably necessary. An agreement may be "reasonably necessary" without being essential. However, if the participants could have achieved or could achieve similar efficiencies by practical, significantly less restrictive means, then the Agencies conclude that the relevant agreement is not reasonably necessary to their achievement. In making this assessment, the Agencies consider only alternatives that are practical in the business situation faced by the participants; the Agencies do not search for a theoretically less restrictive alternative that is not realistic given business realities.

The reasonable necessity of an agreement may depend upon the market context and upon the duration of the agreement. An agreement that may be justified by the needs of a new entrant, for example, may not be reasonably necessary to achieve cognizable efficiencies in different market circumstances. The reasonable necessity of an agreement also may depend on whether it deters individual participants from undertaking free riding or other opportunistic conduct that could reduce significantly the ability of the collaboration to achieve cognizable efficiencies. Collaborations sometimes include agreements to discourage any one participant from appropriating an undue share of the fruits of the collaboration or to align participants' incentives to encourage cooperation in achieving the efficiency goals of the collaboration. The Agencies assess whether such agreements are reasonably necessary to deter opportunistic conduct that otherwise would likely prevent the achievement of cognizable efficiencies. *See* Example 10.

3.37 Overall Competitive Effect

If the relevant agreement is reasonably necessary to achieve cognizable efficiencies, the Agencies

assess the likelihood and magnitude of cognizable efficiencies and anticompetitive harms to determine the agreement's overall actual or likely effect on competition in the relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to offset the potential of the agreement to harm consumers in the relevant market, for example, by preventing price increases.[51]

The Agencies' comparison of cognizable efficiencies and anticompetitive harms is necessarily an approximate judgment. In assessing the overall competitive effect of an agreement, the Agencies consider the magnitude and likelihood of both the anticompetitive harms and cognizable efficiencies from the relevant agreement. The likelihood and magnitude of anticompetitive harms in a particular case may be insignificant compared to the expected cognizable efficiencies, or vice versa. As the expected anticompetitive harm of the agreement increases, the Agencies require evidence establishing a greater level of expected cognizable efficiencies in order to avoid the conclusion that the agreement will have an anticompetitive effect overall. When the anticompetitive harm of the agreement is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the agreement from having an anticompetitive effect overall.

SECTION 4: ANTITRUST SAFETY ZONES

4.1 Overview

Because competitor collaborations are often procompetitive, the Agencies believe that "safety zones" are useful in order to encourage such activity. The safety zones set out below are designed to provide participants in a competitor collaboration with a degree of certainty in those situations in which anticompetitive effects are so unlikely that the Agencies presume the arrangements to be lawful without inquiring into particular circumstances. They are not intended to discourage competitor collaborations that fall outside the safety zones.

The Agencies emphasize that competitor collaborations are not anticompetitive merely because they fall outside the safety zones. Indeed, many competitor collaborations falling outside the safety zones are procompetitive or competitively neutral. The Agencies analyze arrangements outside the safety zones based on the principles outlined in Section 3 above.

The following sections articulate two safety zones. Section 4.2 sets out a general safety zone

[51] In most cases, the Agencies' enforcement decisions depend on their analysis of the overall effect of the relevant agreement over the short term. The Agencies also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from the efficiencies (due to delay in the achievement of, or the realization of consumer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict.

applicable to any competitor collaboration.[52] Section 4.3 establishes a safety zone applicable to research and development collaborations whose competitive effects are analyzed within an innovation market. These safety zones are intended to supplement safety zone provisions in the Agencies' other guidelines and statements of enforcement policy.[53]

4.2 Safety Zone for Competitor Collaborations in General

Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected.[54] The safety zone, however, does not apply to agreements that are per se illegal, or that would be challenged without a detailed market analysis,[55] or to competitor collaborations to which a merger analysis is applied.[56]

4.3 Safety Zone for Research and Development Competition Analyzed in Terms of Innovation Markets

Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration on the basis of effects on competition in an innovation market where three or more independently controlled research efforts in addition to those of the collaboration possess the required

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[52] *See* Sections 1.1 and 1.3 above.

[53] The Agencies have articulated antitrust safety zones in *Health Care Statements* 7 & 8 and the *Intellectual Property Guidelines*, as well as in the *Horizontal Merger Guidelines*. The antitrust safety zones in these other guidelines relate to particular facts in a specific industry or to particular types of transactions.

[54] For purposes of the safety zone, the Agencies consider the combined market shares of the participants and the collaboration. For example, with a collaboration among two competitors where each participant individually holds a 6 percent market share in the relevant market and the collaboration separately holds a 3 percent market share in the relevant market, the combined market share in the relevant market for purposes of the safety zone would be 15 percent. This collaboration, therefore, would fall within the safety zone. However, if the collaboration involved three competitors, each with a 6 percent market share in the relevant market, the combined market share in the relevant market for purposes of the safety zone would be 21 percent, and the collaboration would fall outside the safety zone. Including market shares of the participants takes into account possible spillover effects on competition within the relevant market among the participants and their collaboration.

[55] *See supra* notes 27-29 and accompanying text in Section 3.3.

[56] *See* Section 1.3 above.

specialized assets or characteristics and the incentive to engage in R&D that is a close substitute for the R&D activity of the collaboration. In determining whether independently controlled R&D efforts are close substitutes, the Agencies consider, among other things, the nature, scope, and magnitude of the R&D efforts; their access to financial support; their access to intellectual property, skilled personnel, or other specialized assets; their timing; and their ability, either acting alone or through others, to successfully commercialize innovations. The antitrust safety zone does not apply to agreements that are per se illegal, or that would be challenged without a detailed market analysis,[57] or to competitor collaborations to which a merger analysis is applied.[58]

[57] *See supra* notes 27-29 and accompanying text in Section 3.3.

[58] *See* Section 1.3 above.

Appendix

Section 1.3

Example 1 (Competitor Collaboration/Merger)

Facts

Two oil companies agree to integrate all of their refining and refined product marketing operations. Under terms of the agreement, the collaboration will expire after twelve years; prior to that expiration date, it may be terminated by either participant on six months' prior notice. The two oil companies maintain separate crude oil production operations.

Analysis

The formation of the collaboration involves an efficiency-enhancing integration of operations in the refining and refined product markets, and the integration eliminates all competition between the participants in those markets. The evaluating Agency likely would conclude that expiration after twelve years does not constitute termination "within a sufficiently limited period." The participants' entitlement to terminate the collaboration at any time after giving prior notice is not termination by the collaboration's "own specific and express terms." Based on the facts presented, the evaluating Agency likely would analyze the collaboration under the *Horizontal Merger Guidelines*, rather than as a competitor collaboration under these Guidelines. Any agreements restricting competition on crude oil production would be analyzed under these Guidelines.

Section 2.3

Example 2 (Analysis of Individual Agreements/Set of Agreements)

Facts

Two firms enter a joint venture to develop and produce a new software product to be sold independently by the participants. The product will be useful in two areas, biotechnology research and pharmaceuticals research, but doing business with each of the two classes of purchasers would require a different distribution network and a separate marketing campaign. Successful penetration of one market is likely to stimulate sales in the other by enhancing the reputation of the software and by facilitating the ability of biotechnology and pharmaceutical researchers to use the fruits of each other's efforts. Although the software is to be marketed independently by the participants rather than by the joint venture, the participants agree that one will sell only to biotechnology researchers and the other will sell only to pharmaceutical researchers. The

participants also agree to fix the maximum price that either firm may charge. The parties assert that the combination of these two requirements is necessary for the successful marketing of the new product. They argue that the market allocation provides each participant with adequate incentives to commercialize the product in its sector without fear that the other participant will free-ride on its efforts and that the maximum price prevents either participant from unduly exploiting its sector of the market to the detriment of sales efforts in the other sector.

Analysis

The evaluating Agency would assess overall competitive effects associated with the collaboration in its entirety and with individual agreements, such as the agreement to allocate markets, the agreement to fix maximum prices, and any of the sundry other agreements associated with joint development and production and independent marketing of the software. From the facts presented, it appears that the agreements to allocate markets and to fix maximum prices may be so intertwined that their benefits and harms "cannot meaningfully be isolated." The two agreements arguably operate together to ensure a particular blend of incentives to achieve the potential procompetitive benefits of successful commercialization of the new product. Moreover, the effects of the agreement to fix maximum prices may mitigate the price effects of the agreement to allocate markets. Based on the facts presented, the evaluating Agency likely would conclude that the agreements to allocate markets and to fix maximum prices should be analyzed as a whole.

Section 2.4

Example 3 (Time of Possible Harm to Competition)

Facts

A group of 25 small-to-mid-size banks formed a joint venture to establish an automatic teller machine network. To ensure sufficient business to justify launching the venture, the joint venture agreement specified that participants would not participate in any other ATM networks. Numerous other ATM networks were forming in roughly the same time period.

Over time, the joint venture expanded by adding more and more banks, and the number of its competitors fell. Now, ten years after formation, the joint venture has 900 member banks and controls 60% of the ATM outlets in a relevant geographic market. Following complaints from consumers that ATM fees have rapidly escalated, the evaluating Agency assesses the rule barring participation in other ATM networks, which now binds 900 banks.

Analysis

The circumstances in which the venture operates have changed over time, and the evaluating Agency would determine whether the exclusivity rule now harms competition. In assessing the exclusivity rule's competitive effect, the evaluating Agency would take account of the

collaboration's substantial current market share and any procompetitive benefits of exclusivity under present circumstances, along with other factors discussed in Section 3. The Agencies would consider whether significant sunk investments were made in reliance on the exclusivity rule.

Section 3.2

Example 4 (Agreement Not to Compete on Price)

Facts

Net-Business and Net-Company are two start-up companies. They independently developed, and have begun selling in competition with one another, software for the networks that link users within a particular business to each other and, in some cases, to entities outside the business. Both Net-Business and Net-Company were formed by computer specialists with no prior business expertise, and they are having trouble implementing marketing strategies, distributing their inventory, and managing their sales forces. The two companies decide to form a partnership joint venture, NET-FIRM, whose sole function will be to market and distribute the network software products of Net-Business and Net-Company. NET-FIRM will be the exclusive marketer of network software produced by Net-Business and Net-Company. Net-Business and Net-Company will each have 50% control of NET-FIRM, but each will derive profits from NET-FIRM in proportion to the revenues from sales of that partner's products. The documents setting up NET-FIRM specify that Net-Business and Net-Company will agree on the prices for the products that NET-FIRM will sell.

Analysis

Net-Business and Net-Company will agree on the prices at which NET-FIRM will sell their individually-produced software. The agreement is one "not to compete on price," and it is of a type that always or almost always tends to raise price or reduce output. The agreement to jointly set price may be challenged as per se illegal, unless it is reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity.

Example 5 (Specialization without Integration)

Facts

Firm A and Firm B are two of only three producers of automobile carburetors. Minor engine variations from year to year, even within given models of a particular automobile manufacturer, require re-design of each year's carburetor and re-tooling for carburetor production. Firms A and B meet and agree that henceforth Firm A will design and produce carburetors only for automobile models of even-numbered years and Firm B will design and produce carburetors only for automobile models of odd-numbered years. Some design and re-tooling costs would be saved,

but automobile manufacturers would face only two suppliers each year, rather than three.

Analysis

The agreement allocates sales by automobile model year and constitutes an agreement "not to compete on . . . output." The participants do not combine production; rather, the collaboration consists solely of an agreement *not* to produce certain carburetors. The mere coordination of decisions on output is not integration, and cost-savings without integration, such as the costs saved by refraining from design and production for any given model year, are not a basis for avoiding per se condemnation. The agreement is of a type so likely to harm competition and to have no significant benefits that particularized inquiry into its competitive effect is deemed by the antitrust laws not to be worth the time and expense that would be required. Consequently, the evaluating Agency likely would conclude that the agreement is per se illegal.

Example 6 (Efficiency-Enhancing Integration Present)

Facts

Compu-Max and Compu-Pro are two major producers of a variety of computer software. Each has a large, world-wide sales department. Each firm has developed and sold its own word-processing software. However, despite all efforts to develop a strong market presence in word processing, each firm has achieved only slightly more than a 10% market share, and neither is a major competitor to the two firms that dominate the word-processing software market.

Compu-Max and Compu-Pro determine that in light of their complementary areas of design expertise they could develop a markedly better word-processing program together than either can produce on its own. Compu-Max and Compu-Pro form a joint venture, WORD-FIRM, to jointly develop and market a new word-processing program, with expenses and profits to be split equally. Compu-Max and Compu-Pro both contribute to WORD-FIRM software developers experienced with word processing.

Analysis

Compu-Max and Compu-Pro have combined their word-processing design efforts, reflecting complementary areas of design expertise, in a common endeavor to develop new word-processing software that they could not have developed separately. Each participant has contributed significant assets – the time and know-how of its word-processing software developers – to the joint effort. Consequently, the evaluating Agency likely would conclude that the joint word-processing software development project is an efficiency-enhancing integration of economic activity that promotes procompetitive benefits.

Example 7 (Efficiency-Enhancing Integration Absent)

Facts

Each of the three major producers of flashlight batteries has a patent on a process for manufacturing a revolutionary new flashlight battery -- the Century Battery -- that would last 100 years without requiring recharging or replacement. There is little chance that another firm could produce such a battery without infringing one of the patents. Based on consumer surveys, each firm believes that aggregate profits will be less if all three sold the Century Battery than if all three sold only conventional batteries, but that any one firm could maximize profits by being the first to introduce a Century Battery. All three are capable of introducing the Century Battery within two years, although it is uncertain who would be first to market.

One component in all conventional batteries is a copper widget. An essential element in each producers' Century Battery would be a zinc, rather than a copper widget. Instead of introducing the Century Battery, the three producers agree that their batteries will use only copper widgets. Adherence to the agreement precludes any of the producers from introducing a Century Battery.

Analysis

The agreement to use only copper widgets is merely an agreement not to produce any zinc-based batteries, in particular, the Century Battery. It is "an agreement not to compete on . . . output" and is "of a type that always or almost always tends to raise price or reduce output." The participants do not collaborate to perform any business functions, and there are no procompetitive benefits from an efficiency-enhancing integration of economic activity. The evaluating Agency likely would challenge the agreement to use only copper widgets as per se illegal.

Section 3.3

Example 8 (Rule-of-Reason: Agreement Quickly Exculpated)

Facts

Under the facts of Example 4, Net-Business and Net-Company jointly market their independently-produced network software products through NET-FIRM. Those facts are changed in one respect: rather than jointly setting the prices of their products, Net-Business and Net-Company will each independently specify the prices at which its products are to be sold by NET-FIRM. The participants explicitly agree that each company will decide on the prices for its own software independently of the other company. The collaboration also includes a requirement that NET-FIRM compile and transmit to each participant quarterly reports summarizing any comments received from customers in the course of NET-FIRM's marketing efforts regarding the desirable/undesirable features of and desirable improvements to (1) that participant's product and (2) network software in general. Sufficient provisions are included to prevent the company-specific information reported to one participant from being disclosed to the other, and those provisions are followed. The information pertaining to network software in general is to be

reported simultaneously to both participants.

Analysis

Under these revised facts, there is no agreement "not to compete on price or output." Absent any agreement of a type that always or almost always tends to raise price or reduce output, and absent any subsequent conduct suggesting that the firms did not follow their explicit agreement to set prices independently, no aspect of the partnership arrangement might be subjected to per se analysis. Analysis would continue under the rule of reason.

The information disclosure arrangements provide for the sharing of a very limited category of information: customer-response data pertaining to network software in general. Collection and sharing of information of this nature is unlikely to increase the ability or incentive of Net-Business or Net-Company to raise price or reduce output, quality, service, or innovation. There is no evidence that the disclosure arrangements have caused anticompetitive harm and no evidence that the prohibitions against disclosure of firm-specific information have been violated. Under any plausible relevant market definition, Net-Business and Net-Company have small market shares, and there is no other evidence to suggest that they have market power. In light of these facts, the evaluating Agency would refrain from further investigation.

Section 3.36(a)

Example 9 (Cost Savings from Anticompetitive Output or Service Reductions)

Facts

Two widget manufacturers enter a marketing collaboration. Each will continue to manufacture and set the price for its own widget, but the widgets will be promoted by a joint sales force. The two manufacturers conclude that through this collaboration they can increase their profits using only half of their aggregate pre-collaboration sales forces by (1) taking advantage of economies of scale -- presenting both widgets during the same customer call -- and (2) refraining from time-consuming demonstrations highlighting the relative advantages of one manufacturer's widgets over the other manufacturer's widgets. Prior to their collaboration, both manufacturers had engaged in the demonstrations.

Analysis

The savings attributable to economies of scale would be cognizable efficiencies. In contrast, eliminating demonstrations that highlight the relative advantages of one manufacturer's widgets over the other manufacturer's widgets deprives customers of information useful to their decision making. Cost savings from this source arise from an anticompetitive output or service reduction and would not be cognizable efficiencies.

Section 3.36(b)

Example 10 (Efficiencies from Restrictions on Competitive Independence)

Facts

Under the facts of Example 6, Compu-Max and Compu-Pro decide to collaborate on developing and marketing word-processing software. The firms agree that neither one will engage in R&D for designing word-processing software outside of their WORD-FIRM joint venture. Compu-Max papers drafted during the negotiations cite the concern that absent a restriction on outside word-processing R&D, Compu-Pro might withhold its best ideas, use the joint venture to learn Compu-Max's approaches to design problems, and then use that information to design an improved word-processing software product on its own. Compu-Pro's files contain similar documents regarding Compu-Max.

Compu-Max and Compu-Pro further agree that neither will sell its previously designed word-processing program once their jointly developed product is ready to be introduced. Papers in both firms' files, dating from the time of the negotiations, state that this latter restraint was designed to foster greater trust between the participants and thereby enable the collaboration to function more smoothly. As further support, the parties point to a recent failed collaboration involving other firms who sought to collaborate on developing and selling a new spread-sheet program while independently marketing their older spread-sheet software.

Analysis

The restraints on outside R&D efforts and on outside sales both restrict the competitive independence of the participants and could cause competitive harm. The evaluating Agency would inquire whether each restraint is reasonably necessary to achieve cognizable efficiencies. In the given context, that inquiry would entail an assessment of whether, by aligning the participants' incentives, the restraints in fact are reasonably necessary to deter opportunistic conduct that otherwise would likely prevent achieving cognizable efficiency goals of the collaboration.

With respect to the limitation on independent R&D efforts, possible alternatives might include agreements specifying the level and quality of each participant's R&D contributions to WORD-FIRM or requiring the sharing of all relevant R&D. The evaluating Agency would assess whether any alternatives would permit each participant to adequately monitor the scope and quality of the other's R&D contributions and whether they would effectively prevent the misappropriation of the other participant's know-how. In some circumstances, there may be no "practical, significantly less restrictive" alternative.

Although the agreement prohibiting outside sales might be challenged as per se illegal if not reasonably necessary for achieving the procompetitive benefits of the integration discussed in Example 6, the evaluating Agency likely would analyze the agreement under the rule of reason if

it could not adequately assess the claim of reasonable necessity through limited factual inquiry. As a general matter, participants' contributions of marketing assets to the collaboration could more readily be monitored than their contributions of know-how, and neither participant may be capable of misappropriating the other's marketing contributions as readily as it could misappropriate know-how. Consequently, the specification and monitoring of each participant's marketing contributions could be a "practical, significantly less restrictive" alternative to prohibiting outside sales of pre-existing products. The evaluating Agency, however, would examine the experiences of the failed spread-sheet collaboration and any other facts presented by the parties to better assess whether such specification and monitoring would likely enable the achievement of cognizable efficiencies.



ANTITRUST LITIGATION, ARBITRATION AND USE OF ECONOMISTS OUTSIDE THE US

Global Guide to Competition Litigation

England and Wales

2012

Baker & McKenzie

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England and Wales

Keith Jones, Richard Pike and Francesca Richmond

A. Availability of private enforcement in respect of competition law infringements and jurisdiction

1. Scope for private enforcement actions in England and Wales

Private enforcement actions can be brought by two distinct procedural routes in England and Wales: either before the civil courts (primarily the Chancery and Commercial Divisions of the High Court) or before the specialist Competition Appeal Tribunal ("CAT").

No prior finding of infringement is required in order to bring an action in the civil courts. However, currently a private action can only be brought in the CAT where there has been a prior finding of infringement by the European Commission or one of the national regulatory authorities with power to apply competition law in England and Wales. Further, if that finding of infringement remains subject to appeal, permission from the CAT will be required in order to initiate the claim. The Government is consulting on proposals to amend this regime so that claims may be brought before the CAT where no prior finding of infringement has been made and so that claims can be transferred between the civil courts and the CAT as appropriate.

Any undertaking (defined as a natural or legal person carrying on some commercial or economic activity) may be subject to a private action in respect of loss or damage resulting from a tortious breach of statutory duty – whether Article 101 or 102 TFEU or the Chapter I and II prohibitions set out in the Competition Act 1998.

The effect of Council Regulation 44/2001 (the "Brussels Regulation"), amongst other matters, is that claims can be brought in signatory states:

i) where a defendant is domiciled (Article 2);
ii) against a group of defendants where the claims against them are “closely connected” provided that one or more of the defendants is domiciled in that jurisdiction (Article 6); and
iii) in matters relating to tort, either in the place where damage was suffered or in the place where the event giving rise to the harm occurred (Article 5(3)).[1]

The English High Court has construed Article 6 of the Brussels Regulation in such a way that a subsidiary of a decision addressee domiciled in England and Wales can be used as the “anchor” for jurisdiction provided that it is alleged that the subsidiary knowingly or even innocently implemented the infringing activity that its parent engaged in (e.g. the subsidiary adopted a pricing policy that incorporated an unlawful overcharge).[2]

[1] Note, this is the construction placed upon Article 5(3) by Case 21/76 *Bier v Mines de Potasse d'Alsace* [1976] ECR 1735. It is understood that if the claimant argues that the basis for jurisdiction is that the damage suffered occurred in that place the claimant may only recover damage suffered within the jurisdiction (as opposed to all damage caused as a result of the infringement).
[2] See *Roche Products Limited and others v Provimi Limited* [2003] EWHC 961 and *Cooper Tire & Rubber Company Europe Limited and others v Dow Deutschland Inc and others* [2010] EWCA Civ 864

English courts will, however, take a narrow approach toward claimants seeking to argue that England and Wales is the place where the event giving rise to the harm occurred so as to rely on Article 5(3). In order to meet this criterion, the claimant must show that the event setting the tortious infringement in motion occurred in England and Wales.[3] However, it has been found that the fact that cartel meetings occurred in England and Wales is not sufficient to show that the tortious acts were set in motion within the jurisdiction and the reality of a multi-jurisdictional cartel may well be that the harmful events occurred in several countries.[4] This may mean that claimants seeking to rely on Article 5(3) will have to rely instead on showing that damage occurred in England and Wales, perhaps by virtue of it being the place where purchases of cartelised goods were made, but this is likely to limit any claims to those for damage occurring in England and Wales.

It may also be possible to bring a claim against a director or employee where that director or employee has been closely involved in infringing conduct. It has recently been established that an infringing company cannot seek to recover a contribution to fines from those employees found to have been involved in carrying out the infringement.[5] But it may be that other claims are available, such as claims for contribution towards damages paid to victims.

2. Applicable limitation periods

The rules on limitation differ depending upon the court in which the claim is brought and the cause of action upon which a claim is based.

The limitation period for bringing a tortious claim for damages resulting from an infringement of competition law (i.e. for a breach of statutory duty) in the civil courts is six years from the date upon which the cause of action accrued. Where the infringement has been deliberately concealed (or commissioned in circumstances where the breach was unlikely to be discovered for some time), as with a price-fixing cartel, the limitation period does not begin to run until the claimant discovers the cartel or the time that the court deems the claimant could, with reasonable diligence, have discovered it.[6] This probably means that time will start running no later than the announcement of an infringement decision and may start running sooner depending on the circumstances of the particular case. Appeals in respect of infringement findings do not stop the limitation period running in the civil courts (although the court may order a stay of proceedings at some point to allow for resolution of appeals if it considers it appropriate to do so).

A damages claim before the CAT can be brought up to two years from the later of:

i) the date on which the relevant infringement decision is no longer capable of being appealed or appealed further; or
ii) the date on which the action accrued.

The Court of Appeal found in *BCL Old Co Limited and others v BASF SE and others*[7] that the two-year limitation period in which damages claims must be brought in the CAT begins to run from the last date on which an appeal can be made against the finding of infringement and does not stop running as a result of an appeal only against the penalties imposed.[8] The bringing of an appeal

[3] *Sandisk Corporation v Koninklijke Philips Electronics and others* [2007] EWHC 332 (Ch).
[4] *Cooper Tire and Rubber Co and others v Shell Chemicals UK Ltd and others* [2009] EWHC 2609 (Comm), per Teare J at paragraph 65.
[5] *Safeway Stores Ltd and others v Twigger and others* [2010] EWCA Civ 1472
[6] Section 32 Limitation Act 1980.
[7] [2009] EWCA Civ 434.
[8] See *BCL Old Co Ltd and others v BASF SE and others; Grampian Country Food Group Ltd and others v Sanofi Aventis SA and others* [2009] CAT 29.

against the infringement finding by any defendant stops time running for CAT claims against all defendants.[9]

A claimant must apply to the CAT for permission to bring follow-on proceedings if the relevant limitation period has yet to expire. No permission is required to bring an action before the High Court even if appeals in respect of the underlying decision have not been exhausted.

3. Appeals

An appeal on a point of fact or law can be made from the civil courts to the Court of Appeal (subject to permission to appeal being granted by the Court of Appeal or the relevant court of lower instance) in respect of a finding of an infringement or an award of damages.

A further appeal from the Court of Appeal on points of law of general public importance lies to the Supreme Court (formerly the House of Lords), provided that permission to appeal is granted by either the Court of Appeal or the Supreme Court.

In relation to claims before the CAT, section 49 of the Competition Act 1998 provides for a right of appeal against an award of damages by the CAT, including the right to appeal against the amount awarded. Appeals from the CAT lie to the Court of Appeal, provided that the permission of the CAT or the Court of Appeal has been obtained. Appeals can be made by a party to the proceedings or a person who has sufficient interest in the matter.

4. Availability of class actions for infringement of competition law and/or damages available in England and Wales

A limited form of representative action for consumer claims is available under Section 47B of the Competition Act 1998, which allows designated consumer bodies to bring an action before the CAT on behalf of two or more consumers (not businesses). This is framed as an "opt-in" consumer action, so each consumer must give his or her consent to be joined to the proceedings and each claim included must relate to the same infringement.

Which? (formerly the Consumers' Association), so far the only consumer body specified to bring proceedings under Section 47B, brought a representative action against JJB Sports following a finding by the Office of Fair Trading (a national competition authority in England and Wales) in 2003 that JJB had been involved in a cartel with other retailers in respect of the pricing of replica football kit. The case settled for a relatively small sum overall with few consumers registering an interest so as to opt-in to the claim. It was agreed that £20 was payable to each consumer who had participated in the action and £10 to those who had not but could prove that they had purchased cartelised goods. The motivation to settle for a small overall amount reportedly flowed from difficulties in persuading sufficient consumers to "opt in" to the action.

Representative proceedings, where more than one person has the "same interest" in a claim, may also be brought in the civil courts. Interested persons must opt-in to the action in order to participate. This type of proceeding is relatively uncommon because the "same interest" test that each claimant must meet in order to join the proceedings is difficult to satisfy. An attempt to broaden the application of CPR 19.6 in *Emerald Supplies Ltd v British Airways plc*,[10] so as to essentially create an opt-out representative action, failed on the basis that the criteria for identifying who might qualify for inclusion in the class depended on the outcome of the action itself and also on the basis that the members of the class might not all have the same interest in the outcome of the claim (as some were

[9] *Deutsche Bahn AG and others v Morgan Crucible Company plc and others* [2012] EWCA Civ 1055.
[10] [2009] EWHC 741 (Ch); decision upheld on appeal [2010] EWCA Civ 1284.

direct customers and some indirect, who would have had different interests on , for example, questions of passing on) and so the class of affected persons was not representative

Group litigation orders (GLO) are also available and can be made where one or more claims raise "common or related issues". This test is wider than the requirement that the persons have the "same interest", as is required for representative proceedings (see above). GLOs are rarely used in practice.

The issue of collective redress is a hot topic – the European Commission having published a consultation paper on the issue in February 2011 (SEC(2011)173) and DGCOMP committing in its work objectives for 2012 to present a specific proposal on private damage actions following publication of the Commission's views on collective redress. The U.K. Government Department for Business Innovation and Skills also consulted on reform of private actions in April 2012 and its proposals included introduction of an opt-out collective redress mechanism to facilitate consumer recovery of compensation. No conclusions have been published by these entities as yet (although a European Parliament resolution published in May 2012 indicates that it prefers an opt-in collective redress mechanism) but it is likely that we will see developments in this area.

B. Conduct of proceedings and costs

5. Burden of proof

The claimant bears the burden of proof in establishing on the balance of probabilities whether there has been an infringement and that he has suffered loss as a result of that infringement.

In cases where a prior decision of a national competition authority or the European Commission has already established a competition law infringement, the claimant need only prove causation and loss flowing from the period of infringement established by the decision. If there is no such prior decision, the position is that the damages action will have to be commenced before the civil courts (as opposed to the CAT) and the claimant will need to establish that there has been an infringement as well as causation and loss.

As noted above, the claimant must show a causal link between the infringement and any loss suffered. In order to do this, the claimant must demonstrate that "but for" the defendant's actions, he would not have suffered the loss identified and that he is therefore entitled to be restored to the financial position that he would have been in if the infringement had not occurred. Although not yet the subject of any judicial authority in the English courts, the judgment of the Court of Justice of the European Union in *Manfredi*[11] that "any individual" could make such a claim where a "causal relationship" exists between the harm suffered and the prohibited agreement is assumed to mean that indirect purchasers are able to bring claims.

In *Napp Pharmaceuticals v DGFT* [12] the CAT concluded that, although the standard of proof for an infringement of the competition rules in England and Wales is the ordinary civil standard (i.e. on the balance of probabilities), this standard is to be applied bearing in mind that infringements of competition law are serious matters attracting severe financial penalties.[13] The High Court in

[11] Judgment of the Court (Third Chamber) of 13 July 2006.*Vincenzo Manfredi v Lloyd Adriatico Assicurazioni SpA* (C-295/04), *Antonio Cannito v Fondiaria Sai SpA* (C-296/04) and *Nicolò Tricarico* (C-297/04) and *Pasqualina Murgolo* (C-298/04) *v Assitalia SpA*.
[12] Case No. 1001/1/1/01 (15 January 2002), permission to appeal refused by both the CAT and Court of Appeal [2002] EWCA Civ 796.
[13] Ibid, paragraph 109.

Attheraces v BHB [14] confirmed this approach, clearly stating that the standard of proof is the civil standard of a breach and consequent loss being established on the balance of probabilities, but that the seriousness of an infringement of the competition rules required that the proof of evidence must be "commensurately cogent and convincing".

The burden of proof in establishing that an agreement merits exemption under Article 101(3) TFEU or Chapter I lies with the defendant, which must also prove its case on the balance of probabilities. If there is already a prior infringement decision, the defendant will not be able to invoke this defence before the courts. In relation to "objective justification" under Article 102 TFEU and Chapter II, the evidential burden is likely to be on the defendant.

As noted above, a finding of infringement by a competition authority is not a precondition to a civil action in England and Wales. However, section 58 of the Competition Act 1998 provides that, where there has been a decision (which is no longer appealable) from a relevant competition authority or the CAT that an infringement has occurred, the civil courts are bound by it in subsequent damages claims (although a claimant will still have to demonstrate causation and loss). Moreover, national courts are not allowed to rule counter to a European Commission decision which has already established an infringement of the EU competition rules. Note, however, that the House of Lords in *Crehan v Inntrepreneur Pub Co (CPC) and Others*[15] made clear that, although national courts are under a duty of "sincere cooperation" and must avoid taking conflicting decisions, this does not mean that national courts must follow decisions of the European Commission in all cases, only in relation to the same agreement between the same parties. In that case, although a Commission decision stated that the market was foreclosed, the parties in question had not been participants to the Commission proceedings. The High Court heard further evidence and determined that the market was not foreclosed at the relevant time in respect of the parties involved in the *Crehan* case. The House of Lords, overturning a dissenting Court of Appeal, held that the High Court had taken the correct approach.

6. Joint and several liability of cartel participants

Liability for infringement of competition law involving multiple defendants will ordinarily be joint and several. This means that a claimant may bring an action for damages resulting from a breach of competition law against any defendant (not necessarily all potential defendants) for the entirety of the loss suffered by the claimant as a result of the anti-competitive conduct.

The Civil Liability (Contribution) Act 1978 provides that any person liable for damage suffered by another may recover a contribution from any third party who is also liable in respect of the same damage. To claim such contribution, defendants can join other potentially liable parties to the action against them and/ or pursue third parties in separate proceedings (including after judgment has been given). Actions to recover contribution in reliance on the Civil Liability (Contribution) Act 1978 must be brought within two years of the date upon which the right to claim contribution accrued.

It is for the court to assess how liability should be apportioned between persons responsible for the same damage. The court will make such an award as is considered just and equitable in light of each person's actual responsibility or blameworthiness for the damage in question.

The joint and several nature of the liability complicates settlement discussions because it remains open to other defendants to sue the settling defendant on the theory that the settling defendant has not settled a sufficiently large portion of the joint liability. There are mechanisms which should reduce

[14] [2005] EWHC 3015 (Ch)
[15] [2006] UKHL 38

the risk of such contribution claims being successful in effectively re-opening settlement reached but they have not yet been tested before the English courts.

The U.K. Government consultation paper on reform of private actions invited comments on whether whistle-blowers should be protected from joint and several liability so that their liability to private claims would be limited to damage that claimants could show they had directly caused. However, the consultation paper recognised that this is a finely balanced issue and it is unclear whether any reform in this area is likely.[16]

7. Documents and evidence that can be used by claimants (for example, investigation evidence) and legal privilege

In cases before the ordinary civil courts, there is a duty on both sides to disclose all documents on which they rely that are within their control, which adversely affect their own or the other party's case or which support the other party's case. The principal exception to disclosure is that privileged documents do not need to be disclosed, although it should be noted that privilege against disclosure can be waived. Such waiver can occur inadvertently (for example, if a legally privileged document is forwarded to a third party).

Since October 2007, third parties to an action can obtain, without the need for permission or prior notification to the parties, any statement of case, including the particulars of claim, defence, reply and any further information filed with the civil courts. A party to an action, or any person identified in a statement of case, may apply for an order preventing or restricting disclosure of that statement of case.

The CAT has a broad discretion regarding orders for disclosure, subject to the rules of privilege. The CAT may give directions for the disclosure between, or the production by, the parties of documents or classes of documents. To date it has, however, applied its discretion in a way designed to limit the volume of documentation disclosed.

There is no obligation upon national competition authorities to disclose investigation evidence to third parties in order to assist private enforcement action. However, court orders can be obtained to force such disclosure if the court agrees that such disclosure is proportionate (considering whether the information is available from other sources and the relevance of the leniency materials to the issues in the case). Limited disclosure of specific leniency material was granted applying this analysis in *National Grid Electricity Transmission plc v ABB Ltd and others* [2012] EWHC 869 (Ch).

The U.K. Government consultation paper on reform of private actions indicated that the Government is minded to protect from disclosure applications documents directly involved in the leniency application and which would not have been created if the company in question had not been seeking leniency but it is likely that the U.K. Government will wait for action at the European level rather than legislating unilaterally[17]

8. Pre-action disclosure

Pre-action disclosure may be ordered against a prospective defendant where necessary to dispose fairly of the anticipated proceedings, assist the disputes to be resolved or save costs - although the courts will not tolerate a fishing expedition on the part of the claimant. An application for pre-action

[16] See paragraph 7.8 of the consultation paper.
[17] See paragraph 7.6 of the consultation paper.

disclosure in relation to competition law claims has been rejected in circumstances where the Court considered the claim to be too speculative and the scale of disclosure was too large and unfocused.[18]

This is not to say that pre-action disclosure will never be granted but such an application will need to be carefully considered. Pre-action disclosure may, in some circumstances, be ordered against persons who are not prospective defendants, as illustrated by the judgment of the Court of Appeal in *Total E&P Soudan SA v Edmonds* [19] in which a targeted request for specific documents that could be readily disclosed at little cost or inconvenience was allowed.

9. Average length of time from issue of claim to judgment in England and Wales

A claim in the civil courts typically takes between one and two years to reach a final judgment, depending on the complexity of the case and interlocutory applications brought by the defendant(s), for example, challenges to jurisdiction or stay applications pending the outcome of appeal of an infringement decision. Our experience is that private actions have so far taken longer to resolve than is typical for other civil claims due to the relative novelty and difficulty of the issues raised in private actions brought to date (in terms of jurisdiction, economic analysis etc).

Cases can be expedited in the civil courts and it may also be possible to bring the case to an early conclusion through: (i) an application to strike out where there are no reasonable grounds for bringing or defending the claim; or (ii) an application for summary judgment where the claimant or defendant has no real prospect of success.

Claims before the CAT may be quicker than before the civil courts. For example, in *Enron Coal Services v EWS*[20], the CAT reached final judgment in December 2009, the claim having been brought in November 2008. Damages were not awarded in that case due to the claimant's failure to establish causation.

Appeals to the Court of Appeal will generally add a further year; with a similar period for a further appeal to the Supreme Court.

10. Average cost from issue of claim to judgment in England and Wales

The potential costs of litigating a claim for breach of competition law are difficult to quantify as they will depend on a range of factors (number of parties, volume of documents, procedural issues etc). Both claimants and defendants must consider that this type of claim has the potential to become very complex and could be drawn out over a long period of time, causing costs to spiral. It is not unusual for claimant and defendant costs to exceed £1m per party and sometimes to be several multiples of that amount. Disclosure, forensic accounting and economic analysis can add considerably to legal fees.

English civil courts have a general discretion as to the award of costs between parties, taking account of any offers to settle that are made and the parties' general conduct in the matter. In most cases, the losing party will be ordered to pay the successful party's costs. In practice, the successful party generally only recovers between 70% and 80% of its actual costs.

The CAT may make any order on costs that it considers fit in relation to the whole or part of the proceedings.

[18] *Hutchison 3G UK Ltd v, Vodafone Ltd, 02 Ltd, Orange Personal Communications Services Ltd, T-Mobile UK Ltd* [2008] EWHC 50
[19] [2007] EWCA Civ 50
[20] See *Enron Coal Services Ltd (in liquidation) v English Welsh & Scottish Railway Limited*, [2009] CAT 36

It is worth noting that the Legal Aid, Sentencing and Punishment of Offenders Act 2012 was passed in May 2012 and adopts proposals on costs reforms made by the Jackson Report (published December 2009). It is expected that these changes will be implemented so as to become effective in April 2013. Key changes to the law on costs from the perspective of private actions include:

i) cost management by the court (including exchange of budgets between the parties and recoverable costs being assessed against these budgets);
ii) introduction of true contingency fees (i.e. the lawyers may receive a percentage of any final damages award) (section 45);
iii) the success fee element of conditional fee agreements (the percentage by which actual costs are increased to reflect risk if the claimant is successful) and any after –the-event insurance premium owed by a winning party will no longer be recoverable from the losing party (section 44); and
iv) extending the scope of Part 36 offers (i.e. an offer by one party of an amount to be paid to the other to settle the dispute) so that a defendant who fails to beat a claimant's offer may be ordered to pay an amount additional to the claimant's costs (assessed on an indemnity basis so that the defendant must establish if costs claimed are not properly recoverable) plus interest (section 55). The additional amount is yet to be set but the Jackson Report proposed a 10% uplift be added to the damages finally awarded to the claimant.

11. Third party funding/alternative funding.

There are a number of third party and alternative funding options available in competition cases in England and Wales. A Code of Conduct for Litigation Funders was published by the Civil Justice Council on 23 November 2011 and establishes the following guiding principles:

i) a funder may receive a share of the proceeds of a claim if successful and may not no seek more the proceeds unless a material breach of the funding agreement has occurred (success is to be a contractually defined term in each agreement made);
ii) a funder must maintain adequate capital so as to meet its obligations to fund all disputes that it has agreed to fund for a minimum period of 36 months.
iii) funders may not seek to get the litigant's advisers to cede control of the conduct of the dispute to the funder but the funding agreement may provide for input into settlement decisions (any dispute as to which are to be resolved by obtaining a binding opinion from an independent QC, who has been either instructed jointly or appointed by the Bar Council).
iv) funding agreements should also set out whether the Funder will be liable to the litigant to meet liabilities for: adverse costs; security for costs; insurance premiums; and any other types of financial liability that might arise other than the litigant's own costs.

12. Alternative methods of dispute resolution

Alternative means of dispute resolution are available in England and Wales. Mediation is commonly employed to resolve disputes and court rules require parties to consider the use of mediation or other alternative dispute resolution. In addition, the High Court has held that competition law can be arbitrated if the claims alleging competition law infringement fall within the ambit of a contractual arbitration clause (*ET Plus SA v Welter* [21]).

[21] [2006] LWR 251.

Most claims for damages resulting from an alleged breach of competition law are resolved by settlement rather than proceeding to trial. The details of such settlements are not generally publicly reported, but some have been achieved as a result of an alternative means of dispute resolution.

C. Relief

13. Availability of damages and quantification

The basic rule is that damages are available and awarded in order to restore the claimant to the position it would have been in had the breach causing it loss not occurred. Thus, claimants may seek compensatory damages including interest in respect of any infringement of competition law that has caused the claimant loss. In *Arkin v. Borchard Lines* [22] the judge stated (despite being of the view that there had been no breach of either Article 101 or 102 TFEU) that an assessment of damages would involve starting with the relevant market as it existed at the time of the alleged infringement and then asking what loss, if any, the infringement had, as a matter of common sense directly caused. For this purpose, it would be necessary to reconstruct the market conditions most likely to exist if no infringement had occurred (the counterfactual). By way of example, in the case of price fixing, a customer might be awarded the difference between the price it actually paid for the goods and the price it would have paid in a competitive market. This approach has been confirmed by that taken in subsequent cases (see *Devenish Nutrition Ltd v Sanofi-Aventis SA (France) & Ors*[23], *Crehan*[24], *Healthcare at Home v Genzyme*[25] and *2 Travel Group plc (in liquidation) v Cardiff City Transport Services Limited*[26]).

The Court of Appeal found in *Crehan* that, instead of attempting to calculate the profits that the claimant might have made had he not been subject to an anti-competitive agreement, an appropriate measure of damages might instead be the value of the going concern that the claimant would have had but for the agreement as well as his actual losses. The award of damages made by the Court of Appeal in *Crehan* was overturned by the House of Lords (now the Supreme Court.

There is no binding authority directly establishing that the concept of passing-on will be considered relevant to quantification of damages in England and Wales (i.e. where the claimant is said to have passed on any loss of profit caused by cartel prices by inflating his own prices to the ultimate consumer). However, given the Court of Justice of the European Union's ruling in *Manfredi* that indirect purchasers ought to have standing to bring private claims, it seems logically consistent that the concept of passing on should apply when quantifying damages suffered by both direct and indirect purchasers. Various judicial comments in English cases also suggest that it is very likely to be applied. The U.K. Government consultation paper on reform of private actions considered whether legislation should be put forward so as set a formal position on passing-on but concluded that there was not a strong case to do so and that the question might more appropriately be addressed at EU level.[27]

Finally, it is noteworthy that in 2011 the European Commission published for consultation a draft guidance paper on quantifying harm in actions for damages based on breaches of Article 101 or 102.

[22] [2005] 3 All ER 613.
[23] [2008] EWCA Civ 1086
[24] [2004] EWCA Civ 637. In this case, the House of Lords overturned the damages award on the basis that there was no breach, but did not comment on the approach to quantification taken by the Court of Appeal.
[25] [2006] CAT 29.
[26] [2012] CAT 19.
[27] See paragraph 4.49 of the consultation paper.

While the draft guidance paper adopts an approach similar to that taken by English courts, the European Commission is yet to publish guidance in final form.

14. Punitive and exemplary damages

An award of exemplary damages is a theoretical possibility in a competition damages claim in England and Wales, with one award having been made in a first instance abuse of dominance case (*2 Travel*[28]), but awards are highly unlikely in most cases and any award will be modest in amount.

Exemplary damages are available as a matter of principle in English law where compensatory damages are insufficient alone to punish the defendant in two categories of claim:

i) in relation to an oppressive, arbitrary or unconstitutional action by Government; and/or

ii) where the Defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the claimant. [29]

Competition law cases, if they fall within either category, will fall within the second category identified above in view of the deliberate conduct of a defendant in committing the tortious breach of his statutory duty.

A claim for exemplary damages was considered and dismissed in a cartel follow-on context in the High Court case of *Devenish*[30]. In the case, arising from the vitamins cartel, the Court decided that the principle of *non bis in idem* (i.e. double jeopardy) precludes the award of exemplary damages in a case in which the defendants have already been fined (or had fines imposed and then reduced or commuted) by the European Commission. A similar view is likely to be taken where fines are imposed by domestic authorities. The Court also noted practical difficulties in making an award where there were multiple claimants suffering different degrees of injury and/or where some potential claimants are not before the Court.

Devenish has established that it will always be very difficult to get an exemplary damages award in a competition damages claim before the English Courts but it has not strictly ruled it out. The CAT case of *2 Travel* provides the only example to date of such an award.

2 Travel was an abuse of dominance case where the domestic competition authority, the OFT, found an abuse of dominance in a local bus market. In *2 Travel*, the OFT had issued an infringement decision and opted not to fine the defendant as its turnover did not exceed the statutory minimum. *2 Travel* distinguished *Devenish* on the basis that the fine in that case had been commuted in recognition of the fact that the defendant had blown the whistle on a cartel – the CAT stated that there are good policy reasons not to undermine the incentive to blow the whistle by making exemplary damages available as against those whose fines have been commuted as a matter of leniency policy. However, in *2Travel*, the defendant avoided fines only on the basis that its conduct was considered to be of minor significance and so the CAT concluded that there was no policy reason to bar an award of exemplary damages in the circumstances.

The CAT's judgment in *2 Travel* notes that dominant undertakings will often be unable to predict with certainty whether or not a proposed measure would amount to an infringement and so may take many business decisions in the knowledge that there is a risk of a breach. However, the judgment clarifies

[28] *2 Travel Group PLC (in liquidation) v Cardiff City Transport Services Limited* [2012] CAT 19.
[29] *Rookes v Barnard* [1964] 1 AC 1129,
[30] *Devenish Nutrition Ltd v Sanofi Aventis SA* [2007] EWHC 2394 (Ch).

that, to avoid discouraging risk taking that may ultimately be pro-competitive, dominant undertakings should only be liable for exemplary damages if the risk taken was "unacceptable", i.e.

i) involving conduct that entails a cynical disregard for a claimant's rights; or

ii) behaving outrageously or in outrageous disregard of the claimant's rights.[31]

The CAT explained that whether the risk is, in fact, "unacceptable" will in addition depend upon all the facts of the case, including (for example):

i) Any expected pro-competitive effects of the conduct.

ii) The degree and seriousness of any anti-competitive effects.

iii) The motive of the undertaking for acting.

iv) The practicability of achieving the same commercial or pro-competitive aim by following a different course of action with less serious anti-competitive effects.

The CAT declined to quantify the exemplary damages by reference to the penalty that might be imposed for a breach of the Chapter II prohibition (as suggested by the defendant) and instead noted in quantifying the damages that due regard should be had to the level of compensatory damages awarded and to the economic size of the defendant. The amount actually awarded was modest (just £60,000) and is consistent with the typically modest size of exemplary damages awards in other English law contexts.

2Travel is the first and only case in which an award of exemplary damages have been made in a competition law context. The decision may yet be overturned on appeal.

15. Availability of interim or final injunctions in respect of an alleged competition law infringement

Interim injunctions preventing the continuation of an infringement pending full trial of the issues may be sought from the civil courts. If necessary, the civil courts can grant an interim injunction on less than twenty-four hours' notice and in some cases without even notifying the opposing party. That said, an applicant in a competition law case will generally face difficulties in persuading the court that the circumstances justify an injunction.

Before granting an interim injunction, the court will generally require the applicant to give a cross-undertaking in damages to cover any loss suffered by the defendant as a result of the injunction in the event of the applicant losing the case. When seeking an interim injunction, the applicant must show that it has a "good arguable case". The grant or refusal of an interim injunction is a matter at the court's discretion and is assessed on the balance of convenience (*American Cyanamid Co v Ethicon Limited* [32] - i.e., the risk of injustice to either party of granting or refusing the injunction, considering

[31] In considering whether the defendant had knowledge as to the unlawfulness of its conduct – the CAT applied *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 1 QB 716 in ruling that the persons whose knowledge ought to be attributed to a company will depend upon the facts of the case and need not be the chairman/directors.
[32] [1975] 2 WLR 316

all the circumstances of the case). The court will not grant an interim injunction if damages would be an adequate remedy (i.e., the harm likely to result would be irreparable or unquantifiable)

An interim injunction was awarded in *Adidas v. ITF* [33] in relation to a claim under Article 101 and 102 TFEU, in circumstances where the applicant was able to demonstrate that without the interim injunction, it would not be able to conduct its business properly. This success should be compared with the rejected application for an injunction brought against Pfizer by eight wholesalers in 2007.[34] They requested that the implementation of new distribution arrangements be halted only a month prior to coming into force (having previously addressed their complaints to the OFT). The last minute nature of the application and the complexity of analysis required to establish whether the wholesalers had an arguable case caused the High Court to reject the application.

The U.K. Government consultation paper on reform of private actions includes a proposal that the CAT also be granted the power to grant injunctive relief in appropriate cases. It seems likely that, if implementation occurs in respect of the other proposals granting the CAT power to hear stand alone claims and accept cases transferred from the High Court, the CAT will also be afforded injunctive relief powers.

D. Emerging Trends

The volume of litigation in England and Wales has been increasing steadily over the past twenty years as the body of law in respect of private actions has become more established. The broad scope for disclosure (especially as compared to other EU member states), experienced and efficient commercial courts and, to date, relatively generous approach on jurisdiction have attracted claimants to English courts. Further, despite the expense of legal fees in England and Wales, the "loser pays" principle and soon to be implemented changes to rules on funding of litigation are likely to frame England and Wales as an even more claimant friendly jurisdiction in which to litigate.

We have noted above that the U.K. Government is consulting on a range of proposals designed to facilitate and promote private actions – including a mechanism for opt-out collective actions. It is therefore expected that reform in this area will be implemented in England and Wales in addition to any proposals that might be made at an EU level as and when the European Commission and DGCOMP draw conclusions on collective redress and guidance for quantification of damages. We have already seen a number of law firms and litigation funders established in the U.K. so as to bring claims in this area and expect that these reforms are likely to galvanise such activity and increase private litigation generally so as to further grow the number of claims brought in England and Wales every year.

England and Wales

[33] [2006] EWHC 1318 (Ch)
[34] *AAH Pharmaceutical Ltd and others v Pfizer Ltd and another* [2007] EWHC 565.

Contact Information

Keith Jones
Phone: + 44 20 7919 1573
Email: keith.jones@bakermckenzie.com

Richard Pike
Phone: + 44 20 7919 1416
Email: richard.pike@bakermckenzie.com

Francesca Richmond
Phone: + 44 20 7919 1621
Email: francesca.richmond@bakermckenzie.com

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Arbitrating Competition Law Disputes: a matter of policy?

By Francesca Richmond (http://kluwerarbitrationblog.com/blog/author/francescarichmond/), Baker & McKenzie (http://www.bakernet.com), for YIAG (http://kluwerarbitrationblog.com/groups/?gID=2)

A commentary on the OECD Competition Commission conclusions on using arbitration to effectively resolve competition law disputes
By Francesca Richmond and Sarah West

There has been increasing use of arbitration to resolve disputes involving competition law issues in recent years. However, it is surprising that the number is not even greater given that arbitral processes are particularly suited to this type of complex, multi-jurisdictional dispute. Claimants can be nervous that the validity of such awards might be challenged on public policy grounds, however, in practice there are only limited circumstances in which a civil claim based upon competition law is likely to also engage public policy concerns. Indeed, a recent paper from the Organisation for Economic Co-operation and Development ("*OECD*") concludes that the tide is turning and that arbitration is likely to take greater prominence as part of the toolkit for resolving disputes involving allegations that competition law has been infringed.

The OECD Competition Committee conducted a hearing in October 2010 on the role of arbitration in competition policy and practice and has now published its report on that hearing (http://www.oecd.org/dataoecd/58/40/49294392.pdf) along with two publications drafted by experts in the field that were discussed at the hearing. The paper sets out the key findings of the Committee as to the advantages and disadvantages of arbitration for both claimants and defendants in the context of a competition law dispute, commenting upon: the arbitrability of competition claims; the duty of arbitrators to apply competition law; the ability of national courts to review an arbitral award; and the use of arbitration clauses in merger remedies. The OECD concludes that concerns that arbitration might somehow undermine effective enforcement of competition law or that challenges to arbitral awards on competition law issues might subvert established principles on the review of awards are unjustified.

Enforceability and other issues - are there still hurdles to arbitration?

Competition law as a matter of public policy does not generally deal with the compensation of private parties adversely affected by an infringement but with the investigation and punishment of infringements so as to deter such behaviour in future. As a matter of principle, it is clear that competition issues can be arbitrated without raising public policy concerns (As confirmed by Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc. 723 F.2d 155 (1983), Case 126/197 Eco Swiss v Benetton [1999] ECR I-03055) and civil actions ought not to transgress upon public policy in the vast majority of cases.

CONTRIBUTORS

Roger Alford (Editor) (http://law.nd.edu/people/faculty-and-administration/teaching-and-research-faculty/roger-p-alford/) Notre Dame Law School (http://law.nd.edu/) (http://kluwerarbitrationblog.com/?author=24) Posts (http://kluwerarbitrationblog.com?author=24)

Crina Baltag (Associate Editor) (http://www.transnational-dispute-management.com/about-author-a-z-profile.asp?key=1182) (http://kluwerarbitrationblog.com/?author=549) Posts (http://kluwerarbitrationblog.com?author=549)

Annalise Nelson (Associate Editor) (http://kluwerarbitrationblog.com/?author=469) Posts (http://kluwerarbitrationblog.com?author=469)

Lisa Bench Nieuwveld (http://www.conway-partners.com/en/lawyers/lisa-bench-nieuwveld) Conway & Partners (http://www.conway-partners.com/) (http://kluwerarbitrationblog.com/?author=191) Posts (http://kluwerarbitrationblog.com?author=191)

Gordon Blanke (http://www.habibalmulla.com/Ourteam/8_Gordon-Blanke-MCIArb.aspx) Habib Al Mulla & Co. (http://www.habibalmulla.com/) (http://kluwerarbitrationblog.com/?author=607) Posts (http://kluwerarbitrationblog.com?author=607)

Gary Born (http://www.wilmerhale.com/gary_born/) Wilmer Cutler Pickering Hale and Dorr LLP (http://www.wilmerhale.com/) (http://kluwerarbitrationblog.com/?author=36) Posts (http://kluwerarbitrationblog.com?author=36)

Anthony Charlton (http://www.fticonsulting.com/global2/professionals/anthony-charlton.aspx) FTI Forensic and Litigation Consulting (http://www.fticonsulting.com/) (http://kluwerarbitrationblog.com/?author=337) Posts (http://kluwerarbitrationblog.com?author=337)

AUTHOR SPOTLIGHT

Albert Jan van den Berg (http://www.hvdb.com/nl/all-jan-van-den-berg/)


(http://www.hvdb.com/nl/albert-jan-van-den-berg/)

Albert Jan van den Berg voted best prepared/most responsive arbitrator at 2013 GAR Awards in Bogotá, Colombia. (www.globalarbitrationreview-plays-host-gar-awards/)

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Nonetheless, as civil actions may require determination of whether an infringement has occurred (an area overseen by national competition authorities and affected by the application of public policy) parties can be concerned that an arbitration award will be vulnerable on enforcement if it is inconsistent with public policy. The OECD paper notes that a court will only in very exceptional circumstances set aside or refuse to enforce an arbitral award on the basis of fundamental breach of public policy. The OECD paper also makes clear that, even if such a challenge is raised, the courts should not engage in an in-depth review of the merits of the case but simply verify that arbitrators have addressed competition law issues with reasonable diligence and not reached a conclusion that seriously contradicts public policy. We agree with the OECD position but note that arbitrators must still be live to public policy issues in this area when addressing such claims. For example an arbitral award could potentially be problematic if damages were awarded on a punitive or exemplary basis rather than simply to compensate the claimant. Whilst this measure of damages would be permissible under US law, it is contrary to the policy of the vast majority of EU Member States and so might be overruled as a matter of principle in these jurisdictions.

We consider that it may be difficult to persuade all national courts that a pre-dispute arbitration clause was intended to cover all contractual and non-contractual competition claims. National courts in some European states have tended to define the scope of choice of forum clauses by reference to the types of dispute that the parties are likely to have had in mind when agreeing the terms. Parties are unlikely to be construed to have had in mind at the time of agreeing the arbitration clause that their counterparty might be in a cartel or subjecting them to an abuse of dominance. Arbitration clauses tend to be construed more generously than choice of court clauses, but this may still be an issue. Furthermore, it is unlikely to be commercially acceptable to explicitly draft the clause to cover such a possibility, except in limited circumstances.

The OECD paper also notes that the private nature of arbitration has also led to criticism of its use in competition law claims. The concern is that those engaged in hard-core cartels will use private proceedings to prevent national authorities becoming aware of the conduct. Generally, arbitrators should not refer competition issues to national competition authorities, whether for assistance or determination, without the consent of the parties as this would violate the confidentiality of the arbitration. However, the OECD paper makes clear that arbitrators are not purely at the service of the parties and can raise competition law issues of their own motion if they consider it warranted. Further, it is clear that an agreement to arbitrate claims that anti-competitive behaviour has caused a party damage or should otherwise be stopped does not prevent a separate complaint being made by the affected party to the relevant national competition authorities. Certainly, the fact of a matter being subject to arbitration will not inhibit or prevent a national competition authority from investigating any alleged violation of competition rules. In our view, it is very unlikely that arbitration arrangements will deter those involved in a cartel from seeking leniency from competition authorities or otherwise "blowing the whistle" on a cartel, given the regulatory benefits (and penalties) attached to doing so. Arbitration of such claims is therefore unlikely to have a chilling effect on infringements coming to public attention.

We think that a more pertinent issue is that it may be easy for claimants in cartel claims to avoid the effect of arbitration clauses by suing defendants with whom they had no contractual relations and thus no arbitration agreement. A participant in a cartel is usually deemed to be jointly and severally liable for all loss caused by all participants in the cartel, and thus can be sued by the customers of other cartelists and not just by its own customers. In the US, the Second Circuit got round this problem by holding that a defendant's arbitration clauses with its customers are binding on non-customers seeking to sue it for losses caused by a cartel (JLM Industries, Inc. v. Stolt-Nielsen SA, 387 F.3d 163 (2d Cir. 2004). It is probably less likely that this approach would be followed in the UK and other EU jurisdictions.

Karel Daele (http://www.mishcon.com/people/karel_daele)
Mishcon de Reya (http://www.mishcon.com/) (http://kluwerarbitrationblog.com/?author=505) Posts (http://kluwerarbitrationblog.com/?author=505)

Justin D'Agostino (http://www.herbertsmithfreehills.com/people/justin-d-agostino)
Herbert Smith Freehills (http://www.herbertsmithfreehills.com/) (http://kluwerarbitrationblog.com/?author=334) Posts (http://kluwerarbitrationblog.com/?author=334)

Matthew Gearing (http://www.allenovery.com/AOWEB/PeopleOffices/CVDetails.aspx?contentTypeID=4&itemID=3877&pre)
Allen & Overy LLP (http://www.allenovery.com/) (http://kluwerarbitrationblog.com/?author=54) Posts (http://kluwerarbitrationblog.com/?author=54)

J. Martin Hunter (http://www.essexcourt.net/members/barrister.asp?b=50)
Essex Court Chambers (http://www.essexcourt.net/) (http://kluwerarbitrationblog.com/?author=182) Posts (http://kluwerarbitrationblog.com/?author=182)

Jean E. Kalicki (http://www.arnoldporter.com/professionals.cfm?action=view&id=254)
Arnold & Porter LLP (http://www.arnoldporter.com/professionals.cfm?action=view&id=254) (http://kluwerarbitrationblog.com/?author=494) Posts (http://kluwerarbitrationblog.com/?author=494)

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Matthias Scherer (http://www.lalive.ch/e/lawyers/index.php?lawyer=163)
Lalive (http://www.lalive.ch/) (http://kluwerarbitrationblog.com/?author=185) Posts (http://kluwerarbitrationblog.com/?author=185)

Georg von Segesser (http://www.schellenberg-wittmer.ch/Lawyers/Overview/Person/von-Segesser-Georg.aspx?t=segesser&c=0)
Schellenberg Wittmer (http://www.swlegal.ch/) (http://kluwerarbitrationblog.com/?author=41) Posts (http://kluwerarbitrationblog.com/?author=41)

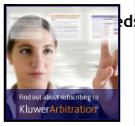
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Linklaters (http://www.linklaters.com/) (http://kluwerarbitrationblog.com/?author=513) Posts (http://kluwerarbitrationblog.com/?author=513)

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In these circumstances where a defendant is jointly and severally liable for the whole loss, we consider that it may also encounter difficulties recovering contributions from the other cartelists. Defendants generally prefer to have the claimants' total damages and the split between cartelists decided in the same proceedings and at the same time in order to avoid delay and inconsistency of approach. This may not be possible where customers claim in an arbitration as there is unlikely to be a pre-dispute arbitration agreement that can be relied on to compel the other cartelists to join the arbitration.

Another concern noted by the OECD paper is the potential limitation on the ability to compel disclosure of certain information in arbitration. National courts may be able to request assistance or information from national competition authorities in circumstances where an arbitrator cannot and courts also have specific powers over parties to litigation. However, in most jurisdictions, disclosure in litigation is in any case limited (the US and UK being notable exceptions) and arbitrators in any case are often able to ask for judicial assistance in compelling the production of documents. We do not therefore see a significant difference in pursuing civil claims by arbitration as compared to litigation when considering access to information and disclosure. However, this inability for arbitrators to refer questions to other authorities may have more significant implications. When a novel situation is encountered in a civil court, it has the ability to refer the issue to the European Court of Justice for determination, but this power does not extend to arbitrators (Nordsee v Rederei Mond [1982] ECR 1095). There is therefore a risk that principles of EU law will be applied inconsistently by different arbitrators.

When to arbitrate?

The OECD paper highlights several situations where it may be appropriate to use arbitration in a competition law context:

1. Stand-alone contractual claims – for example, where one party alleges that an exclusive supply agreement or restrictive covenant illegally restricts competition in breach of Article 101 of the Treaty of the Functioning of the European Union (TFEU) but there is no underlying regulatory finding that supports the allegation.

2. Follow-on damages claims that rely on an infringement finding by a competition authority in order to establish the liability of the defendant (meaning that the claimant need only establish the measure of damages). For instance, where a group of manufacturers have been found to have been fixing wholesale prices at a particular level, in breach of Article 101 TFEU, and an affected retailer or distributer decides to bring a follow-on damages claim for losses resulting from the inflated prices. Alternatively the manufacturer may have abused its dominant position in breach of Article 102 TFEU by engaging in predatory pricing (i.e. deliberating selling at less than cost in the short term so as to foreclose rivals from the market), in which case a competitor may bring a follow on damages claim. Both these types of claim typically involve a simple assessment of damages, in which case an expeditious, private arbitration may be more advantageous to the parties than a case in the Courts that can be prolonged by way of jurisdiction challenge and procedure delay.

3. In respect of merger remedies, where parties have been asked to make certain commitments in order to remedy competition concerns in order to clear the transaction. An example of where arbitration may be appropriate is where access commitments have been imposed, and the commitment obliges the parties to grant third parties "fair and reasonable" access to physical infrastructures or intellectual property rights to stimulate competition. Any disputes relating to the terms and conditions of those access rights, or what is "fair and reasonable", can be dealt with by arbitration if an arbitration clause is included in the commitment agreement.

In each of the above scenarios, there are several key advantages for parties in using arbitration as highlighted in the OECD paper:

• *Confidentiality*: Unlike litigation, arbitration proceedings are conducted in private. Not only is any information disclosed as part of the proceedings confidential but so is the fact of proceedings taking

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place and the amount of any final award or settlement. This has clear advantages in respect of damages claims, particularly for defendants, as third parties will not be have access to information potentially helpful to their own claims or be attracted or encouraged to make a claim if an award or settlement results.

• *Jurisdiction*: Competition litigation before EU national courts has been marked by jurisdictional wrangles as to who may be sued and where. An arbitration clause does not allow a defendant to hide behind place of domicile or force claimants to draw innocent subsidiaries of an infringer into a claim in order to anchor it in their jurisdiction of choice. The OECD notes that this detachment from a particular legal order can also be useful by separating the arbitral proceedings from any investigation by competition authorities in particular jurisdictions.

• *Flexibility over the process*: The parties have the ability to choose a specialist arbitrator, or panel of arbitrators, and the legal rules and principles for the procedure itself. Given the complexity of competition cases, and the frequent need to consult expert economists and competition specialists, parties may be better able to tailor the resolution of the dispute with the aid of their choice of judges and experts on the panel.

• *Speed of the procedure*: the complexity of issues at play in a competition dispute can slow the litigation process significantly and arbitration can offer a faster solution (both by virtue of greater control over selection of the decision-makers by reference to availability and flexibility of the process).

• *Enforceability of the arbitral award*: An arbitral award will be recognised in a number of jurisdictions, due to the international conventions that govern arbitration, to an extent not possible with court judgements (which often must be recognised and subject to further proceedings to be enforced). For example, the New York Convention requires courts of the 145 contracting states to recognise and enforce arbitration awards made in other states.

Practical tips to avoid potential pitfalls

The OECD paper reassures parties contemplating arbitration of competition law claims that the risk of an arbitration award being challenged successfully on policy grounds can be minimised. Practical tips in this context include:

1. Arbitrators only have the power to determine issues that parties have agreed to arbitrate, so it is important to specify when drafting an arbitration clause or agreeing to arbitrate whether it is intended that the agreement to arbitrate encompasses claims involving competition law issues (ET Plus S.A. v Welter [2005] EWHC 2115 (Comm) [2006] 1 Lloyd's Rep 251, paragraph 51).

2. The parties might consider when appointing an arbitrator whether that individual is competent (and confident) in determining competition law issues. It may be that, although there is a competition element to the claim, the question of whether an infringement has occurred is established and so the expertise required is in fact in determining the economic effect of such an infringement. Choosing an arbitrator equipped to address these issues and who has a clear understanding of the evidence required to form a view on them may well speed the process overall and minimise the costs of making the case.

3. Competition claims are often multi-jurisdictional and may be based on tort or an underlying contract. Conflict of laws issues accordingly can result and parties should give thought to the seat of arbitration as this may be crucial in determining the law applicable to the arbitral proceedings.

4. If the arbitration agreement involves the US, careful consideration should be given to specific issues under US law. US competition law ensures that claimants must not be deprived of their statutory rights to claim damages, including the right to claim treble damages and instigate opt-out class actions. These latter claims will be precluded from arbitration in the US if the agreement to arbitrate is silent on the issue.

Conclusion

The OECD paper clearly sets out the advantages and disadvantages of arbitration and addresses concerns regarding the enforceability of awards that determine competition law claims. Competition law disputes often involve multi-jurisdictional issues, exchange of highly confidential information on market position and turnover, and production of expert economic evidence as to the defendant's market position and profit margin. As such, these disputes raises procedural issues that the flexibility and confidentiality of the arbitral process is uniquely suited to answer – a point that has even been acknowledged by the English Court of Appeal Attheraces [2007] EWCA Civ 38 at paragraph 7).

Therefore, as the OECD concludes, not only does the arbitration of competition claims not undermine the enforcement of competition law or principles of arbitration but arbitration can be a particularly useful method in resolving competition law claims. As such, we are likely to see a continued increase in the use of arbitration, and other alternative dispute resolution mechanisms, to determine competition law disputes.

Baker & McKenzie LLP

CATEGORIES: Arbitration (http://kluwerarbitrationblog.com/blog/category/arbitration/), Competition Law (http://kluwerarbitrationblog.com/blog/category/competition-law/), Enforcement of an arbitration clause (http://kluwerarbitrationblog.com/blog/category/enforcement-of-an-arbitration-clause/), Jurisdiction (http://kluwerarbitrationblog.com/blog/category/jurisdiction/), Public Policy (http://kluwerarbitrationblog.com/blog/category/public-policy/) |

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Geoffrey M Beresford Hartwell · a year ago
An underused advantage of arbitration is the option to use arbitrators having technical and scientific skills. Nowadays such Arbitrators often will have been trained in arbitral techniques and the relevant law of contract and obligations. It seems practicable to provide information and training to make these practitioners ready to deal with competition issues also.

In multi-jurisdictional matters, expert arbitrators arguably are less likely than Judges and lawyers to carry with them the baggage of their own National Law.

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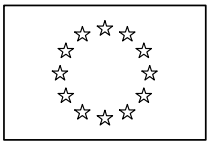
Jurisdiction Guides
Quick Reference Table

	ARGENTINA	AUSTRALIA	AUSTRIA	BELGIUM	BRAZIL	CANADA	CHINA	CZECH REPUBLIC
COST OF BRINGING/ DEFENDING AN ACTION	LOW	--	MID	LOW	LOW	VARIABLE	--	LOW
ARE STAND ALONE DAMAGES ACTIONS POSSIBLE?	UNDETERMINED	YES	YES	YES	YES	YES	YES	YES
APPLICABLE LIMITATION PERIOD	UNDETERMINED, may vary from 2, 5 or 10 years from cause of action	6 years from cause of action	3 years from knowledge (capped at 30 years from date of damage)	Tort: 5 years from knowledge (capped at 20 years from date of damage) Contract: 10 years	3 years (5 years for a class action brought by Public Prosecutor or a trade association)	Section 36 claims must be brought within 2 years of the offensive conduct or disposition of any criminal proceedings. Limitation for common law claims varies	2 years from the date the injured party knew or should have known of the infringement	4 years from knowledge (capped at 10 years from date of damage)
DISCLOSURE	VERY LIMITED	YES	VERY LIMITED	VERY LIMITED	VERY LIMITED	YES - WIDE	LIMITED	VERY LIMITED
ARE CLASS ACTIONS AVAILABLE?	NO	YES	NO (note, right to claim can be purchased and collected into one action)	NO	Public actions (i.e. brought by the Public Prosecutor or a trade association and approved by the Ministry of Justice)	YES	NO	NO
ARE GROUP OR REPRESENTATIVE ACTIONS AVAILABLE?	YES (but limited to consumer collective action)	YES	LIMITED (consumer collective action possible)	YES (collective claims)	YES	YES	YES	LIMITED
AVERAGE LENGTH OF FIRST INSTANCE PROCEEDINGS	3 years	4 years	9 months - 2 years	1 - 2 years	2 - 4 years	2 - 5 years; variable by province	6 months - 3 years	2 - 3 years
HAVE ANY DAMAGES ACTIONS BEEN BROUGHT?	YES (one abuse of dominance case)	YES	YES	YES	YES	YES	YES	YES
HAS THERE EVER BEEN A DAMAGES AWARD?	YES	YES	YES	NO (all claims settled to date or otherwise pending determination)	NONE CONFIRMED PUBLICLY	YES	--	–
MEASURE OF DAMAGES AVAILABLE	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest) and restitution	Compensatory (including loss of profit and interest)
RIGHT TO SEEK CONTRIBUTION	YES (as part of the same proceedings)	To be determined	YES (a claimant should not be pursued for all damage if it can be apportioned)	YES	NO	YES	YES	YES
IS THE PASSING ON DEFENCE AVAILABLE?	YES	YES	POSSIBLY	YES	NOT DETERMINED	NO	NOT DETERMINED	YES

	ENGLAND & WALES	FRANCE	GERMANY	HUNGARY	INDIA	ITALY	JAPAN	MEXICO
COST OF BRINGING/ DEFENDING AN ACTION	HIGH	MID	MID	LOW	LOW	HIGH	MID	LOW
ARE STAND ALONE DAMAGES ACTIONS POSSIBLE?	YES	YES	YES	YES	NO	YES	YES	YES
APPLICABLE LIMITATION PERIOD	High Court - 6 years CAT - 2 years from final decision of CAT /relevant appeal	5 years from knowledge / manifestation of damage	3 years from end of year in which cause discovered (recovery capped at 10 years from date of damage)	5 years from damage (extended by one year from knowledge if damage is concealed)	A reasonable period, likely 3 years from the date of damage.	Tort: 5 years from damage Contract: 10 years	Tort: 3 years from knowledge (capped at 20 years from time of tortious act) Contract: 5 years from breach	2 years (3 years and six months for class actions)
DISCLOSURE	YES - WIDE	LIMITED	LIMITED	LIMITED	LIMITED	LIMITED	VERY LIMITED	YES
ARE CLASS ACTIONS AVAILABLE?	NO	NO	NO	NO	NO	YES (enacted January 2010)	NO	YES
ARE GROUP OR REPRESENTATIVE ACTIONS AVAILABLE?	LIMITED	LIMITED	IN PRACTICE (bundling of claims is possible)	LIMITED	LIMITED (collective consumer complaints are possible and claimants can opt-out)	YES	LIMITED	YES
AVERAGE LENGTH OF FIRST INSTANCE PROCEEDINGS	1 - 2 years	1 - 2 years	2 - 3 years	2 - 5 years	–	2 - 4 years	2 - 4 years	9 months - 2 years
HAVE ANY DAMAGES ACTIONS BEEN BROUGHT?	YES	YES	YES	YES	YES	YES	YES	NO
HAS THERE EVER BEEN A DAMAGES AWARD?	YES	YES	YES	NO (first actions are pending determination)	NO	YES	YES	NO
MEASURE OF DAMAGES AVAILABLE	Compensatory (including loss of profit and interest) Exemplary damages may be recoverable in some cases	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest) 10% overcharge assumed	Compensatory	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	YES
RIGHT TO SEEK CONTRIBUTION	YES	YES (individuals should not be pursued for all damage if damage can be apportioned)	–	YES (leniency applicant may *sometimes* refuse to pay if claimant can recover from other cartelists)	NO	YES	YES	YES
IS THE PASSING ON DEFENCE AVAILABLE?	YES, IN THEORY	YES	NO	YES	YES, IN THEORY	YES	YES	YES, IN THEORY

	THE NETHERLANDS	POLAND	RUSSIA	SPAIN	SWEDEN	SWITZERLAND	TURKEY	UNITED STATES
COST OF BRINGING/ DEFENDING AN ACTION	MID	LOW	LOW	LOW	LOW	MID	LOW	HIGH
ARE STAND ALONE DAMAGES ACTIONS POSSIBLE?	YES	YES	YES	YES	YES	YES	NO	YES
APPLICABLE LIMITATION PERIOD	5 years from knowledge (capped at 20 years)	3 years (capped at 10 years from date of damage)	3 years from knowledge (1 year if claim is that underlying contract is void)	1 year from when damage apparent; 15 years if seeking nullity of contract / restitution	10 years from damage	1 year from knowledge of damage (capped at 10 years from date of conduct)	1 year from knowledge (capped at 10 years)	4 years in respect of claims based on federal law (limitation under state law varies)
DISCLOSURE	YES	LIMITED - specific disclosure	VERY LIMITED	YES	YES	LIMITED (but can generally get file of Comp Authority admitted)	LIMITED	YES – WIDE
ARE CLASS ACTIONS AVAILABLE?	LIMITED	YES	NO	NO	YES	NO	NO	YES
ARE GROUP OR REPRESENTATIVE ACTIONS AVAILABLE?	IN PRACTICE (bundling of claims is possible)	YES	LIMITED	LIMITED	YES	LIMITED	IN PRACTICE (bundling of claims is possible)	YES
AVERAGE LENGTH OF FIRST INSTANCE PROCEEDINGS	1 - 2 years	1 - 2 years	3-6 months	1 - 1.5 years	3 - 4 years	2 years	1 – 3 years	3 years
HAVE ANY DAMAGES ACTIONS BEEN BROUGHT?	YES	NO	YES	YES	YES	YES	No published decisions	YES
HAS THERE EVER BEEN A DAMAGES AWARD?	NO (all settled to date)	NO	YES	YES	YES	YES	No published decisions	YES
MEASURE OF DAMAGES AVAILABLE	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Undetermined	Compensatory (including loss of profit and interest)	Compensatory (including loss of profit and interest)	Compensatory (including less of profit and interest) and/or restitution	Compensatory (including loss of profit) Treble damages are also available	Compensatory (including less of profit and interest) and/or restitution. Treble damages are available automatically under federal law and also some state laws
RIGHT TO SEEK CONTRIBUTION	YES	YES	YES	LIKELY	YES	YES)	YES	NO
IS THE PASSING ON DEFENCE AVAILABLE?	YES	NO (but a similar concept is arguable)	Undetermined	YES	YES	LIKELY (but difficult to rely on)	--	NO

NOTE, this table is indicative as of September 2012 - all issues have not yet been finally determined in each jurisdiction.



EUROPEAN COMMISSION

DG Competition

Brussels, June 2011

DRAFT GUIDANCE PAPER

QUANTIFYING HARM IN ACTIONS FOR DAMAGES BASED ON BREACHES OF ARTICLE 101 OR 102 OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION

- Public Consultation -

− Public Consultation −

The full effectiveness of the EU antitrust rules (Articles 101 and 102 TFEU) requires that any individual can effectively claim compensation for the harm caused by an infringement of these rules. Damages actions based on an infringement of these rules complement public enforcement by allowing those who have been harmed to receive compensation for their harm. While the right to compensation is recognised by EU law, a range of obstacles currently stand in the way of injured parties effectively receiving the compensation to which they are entitled.

In its 2005 Green Paper on damages actions for breach of the EC antitrust rules, the Commission identified difficulties in quantifying the harm suffered by injured parties as one of the key issues in antitrust damages actions. In its 2008 White Paper, Commission announced its intention to draw up a framework with pragmatic, non-binding guidance on quantifying the harm suffered in such actions.[1]

In preparation of such guidance and to make it suited to the practical needs of judges and parties in antitrust damages cases, DG Competition sought expertise, *inter alia*, from legal and economic practitioners and academics, and analysed current practices in the quantification of antitrust harm suffered by injured parties in a range of cases before national courts.[2]

The aim of the present draft Guidance Paper is to offer assistance to courts and parties involved in actions for damages by making more widely available information relevant for quantifying harm caused by infringements of the EU antitrust rules. The Guidance Paper therefore provides insights into the harm caused by infringements of these rules to different categories of injured parties and, in particular, presents the main methods and techniques currently available to quantify such harm.

DG Competition invites all interested parties to make comments on this draft Guidance Paper. We encourage submissions from stakeholders who are directly involved in antitrust damages actions, be it as members of the judiciary, as parties, or as their legal or other advisors. DG Competition would particularly welcome comments on the practical usefulness and linguistic accessibility of the Guidance Paper and possible suggestions for improvements in this respect, as well as on any recent developments in the judicial practice of the courts of the Member States with regard to the quantification of harm.

Comments on this draft Guidance Paper should be sent to DG Competition not later than 30 September 2011.
Received contributions will be published on the Internet. It is important to read the specific privacy statement attached to this consultation for information on how your personal data and contribution will be dealt with (see at the end of this document). It is possible to request that submissions or parts thereof remain confidential. Should this be the case, please indicate clearly on the front page of the submission that you request it should not be made publicly available. In this case a non-confidential version of the submission should also be

[1] The Commission's 2005 Green Paper (COM(2005) 672 final) and 2008 White Paper (COM(2008) 165 final) are available at http://ec.europa.eu/competition/antitrust/actionsdamages/index.html.

[2] For the studies commissioned by the DG Competition and the submissions received from external experts see the website indicated in previous footnote.

forwarded to DG Competition for publication. Comments should be sent either by e-mail or by regular mail to:

European Commission
Directorate-General for Competition, Unit A 1
Quantifying harm in antitrust damages actions − HT.2290

B-1049 Brussels, Belgium

comp-damages-actions@ec.europa.eu

This document has been drafted by the services of the European Commission for consultation purposes. It does not purport to represent or pre-judge any formal position of the Commission on the issues set out therein.

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PART 1 — CONTEXT AND GENERAL APPROACH TO QUANTIFYING HARM IN COMPETITION CASES

I. LEGAL CONTEXT

A. The right to compensation

1. Everyone who has suffered harm because of an infringement of Article 101 or 102 of the Treaty on the Functioning of the European Union (TFEU) has a right to be compensated for that harm. The Court of Justice of the EU held that this right is guaranteed by primary EU law.[3] Compensation means placing the injured party in the position it would have been in had there been no infringement. Therefore, compensation includes reparation not only for actual loss suffered (*damnum emergens*), but also for loss of profit (*lucrum cessans*) and the payment of interest.[4] Actual loss means a reduction in a person's assets; loss of profit means that an increase in those assets, which would have occurred without the infringement, did not happen.[5]

2. In so far as there are no EU rules governing the matter, it is for the domestic legal system of each Member State to lay down the detailed rules governing the exercise of this right to compensation guaranteed by EU law. Such rules, however, must not render excessively difficult or practically impossible the exercise of rights conferred on individuals by EU law (principle of effectiveness), and they must not be less favourable than those governing damages actions for breaches of similar rights conferred by domestic law (principle of equivalence).[6]

B. National rules on quantification and this Guidance Paper

3. In an action for compensation of harm suffered because of an infringement of Article 101 or 102 TFEU, national courts have to determine the amount to be awarded to the claimant in the event that the claim is well-founded.[7] Assessing and proving the quantum of damages in actions for damages is often difficult. This is particularly true in competition law cases.[8]

4. National law – which has to be laid down and applied in accordance with the rules and principles of EU law referred to in paragraphs 1 and 2 above – determines the legal framework in which courts fulfil their function of adjudicating disputes between parties. With regard to quantifying damages, this legal framework will, for instance, include rules on:

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3 See Case C-453/99 *Courage* [2001] ECR I-6297, paragraph 26; Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 60. These cases directly concern Article 101 TFEU (ex Article 81 EC Treaty); the same principles apply however also to Article 102 TFEU (ex Article 82 EC Treaty).

4 See Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 95.

5 See Opinion of Advocate General Capotorti in Case 238/78 *Ireks-Arkady GmbH* v *Council and Commission* [1979] ECR 2955, paragraph 9.

6 See Case C-453/99 *Courage* [2001] ECR I-6297, paragraph 29; Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 62.

7 This Guidance Paper is only concerned with the assessment of harm in the context of claims for financial compensation. While the present paper does not specifically cover the determination of the award in other civil law remedies, its insights may also be used in making such determination, in particular with regard to actions (under applicable national law) for restitution.

8 See, in more detail, paragraphs 10 *et seq*. in Section II below.

- the heads of damages to be compensated and general rules of liability governing claims for compensation;

- requirements such as causality or proximity that define a link between the illegal act and the harm which justifies that the infringer is held liable for reparation of that harm;[9]

- the procedural framework in which claims for damages are adjudicated. National rules typically provide for an allocation of the burden of proof and of the respective responsibilities of the parties to make factual submissions to the court;[10]

- the appropriate standard of proof, which may vary between different stages of the proceedings, and may also be different for questions of liability for damages and those of the quantum of damages;

- to what extent and how courts are empowered to quantify the harm suffered on the basis of approximate best estimates or equitable considerations; and

- the admissibility and the role of evidence in civil litigation and its evaluation (and in particular of expert evidence).

5. Within their respective legal frameworks, legislators and courts have often adopted pragmatic approaches in determining the amount of damages to be awarded. For instance, they have established presumptions and allowed for the burden of proof to shift, e.g. once a party has provided a certain amount of facts and evidence. Also, the law of the Member States may provide that the illicit profit made by the infringing undertaking(s) plays a role — either directly or indirectly — in estimating the harm suffered by injured parties.[11]

6. The purpose of this Guidance Paper is to place at the disposal of courts and parties to damages actions economic and practical insights that may be of use when national rules and practices are applied. To this end, the Guidance Paper outlines insights into the harm caused through anticompetitive practices prohibited by the Treaty and information on the main methods and techniques available to quantify such harm.[12] Such guidance may also help parties in finding a consensual resolution of their disputes, be it within or outside the context of judicial proceedings or alternative dispute resolution mechanisms.

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9 The Court of Justice has clarified in this respect that whilst any individual must be able to claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under EU competition law, it is for national law to prescribe the rules governing the exercise of that right, including those on the application of the concept of 'causal relationship', provided that the principles of equivalence and effectiveness are observed; see Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraphs 61, 64; Case C-453/99 *Courage* [2001] ECR I- 6297, paragraph 29.

10 See, for an example of such distribution of this burden in competition cases, *Kammergericht Berlin* (Higher Regional Court, Berlin), decision of 1 October 2009, case No 2 U 10/03 Kart *(Vitaminpreise)*.

11 See paragraph 126 in Part 3 below.

12 The Commission has found useful assistance in preparing this Guidance Paper in various studies it commissioned as well as in the comments received from external experts; see http://ec.europa.eu/competition/antitrust/actionsdamages/index.html.

7. This Guidance Paper is purely informative, does not bind national courts and does not alter the legal rules applicable in the Member States to damages actions based on infringements of Article 101 or 102 TFEU.[13] In particular, whether any and, if so, which of the methods and techniques described in this Guidance Paper are considered appropriate to use in a given case before the courts of the Member States depends on national law applied in accordance with the above-mentioned EU law principles of effectiveness and equivalence. Relevant considerations in this respect are likely to include whether a certain method or technique meets the standard required under national law, whether sufficient data are available to the party charged with the burden of proof to apply the method or technique and whether the burden and costs involved are proportionate to the value of the damages claim at stake. Excessive difficulties in exercising the right to damages guaranteed by EU law and therefore concerns in view of the principle of effectiveness could arise, for instance, through disproportionate costs or through overly demanding requirements regarding the degree of certainty and precision of a quantification of the harm suffered.[14] It may be that national courts, in a particular case, can use pieces of direct evidence relevant for the quantification of harm, such as documents produced by an infringing undertaking in the course of business regarding agreed price increases and their implementation or assessing the development of its market position. The availability of such evidence may play an important role when a court decides whether any, and if so which, of the methods and techniques set out below are necessary to be used by a party to meet the required standard of proof under applicable law.[15]

8. Nothing in this Guidance Paper should be understood as arguing against the use of such direct evidence or against the use of more pragmatic approaches, or as raising or lowering the standard of proof or the level of detail of the factual submissions required from the parties in the legal systems of the Member States. Under applicable rules, and in accordance with the principles of effectiveness and equivalence, it may well be sufficient (including in cases where courts are called upon to make a finding based on approximate estimates or equitable considerations) for the parties to provide facts and evidence on the quantum of damages that are less detailed than the methods and techniques discussed in this Guidance Paper.

9. It should also be noted that the economic insights into the harm caused by antitrust infringements and methods and techniques to quantify such harm can evolve over time along with theoretical and empirical research and the judicial practice in this area.

II. GENERAL APPROACH TO QUANTIFYING HARM IN COMPETITION CASES

10. Compensation for harm suffered aims to place the injured party in the position in which it would have been had the infringement of Article 101 or 102 TFEU not occurred. Quantification of harm suffered therefore requires the actual position of the

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13 Neither does it affect the rights and obligations of Member States and natural or legal persons under EU law.

14 See also paragraphs 13 and 14 below.

15 Which substantive law is applicable in a given individual case will often be determined by EU Regulations, in particular Article 6 of Regulation 864/2007 on the law applicable to non-contractual obligations, OJ 2007 L 199/40. The applicable procedural rules will usually be those in force in the country of the court hearing the action (*lex fori*).

injured party to be compared with the position in which this party would have been but for the infringement. This assessment is sometimes called 'but-for analysis'.

11. The central question in antitrust damages quantification is hence to determine what is likely to have happened without the infringement. This hypothetical situation cannot, however, be observed and some form of estimation is therefore necessary to construct a reference scenario with which the actual situation can be compared. This reference scenario is referred to as the 'non-infringement scenario' or the 'counterfactual scenario'.

12. The type of harm for which the claimant seeks compensation determines which kind of economic variables (such as, for instance, prices, sales volumes, profits, costs or market shares) need to be considered. For example, in a cartel leading to higher prices for customers of the cartelists, a non-infringement price will need to be estimated to have a reference point for comparing it with the price actually paid by these customers. In an abuse of dominance case leading to the market foreclosure of competitors, the profits lost by these competitors may be measured by comparing their actual turnover and profit margins with the turnover and profit margins they were likely to have generated without the infringement.

13. It is impossible to know with certainty how a market would have exactly evolved in the absence of the infringement of Article 101 or 102 TFEU. Prices, sales volumes, and profit margins depend on a range of factors and complex interactions between market participants that are not easily estimated. Estimation of the hypothetical non-infringement scenario will thus by definition rely on a number of assumptions.[16] In practice, the unavailability or inaccessibility of data will often add to this intrinsic limitation.

14. For these reasons, quantification of harm in competition cases is, by its very nature, subject to considerable limits as to the degree of certainty and precision that can be expected. There cannot be a single 'true' value of the harm suffered that could be determined, but only best estimates relying on assumptions and approximations. Applicable national legal rules and their interpretation should reflect these inherent limits in the quantification of harm in damages actions for breaches of Articles 101 and 102 TFEU in accordance with the EU law principle of effectiveness so that the exercise of the right to damages guaranteed by the Treaty is not made practically impossible or excessively difficult.

15. This Guidance Paper outlines a number of methods and techniques that have been developed in economics and legal practice to establish a suitable reference scenario and to estimate the value of the economic variable of interest (for example, in a price cartel the likely price that would have been charged for the product had the

[16] The limits and implications of such assessment of a hypothetical situation have been recognised by the Court of Justice (in the context of quantifying loss of earnings in an action for damages against the European Community in the agricultural sector): 'the loss of earnings is the result not of a simple mathematical calculation but of an evaluation and assessment of complex economic data. The Court is thus called upon to evaluate economic activities which are of a largely hypothetical nature. Like a national court, it therefore has a broad discretion as to both the figures and the statistical data to be chosen and also, above all, as to the way in which they are to be used to calculate and evaluate the damage', see Joined Cases C-104/89 and C-37/90 *Mulder and others* v *Council and Commission* [2000] ECR I-203, at paragraph 79.

infringement not occurred).[17] The methods and techniques are based on different approaches and vary in terms of the underlying assumptions and the variety and detail of data needed. They also differ in the extent to which they control for factors other than the infringement that may have affected the situation of the claimant. As a result, these methods and techniques may be more or less difficult, time-consuming and cost-intensive to apply.

16. Once a value for the relevant economic variable (such as, price or, for instance, profit margins, or sales volumes) in the hypothetical non-infringement scenario has been estimated, a comparison with the actual circumstances (e.g. the price actually paid by the injured party) is necessary to quantify the harm caused by the infringement of Article 101 or 102 TFEU.

17. Addition of interest will also need to be considered. The award of interest, pursuant to the applicable national rules, is an essential component of compensation for harm suffered through infringements of rights conferred by the Treaty. As the Court of Justice has emphasised, full compensation for the harm sustained must include the reparation of the adverse effects resulting from the lapse of time since the occurrence of the harm caused by the infringement.[18] These effects are monetary devaluation[19] and the lost opportunity for the injured party to have the capital at its disposal.[20] National law may account for these effects in the form of statutory interest or other forms of interest, as long as they are in accordance with the above-mentioned principles of effectiveness and equivalence.

III. STRUCTURE OF THE GUIDANCE PAPER

18. The basis of a claim for damages is the submission that an infringement of Article 101 or 102 TFEU adversely affected the situation of the claimant. Broadly speaking, two principal categories of harmful effects of such infringements can be distinguished:

(a) Infringers can exploit their market power by raising the prices their direct customers pay.[21] Among the infringements having such effect are exploitative abuses within the meaning of Article 102 TFEU. Undertakings can also raise prices to their customers by engaging in the kind of practices forbidden by Article 101 TFEU. Typical examples are price fixing, market sharing or output limitation cartels.

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17 See Part 2 below.

18 See Case C-271/91 *Marshall* [1993] ECR I-4367, paragraph 31; Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 97; see also European Commission, White Paper on damages actions for breach of the EC antitrust rules (COM(2008) 165), section 2.5 and the accompanying Commission Staff Working Paper (SEC(2008) 404), paragraph 187.

19 See Case C-308/87 *Grifoni II* [1994] ECR I-341, paragraph 40 and Opinion of Advocate General Tesauro in Case C-308/87 *Grifoni II* [1994] ECR I-341, paragraph 25; Joined Cases C-104/89 and C-37/90 *Mulder and others* v *Council and Commission* [2000] ECR I-203, paragraph 51. In the context of loss of purchasing power, see Joined Cases T-17/89, T-21/89 and T-25/89 *Brazzelli Lualdi* [1992] ECR II-293, paragraph 40.

20 See opinion of Advocate General Saggio in Joined Cases C-104/89 and C-37/90 *Mulder and others* v *Council and Commission* [2000] ECR I-203, paragraph 105.

21 Where the infringement affects the buying activity of the infringing undertakings, the corresponding effect will be the decrease in the purchase prices that these undertakings have to pay to their suppliers. See paragraph 115 in Part 3, Section 1 for more details.

Raised prices mean that the customers who purchase the affected product or service[22] pay an overcharge. Moreover, a rise in prices may also lead to less demand and may entail a loss of profits for customers who use the product for their own commercial activities.[23]

(b) Undertakings can also infringe Articles 101 and 102 TFEU by excluding competitors from a market or reducing their market share. Typical examples are abuses of a dominant position through margin squeeze, predatory pricing or tying, or certain vertical exclusivity agreements between suppliers and distributors that infringe competition law.[24] Such practices have a significant effect on competitors, who suffer harm as they forego business opportunities and profit in this market. Where foreclosure of competitors is successful and competitive pressure in a market diminishes, customers will be harmed too, typically by a rise in prices.

19. Infringements of Articles 101 and 102 TFEU can also have further harmful effects, for example adverse impacts on product quality and innovation. The Guidance Paper focuses on the two principal categories of harm and the categories of injured parties[25] described in paragraph 18. The methods and techniques described in the Guidance Paper may, nonetheless, also be relevant in damages actions concerning other types of harm and other injured parties.

20. Part 3 of the Guidance Paper addresses specifically the quantification of the kind of harm referred to in paragraph 18(a). This part includes a description of the basic effects on the market of price increases resulting from an infringement and illustrates how these types of harm (in particular the harm resulting from the payment of an overcharge and the harm associated with a reduction in demand) can be quantified.

21. Part 4 of the Guidance Paper addresses specifically the quantification of the kind of harm referred to in paragraph 18(b). This part includes a description of the possible effects of the exclusion of competitors from a market and illustrates through examples how these types of harm (namely the loss of profit of the excluded competitor and the harm to customers) can be quantified.

22. The main methods and techniques available to quantify the harm resulting from infringements of Article 101 or 102 TFEU are common to all kinds of harm caused by such infringements. Part 2 of the Guidance Paper therefore provides a general overview of these methods and techniques. In particular, it gives more information on the basic assumptions on which these methods rely and explains their application in practice.

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22 For ease of presentation, in the following reference will only be made to 'products' affected by an infringement, which should however be understood as also referring to the 'services' affected.

23 See paragraphs 109 *et seq*. in Part 3, Section I for more details.

24 Vertical agreements are those concluded between undertakings from different levels of the supply chain.

25 The Guidance Paper does not specifically address the situation of persons other than those mentioned in points (a) and (b) of paragraph 18, although other persons (such as suppliers of the infringers or customers of law-abiding competitors of the infringers) may also be harmed by infringements leading to price overcharges or the exclusion of competitors; see also footnote 112.

PART 2 — METHODS AND TECHNIQUES

I. OVERVIEW

23. Various methods are available to construct a non-infringement scenario for the purposes of quantifying the harm in damages actions in competition cases. The methods most widely used by parties and courts estimate what would have happened without the infringement by looking at the time periods before or after the infringement or at other markets that have not been affected by the infringement. Such comparator-based methods take the data (prices, sales volumes, profit margins or other economic variables) observed in the unaffected period or on the unaffected markets as an indication of the hypothetical scenario without the infringement. The implementation of these methods is sometimes refined by the use of econometric techniques.[26] Various comparator-based methods and techniques to implement these methods are described in Section II below.

24. Methods other than comparator-based are addressed in Section III below. One of these methods uses economic models fitted to the actual market to simulate the likely market outcome that would have occurred without the infringement. These models draw on economic theory to explain the likely functioning of a market in view of its main features (e.g. the number of competitors, the way these compete with each other, the degree of product differentiation, entry barriers). Further methods include the cost-based method, which uses production costs for the affected product and a mark-up for a 'reasonable' profit margin to estimate the hypothetical non-infringement scenario.

25. Each of these methods and techniques has particular features, strengths and weaknesses that may make them more or less suitable to estimate the harm suffered in a given set of circumstances. In particular, they differ in the degree to which they rely on data that are the outcome of actual market interactions or on assumptions based on economic theory and in the extent to which they control for factors other than the infringement that may have affected the claimant for damages. Moreover, the methods and techniques differ in the degree to which they are simple to use and in the amount of data required.

26. While these methods seek to construct how the market in question would have evolved absent the infringement, more direct evidence available to the parties and to the court (for instance, internal documents of the infringing undertakings on agreed price increases) may also provide, under applicable national legal rules, useful information for assessing quantum of damages in a given case.[27]

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[26] Econometrics combines economic theory with statistical or quantitative methods to identify and measure economic relationships between variables.

[27] See for an example of such an approach *Oberlandesgericht Karlsruhe* (Higher Regional Court, Karlsruhe), decision of 11 June 2010, case No 6 U 118/05 (appeal pending), where specifically agreed price increases of the infringing undertakings of a cartel were used, under applicable legal rules on the distribution of fact pleading and the establishment of *prima facie* evidence, to determine the damages award.

27. Section IV below sets out considerations on the choice of method, which will usually depend on the specific features of that case and on the requirements under applicable law.[28]

II. COMPARATOR-BASED METHODS

28. To appreciate how comparator-based methods work in practice, it is useful to consider a (entirely fictitious) example of a hypothetical damages action based on a cartel infringing Article 101 TFEU.[29]

> **The flour cartel**
>
> Assume that all of the milling companies in a particular Member State have been found, by the national competition authority, to have fixed among themselves the prices for the grinding of cereals and the production of flour.
>
> A bakery that regularly purchased flour in recent years brings a damages claim against one of the milling companies. The bakery submits that the infringement has led to an illegal rise in prices for the flour it purchased from that milling company. The bakery asks for compensation for this price overcharge it paid over the past years.

29. The key question regarding the quantification of harm in the aforementioned example is to find out what price the claimant bakery would have paid for flour had there been no infringement. If a comparator-based method is used to do so, these methods compare the price in the infringement scenario with a non-infringement scenario that is established on the basis of price data observed either

- on the same market at a time before and/or after the infringement (1); or
- on a different but similar geographic market (2); or
- on a different but similar product market (3).

It is also possible to combine a comparison over time with a comparison across different geographic or product markets (4).

30. In the example of the flour cartel, the application of the methods focuses on price. It is, however, likewise possible to use these methods to estimate other economic variables such as market shares, profit margins, rate of return on capital, value of assets, or the level of costs of an undertaking. Which economic variable can be usefully considered for the purposes of damages quantification depends on the circumstances of the case at hand.

31. The data used in such a comparison across markets or over time can be data that relate to the entire market (i.e. the average of the price for flour charged to all bakeries operating in a neighbouring geographic market) or data that relate to certain specific market participants only (i.e. the price charged for flour to certain customer groups such as wholesale purchasers operating in a neighbouring market). It could

[28] See, in this context, paragraph 7 above.

[29] This example is further developed at paragraph 127.

also be appropriate, in particular in cases concerning exclusionary practices, to compare data relating to only one market participant. An example for such a comparison between individual companies, i.e. the injured party and a sufficiently similar comparator firm, may be the comparison between the profits achieved by a company trying to enter a new market where it faced exclusionary practices in breach of the EU competition rules and the profits that a comparable new entrant achieved on a different but similar geographic market without being affected by anticompetitive practices. Sections A.1 to 4 below cover the comparison with aggregated market data and firm-level data alike.[30]

32. The strength of all comparator-based methods lies in the fact that they use real-life data that are observed on the same or a similar market.[31] The comparator-based methods rely on the premise that the comparator scenario can be considered representative of the likely non-infringement scenario and that the difference between the infringement data and the data chosen as a comparator is due to the infringement. Whether the level of similarity between infringement and comparator markets or time periods is considered sufficient in order to perform a comparison depends on national legal systems. Where significant differences exist between the time periods or markets considered, various techniques are available to account for such differences[32].

A. Methods for establishing a non-infringement scenario

(1) Comparison over time on the same market

33. One frequently used method consists in comparing the actual situation during the period when the infringement produced effects with the situation on the same market before the infringement produced effects or after they ceased.[33] For instance, where an undertaking abused its dominant position by foreclosing a competitor from the market during 2004 and 2005, the method could look at e.g. the competitor's profits during the infringement period and its profits in 2002 and 2003 when there was not yet an infringement.[34] Another example would be a price fixing cartel (such as the flour cartel example mentioned above) that lasted from 2005 to 2007 where the method could compare the price paid by the cartel customers during the infringement

30 The comparison with firm-level data of another company could, theoretically, be made not only for companies that operate in *another* geographic or product market as discussed in Sections 2-4 below, but also for data of companies operating in the *same* product and geographic market as the injured party. In practice, such intra-market comparisons do not play a significant role, possibly because within the same market it can be difficult to find a sufficiently comparable other company that was not affected by the infringement. The following sections therefore do not further discuss such comparisons within a market.

31 This aspect is emphasised, for instance, by the *Bundesgerichtshof* (Federal Court of Justice, Germany), decision of 19 June 2007, case No KRB 12/07 (*Paper Wholesale Cartel*).

32 See for more detail paragraphs 53-84 in Section B below.

33 See, for example, *Corte d'Appello di Milano* (Court of Appeal, Milan), decision of 11 July 2003, (*Bluvacanze*) and *Corte d'Appello di Milano* (Court of Appeal, Milan), decision of 3 February 2000, case No I, 308 (*Inaz Paghe* v *Associazione Nazionale Consulenti del Lavoro*) (in both cases, comparison before, during and after); *Landgericht Dortmund* (Regional Court, Dortmund), decision of 1 April 2004, case No 13 O 55/02 Kart (*Vitaminpreise*) (during and after comparison); *Landesgericht für Zivilrechtssachen Graz* (Regional Civil Court of Graz), decision of 17 August 2007, case No 17 R 91/07 p (*Driving school*) (accepting a comparison during and after).

34 For more detailed examples of the method's application in cases of exclusionary practices, see Part 4 below.

period with the price paid by customers in a period after the infringement, e.g. in 2008 and 2009.[35]

34. There are, in principle, three different points of reference that can be used for the comparison over time:[36]

- an unaffected *pre*-infringement period (comparison 'before and during' — in the flour cartel example: comparison of the prices paid for flour in the same market *before* the infringement had effects with those affected by the infringement);
- an unaffected *post*-infringement period (comparison 'during and after' — in the flour cartel example: comparison of the prices affected by the infringement with prices paid in the same market *after* the infringement ended); and
- both an unaffected *pre- and post*-infringement period (comparison 'before, during and after').

35. An advantage of all methods comparing, over time, data from the *same* geographic and product market is that market characteristics such as the degree of competition, market structure, costs and demand characteristics may be more comparable than in a comparison with different product or geographic markets. However, also in comparisons over time it happens that some differences between the two data sets are not only due to the infringement. In such cases, it may be appropriate to make adjustments to the data observed in the comparator period to account for differences with the infringement period[37] or to choose a different comparator period or market. For instance, in the case of a long-lasting infringement, the assumption that e.g. prices of 10 years ago would have remained unchanged over time absent the infringement is probably overly strong and may lead to opting e.g. for a comparison with the pre-infringement period *and* the post-infringement period.[38]

36. In a comparison over time, choosing among the reference periods described in paragraph 34 above will depend on the specifics of the case, including market characteristics and availability of data. For example, in the case of long-lasting infringements, data from the pre-infringement period may simply no longer be available.

37. Where data are available, the choice between a comparison 'before and during', 'during and after' or 'before, during and after' can be determined by a range of factors. It is highly unlikely to find any reference period where market circumstances exactly represent what would have happened in the infringement period had the infringement not occurred. It is only possible to identify a sufficiently similar time period that allows a likely non-infringement scenario to be reasonably approximated.

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35 For more detailed examples of the method's application in cases of infringements that lead to a price overcharge, see Part 3 below.

36 The comparison over time method is also referred to as the 'before-after method' or 'benchmark method'.

37 On such adjustments and, in particular, the possibility to use regression analysis, see paragraphs 53-84 in Section B below.

38 In cases of long infringement periods, it may also be appropriate to address practical issues of comparability of data that result from changes in the way that data have been recorded by companies (e.g. changes in accounting practices or changes in the data organisation software).

Factors to be considered in this context may include uncertainties as to which time periods were actually not affected by the infringement. Some infringements start, or cease, gradually; and often doubts exist regarding the exact beginning of an infringement and, in particular, the effects it produces. Indeed, decisions of competition authorities regularly mention evidence suggesting that the infringement may have started earlier than the period established as the infringement period for the purposes of the decision.[39] Econometric analysis of observed data can be a way to identify when the infringement's effects started or ceased.

38. The ending of an infringement and its effects may be more easily established than its beginning, but here too uncertainties could arise as to whether the period immediately after the infringement's end is unaffected by the anticompetitive behaviour.[40] For example, when there is some delay until market conditions return to a non-infringement level, using data from the period immediately after the infringement could lead to an underestimation of the effect of the infringement.[41] The pre-infringement period may be a more suitable reference point where central market characteristics changed radically towards the end of the infringement period due to exogenous factors (e.g. a steep increase in raw material costs or an increase in demand for the product).[42]

39. Nonetheless, even when there are doubts as to whether or not a certain period before or after the infringement was affected by the infringement, this period could, in principle, still serve as a reference period in order to obtain a safe estimate of the harm that will at least have been suffered ("lower-bound" estimate or "minimum damage").[43]

40. In certain circumstances, the non-infringement scenario may be appropriately estimated on the basis of two reference periods (before and after the infringement), for example, by using the average from these periods or by using other techniques to reflect a trend in the development of market circumstances during the infringement.[44]

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39 It is possible that a competition authority limits the finding of an infringement to a certain period, while in fact the infringement may have had a longer duration.

40 See the decision of the *Oberlandesgericht Karlsruhe* (Higher Regional Court, Karlsruhe) of 11 June 2010 in case No 6 U 118/05 (appeal pending), for an example where a national court ruled that the prices charged in the five months after the infringement ended were still influenced by the cartel.

41 It may also occur that prices are, for a short period after the end of a cartel, particularly low as companies might temporarily engage in aggressive pricing strategies until the 'normal', i.e. non-infringement, equilibrium on the market is reached.
Specifically in oligopolistic markets another issue may arise, namely that the participants in a cartel can use the knowledge gained through the cartel to coordinate their behaviour afterwards without infringing Article 101. In such a situation, post-infringement prices are likely to be higher than without the infringement and can only serve to make a lower-bound estimate of the harm suffered; see also paragraphs 134 *et seq*. in Part 3, Section II below.

42 For the short period of the infringement after such a change, post-infringement data can be the more appropriate comparator as they may better reflect the market characteristics after the change. However, where the change in market characteristics was caused by the infringement itself (e.g. where due to anticompetitive foreclosure several competitors exited the market), the post-infringement period is obviously not a suitable comparator to estimate the situation that would have existed without the infringement.

43 If during the infringement exogenous factors lead to a decrease in prices (e.g. a sharp fall in input costs of the infringer), the inference of a lower bound could be rebutted.

44 For example interpolation or regression analysis. For these different techniques to implement comparator-based methods, see paragraphs 53-84 in Section B below.

Pre-infringement data could also be used as the reference period up to a certain point during the infringement when a significant change in market circumstances occurred, and post-infringement data as the reference period for the time thereafter.

41. Also the choice of data can contribute to building a sufficiently similar basis for the comparison: there can be situations where aggregated data such as industry price averages (or averages for certain groups of firms) are sufficiently representative,[45] whilst in other situations it would be more appropriate to use only data from pre- or post-infringement transactions by the injured company or average data that relate to similar companies. For example, where the injured party or the infringer belongs to a specific group of market players such as wholesale customers (as opposed to end customers), pre- or post-infringement prices charged to wholesale customers may be an appropriate reference point.

42. Making an informed choice of reference period and type of data will usually require good knowledge of the industry in question. The choice will also be influenced by the availability of data and the requirements of applicable rules regarding the standard and burden of proof.

(2) Comparison with data from other geographic markets

43. Another comparator-based method consists in looking at data observed in a different geographic market[46] for the purpose of estimating a non-infringement scenario.[47] These may be data observed across the entire geographic comparator market or data observed in relation to certain market participants only. For instance, in the example of a flour cartel mentioned above at paragraph 28, the prices paid by the claimant bakery during the infringement period could be compared with the prices paid on average by similar bakeries, in a different geographic market untouched by the infringement. The same type of comparison can, in principle, be undertaken with regard to any other economic variable, e.g. the market shares, profit margins, rate of return on capital, value of assets, or level of costs of an undertaking. A comparison with the commercial performance of firms active on another geographic market that is unaffected by the infringement[48] will be particularly relevant in cases of exclusionary behaviour.

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45 For further detail on the use of averages in implementing comparator-based approaches, see paragraph 64 in Part 2, Section II below.

46 For the concepts of relevant (geographic and product) market, see Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5.

47 This method is also referred to as 'yardstick method' or 'cross-sectional method'. These terms are also used to refer to the comparator-based method that looks at data observed in different but similar product markets, see paragraphs 48-49 in Section 3 below.
For examples of the use of the comparator-based method looking at different geographic markets see, for instance, *Cour d'Appel de Paris* (Court of Appeal, Paris), decision of 23 June 2003 (*Lescarcelle-De Memoris* v *OGF*); *Juzgado Mercantil numero 5 de Madrid* (Commercial Court, Madrid), decision of 11 November 2005, case No 85/2005 (*Conduit-Europe, S.A.* v *Telefónica de España S.A.*), confirmed by *Audiencia Provincial de Madrid* (Court of Appeal, Madrid), decision of 25 May 2006, case No 73/2006; *Bundesgerichtshof* (Federal Court of Justice, Germany), decision of 19 June 2007, case No KBR 12/07 (*Paper Wholesale Cartel*) (in the context of assessing the illicit gain by cartelists for the purpose of calculating a fine).

48 The comparator firm might, in principle, also be a firm active on the infringement market provided that its performance was not significantly influenced by the exclusionary behaviour. Even if the comparator firm was not directly affected by the infringement, it may still have been indirectly affected, e.g. by

44. The more a geographic market is similar (except for the infringement effects) to the market affected by the infringement, the more it is likely to be suitable as a comparator market. This means that the products traded in the two geographic markets compared should be the same or, at least, sufficiently similar. Also the competitive characteristics of the geographic comparator market should be similar to the characteristics of the affected market except for the infringement. This may well be a market that is not perfectly competitive.

45. The method of using geographic comparator markets for deriving a non-infringement scenario is, in practice, mainly used when the infringement concerns geographic markets that are local, regional or national in scope.[49] Where the infringement market and the geographic comparator market are neighbouring areas, possibly within one country, there may be an increased likelihood that they are sufficiently similar for the purpose of a comparison.[50]

46. The comparator market does not always need to be sufficiently similar in its entirety. Where, for instance, the prices paid by one customer group (e.g. wholesalers) or the profits earned by one competitor company (e.g. a new entrant) in the comparator market are used as a reference, it is important that the market position of this customer group or this competitor is sufficiently similar to that of the injured party on the infringement market.[51]

47. The choice of a geographic comparator market may also be influenced by uncertainties about the geographic scope of an infringement. Geographic markets on which the same or a similar infringement occurred are, in principle, not good candidates for being used as comparator markets. Also neighbouring markets on which no similar infringement occurred may still have been influenced by the anticompetitive practices on the infringement market (e.g. because prices on the neighbouring market were raised in view of the increased prices on the infringement market and lesser competitive pressure emanating from this market). A comparison with such markets will not show the full extent of the harm suffered, but they may, nonetheless, constitute a useful basis to establish a lower-bound estimate of the harm caused on the infringement market. This means that a party to an action for damages could, in principle, safely choose to rely on the comparison with a geographic market that was influenced by the same or a similar infringement, in particular where such influence is likely to have been rather small.

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gaining market shares from a foreclosed competitor. The risk of being directly or indirectly influenced by the infringement is lower if the comparison is carried out in relation to a similar firm active on another geographic market. Characteristics that could be relevant when considering the sufficient similarity of firms include their size, cost structure, customers and features of the product they sell.

[49] It might, however, also be used when the relevant market is wider than national provided that a sufficiently similar comparator market can be identified.

[50] See, however, paragraph 47 below.

[51] This may, however, not easily be the case if the overall characteristics on the comparator market are all too different from the infringement market.

(3) Comparison with data from other product markets

48. Similar to the comparison across geographic markets is the approach to look at a different product market[52] with similar market characteristics.[53] For example, in a case of exclusionary behaviour partially foreclosing a company selling one product, the profit margin earned by that company in the infringement market could be compared with the profit margin for another product that is traded (by a similar or the same company) in a distinct but similar product market.

49. The considerations discussed in the context of geographic comparator markets are, *mutatis mutandis*, also likely to be relevant for the choice of a suitable comparator product market. They will often relate to the degree of similarity between the two product markets. In particular, the comparator product should be carefully chosen with a view to the nature of the products compared, the way they are traded and the characteristics of the market e.g. in terms of number of competitors, their cost structure and the buying power of customers.[54] Uncertainties as to whether a potential comparator product market was affected by the infringement or a similar infringement of Article 101 or 102 TFEU can also play a role.

(4) Combining comparisons over time and across markets

50. Where sufficient data are available, it may be possible to combine comparisons over time and comparisons across markets. This approach is sometimes called the 'difference in differences' method because it looks at the development of the relevant economic variable (e.g. the price for flour) in the infringement market during a certain period (difference over time on the infringement market) and compares it to the development of the same variable during the same time period on an unaffected comparator market (difference over time on the non-infringement market).[55] The comparison shows the difference between these two differences over time. This gives an estimate of the change in the variable produced by the infringement and excludes all those factors that affected both the infringement and the comparator market in the same way. The method is thus a way to isolate the effects of the infringement from other influences on the relevant variable.

51. A simple example derived from the flour cartel mentioned above may illustrate the method: assume that a before, during and after comparison reveals an increase in price of € 40 per 100 kg bag of flour in the Member State where the cartel occurred between 2005 and 2008. Looking at an unaffected geographic market over the same period may show that prices for flour rose by € 10 per 100 kg bag due to increased costs for an input product (cereals). Assuming that the increased input costs also concerned the infringement market, a comparison of the different development of

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52 For the concepts of the relevant (geographic and product) market, see Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5.

53 This method is sometimes also referred to as 'yardstick method' or 'cross-sectional method' (as is the the comparator-based method looking at different geographic markets).

54 Similarity of market characteristics may be more likely if the two products compared are traded in the same geographic market. Although the circumstances may also be sufficiently similar where the same or similar products from different geographic markets are compared.

55 This can be a geographic or a product comparator market.

prices on the infringement and the comparator market would indicate the price difference caused by the flour cartel. In the example, this would be €30 per unit.

52. The strength of the "difference in differences" method is therefore that it can subtract out changes unrelated to the infringement that occurred during the same time period as the infringement.[56] It rests, however, to a large extent on the assumption that these other changes affected both markets similarly.[57] The considerations regarding the application of the comparison over time and across market methods, in particular the need for sufficient similarity, are also relevant for the difference in differences method. From a practical point of view, this method usually requires a range of data from different markets and periods of time that may not always be easy to obtain; lesser amounts of data may, however, still allow lower-bound or approximate estimates to be derived.[58]

B. Implementing the method in practice: techniques for estimating the price or other economic variable in the non-infringement scenario

53. Once a suitable comparator-based method for establishing a non-infringement scenario has been chosen, various techniques are available to implement this method in practice. These techniques differ mainly in the degree to which they rely on individual or average data (e.g. price observations), and in the degree to which the data observed in the comparator market[59] or period are subject to further adjustment. As a consequence, these techniques differ in the amount of data they require in order to be carried out.

54. One possibility in implementing comparator-based methods is to use comparator data directly in the form they are observed and to estimate on this basis a value for the economic variable under consideration in the non-infringement scenario (e.g., in the above example, the price of flour). Where more than one data observation is available (e.g. the price of flour in a range of transactions on a geographic comparator market), they can be combined through a calculation of averages into one or more values for the non-infringement scenario. Such average value(s) for the non-infringement scenarios could then be compared to the average value(s) actually observed during the infringement, e.g. the prices really paid for flour (see in more detail in Section (1) below).

55. Where certain factors (such as an increase in raw material prices) have influenced only the comparator or only the infringement market or period, it should be considered, depending on the standard of proof required and depending on applicable

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56 Compared to a simple comparison across markets, the difference in differences method also has the advantage of filtering out fixed differences between markets (such as differences due to constantly lower input costs in one of the markets).

57 If, for example, price increases unrelated to the infringement were higher in the affected market than in the comparator market during the infringement period, application of the difference in differences method using simple averages would overestimate the amount of damages. An econometric implementation of the difference in differences technique may help control for such factors.

58 See, for an example of a national court establishing a lower bound in the course of estimating the quantum of damages (although not using the difference-in-differences method, but the comparison over time method), *Kammergericht Berlin* (Higher Regional Court, Berlin), decision of 1 October 2009, case No 2 U 10/03 Kart.

59 As mentioned in paragraph 31 above, the data used in such comparison across markets or over time can be data that relate to the entire market or data that relate to certain specific market participants only.

rules regarding causality, whether adjustments need to be made to the observed data in order to account for such influences. These could be simple adjustments to the data in cases where the influencing factor and the magnitude of its effects can be relatively easily ascertained and accounted for (see Section (1) below). More sophisticated adjustments of observed comparator data can be obtained on the basis of econometric techniques, in particular through the use of regression analysis, which is described in Section (2) below. Whether it is for the defendant or the claimant to plead, substantiate and prove such adjustments is a matter of applicable law.[60]

56. In a given case, the choice between these different techniques depends on the specific circumstances of the case and applicable legal rules, taking account of the different advantages and disadvantages of these techniques, for instance with regard to their accuracy and precision and the data requirements they entail (see Section (3) below).

(1) Simple techniques: individual data observations, averages, interpolation and simple adjustments

57. Depending on the requirements under applicable national law and on the circumstances of the case, especially the degree of similarity between the infringement market and the comparator market or period, the data observed may be compared directly, i.e. without further adjustments, with the data observed in the infringement market.[61]

58. The amount of data observed for the variable of interest (e.g., in the flour cartel example, the price for flour) in the comparator markets or comparator time periods may range from only one or very few data observations (i.e. the price observed in a small number of transactions) to a large number of data observations. In bidding markets, for example, auctions may occur very infrequently and at the time of the damages estimation only the price observed in the one tender after the infringement may be available. A similar situation could occur in industries where long-term contracts are common. It may be appropriate to use damages estimations based on single data observations where these are sufficiently representative for the period of interest.

59. Where looking at comparator markets or time periods produces a greater number of data observations, e.g. the prices paid by the injured party in a series of post-infringement transactions, or the prices paid by a number of customers in another geographic market, these data observations can be used either individually or in the form of averages.[62]

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60 See, for instance, *Kammergericht Berlin* (Higher Regional Court, Berlin), decision of 1 October 2009, case No 2 U 10/03 Kart., as an example of the distribution of fact pleading obligations in the quantification of harm.

61 For instance, time-based comparison could be based on the simple observation of prices before and during the infringement. For an example of the legal implications of such method see *Corte Suprema di Cassazione* (Supreme Court of Cassation, Italy), decision of 2 February 2007, case No 2305 (*Fondiaria SAI SpA* v *Nigriello*).

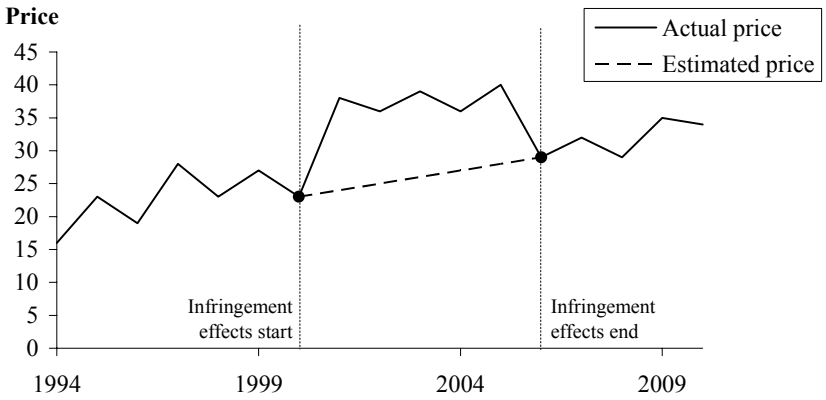
62 For the purposes of this Guidance Paper, the term 'average' is used as referring to the mean, i.e. the average calculated by dividing the sum of observations by the number of observations. There may, however, be situations where it may be more appropriate to use other descriptive statistics (i.e. the median or the mode). For example, where in a market of 25 companies, 21 charge a price of € 50 and

60. The use of various forms of averages or other forms of data aggregation can be appropriate, provided that like with like is compared. For example, where a wholesaler claims damages for having purchased a product in January, May, July and October 2009 from the participants in a price cartel and where the chosen method is comparison with another geographic market, the monthly average prices paid in that market by the *same type of customer* (wholesaler) during the *same months* may be the appropriate reference point (i.e. comparing January data with January data, May data with May data, and so forth). Comparing data from the same months will, for instance, account for seasonal differences over a year and thus make the comparison more reliable. If, however, little monthly price variation exists, the average price on the comparator market for the entire year of 2009 may be considered an appropriate indicator. It may also be the case that yearly data or other average data (e.g. aggregated industry data) are simply the only information available. Legal systems in the Member States may generally allow parties to rely on average data whilst granting the defendant the opportunity to show that significant differences exist, and they may require the use of more disaggregated data where available.

61. Another simple technique for deriving a comparator value from a range of data observations is linear interpolation. Where a comparison over time has produced price series from before and after the infringement, the "non-infringement" or "counterfactual" price during the infringement period can be estimated by drawing a line between the pre-infringement price and the post-infringement price, as shown in the illustration below. From this line, a comparator value can be read for each relevant point in time during the infringement period. Compared with the calculation of a single average value for price during the entire infringement period, interpolation therefore allows to some degree to account for trends in price developments over time that are not due to the infringement. Reading comparator data from the interpolated line will, therefore, produce more accurate results than using an average value for the period, e.g. in cases where damages are claimed that result from transactions (or other events) which occurred only towards the beginning or the end of the infringement period.[63] The following illustration gives a simple example of linear interpolation (the dotted line shows the interpolated non-infringement price, the full line the actually observed prices):

four a price of € 75, the modal price of € 50 (the price most observed in the sample) may be the more meaningful representation of the market price than the mean of € 54 (in this example, the modal price equals the median price, which is the price charged by the middle-ranked company).

63 Interpolation likewise has advantages over using averages where the number of transactions (or other events) is unevenly distributed during the infringement period.



Linear extrapolation works similarly to interpolation except that the line is continued from either only pre- or only post-infringement data.[64]

62. There may be situations where it is quite straightforward to identify a differentiating factor between an infringement market (or period) and a comparator market (or period) and to make the corresponding adjustment to the value of the observed comparator data. For example, certain seasonal effects occurring on a market may have a pattern and a magnitude that can in some cases be rather easily understood from internal business records of a party or from other sources, such as expert statements. In these cases, for example, the straight line obtained in a simple linear interpolation should be adjusted to reflect such patterns.[65]

(2) Regression analysis

a. Concept and purpose of regression analysis

63. Regression analysis uses statistical techniques to investigate patterns in the relationship between economic variables and to measure to what extent a certain variable of interest[66] (e.g., in the flour cartel example, the price for flour[67]) is influenced by other variables that are not affected by the infringement[68] (e.g. raw material costs, variations in customer demand, product characteristics, the level of market concentration[69]). Regression analysis therefore makes it possible to assess

64 Extrapolation thus extends a trend existing in a time series either before or after the infringement. For example, if in the three years before a cartel prices were €12, €13.20, and €14.52 respectively (reflecting a 10% increase each year), a simple technique would be to estimate that prices during the two-year duration of a cartel were €15.97 and €17.57 respectively; a more accurate estimation of the underlying trend could be obtained through using regression analysis.

65 Such adjustment, could, data permitting, be done in a more sophisticated way by using regression analysis as explained in the following section.

66 Also referred to as an 'explained variable' or 'dependent variable'.

67 Possible other variables of interest for which regression analysis may be applied include, for instance, sales volumes, market shares or profit margins (e.g. those of an excluded competitor who claims damages for loss of profits through a reduction of sales or a decrease in its margins), costs of production (which may also be relevant in the context of a loss of profits estimation).

68 Also referred to as 'explanatory variable(s)' or 'influencing variable(s)'.

69 Other factors influencing the variable of interest may, for example, include customer and order sizes, the technology used for production, the size and cost structure of the firms offering the product, or advertising expenditure.

whether, and by how much, factors other than the infringement have contributed to the difference between the value of the variable of interest observed on the infringement market during the infringement period and the value observed in a comparator market or during a comparator time period. Regression analysis is thus a way to account for alternative causes for the difference between the compared data sets. All comparator-based methods are, in principle, capable of being implemented through regression analysis provided that sufficient data observations are available.[70]

64. In a regression analysis, a number of data observations for the variable of interest and the likely influencing variables are examined by means of statistical techniques. The relationship identified is usually described in the form of an equation (referred to as a 'regression equation' or 'regression model'). This equation makes it possible to estimate the effects of influencing variables on the variable of interest and to isolate them from the effects of the infringement. Regression analysis estimates how closely the relevant variables are correlated[71] with each other, which may in some instances be suggestive of a causal influence of one variable on the other.[72]

65. There are two main approaches to carrying out a regression analysis for damages estimation, depending on whether only data from non-infringement periods (markets) are used to build the regression equation or whether, in addition to non-infringement data, also data from within the infringement period (market) are used. If only data from non-infringement periods are used to estimate the regression, the regression equation would be used to 'forecast' the effect on the variable of interest during the infringement period on the basis of the pattern identified outside this period ('forecasting approach').[73] Where, in addition, also data from the infringement period (market) are used to estimate the regression, the effect of the infringement would be accounted for in the regression equation through a separate indicator variable (called 'dummy variable').[74] Whether it is more appropriate to apply the forecasting or the dummy variable approach will depend on the circumstances of the case.[75]

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70 A sufficient number of data observations is, however, required to apply statistical methods in a meaningful manner. Such sets of data observations could be obtained (in comparisons over time) from time series of observations, or (in comparisons at one point in time) from a range of comparator markets or from a range of firms or a range of transactions, or a combination of both (observations over time from a range of markets, firms or transactions).

71 In multivariate regression analysis (see in more detail below), the correlation established is a conditional correlation, i.e. one where the effect of other variables is controlled for.

72 Provided this is consistent with a coherent economic framework and with other pieces of qualitative and quantitative evidence.

73 This 'forecasting approach' is sometimes also referred to as a 'residual model approach'. This approach is illustrated in the graph in paragraph 72 below.

74 Such a 'dummy variable' measures whether there has been an upward shift in the variable of interest during the infringement period.

75 In particular, while the forecasting method has the advantage of allowing the choice of a regression model that is only based on data observations from the non-infringement period (and hence, untainted by the effects of the infringement), using data from both periods/markets may allow a more precise and accurate estimation of the parameters of interest, in particular if the available non-infringement data are limited or do not allow the dynamics of the industry at hand to be fully captured. In practice, both methods can often be combined, e.g. by selecting the model on the basis of the pre-infringement period and estimating a dummy-variable regression using data from both periods (and allowing, if appropriate, the effects of the other influencing variables to vary in the infringement and non-infringement periods).

b. Examples and illustrations

66. A simple example that, for illustrative purposes, looks only at one potential influencing variable may show the basic steps in regression analysis. Assume that, in the above-mentioned example of a flour cartel, the prices paid by bakeries during the cartel period to the milling companies are compared with the prices paid by bakeries to the milling companies in the pre-infringement period, and that this comparison shows a price increase during the infringement period of 20 %. Assume further that there are indications that this increase is not exclusively due to the cartel but that during the infringement period costs for an important input material (e.g. cereals) also increased significantly. It is therefore not clear how much of the increase in price for flour is due to the infringement and how much is due to the increased input costs (the rise in cereals prices).

67. One option to address this uncertainty could be to use data from another period or market where input costs (price for cereals) were more similar and no infringement existed, but there may be situations where this is not possible.[76] Regression analysis can offer a tool to account for the variation in input costs, by showing the statistical relationship between input costs and price for flour. To this end, a range of data observations on input costs (cereal prices) and on prices for flour during the period not affected by the infringement could be examined.[77] Through applying statistical techniques to these data observations, it is possible to establish a pattern of how the prices for cereals influenced the price for flour in a period where the flour prices were not influenced by the infringement. It is then possible to deduce a statistical relationship between the price for flour and the price for cereals from this period. By applying the insight on this relationship to the prices for flour from the infringement period, it is possible to eliminate the part of the increase of prices for flour not imputable to the infringement, but to the change in input costs. This allows to 'forecast' prices for flour without the cartel overcharge but including the price increase caused by higher input costs.

68. The following graph gives a simple illustration of how such a statistical relationship is deduced. The chart shows several data observations of the input costs (cereals prices) and the corresponding price for flour at the same point in time during a non-infringement period. For instance, when at one particular moment the price for cereals was 60, the price for flour was 128. It is possible to calculate the coordinates of the line that best fits all data observations in order to represent the statistical relationship (correlation) between the price for cereals and the price for flour. This relationship is expressed in the graph below as a line and can be, and usually is, also expressed as an equation.[78] The steepness of this line shows what increase in the price for flour is associated with a certain increase in the price for cereals. In the

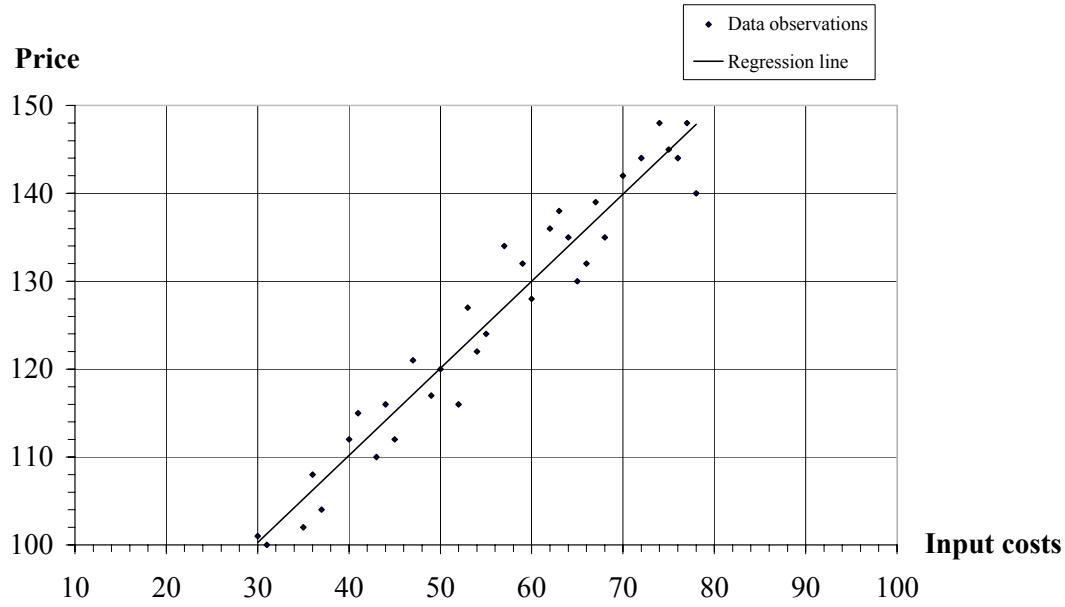
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[76] For instance, because reliable data from other periods (or markets) are not available or because in such other periods (or markets) market characteristics differed significantly.

[77] On the possibility of whether or not to also consider data from the infringement period (market), see paragraph 75 below.

[78] Estimating a regression of price (as the variable of interest) over input costs (as the influencing variable) provides the coordinates of this line. In this example, the ordinary least squares (OLS) technique is used to calculate the coordinates of a straight line that is located at a minimal distance ('least squares') from the set of data points on the graph. The OLS technique is a common statistical method to estimate the parameters of a linear regression model. Which statistical technique is used and how it is adjusted to the case at hand will depend on what is known about the general functioning of the industry in question.

example shown in the graph, the identified relationship indicates that e.g. a rise in the price for cereals from 50 to 60 relates to a rise in price for flour from 120 to 130. As an increase in input costs (cereals) by € 10 is associated with a flour price increase of € 10, the statistical relationship thus shows that an increase in this input cost is fully passed on.



69. Knowing the pattern of how the input cost (cereals prices) influenced prices for flour outside the infringement period makes it possible to estimate ('forecast') how much the observed higher values of these costs (cereals prices) during the infringement period influenced prices for flour. Excluding these effects from the price comparison allows the price overcharge caused by the infringement to be estimated on a more reliable basis than without the regression analysis. In the above example, if during the infringement period the price for flour was 140 instead of 120 during the non-infringement period, but the input cost (cereals prices) increased from 50 to 60, the likely price for flour without the cartel would not be 120 but 130.

70. Whilst the example described so far concerned only the influence of a *single* other variable (cereals price as input cost) on the variable of interest (flour price), regression analysis in competition practice usually has to account for *several* other factors influencing the variable of interest (*multiple* regression analysis[79]). In this situation, data need to be observed for all additional relevant influencing variables and a regression equation needs to be deduced from these data that reflects their relationship to the variable of interest. For instance, in the above-mentioned flour cartel example, it may be the case that during the infringement period the milling companies not only had to pay higher prices for cereals, but were also subject to an increase in energy and labour costs and introduced a more efficient milling and packaging technology, all of which may have had an impact on the price of the flour

[79] Also referred to as 'multivariate regression analysis' as opposed to 'single variable ('univariate') regression analysis' as used in the above example.

they sold to bakeries during the cartel period. To identify the statistical pattern of how these factors influenced the flour price, series of data observations for each of these influencing variables need to be analysed.

71. When undertaking a regression analysis, it is important to consider all variables that are relevant in the specific case. Suppose that either the defendant or the claimant uses, in a comparison of the flour prices charged by a mill before and during an infringement, a multiple regression analysis to control for the potential influence on the flour price of the above-mentioned factors (i.e. the cereal prices, energy and labour costs and milling and packaging technology). If, however, a significant demand change took place during the cartel (e.g. higher demand by bakeries for flour due to an increased demand by end customers for bread and cake) and if the influence of this event on the price for flour is not accounted for in the regression equation, the estimate of the infringement effect is likely to be biased, despite the otherwise comprehensive regression analysis.[80] It is for the applicable national law to determine, in accordance with the principle of effectiveness, the party on which the burden falls to invoke and prove facts, such as the above-mentioned change in demand or the completeness of the variables considered in a regression analysis.

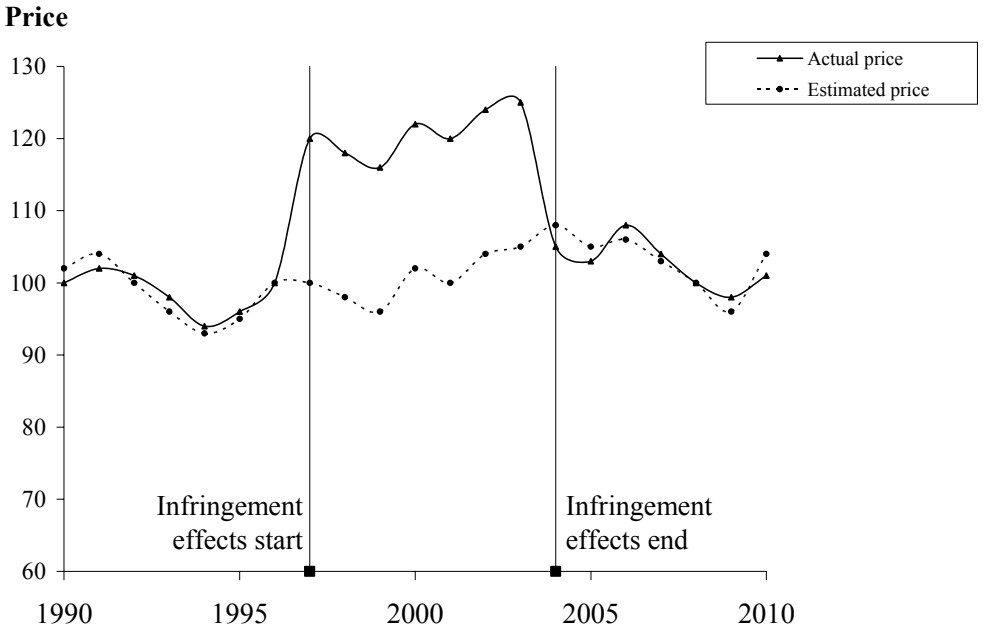
72. The basis of each damages quantification using regression analysis is thus the statistical relationship between the variable of interest (e.g. price) and the relevant explanatory variable(s) expressed in a regression equation. When the forecasting approach is used,[81] the estimation of a regression equation using data from the non-infringement period constitutes the first step. In a second step, using this regression equation and the observed values of these relevant variables during the infringement period, the price injured parties are likely to have paid without the infringement can then be estimated. In a third step, the difference between this likely non-infringement price and the price actually paid by the injured parties gives an estimate of the overcharge resulting from the infringement. The graph below illustrates the second and the third step. When the dummy variable approach is used, the regression analysis combines the three steps described above.[82]

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80 It is, however, important not only to include all relevant factors in the regression model, but also to refrain from including variables that appear clearly irrelevant (on the basis of industry knowledge). In fact, damages estimates could be wrongly lowered (even down to zero) if irrelevant variables are included in order to explain the price variation in the model.

81 The alternative approach is the dummy variable approach; see paragraph 65 above. Unlike the forecasting approach, the dummy variable approach estimates the effect of the infringement in a single step, by carrying out a regression analysis using data from both the infringement and non-infringement periods. In the case of the example above, this approach would estimate the effect of the cartel as the upward shift in price that is observed during the cartel period (i.e. the coefficient of the dummy variable in the regression equation) and is not explained by changes in other influencing variables, such as raw material costs.

82 In this case, the regression equation is estimated using data from both the infringement and non-infringement periods and directly indicates how much the variable of interest changed during the infringement period after accounting for the effect of other explanatory variables.



73. The regression analysis illustrated in this graph is based on the forecasting approach, in which a regression is carried out on pre- and post-infringement data to establish in an equation the statistical relationship between price and various relevant explanatory variables (input costs and other relevant factors). Using this equation and the observed values of the relevant explanatory variables, an estimated price can be derived that is likely to have prevailed absent the infringement (dotted line). The continuous line is the actually observed price. The difference between the continuous and the dotted line during the infringement period is the estimated overcharge. The dotted line outside the infringement period is also derived from the regression equation and can serve, through comparison with the actually observed non-infringement prices (continuous line), to assess the predictive power of the regression model.

c. Requirements for applying regression analysis

74. Carrying out a regression analysis requires knowledge of various statistical techniques to measure the relationship between variables, to construct an appropriate regression equation and to calculate the precision of the parameters in this equation. In addition, it is necessary to have a good understanding of the industry concerned, in the first place, to formulate the right hypotheses when constructing the regression equation and to make the right choice as to the factors that are likely to have significantly influenced the variable of interest (and which should therefore be included in the analysis). Industry understanding is furthermore necessary to make informed choices about which statistical techniques to use in a given situation, for instance, to account for unusual observations (outliers) or other specific features in data sets. In particular, where the influencing variables were themselves affected by the infringement, biased results may occur if this aspect is not taken into account,

e.g. through applying specific statistical techniques[83] or through using data observations that lie outside the infringement period or market.[84]

75. Without a sufficient number of data observations, statistical analysis cannot identify relationships between economic variables. To identify the effect of influencing variables on the variable of interest therefore requires that a sufficient range of data observations is available for all variables considered. Regression analysis therefore typically requires extensive data. However, statistical techniques may help to overcome some gaps in data or biases in their interpretation[85] and there can be situations where also the analysis of a smaller number of data observations is meaningful.

76. Data observations can, in principle, be gathered at different levels of aggregation. For example, where the relationship between price and input cost is to be analysed, data series either for the prices charged in individual transactions, for annual industry average prices or — in between — monthly data at firm level could be examined next to data series either for individual input costs per unit or for industry cost averages respectively. Using disaggregated data makes it possible to analyse a greater number of observations and therefore to obtain more precise estimates. Where such disaggregated data do not exist or are not accessible to the party carrying out the regression analysis, the analysis of aggregated data may still produce informative results, in particular if the aggregated data have a high frequency.

77. Where used appropriately and on the basis of sufficient data observations, regression analysis can considerably refine the damages estimation through comparator-based methods. It should be stressed, however, that even very sophisticated regression equations rely on a range of assumptions and will (like any technique to predict a hypothetical situation) only be able to deliver estimates. It is good practice to consider the assumptions underlying a regression equation, because some assumptions may be more appropriate than others in a given situation and may lead to significantly different results.

78. Whether, by which party and at which stage of the proceedings a regression analysis is carried out in a court case will *inter alia* depend on the existence or accessibility of data and the rules under applicable law regarding fact pleading requirements, disclosure of evidence, the standard of proof and the allocation of the burden of proof between the claimant and the defendant.

79. The different forms of regression analysis mentioned above (paragraphs 65 *et seq*.) are sometimes referred to as 'reduced form' approaches, as they directly estimate parameters of an equation that are themselves derived from other economic relationships (e.g. the interaction of supply and demand), without modelling these explicitly. Alternatively, econometric models can be built to estimate these underlying economic relationships. Although such econometric models, which are usually referred to as 'structural', often rely on particularly strong assumptions, they

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83 For example, the use of instrumental variables, an econometric technique that may be applied to correct such bias.

84 In particular, by using the forecasting approach described above, where the value of the influencing variables included in the model to predict the counterfactual are corrected for the infringement effect on these variables.

85 E.g. where a sample of data observations is not fully representative.

may bring a deeper understanding of the market concerned and form an integral part of simulation exercises to estimate damages (as further detailed in section III.A).

(3) Choice of techniques

80. Sections 1 and 2 above have described different techniques whereby comparator-based methods can be implemented in practice. In a given case, the choice of technique will usually depend on a range of aspects, in particular the legal requirements and the factual circumstances of the case. Considerations relating to the standard and burden of proof are likely to be very relevant in practice.

81. Econometric techniques can increase the degree of accuracy of a damages estimate and may thus help in meeting a higher standard of proof if required under applicable rules. Whether regression analysis is required (possibly in addition to other evidence available) to meet such a standard, and on which party the burden of proof falls in this respect are questions of applicable law, including the EU law principle of effectiveness. It should be considered that carrying out an econometric analysis usually requires a significant number of data observations, which may not always be accessible. Moreover, it may also be that in a given procedural situation the applicable standard of proof does not require the party charged with the burden of proof to go further than the techniques mentioned in Section 1 above. This could be because the national legal system concerned considers the markets or periods compared as sufficiently similar and the estimate of damages resulting from the simple comparison as sufficiently accurate for what the party has to show in the given procedural situation. It may also be that the legal system, in view of the damages estimation presented by a claimant and the data that are reasonably accessible to him, provides for a shift of the burden of proof from the claimant to the defendant. In such a situation, the defendant may consider carrying out a regression analysis to rebut the submission of the claimant.

82. Considerations of proportionality may also play an important role, as the gathering of data and their econometric analysis can entail considerable costs (including those of third parties) that may be disproportionate to or even exceed the value of the damages claim at hand. Such considerations may also become relevant with a view to the principle of effectiveness.[86]

83. Courts in the EU have mainly used straightforward implementations of comparator-based methods without regression analysis, often on the basis of averages.[87] They have also accepted simple adjustments to the value of observed data when it is quite straightforward to identify a differentiating factor between an infringement market (or period) and a comparator market (or period). To date, little experience exists with econometric analysis in actions for antitrust damages before courts in the EU,[88] although such techniques can, as described above, provide valuable help in quantifying the harm suffered through infringements of Article 101 or 102 TFEU.

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86 See above paragraph 2 in Part 1, Section 1.

87 The use of averages was accepted in e.g. *Landgericht Dortmund* (Regional Court, Dortmund), decision of 1 April 2004, Case No 13 O 55/02 Kart (*Vitaminpreise*); WuW/DE-R 1352.

88 For a recent example concerning lost profits in an exclusionary case see *Juzgado Mercantil numero 2 de Barcelona* (Commercial Court, Barcelona), decision of 20 January 2011, case No 45/2010 (Céntrica Energìa S.L.U./Endesa Distribuciòn Eléctrica S.A.)

84. Courts in the EU sometimes also apply a 'safety discount', i.e. they deduct from the observed data values an amount sufficient, under the standards of applicable law, to take account of uncertainties in a damages estimate.[89] Regression analysis can also be considered to account for these other possible influencing factors, and to obtain a "lower bound estimate" of the damages incurred.[90]

III. SIMULATION MODELS, COST-BASED ANALYSIS AND OTHER METHODS

85. Alongside comparator-based methods, other methods exist to establish an estimate for the hypothetical non-infringement situation. Such other methods include, in particular, the simulation of market outcomes on the basis of economic models (A), and the approach to estimate a likely non-infringement scenario on the basis of costs of production and a reasonable profit margin (B).

A. Simulation models

86. Simulation methods draw on economic models of market behaviour. Economic studies on how markets function and how firms compete with each other have shown that markets with certain characteristics may allow the likely outcomes of market interaction to be predicted, for instance the likely price or production levels or profit margins. The branch of economics known as industrial organisation has developed models of competition for various types of markets that can simulate such outcomes. These models range from monopoly models to, at the other end of the spectrum, perfect competition models. Intermediate models designed to reflect firm behaviour in oligopolistic markets are, in particular, those designed originally in the 19th century by the economists Augustin Cournot and Joseph Bertrand and numerous extensions and variations of the Cournot and Bertrand models. These include, in particular, also dynamic oligopoly models based on game theory[91] that take into account the repeated interaction between firms in the market.[92]

87. Prices are likely to be highest (and sales volumes lowest) in a monopoly and prices are likely to be lowest (and sales volumes highest) in a situation of perfect competition. The particular oligopolies described by Bertrand ('Bertrand oligopoly')[93] in markets with differentiated goods[94] and by Cournot ('Cournot

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89 For instance, to exclude the effects on the variable of interest of possible other factors. See e.g. *Kammergericht Berlin* (Higher Regional Court, Berlin), decision of 1 October 2009, case No 2 U 10/03 Kart.; *Oberlandesgericht Karlsruhe* (Higher Regional Court, Karlsruhe) of 11 June 2010 in case No 6 U 118/05 (appeal pending).

90 Indeed, in addition to providing damages estimates that already control for the influence of other factors, regression analysis also measures the precision of these estimates (in the form of *standard errors*), from which lower (and upper) bounds on the estimated damages can be obtained.

91 Game theory is the study of how people and firms behave in strategic situations in which they must consider how others respond to their action.

92 Taking into account the repeated interaction between firms in the market can be useful to explain, for instance, coordinated behaviour between firms or market entry of a new competitor. Dynamic models can be particularly useful for explaining exclusionary behaviour and to build a counterfactual to estimate the resulting damage.

93 The Bertrand oligopoly model of competition describes a market with a relatively small number of firms (and high barriers to entry) that compete on price, not output quantity. Firms set their price based on their beliefs about the prices their competitors will charge. In this model, prices increase with the degree of product differentiation.

oligopoly')[95] will normally lead to prices and volumes somewhere between perfect competition and monopoly levels; the exact outcome depends on the number of firms in the market and barriers to entry, on the degree of differentiation between them and their products and on other characteristics of the market at hand, such as demand characteristics (especially, how sensitive customers are to changes in price), and the capacities and cost structure of producers.

88. Based on such theoretical insights that link the market outcome e.g. in terms of prices to a given set of market characteristics, simulation models can be built to estimate the prices (or other variables) that are likely to have prevailed in the market had an infringement of Article 101 or 102 TFEU not occurred. The simulation model should be constructed in such a way that it replicates (a) the most significant factors influencing supply (in particular, the way competition takes place between firms ('competitive interactions')[96] and the cost structure of firms) and (b) demand conditions (in particular, the extent to which customers respond to price changes). These factors would be expressed as a set of equations in which a number of parameter values need to be included. These values may be known, estimated econometrically or assumed so that the output of the model matches some observed variables. When using simulation models to generate a non-infringement scenario, the relevant market structure and other characteristics must be those that would have existed without the infringement; these may correspond to the structure and other characteristics of the market observed in the infringement scenario, but they may also differ to some extent.[97]

89. An example may illustrate the use of simulation modelling to estimate damages. In the example of a cartel on a differentiated product market (e.g. confectionary chocolates), non-infringement prices could be estimated as follows, using data from the non-infringement period. First, one would estimate how the demand for each chocolate product varies with its own price (own-price elasticity) and with the price of competing products (cross-price elasticity).[98] Second, one would decide which

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94 In a market with homogeneous goods with no capacity constraints, Bertrand price competition will, in contrast, lead to very competitive outcomes. Homogenous goods are goods that have little differences in terms of quality or features.

95 The Cournot oligopoly model of competition describes a market with a relatively small number of firms (and high barriers to entry) that compete on the amount of output they will produce. Before they choose prices, they set their quantity (or capacity) simultaneously on the basis of how much they each believe the other firms will produce.

96 The term 'competitive interactions' is used to indicate how competition between firms takes place, e.g. (but not limited to) Bertrand or Cournot competition, or how firms refrain from competing between each other (in the case of collusive behaviour infringing competition rules). Markets on which price formation occurs through auctions or other bidding processes may also be conducive to modelling as interaction between competitors often follows fixed rules (prices or output quantities likely to result from an auction or other bidding process not affected by the infringement could, in particular, be estimated by oligopoly models that incorporate game theory to simulate the likely bidding behaviour of competitors in a non-infringement scenario).

97 As the infringement may have led to a change in the market structure or may have prevented changes in the market that would otherwise have occurred (e.g. the exit of an inefficient competitor), the (hypothetical) market characteristics in the non-infringement scenario are not necessarily the same as those that could be observed in the infringement scenario. In addition, market shares observed during an infringement may significantly differ from those that would have prevailed in the absence of the infringement as cartel members may allocate markets between themselves.

98 Technically, this would involve estimating a demand system, which is an example of the structural econometric analysis mentioned in paragraph 79.

model appropriately reflects the competitive interaction between firms in the non-infringement period (e.g. the Bertrand model of competition in the confectionary chocolates example). On this basis, it can be calculated at which prices the profits of the firms are maximised in view of the cost parameters (e.g. marginal costs) and demand parameters (e.g. the level of demand).[99] The value of some of these parameters can then be adapted to reflect the relevant conditions during the infringement period (e.g. supposing the cost of cocoa increases by 10%). With all this information expressed in equations, it can be simulated (under the assumption that firms strive for maximised profits) what prices these firms are likely to have charged during the infringement period. The cartel overcharge can then be estimated by taking the difference between the observed prices and the simulated non-infringement prices.

90. This example is particularly demanding in terms of data requirements and assumptions. Simpler simulation models may be envisaged to estimate damages but they rely even more heavily on crucial assumptions that are difficult to verify. For example, damages following a cartel infringement could be calculated by comparing monopoly prices (aimed at reflecting prices during the cartel) with prices expected under a Cournot model (aimed at reflecting prices in the non-infringement scenario), using data such as market shares, costs, and market price elasticity. However, such a method crucially depends on the assumed competitive interactions in the infringement and non-infringement scenarios and entails the risk that these do not mirror sufficiently closely the way in which the cartel operates during the infringement period and the way in which competition on the market would have operated absent the infringement.

91. Simulation models can be used to estimate market outcomes not only in cartel cases (or other price raising infringements), but also in cases of exclusionary behaviour. For example, an oligopoly model could be used to simulate the sales volume and the market share a foreclosed competitor would have attained had the infringement not taken place.

92. Each model simulating market outcomes is an approximation of reality and relies on theoretical and often also factual assumptions regarding market characteristics and the likely behaviour of producers and customers. Although, by their very nature, models rely on simplification of reality, even simple models may in certain cases provide useful insights regarding the likely damages.[100] Building a comprehensive model that replicates a range of specific features of the market in question, if it can be properly solved and evaluated, can increase the likelihood that the result of the simulation is a reasonable estimate for the hypothetical non-infringement scenario. Even very comprehensive models, though, still depend very much on the right assumptions being made, in particular regarding the central questions of what is the likely mode of competition and the likely customer demand in the non-infringement scenario. Moreover, the development of complex simulation models can be technically demanding and may require significant amounts of data that may not

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99 The value of these parameters (e.g. the value for marginal costs used in the calculation) in the non-infringement period can be determined so that the derived prices and volumes match the observed data.

100 Therefore, pointing out that a model relies on seemingly simplifying assumptions should therefore on its own not be sufficient to dismiss it; rather, one should consider how some of the simplifying assumptions are likely to affect its results.

always be accessible to the party concerned or possible to be estimated with sufficient reliability.

93. Nonetheless, both simple and more complex simulation models could provide useful insights when estimating the outcomes that a market would have produced absent an infringement of Article 101 or 102 TFEU. Whether and in which procedural situation legal systems will consider that the use of an economic simulation is appropriate and its results are sufficiently reliable will depend on the specific circumstances of the case in point and the requirements under applicable legal rules.

B. Cost-based method

94. Another approach to estimating the likely prices that would have emerged absent the infringement is provided by the cost-based method.[101] This method consists in using some measure of production costs per unit, and adding a mark-up for a profit that would have been 'reasonable' in the non-infringement scenario. The resulting estimate for a per unit non-infringement price can be compared to the per unit price actually charged by the infringing undertaking(s) to obtain an estimate of the overcharge.[102]

95. Different types of production costs may be suitable for implementing the cost-based method, depending on the characteristics of the industry concerned. It is, however, essential to ensure that the treatment of costs and margins is consistent. For example, if variable costs (i.e. costs that vary with the level of production) are considered as the basis of this exercise, a gross margin (i.e. the margin earned once variable costs have been deducted) should be added to calculate the price. It should also be noted that the relevant cost for determining prices may be not only the cost of the infringer, but also the cost of one of its competitors (e.g. if the price in the market is determined by the least efficient producer).

96. The first step of the cost-based method is to determine the production cost per unit. Per unit costs can be estimated by dividing the actual relevant production costs incurred by the infringer(s) for the relevant business activity by the total number of products produced. This approach can be rather straightforward where companies or separate business divisions of companies produce only one main product. Such companies or business divisions sometimes publish their major cost data or file this information as part of their audited accounts with public registries. In other situations, the access to data and the allocation of costs to the product affected by the infringement is more difficult. Where accounting data are available, adjustments may be necessary given that the notions of costs in accounting terms can differ from the notions of costs in economic terms.

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101 This method is also referred to as the 'cost plus method' or 'bottom-up costing method'. It is mentioned, as a subsidiary approach in cases where comparator-based methods are not appropriate, by the *Bundesgerichtshof* (Federal Court of Justice, Germany), decision of 19 June 2007, case No KBR 12/07 (*Paper Wholesale Cartel*).

102 Usually, the cost-based method is considered for quantifying price overcharges. The method, or elements of it, may, however, also be used for quantifying other forms of harm such as the profits lost by foreclosed competitors. For instance, the *Oberlandesgericht Düsseldorf* (Higher Regional Court, Düsseldorf), decision of 16 April 2008, case No VI-2 U (kart) 8/06, 2 U 8/06 (*Stadtwerke Düsseldorf*), estimated the lost profits of a foreclosed competitor by considering the costs of the competitor and the likely profit margin expressed as a proportion of these costs.

97. It may occur that the observed production costs during the infringement are not representative of the production costs that would have been likely without the infringement. This could mainly be for two reasons: first, in the event of infringements of Article 101, companies which due to their collusive behaviour are not subject to the competitive pressure that would exist in the non-infringement scenario may operate less efficiently and therefore generate higher production costs than under competitive pressure. Second, infringers may restrict output and may therefore, during the infringement, forego economies of scale that would have led to lower production costs. Where indications for such situations exist, adjustments to the observed costs data of the infringer(s) may be appropriate. Where such adjustments are not made, the observed costs may still contribute, under the cost-based method, to a lower-bound estimate of the possible price overcharge.

98. The second step of the cost-based method requires a 'reasonable' profit margin to be estimated and added to the per unit production costs. Various approaches exist to estimate a 'reasonable' profit margin. They are based either on a comparison over time or across markets, or on economic models, and thus have commonalities with the methods described in the preceding Sections. For instance, an estimate for the profit margin that could reasonably be expected in a non-infringement scenario may be derived from the profit margins made by similar undertakings in a comparable geographic market not affected by the infringement or in comparable product markets.[103] Similarly, the profit margins of the infringing (or a similar) undertaking during the pre- or post infringement periods could be used as a basis for the estimate. Both these comparator-based methods rest on the assumption that the reference period, market or firm are sufficiently similar,[104] in particular with respect to market characteristics that are relevant for profit margins such as the level of competition in the market,[105] the cost structure of producers (including costs of innovation), capacity utilisation and capacity constraints. These assumptions are not always easily verified, as a large number of factors and strategic decisions are likely to determine a firm's price and margin setting.

99. Another approach to estimating a 'reasonable' profit margin is to consider the nature of competition and the characteristics of the market absent the infringement and to derive a likely profit margin from the insights from industrial organisation models.[106] For instance, absent the infringement, prices may be likely to tend towards costs due to relative homogeneity of goods and overcapacities in the market; in such cases, the likely profit margin of producers would be relatively low.[107]

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103 See *Bundesgerichtshof* (Federal Court of Justice, Germany), decision of 19 June 2007, case No KBR 12/07 (*Paper Wholesale Cartel*), referring to the profit margins generated in 'comparable industries'.

104 For relevant considerations regarding sufficient similarity see above paragraphs 33-52 in Part 2, Section II.

105 E.g. whether competition would have been so strong as to drive the price downwards towards marginal costs (as assumed in the model of perfect competition) or whether profit margins, due to an oligopolistic structure, would have been higher even without the infringement.

106 See above paragraphs 86 *et seq*. in Part 2, Section III.

107 The cost of capital (i.e. the cost at which a firm can obtain capital on the market) is sometimes considered as an approximation of a 'reasonable' profit margin in such cases. However, margins in the absence of an infringement may significantly differ from the cost of capital, for example in the absence of perfect competition or in the presence of firm-specific cost advantages for certain firms, or demand and supply shocks.

100. It is clear from the above that both the estimation of likely non-infringement costs and the estimation of a 'reasonable' profit margin can, in practice, require a range of difficult issues to be considered. In addition, the cost-based method supposes access to data that may be in the possession of the opposing party or a third party. Nonetheless, depending on the circumstances of the particular case and on the requirements under applicable legal rules, it may provide useful insights to support an estimation of the harm suffered through an antitrust infringement.

C. Other methods

101. The methods described in this Guidance Paper are those that have received most consideration so far in legal practice and academic scholarship. They should, however, not be seen as an exhaustive list, firstly, as the methods described could further evolve or others could be developed in practice.

102. Secondly, there are methods *not* discussed in this Guidance Paper could nonetheless prove useful, in particular, in order to establish an upper- or lower-bound[108] or approximate estimate[109] for the harm suffered. Especially where the legal systems provide for the possibility of an approximate estimation, national courts have opted for pragmatic techniques rather than a sophisticated implementation of the methods set out in Sections A and B above to establish the amount of damages to be awarded to injured parties. For instance, in cases where a new entrant has been foreclosed in breach of Article 101 or 102 TFEU, business plans have sometimes been used[110] as a source of information on the likely profits of a business, albeit in some instances adjusted depending on the market circumstances or through the use of data from a comparator market or undertaking.

103. It is for national courts to establish whether, under the applicable rules, a method can be accepted for the quantification of harm in a given case, provided that the principles of effectiveness and equivalence of EU law are observed.

IV. CHOICE OF METHODS

104. Each of the methods described in Sections II and III above can, in principle, provide useful insights in relation to all infringements of Article 101 or 102 TFEU and the different types of harm such infringements tend to produce. In particular, they make it possible to estimate not only the amount of illegal price overcharge in a price fixing cartel but also, for example, the sales volume or the profit lost by a company suffering harm through an exclusionary abuse by a dominant competitor.

105. It should be stressed that it is only possible to estimate, not to measure with certainty and precision, what the hypothetical non-infringement scenario is likely to have looked like. There is no method that could be singled out as the one that would in all

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108 For example, an upper-bound estimation could be obtained through critical loss analysis. This technique assesses for a price increase what loss in quantities would make that price increase unprofitable.

109 For instance, counterfactual profits could be *prima facie* identified by taking as a benchmark the cost of capital, on the assumption that, absent the infringement, the undertaking would have earned the cost of capital, which represents the minimum return required by providers of capital to an undertaking. On the limitations of this approach, see footnote 107.

110 See for instance *Højesteret* (Danish Supreme Court), judgment of 20 April 2005, case UFR 2005.217H *(GT Linien A/S* v *De Danske Statsbaner DSB and Scandlines A/S).*

cases be more appropriate than others. Each of the methods described above has particular features, strengths and weaknesses that may make it more or less suitable to estimate the harm suffered in a given set of circumstances. In particular, the methods differ in the degree to which they are simple to apply, in the degree to which they rely on data that are the outcome of actual market interactions or on assumptions based on economic theory and in the extent to which they take into account factors other than the infringement that may have affected the situation of the parties.

106. In the specific circumstances of any given case, the appropriate approach to quantification must be determined under the applicable rules of law. Relevant considerations may include, alongside the standard and burden of proof under applicable legal rules, the availability of data, the costs and time involved and their proportionality in relation to the value of the damages claim at stake. The costs to be considered in this context may not only be those incurred when the party bearing the burden of proof applies the method, but also include the costs for the other party to rebut its submissions and the costs to the judicial system when the court assesses the results produced by the method, possibly with the help of a court-appointed expert. The costs and burden for an injured party and their proportionality may become particularly relevant with a view to the principle of effectiveness.[111] Moreover, the decision under applicable law as to whether and, if so, which of the methods and techniques described in this Guidance Paper should be used may also depend on the availability of other evidence, for instance documentary evidence produced by the undertakings on the course of business showing that an illegally agreed price increase was actually implemented at a certain amount.

107. It may be that in a given case the application of *several* methods (e.g. comparison over time and comparison across geographic markets) is envisaged, either alternatively or cumulatively. Where two different methods yield results that are similar, such findings may lead a legal system to attribute stronger evidentiary value to the damages estimate, possibly a lower bound, based on these methods. Where, however, the application of two methods produces apparently contradictory results (especially when two opposing parties each rely on a different method), it is normally not appropriate either to simply take the average of the two results nor would it be appropriate to consider that the contradictory results cancel each other out in the sense that *both* methods should be disregarded. In such a scenario it would rather be appropriate to examine the reasons for the diverging results and to carefully consider the strengths and weaknesses of each method and its implementation in the case at hand.

[111] See above paragraph 2 in Part 1, Section 1.

PART 3 — QUANTIFYING HARM CAUSED BY A RISE IN PRICES

I. EFFECTS OF INFRINGEMENTS LEADING TO A RISE IN PRICES

108. Anticompetitive practices can have the effect of raising the prices that direct and often also indirect customers[112] of the infringing undertakings pay for the product concerned. Typical examples of infringements leading to such increases are price cartels, or excessive pricing by a dominant undertaking. Customers can also be affected by practices that limit output or allocate customers or markets — distortions of competition which in turn normally lead to a rise in prices. A different type of harm is caused where infringements adversely affect the market position of competitors; the quantification of such harm and its consequences for customers is discussed in Part 4 below.

109. In so far as infringements lead to a rise in prices for the products concerned, two main kinds[113] of harm caused by such infringement can be distinguished:

(a) the harm resulting from the fact that direct and indirect customers of the infringing undertakings have to pay more for each product they purchase than without the infringement (the 'overcharge'). This type of harm is further discussed in Section II; and

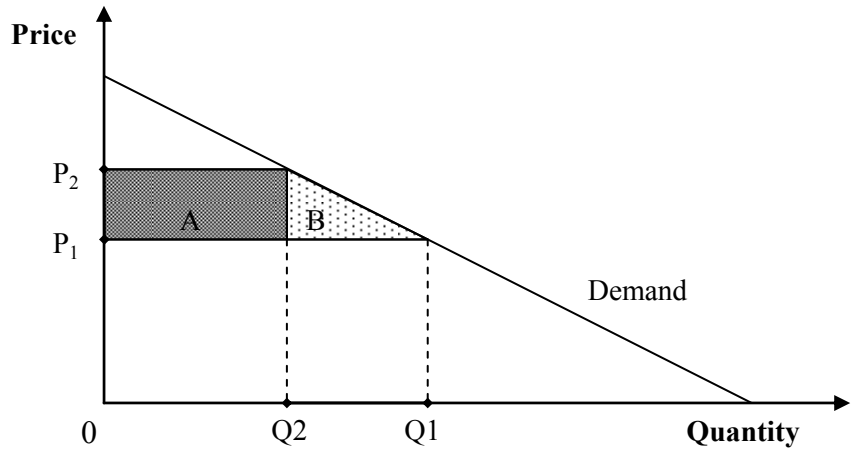
(b) the harm resulting from the so-called 'volume effect', which is caused by the fact that fewer of the products in question are bought due to the rise in prices. This type of harm is further discussed in Section III.

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112 The direct customers of the infringing undertakings are those who purchase a product directly from one of the infringing undertakings; indirect customers are those who purchase a product affected by the infringement from such direct customers or from other indirect customers. In some instances, undertakings that do not infringe the competition rules themselves can raise their prices, as market prices are higher because of the infringement. Customers who purchase from these undertakings are sometimes referred to as 'umbrella customers'. To what extent such customers can claim compensation for the harm from the infringing undertakings depends on the applicable legal rules.

113 For other kinds of harm, see above paragraph 19 in Part 1, Section III.

The following figure represents in a stylised way these two main effects:



110. P_1 is the price charged if no infringement of Article 101 or 102 TFEU affects the market. In a perfectly competitive market, this price will equal the supplier's marginal cost[114] of providing that product. Many markets are in fact not perfectly competitive and non-infringement prices on these markets will be above the level of marginal costs. At price P_1, Q_1 is the quantity of the product bought by customers.

111. P_2 is the higher price resulting from an infringement having an effect on price. This in turn leads to lower demand (Q_2) because some customers will consider that the higher price they have to pay exceeds the value of owning the product or of benefiting from the service. This effect is referred to as the 'volume effect' or the 'quantity effect'. The degree to which a rise in prices affects demand depends on demand elasticity.[115]

112. Rectangle A represents the value transferred from the customers to the infringers due to the infringement: the customers who buy at the higher price P_2 have to transfer more money to the infringing undertaking(s) in order to obtain the product. They can demand compensation for having had to pay more and Section II below will explain how to quantify this harm.

113. Triangle B represents the volume effect and thus the value foregone by those who would have bought the product for price P_1, but refrain from doing so when the price rises to P_2.[116]

114. Some customers use the product in question for their own commercial activities — for example to sell it on or to manufacture other goods. When they do not buy at

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114 These are the costs for suppliers to produce one more unit.

115 Demand elasticity measures by what percentage the quantity sold of a product in a given market varies in response to a one percent price change for a particular demand level, and provides a useful indication of the magnitude of the volume effect for small price changes.

116 For the economy as a whole, this triangle therefore represents the loss in value for customers due to a reduction in output: while the overcharge affects the distribution of assets within the economy, triangle B means welfare not created because of the infringement. This is referred to in economics as 'deadweight loss'.

price P_2 (or buy less), they forego the profit they would have made had they been able to purchase at price P_1. They can claim reparation for this loss of profit and Section III below will illustrate how to quantify this harm. Other customers are end-consumers. If these do not purchase at price P_2 this means that they fail to enjoy the utility of these products or services, for which they would have been prepared to pay price P_1.[117] Applicable legal rules may provide that some or all of such harm should be compensated for such failure to enjoy the usefulness of the product. At a minimum, end-consumers who have to bear higher costs (for example for the purchase of a substitute good) and who therefore have suffered an actual loss[118] must be able to obtain compensation.

115. The foregoing summarises the basic effects on the market of infringements that lead to a *higher* selling price. Infringements of Article 101 or 102 TFEU can also affect the demand side and lead to lower purchasing prices paid by infringers in their own supply with products, for example in the case of a buyers' cartel or in the abuse of market power exercised by a dominant buyer vis-à-vis its suppliers. In such a case, the price effects would consist in an 'undercharge' for the supplier of the infringer, and often also an overcharge on the downstream markets, i.e. for the direct and indirect customers of the infringer.[119] The same methods used to quantify an overcharge can, in principle, also be used to quantify the undercharge, e.g. the lower prices paid by the members of a buyers' cartel vis-à-vis their suppliers.

116. The same methods can, in principle, also be used[120] where at first sight no overcharge is visible, because the infringement served to artificially stabilise prices over a certain period of time in which prices would under normal market circumstances (i.e. without infringement) have declined. In the following, the term "overcharge" designates also these situations.

II. QUANTIFYING THE OVERCHARGE

117. Different types of infringements lead directly or indirectly to overcharges. Antitrust damages actions often deal with overcharges caused by cartels, which will be addressed in Section A below. The quantification of overcharges caused by other types of infringements will be addressed in Section B below.

A. Quantifying overcharges caused by cartels

118. In an action for compensation, it will be necessary — within the framework of applicable legal rules — to quantify the overcharge paid by the claimant(s). Economic and legal studies have analysed the effects of cartels; some insights from

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117 It is also possible that customers would have been prepared to pay a price higher than P_1, but lower than P_2.

118 See, for this legal term, Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 95.

119 In order to drive down input prices, the cartel members/dominant buyers with downstream market power are likely to restrict their input purchases, hence also reducing output sales and increasing downstream prices.

120 Only the method based on comparison between time periods in the variant of 'before and during' comparison (i.e. comparing the infringement prices with pre-infringement prices) would obviously be unsuitable, unless regression analysis or simple adjustments are applied to account for the factors that would lead to a price decrease under normal market circumstances (e.g. decreased raw material costs).

these studies are set out below in Section 1. In actions for damages, it is useful to distinguish between the initial overcharge paid by the direct customer of the infringing undertaking (see below Section 2) and the possible harm that such overcharge causes to indirect customers at different levels of the supply chain (Section 3).

(1) Effects of cartels

119. Cartels are agreements and concerted practices between two or more undertakings aimed at influencing the parameters of competition through practices such as fixing the purchase or selling price or other trading conditions, allocating production or sales quotas or sharing markets (including bid-rigging). For the purpose of finding whether such practices infringe Article 101 TFEU there is no need to quantify the concrete effects of such a practice, because the object of the cartel agreement is the prevention, restriction or distortion of competition.[121]

120. Infringing the competition rules exposes the cartel members to the risk of being discovered and thus subject to a decision finding an infringement and imposing fines. The fact alone that undertakings nonetheless engage in such illegal activity suggests that they expect to reap substantial benefits from their actions, i.e. that they expect the cartel to have effects on the market and, hence, on their customers.[122]

121. A study undertaken for the Commission examined the empirical evidence on the existence of overcharge effects and on their magnitude.[123] This study draws on a range of existing empirical studies on the effects of cartels. In particular, it refines the sample of cartels examined in the most comprehensive existing study by considering only cartels (a) that started after 1960 (thus taking into account only more recent cartels), (b) for which an estimate of the average overcharge was available (rather than only an estimate of the highest or lowest overcharge), (c) for which the relevant background study explicitly explained the method for calculating the average overcharge estimate, and (d) which were discussed in peer-reviewed academic articles or chapters in books.[124] While some care is required in interpreting the results of this exercise,[125] the study undertaken for the Commission contains some useful information as to the effects of cartels.

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121 See judgments of the General Court in Joined Cases T-25/95 etc. *Cimenteries CBR SA* v *Commission* [2000] ECR II-491, paragraphs 837, 1531, 2589; Case T-202/98 *Tate & Lyle* v *Commission* [2001] ECR II-2035, paragraphs 72–74; see also Communication from the Commission: Guidelines on the application of Article 81(3) of the Treaty, OJ C 101, 27.4.2004, p. 97, paragraphs 20–23.

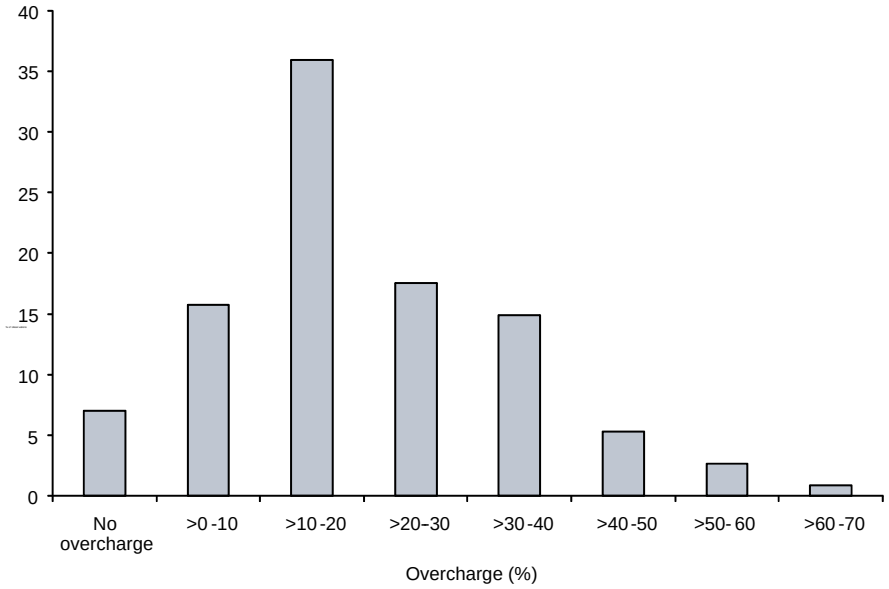
122 See also the decision of the *Kammergericht Berlin* (Higher Regional Court, Berlin) of 1 October 2009 in case No 2 U 10/03, where the court referred to a similar argument.

123 See the external study prepared for the Commission 'Quantifying antitrust damages' (2009), pages 88 *et seq*., available at http://ec.europa.eu/competition/antitrust/actionsdamages/index.html.

124 In all, the study considers 114 cartels based on different types of collusion, including bid-rigging. The sample includes international and national cartels that affected a wide range of different industries. The geographic spread of the sample extends to the US and Canada as well as cartels from Europe and other regions.

125 In particular, it seems possible that cartels that do have an effect on the market receive more attention in empirical studies than those that have no effects, which may lead to a certain bias in the findings; see the study 'Quantifying antitrust damages', page 89 (ref. in footnote 123), for further details about the interpretation of the data used in the study.

122. On the basis of the data observed, this study found that in 93 % of all cartel cases considered, cartels do lead to an overcharge. As to the magnitude of the cartel overcharge, this study made the following findings:[126]



123. According to this study, there is thus a considerable spread of the overcharges observed (with some cartels even having an overcharge of more than 50 %). About 70 % of all cartels considered in this study have an overcharge of between 10 % and 40 %. The average overcharge observed in these cartels is around 20 %.

124. The insights of this study concord with those of other available empirical studies, namely that (a) the vast majority of cartels do in fact lead to an overcharge, and (b) there is considerable variance in the overcharges observed. Also, all of these other empirical studies come largely to a similar estimate of the magnitude of the average overcharges as described above.[127]

125. These insights into the effects of cartels do not replace the quantification of the specific harm suffered by claimants in a particular case. However, national courts have, on the basis of such empirical knowledge, asserted that it is likely that cartels normally do lead to an overcharge and that the longer and more sustainable a cartel was, the more difficult it would be for a defendant to argue that no adverse impact on price did take place in a concrete case.[128] Such inferences, however, are a matter for national legal systems.

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126 Study 'Quantifying antitrust damages', page 91 (ref. in footnote 123). That magnitude is expressed as a percentage of the actual price. This means that if the actual price (meaning the price paid as influenced by the infringement) is € 100 and the overcharge is said to be 10 %, the price absent the infringement is deemed to be € 90.

127 For details and further references see the study 'Quantifying antitrust damages', pages 89 *et seq*. (ref. in footnote 123).

128 See for example *Bundesgerichtshof* (Federal Court of Justice, Germany), decision of 28 June 2005, case No KRB 2/05 (*Transportable concrete*) (in the context of assessing the illicit gain by cartelists for the purpose of calculating a fine).

(2) The initial overcharge paid by the direct customer

126. All of the methods and techniques described above in Part 2 can, in principle, be used to quantify the initial overcharge paid by the direct customers of the infringing undertakings.[129] Also, other types of evidence (such as, for instance, a specific agreement on the rise in prices as shown by internal documents) may also provide valuable insights into the scope of the overcharge. As the initial overcharge is a transfer of money from the direct customer to the infringing undertaking(s), any information that may exist on the illicit profits made by infringers can also serve to quantify this overcharge.[130]

127. In order to illustrate how methods and techniques can be used to estimate prices in a non-infringement scenario and, based on this estimate, to determine the overcharge paid by the customers of infringing undertakings, it is useful to consider the stylised example of a flour cartel already mentioned in Part 2.[131]

The flour cartel

In this example, all the flour in a certain Member State is produced by four milling companies (Mill A, Mill B, Mill C and Mill D). These mills purchase cereals from various farmers, grind the cereals and apply the appropriate treatments, package the flour and sell it on to bakers. These bakers use the flour to bake bread, which they sell on to consumers as well as to supermarkets.

The national competition authority investigates the market on suspicion of price-fixing and in January 2008 carries out unannounced inspections on the premises of the milling companies. In July 2010 the competition authority adopts a decision in which it establishes that all four milling companies infringed Article 101 TFEU by participating, during the period from 1 January 2005 till 31 December 2007, in a single and continuous infringement regarding the production of flour, covering the whole Member State, which consisted of fixing prices.

A bakery company having purchased flour from one of the milling companies (Mill A) sues this company for compensation of the harm suffered because of the infringement of Article 101 TFEU.[132] The bakery claims that the infringement has led to a rise in prices for the flour and demands compensation for the payment of this overcharge for all purchases made in 2005, 2006 and 2007.

128. The bakery is a direct customer of one of the infringing undertakings. If the infringement caused higher prices, the bakery paid an overcharge for each of the units of flour purchased while price was affected. Application of the methods and techniques described will yield an estimate of the price which the bakery would have

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129 These methods and techniques can also be used to quantify the overcharge paid by the umbrella customers (see footnote 112 above), provided that applicable legal rules provide that they are entitled to receive compensation.

130 See also Section 33(3)(3) of the German Act against restraints on competition (*Gesetz gegen Wettbewerbsbeschränkungen*), which states that the proportion of the profit which the infringing undertaking made from the infringement may be taken into account when estimating damages.

131 Any resemblance of this fictitious example to real events would be purely coincidental; the example cannot be seen as reflecting the Commission's views regarding any specific undertaking or sector or the market definition in such a sector.

132 National law might well provide that all members of a cartel are jointly and severally liable for the entire harm caused by the cartel. The present example has no implications for these rules.

paid for the flour had there been no infringement. By subtracting that non-infringement price from the price actually paid by the bakery, the cartel overcharge per unit purchased can be determined. That figure has to be multiplied by the number of units bought by the bakery in order to determine the actual direct overcharge loss (assuming that there were no significant changes in the overcharge during the infringement period).

129. As discussed above in Part 2, several methods and techniques are generally suitable to quantify the non-infringement price. It should be stressed that this non-infringement price is necessarily hypothetical and can therefore only be an estimate.[133] The choice of a method and technique in a given litigation scenario will depend on a wide range of factors, in particular the standard of proof under applicable legal rules and the availability of data.[134] For the estimation of the overcharge paid by the bakery in the present example, the use of comparator-based methods will be illustrated as these are most often used in practice and will often yield helpful results in quantifying the initial overcharge.

a. Comparison over time

130. In the present example, the claimant bakery company bought flour from Mill A before, during and after the time for which the national competition authority found an infringement. As described above, using the prices actually paid before or after the infringement to reconstruct the prices as they would have been without the infringement makes it necessary, first, to determine which prices were affected by the infringement and which were not. This means finding out at which point the cartel infringement began to have an effect on the flour market and at which point that effect ended.

131. In the present case, the national competition authority has determined the duration of the infringement. In fact, the decision details the evidence the authority had, which indicates that the milling companies met in January 2005 to discuss prices and thereafter continued to meet on a monthly basis, adjusting their pricing arrangements. The last meeting was held in December 2007. The authority found no evidence of meetings after it inspected the companies in January 2008. In a first step, therefore, the prices before January 2005 and after December 2007 appear to be suitable material for a time-based comparison. However, as described in Part 2, further consideration should be given to the extent to which these figures are useful to serve as comparators.

132. As mentioned above, the decision by a competition authority might limit the finding of an infringement to a certain period for which solid evidence is available to the authority, while indicating that the infringement might have had a longer duration.[135] It may then be appropriate not to use the relevant price data for the period that might have been affected by the infringement (and thus include an overcharge), although such data may nonetheless be used to determine a lower bound for the damages estimation, i.e. a safe estimate of what the harm suffered has been at least.

133 See above paragraphs 10-15 in Part 1, Section II.

134 See above paragraphs 101-103 in Part 2, Section III.

135 See paragraph 37 in Part 2, Section II.

133. Also, the timing of the cartel infringement may be different from the timing of the effects of the infringement: the milling companies infringed Article 101 TFEU by entering into an anticompetitive agreement. For the purpose of determining which prices observed could be regarded as unaffected by the infringement, it is necessary to look at the timing of the effects of that agreement, not its conclusion. If it can be shown that the companies met in January 2005 for the first time, but that their agreement was implemented from March 2005 onwards, prices before March 2005 would not be tainted by the infringement.

134. As regards the suitability of using post-infringement price observations, it is possible that the cartel produced effects on the market even after the cartel members had ceased to engage in the kind of cooperation forbidden by Article 101 TFEU.[136] This may, in particular, be the case in oligopoly markets, where the information gathered because of the cartel might allow cartel members to adopt on a sustainable basis — after the cartel infringement has ended — a course of action aimed at selling at a price higher than the price likely associated with absence of the cartel infringement, without engaging in the sort of practices forbidden by Article 101 TFEU.[137] It is also possible that, after the end of the cartel, former cartel members resort to another type of infringement of the competition rules that raises prices for their customers. In these cases any time comparison based on the prices observed after the infringement ceased might lead to an underestimation of the overcharge paid by the customers of the infringers, as the post-infringement prices might still be influenced by an infringement. Where in the present example, the claimant bakery has reasons to believe that this might be the case for the prices paid in 2008 and thereafter, it could only use these prices in its submission to the court to estimate a lower bound of the overcharge harm suffered.

135. In the present example, the claimant bakery finds that the prices paid before the infringement are well suited to estimate the likely hypothetical price. If the bakery compares infringement and non-infringement prices as they are observed, it implicitly assumes that the entire difference between the prices paid in the non-infringement years 2003 and 2004 and the prices paid in the infringement years 2005, 2006 and 2007 is due to the infringement. It is possible, however, that causes other than the infringement had a significant influence on the development of prices during the infringement period. Changes in grain prices, for instance, might be an alternative cause that influenced price developments, and they may be accounted for by using the techniques set out in Part 2, Section II B above. In so far as significant other influences can be identified and the price data are adjusted for their effects, the submission that the remaining difference between the prices in the non-infringement and the infringement periods is due to the infringement gains additional strength.[138]

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136 See also paragraph 38 in Part 2, Section II.

137 For further insights into the workings of such 'coordinated effects', see Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31, 5.2.2004, p. 5, paragraph 39.

138 This is without implications for the application of national rules allowing the claimant to use the basic, unadjusted comparisons between prices charged in infringement and non-infringement periods to make an initial pleading, or to fulfil the duties incumbent upon him under national legal rules with regard to fact-pleading (in particular where national law allows a court to determine the damages award by way of approximate estimation or determination on an *ex-aequo-et-bono* basis). Also, rules on the standard and the burden of proof remain unaffected.

The circumstances in which such adjustments would be required from claimants or defendants will depend on the rules of applicable law.

b. Other comparator-based methods

136. Besides comparisons over time, other comparator-based methods as described above in Part 2 may also be useful in quantifying the amount of the initial overcharge paid by the direct customer. In the example of the flour cartel, the claimant bakery could alternatively use a comparison with prices from another geographic market or another product market to show what the prices in its own market are likely to have been without the infringement.

137. One possibility would be the comparison with price data observed on a different geographic market for flour. On the assumption that the flour cartel as described above covered a national market, price data from another Member State could be used to construct the non-infringement price. In the case of markets with a sub-national regional scope, sales prices for flour from a different regional market could be a suitable reference point.

138. In order to be a suitable indicator for the prices as they would have been absent the infringement, the comparator prices should themselves not be influenced by the same or a similar infringement of the competition rules. If in the example of the flour cartel price data from a neighbouring geographic market are used and there is evidence that the anticompetitive agreement also covered that neighbouring market, prices from that market would lead to an underestimation of the overcharge. Also, in the case of neighbouring markets, the infringement in one market may have had an influence on that neighbouring market (for example through a rise in demand in the market without infringement), which might therefore not reflect non-infringement prices either.

139. Where the comparator market has different market characteristics, price data from that market might likewise not be sufficiently indicative of the prices as they would have been had there been no infringement. In the present example, the market concerned by the infringement is supplied by four milling companies. For instance, if it can be shown that prior to entering into the infringing practices, vigorous competition existed, price data from a neighbouring market characterised by the presence of a dominant milling company might not adequately reflect the prices as they would have been had there been no cartel and may only serve as a basis for a lower-bound estimate.

140. If the claimant bakery uses price data from a different geographic market in the form in which they are observed, it makes the implicit assumption that the remaining differences between the prices actually paid to the infringers and the prices prevailing on that comparator market are due to the infringement. Depending on the circumstances of the case and requirements under applicable law, the techniques described in Part 2 Section II B above may be used to identify and account for possible alternative influences on prices. It is a matter of applicable law to determine which party bears the burden of proof for such alternative influences or other counterarguments against the claimant's estimation of a quantum of damages.

141. A further possibility to estimate the non-infringement price is comparison with price data observed on other product markets. In the case of flour, it may, however, be difficult to find a sufficiently similar product market not affected by the same or a similar infringement.

(3) The pass-on of overcharges

142. Direct customers of the infringing undertakings who pay an overcharge caused by the cartel may themselves sell on the affected products (or use them as input for their own production of other goods or services). In the example of the flour cartel discussed above, the bakeries are the direct customers of the infringing undertakings and they use the purchased flour to bake bread, which they then sell on either directly to final customers or to supermarkets. These direct customers (bakeries), in reaction to the price increase they face, may raise the prices for their own goods or services (the bread they sell on), thereby passing on some or the entire initial overcharge to their own customers (the consumers or supermarkets). The same effect exists where it is *indirect* customers (such as, for instance, the supermarkets in the present example) who themselves raise their own selling prices in their business deals with their customers, thereby passing on an overcharge which was first passed on to them.

143. Such pass-on of overcharges normally entails a volume effect: as described above in paragraphs 109 *et seq*., a rise in prices normally leads to a decrease in demand. In the example of the flour cartel, in so far as the bakery passes on the overcharge by raising the prices it charges for the bread to the supermarkets and end customers, it may reduce the adverse financial impact of the overcharge on itself, but it will suffer decreased demand.[139] This decrease in demand means, for the bakery, less sales and a loss of profit — harm that is also caused by the infringement and should be compensated (see Section III below).

144. The price increase through pass-on and the reduction in sales are thus intrinsically connected. In fact, both pass-on and volume effects are determined by the same factors, in particular, the elasticity of demand from downstream customers. This is because the market conditions regarding downstream demand affect both the sales price and the corresponding sales volumes at which the bakery would maximise its profits.

145. In the context of a claim for compensation of overcharges in an antitrust damages action, the pass-on of overcharges can become relevant in two different types of situations:

(a) In an action brought by the direct customer claiming reparation for the initial overcharge paid by him (in the present example: the claim by the bakery against Mill A), the defendant cartel infringer might argue that the direct customer should not, in fact, be compensated for the overcharge harm to the extent that he raised his own prices and thus passed on the overcharge. This is commonly referred to as the

139 This connection between a company passing on an overcharge and its own sales volume has, in a different context, also been emphasised by the Court of Justice in Case C-147/01 *Weber's Wine World* [2003] ECR I-11365, at paragraphs 98-99: 'even where it is established that the … charge … has been passed on in whole or in part to third parties … the person may suffer as a result of a fall in the volume of his sales'.

'passing-on defence'. Pass-on by the purchaser may, as mentioned above, lead to a loss of sales and therefore a loss of profit for him.

(b) An action brought by an indirect customer against the infringer (for example, a supermarket or a consumer who purchased bread from the bakery and who brings a claim against the milling companies) will also depend on a pass-on argument. Indeed, the indirect purchaser can claim compensation for an overcharge only where the initial overcharge paid by the direct customer has been passed on partially or entirely to him. This can be of relevance for claimants situated at different levels of the supply chain, including end customers.

146. Different legal rules exist concerning the availability of the passing-on defence and the burden of proof in this context.[140] The economic insights into the quantification of pass-on set out in paragraphs 148 *et seq*. below can be of use no matter how these rules are designed.

147. In both situations considered above, claimants and defendants could rely on two different approaches to substantiate their claim that the overcharge was passed on to the indirect customer: they could either (a) quantify the initial overcharge and determine the pass-on rate to the indirect customer, possibly at several levels of the supply chain and using the econometric techniques outlined above, or (b) use the methods and techniques outlined above to determine whether the indirect customer concerned paid an overcharge. For instance, where an indirect customer brings a claim for compensation of an overcharge caused by a cartel, that indirect customer can either show that there was an initial overcharge and that this overcharge was passed on to him[141] or he may quantify the overcharge passed on to his level in the same manner as a direct customer would quantify an initial overcharge, namely by comparing the actual price he paid with the likely price in a non-infringement scenario: comparator-based methods can provide useful insights into the amount of overcharge paid by indirect customers, without it being necessary to identify the degree of pass-on. By using a time comparison, for instance, for the prices paid by the indirect customer before and during the infringement, it can be possible to ascertain how much those prices rose because of the infringement, without having to make a finding concerning the pass-on rate.

148. It is not possible to establish a typical pass-on rate that would apply in most situations. Rather, careful examination of all the characteristics of the market in question will be necessary to assess pass-on rates. In a specific case, the existence and degree of pass-on is determined by a range of different criteria and can therefore only be assessed having regard to the conditions of the market in question.

149. Where the direct customer of the infringing undertakings uses the cartelised goods to compete in a downstream market, it is likely that the direct customer will normally not be able to pass on this increase in cost (or only to a very limited degree) if his own competitors in that downstream market are not subject to the same or a similar

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140 See Commission White Paper on damages actions for breach of the EC antitrust rules (COM(2008) 165 final, 2.4.2008) for policy proposals concerning the treatment of pass-on in antitrust damages actions.

141 Where the indirect customer substantiates his claim with reference to a pass-on rate and the infringement concerns a cost factor which is small compared to the entire cost of the product, the pass-on rates of other, more important cost factors that may be more easily estimated might serve as a useful indicator.

overcharge (for example, where they receive their input from a market that is not subject to the cartel). In the example of the flour cartel, the claimant bakery is in competition with other bakeries for the production and supply of bread. In so far as these other bakeries do not obtain their flour from the cartel members, but are able to buy it at a lower price elsewhere, the bakery having to buy from the cartel is placed at a competitive disadvantage vis-à-vis its own competitors that prevents it from passing on the extra cost of the overcharge.

150. Where all the undertakings in that downstream market are hit by the cartel and are thus similarly exposed to the payment of the direct overcharge, it is likely that the direct customer will be able to pass on at least part of that overcharge. The degree of such pass-on is influenced by the intensity of competition in the downstream market: if the downstream market is perfectly competitive, the pass-on rate in this case will be virtually 100 %. This reflects the fact that in perfectly competitive markets, price equals marginal costs and a rise in prices for the input will therefore directly lead to an equal rise in cost/output price. For less than perfectly competitive markets, it is likely that affected firms will pass on at least part of the overcharge, though not necessarily 100 %. For example, if the direct customer is a monopolist on the downstream market, he will choose a pass-on rate that reflects — for him — a profit-maximising price in view of the decrease in demand that the pass-on of the overcharge is likely to generate.[142]

151. The other characteristics that may also have an influence on the degree of pass-on in such situations (everything else being constant) include:

- The price elasticity of demand and the question whether customers become more or less sensitive to price as prices rise. In particular, pass-on is generally more likely if customers do not easily switch to other products following a price increase (inelastic demand) and if customers become less sensitive to price increases when prices are higher.

- The variation of marginal cost with output changes. For instance, a substantial pass-on is less likely if marginal cost significantly decreases following a reduction in output, because the lower output would become less costly to produce (e.g. in the presence of capacity constraints). Conversely, a substantial pass-on is more likely if marginal cost does not significantly decrease following a reduction in output (e.g. due to the absence of capacity constraints).

- The impact of the infringement on different types of costs. Where the infringement impacts on variable costs, this renders pass-on more likely than if the impact is on fixed costs.

- The duration of the infringement and the frequency of business exchanges. Where infringements last for a long time, it is more likely that some level of pass-on occurs; the same applies to sectors where business exchanges and price adjustments are frequent.

[142] The exact extent of this pass-on will depend on the demand the direct customer faces and his cost structure. For example, in the simple case of a monopolist facing linear demand (meaning that the relationship between the quantity and price can be represented by a straight line) and constant marginal costs, the pass-on will be 50 % of the direct overcharge.

B. Quantifying overcharges caused by other types of infringements leading to overcharge harm

152. Cartels are but one of the infringements leading to a rise in prices for customers of the infringing undertakings and thus to overcharge harm (or, in the case of infringements pertaining to the supply to the infringing undertakings, to an 'undercharge'). Other examples of behaviour that can lead to overcharge harm include infringements of Article 101 TFEU by way of certain anti-competitive joint ventures and the abusive charging of excessive prices by a dominant undertaking within the meaning of Article 102 TFEU.

153. A common feature of these infringements is the fact that they may directly or indirectly allow the infringing undertaking(s) to raise the prices for their customers.[143] The payment of such overcharge in turn leads to a decrease in demand and thus to a volume effect as described above.

154. The methods and techniques whose application to the case of cartel overcharge has been described above[144] can be used to quantify the overcharge harm caused by other infringements.

III. QUANTIFYING THE HARM CAUSED BY THE VOLUME EFFECT

155. A rise in prices for a particular product leads to less demand. The degrees to which both prices rise and quantities decrease following an infringement depends on the same cost and demand parameters, and are determined jointly. Hence, the overcharge and volume effects are intrinsically linked.

156. For an overcharge to an intermediate customer (as discussed above in paragraphs 142 *et seq*.), the volume effect is also closely linked to the pass-on of overcharges along the supply chain to the final customer: where a customer of the infringing undertakings does not pass on the overcharge and thus absorbs it entirely, his own sales will not decrease because of the infringement as his customers will not experience a rise in prices due to the infringement. Where, however, the overcharge is passed on partly or entirely to the final customer, that customer will be subject to the rise in prices described in paragraph 109 and will reduce his demand. This in turn will reduce demand upstream in the supply chain.

157. As explained above, for those direct or indirect customers of the infringing undertakings who use the product in question for their own commercial activities, this decrease in demand ('volume effect') means that they sell less because of the infringement and therefore forego the profit they would have made on the units they failed to sell because of this effect. This loss of profit is harm for which compensation may be awarded[145] and, in principle, the methods and techniques described above in Part 2 could be used to quantify it.[146]

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143 Or, if the infringement relates to the supply to the infringing undertakings, to lower the price these suppliers obtain from their customers.

144 See paragraphs 130 and following, and 136 and following.

145 Joined Cases C-295/04 to C-298/04 *Manfredi* [2006] ECR I-6619, paragraph 95.

146 Except for the cost-based method.

158. In particular, the comparator-based methods and techniques, whose application to the quantification of the initial overcharge paid by the direct customer is discussed above, can provide the claimant with useful insights in determining the decrease in his turnover and profits. For instance, a comparison over time or across markets can be used to reconstruct the sales volume in the non-infringement scenario, i.e. how many units the claimant would have been able to sell had there been no infringement. Likewise, the application of these methods and techniques can be used to arrive at the hypothetical profit margin in a non-infringement scenario. In some instances, a court may also agree to these methods being used in a simplified fashion, for instance by determining an average profit margin per transaction and then multiplying it by the units that were not sold because of the infringement.[147]

159. Loss of profit is a form of harm often associated with infringements that have the effect of excluding competitors from the market. Part 4 of the Guidance Paper discusses the quantification of such harm in more detail. The insights presented in that part can also be relevant when it comes to quantifying the loss of profit caused by a rise in prices.

[147] See also below, paragraph 171.

PART 4 — QUANTIFYING HARM FROM EXCLUSIONARY PRACTICES

I. EFFECTS OF EXCLUSIONARY PRACTICES

160. Infringements of Article 101 or 102 TFEU can have the effect of completely excluding competitors from a market or of reducing their market shares. Such effects of infringements on competitors are commonly referred to as 'foreclosure'. Examples of these practices are abuses of a dominant position prohibited by Article 102 TFEU through, for instance, predation, exclusive dealing, refusal to supply, tying, bundling, or margin squeeze.[148] Such abuses are called "exclusionary abuses". Foreclosure of a competitor can also be the object or effect of a practice prohibited by Article 101 TFEU. It is therefore possible to refer to "exclusionary pratices", covering both infringements of Article 101 and of Article 102 TFEU.

161. Through exclusionary practices prohibited by the Treaty's competition rules, infringers distort competition in order to improve or artificially maintain their position on the market. This immediately affects their competitors by deteriorating their position in a market, driving them out of a market or preventing them from entering a market. Exclusionary practices can affect the costs borne by a competitor, the price it is able to charge for its products, or the quantities it is capable of producing and selling. They typically lead to a loss of profit for the competitors concerned.

162. Moreover, by illegally affecting the market position of competitors and thereby the level of competition in the market, such practices lead to harm to customers in the form of higher prices or reduced choice, quality or innovation. However, the detrimental effects of exclusionary practices on customers may not always manifest themselves immediately, as these practices target competitors in the first place, thereby reducing the competitive constraints exerted by them on the infringer(s). Whereas infringements of the kind described in Part 3 normally produce an immediate illegal profit for the infringers and immediate harm for their customers, exclusionary practices could result in an initial disadvantage for the infringers and in better prices for customers in the short run, as typically occurs in predatory pricing. The following sections will separately approach the issues of quantifying harm suffered by competitors (Section II) and harm suffered by customers (Section III).

163. The Treaty guarantees consumers and undertakings that have suffered harm caused by an exclusionary practice a right to compensation regardless of whether they are customers or competitors of the infringers. As already stated, the Court of Justice has specified that such compensation encompasses the actual loss suffered (*damnum emergens),* compensation for the profit they have lost due to the infringement *(lucrum cessans)*, and the payment of interest.[149] For the purposes of quantifying harm from exclusionary practices, the following Sections will primarily refer to the concept of 'loss of profit', in line with the case-law of the Court of Justice. The concept of 'loss of profit' will be used in a broad sense, as meaning any difference

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148 For a description of these practices see also Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7.

149 Joined Cases C-295/04 to 298/04 *Manfredi* [2006] ECR I-6619, paragraph 95.

between the actual profits generated by an undertaking and the profits it would have generated in the absence of the infringement. The approaches to quantifying such loss of profit described in the following are without prejudice to the possibility of injured parties to claim compensation under other heads of damage under national law. Indeed, some elements of lost profits in a broad sense may be classified under different legal concepts under the law of Member States (such as loss of chance[150] or loss of reputation) and there may also be heads of damage caused by exclusionary behaviour that go beyond the notion of lost profits.

II. QUANTIFYING HARM TO COMPETITORS

164. Loss of profit to competitors can be caused by reduced revenues (e.g. through the reduction in the quantity that such competitors can sell) or increased costs (e.g. when the infringement affects the price of an input). The overall situation can be reflected in a decrease in the competitor's market share. In the following Sections, after a short description of how exclusionary practices affect competitors over time (A), and an outline of the general approach to the quantification of lost profits (B), some typical situations in the quantification of exclusionary practices will be addressed, namely in cases where they affect existing competitors (C) and new entrants (D) and when the harm they produce extends also to the future (E).

A. The time dimension of exclusionary practices

165. Depending on the period considered, exclusionary practices can affect competitors in different ways. When an exclusionary practice starts, competitors typically face difficulties in selling their products or (where the practice concerns the upstream market) obtaining supplies. This translates into a deterioration of their profit through higher costs or reduced revenues. Competitors may typically suffer a drop in their market shares, or a lower market share than they could have expected absent the infringement (for instance where their expansion is prevented). This phase may coincide with an increase in profits for infringers. This is, however, not necessarily so, since infringers may have to bear costs due to the implementation of the exclusionary practice (e.g. by lowering their price, by not supplying a competitor and thus reducing their own sales, or by offering rebates or other advantages to customers that could lower profits in the short term). Competitors may eventually be forced out of the market.

166. Once competitors have been successfully prevented from entering a market, or once their market presence has been reduced or eliminated, infringers usually recoup and benefit from increased profits to the detriment of customers and foreclosed competitors. When this occurs (either very soon after the infringement started or after a certain period of time), customers may have to pay a higher price and suffer a loss of quality or choice. The full exclusion of a competitor from a market is not a prerequisite for these effects on customers. Such effects may occur also from the very beginning of the exclusionary practice, and even if competitors are still on the market, provided the competitive pressure they exercise is weakened.

[150] Loss of a chance identifies the business opportunities forgone by an undertaking due to the illegal exclusionary practice.

167. When the exclusionary practice is detected by public enforcers or brought to an end as a result of private actions, competitive conditions could be progressively restored. It is important to stress that the restoration of market conditions as if the infringement had not occurred is factually impossible in many cases. This depends mainly on structural effects of the infringement that may be difficult and lengthy to undo (existing contractual obligations, network effects, or other barriers to the re-entry of a foreclosed competitor). Therefore, in some instances full convergence between the non-infringement scenario and the actual market development cannot take place.

B. General approach to the quantification of lost profits

168. In order to determine whether and to what extent competitors have suffered a loss of profits, it is necessary to compare the profit obtained by competitors during the infringement in the market affected by it with the profit they would have obtained from those products in a non-infringement scenario (i.e. the counterfactual scenario).[151] Whenever it can be shown that the foreclosed competitor would have earned higher profits in a non-infringement scenario, and that the difference is caused by the infringement, the competitor has suffered harm, even if its market share is unchanged or profits increased due to other factors.[152]

169. The actual profits earned by the undertaking in question are normally determined by deducting the actual costs incurred from the actual revenues earned. Similarly, profits that would have been obtained in a non-infringement scenario (counterfactual profits) can be determined by deducting the estimated costs in a non-infringement scenario (counterfactual costs)[153] from the revenues expected in the absence of the infringement (counterfactual revenues).[154] The amount of profits lost is the difference between counterfactual and actual profits. In the case of prevented entry, the actual profits are normally zero, or can even be a negative number if the foreclosed competitor incurred costs (e.g. investment to enter the market) that did not return any revenue.

170. This basic approach to calculating lost profits can be put into practice in different ways. For instance, it is possible to compare the revenues of the foreclosed competitor in the non-infringement scenario with actual revenues from the market as affected by the infringement. Once the lost revenues have been established, it is possible to deduct the costs that the undertaking has avoided due to the lower volumes produced, in order to obtain a value of lost profits. This approach to

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151 This does not concern claims aimed at recovering only part of that loss, e.g. only the additional costs incurred. Such claims arise in practice also because of the availability of more straightforward approaches to quantifying the harm suffered. See below, paragraph 172.

152 For instance, a new entrant with high potential for growth may maintain its profit levels but would have increased them absent the infringement.

153 When estimating the profit lost by the undertaking in question, it is necessary to take into account the additional costs it would have naturally faced to increase production. In this respect, the cost per unit incurred by the undertaking does not necessarily correspond to its cost per unit in the counterfactual scenario. For instance, in the case of increasing returns to scale, the cost per unit in the counterfactual scenario would be lower than the observed cost as the undertaking's production would be higher in the counterfactual scenario (i.e. had it not been affected by the infringement).

154 E.g. *Stockholms tingsrätt* (Stockholm District Court), judgment of 20 November 2008, joined cases T 32799-05 and T 34227-05 (*Europe Investor Direct AB and others* v *VPC Aktiebolag)*, appeal pending.

assessing lost profits does not make it necessary to quantify the entire costs that would have been incurred by the company, but only an estimate of those costs that have not been incurred because of the infringement.

171. There are also some further pragmatic approaches to assessing lost profits that may be suitable in certain specific cases. For instance, an average profit margin per unit of the product traded in the non-infringement scenario could be estimated and then multiplied by the number of units that have not been sold due to the infringement.[155] Such an estimate of the average per unit profit may be based on one or more transactions that can be considered as sufficiently representative of the claimant's business for the product concerned. It is worth noting that in this calculation the avoided costs would implicitly be included[156].

172. Practice of antitrust damages actions shows that foreclosed competitors sometimes choose to claim damages only for part of the harm, for instance the costs incurred in order to respond to an exclusionary practice,[157] the non recoverable costs ('sunk costs') incurred with a view to entering a market from which they have been foreclosed[158] or the amount judged excessive in cases of margin squeeze or of discriminatory pricing[159] that infringe EU competition law. The quantification methods and techniques illustrated in the present Guidance Paper do not prejudice the possibility to bring claims only for part of the harm suffered. This choice is sometimes prompted by the consideration that quantifying such heads of damage is more straightforward or may require less data, and that evidence is more easily available. Also when claimants seek compensation for loss of profits, quantification of harm on the basis of additional costs incurred (sunk and non-sunk) will generally constitute a lower bound when estimating the full loss of profit.

173. Whichever the method or technique chosen, quantifying lost profits may entail evaluating complex data referring to a hypothetical non-infringement situation against which the actual position of the foreclosed competitor needs to be assessed, often with a view at likely future developments. Assessing the profits that a company would have made, including future profits, may depend on such a number of factors that it could be appropriate to provide for less demanding requirements when it comes to quantification. Therefore, legal systems may allow courts to exercise some

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155 For an example of a pragmatic approach based on real data on costs and revenues implemented through regression techniques, see *Juzgado Mercantil numero 2 de Barcelona* (Commercial Court, Barcelona), decision of 20 January 2011, case No 45/2010 (Céntrica Energìa S.L.U./Endesa Distribuciòn Eléctrica S.A.)

156 In order to estimate the average profit margin, it could be still appropriate to consider how costs and revenues in the counterfactual scenario would have evolved without the infringement. For example, profit margins observed in a pre-infringement period could have been reduced during the infringement period for reasons unrelated to the infringement, due to a reduction in demand or an increase in input costs that are caused by other factors. In addition, the reduction in the output of the excluded competitor could affect its unit cost, hence also affecting the margin on the units it continues to sell.

157 E.g. additional marketing expenses necessary to retain the market position.

158 E.g. the costs of building a new factory on that market.

159 See e.g. *Lietuvos apeliacinis teismas* (Lithuanian Court of Appeal), decision of 26 May 2006, case No 2A-41/2006 (*Stumbras*); *Højesteret* (Supreme Court, Denmark), decision of 20 April 2005, case No 387/2002 (*GT Linien A/S* v *DSB*).

discretion as to the figures and statistical method to be chosen, and the way in which they are to be used to evaluate the damage.[160]

C. Existing competitors

174. In order to quantify the harm they suffered because of an exclusionary practice, competitors may choose to rely on the methods or techniques described in Part 2. The non-infringement scenario could be reconstructed by comparison with the performance of the same undertaking in a time period that was not affected by an infringement, a similar undertaking on the same market, aggregated industry profits[161] or the performance of the same or a similar undertaking in a market other than the one in which the exclusionary practice occurred. Alternatively, methods based on simulations may provide an estimate of the non-infringement scenario, i.e. simulating on the basis of a number of assumptions (regarding e.g. the type of competitive interactions among firms) what the likely situation would have been if the excluded competitor could have been active on the market and unaffected by the exclusionary practice. The use of other methods is also possible, e.g. financial data from the undertakings involved could provide useful insights on the likely returns of companies had they not been affected by an infringement.

Refusal to supply an essential input for commercial solvents

Worldco is a leading international producer of raw materials that are an essential input in the manufacturing of commercial solvents. Eusolv is a company that has been active on the market for commercial solvents since 1995, and most of its turnover is made from sales of Betanol. In order to produce Betanol, Eusolv purchases Rawbeta from Worldco. Worldco is dominant in the production of Rawbeta, which is the only raw material suitable for producing Betanol on an industrial scale and at prices that enable Betanol to be marketed. Worldco also supplies Rawbeta to its subsidiary Subco, which since 2004 has been producing Betanol and competes with Eusolv.

In 2006, Worldco decides to stop supplying Rawbeta to companies selling Betanol in the European Union, with the exception of its own subsidiary Subco. Eusolv initially tries to acquire sufficient Rawbeta from alternative suppliers or to replace its Rawbeta input with other raw materials produced through experimental processes, which are significantly more costly and produce sharp rises in the sales price of Betanol, together with a decrease in its quality and suitability for commercial purposes. As a consequence, Eusolv suffers a progressive decline in its sales and finally discontinues the production of Betanol in 2010. In the same year, Eusolv brings a damages action against Worldco and its subsidiary Subco in order to recover the profits it lost due to the refusal to supply. The court holds that Worldco's practice amounted to an abuse of a dominant position prohibited by Article 102 TFEU.

(1) Comparison over time

175. When an exclusionary practice affects existing competitors, it is likely that data from the same undertaking in an unaffected period are available. In such cases, the profits

160 See for instance Joined Cases C-104/89 and C-37/90 *Mulder and others* v *Council and Commission* [2000] ECR I-203, paragraph 79.

161 See above at paragraphs 31, 41 and 60.

lost by the harmed competitor could be estimated by means of a comparison over time. The non-infringement scenario could, for example, be constructed by reference to data on revenues and costs of the harmed undertaking before the exclusionary infringement produced effects.[162] In many exclusionary practices cases, data from after the infringement may not be available or would not be equally suitable, particularly if the infringement produced effects that may alter the structure of a market and are unlikely to disappear in the short term, for instance when the competitor is excluded from the market and there are barriers to re-entry in the short term, or when the competitor has lost market shares that could be difficult to regain because of network effects.[163]

In the Betanol example, reliable data from after the infringement are not available, since Eusolv, the harmed undertaking, is no longer active on the market, and its effective re-entry into the market may not occur promptly after the termination of the infringement. Eusolv thus decides to construct a likely non-infringement scenario by using data from before 2006, when the exclusionary practice was initiated.

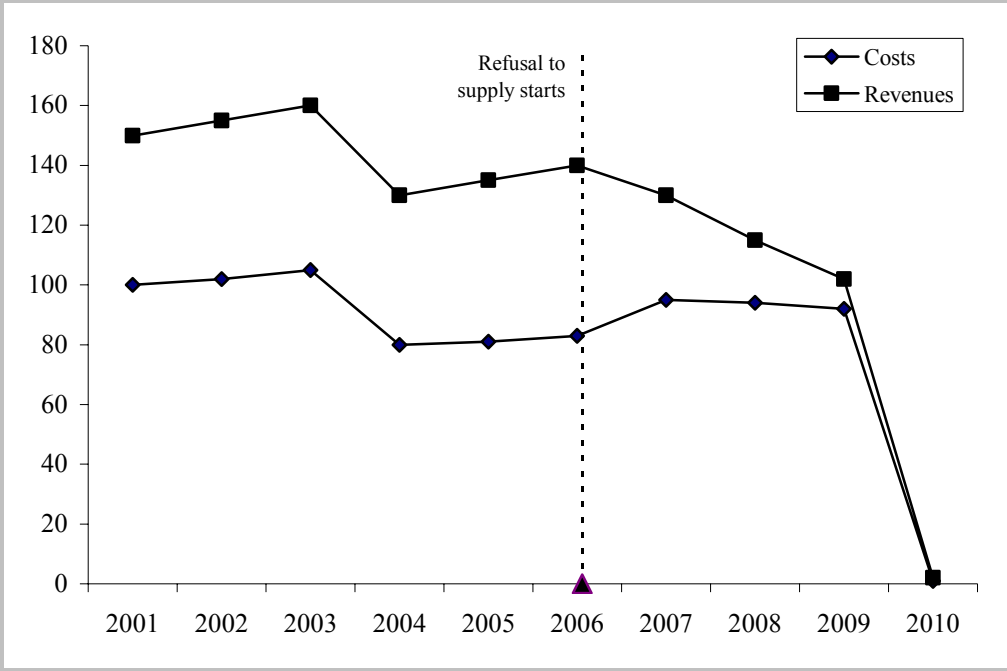
176. Under some circumstances, the pre-infringement revenue and cost data used for the comparison could be refined. For instance, and depending on applicable national rules on evidence and on the burden of proof, a defendant may challenge the amount estimated by the claimant by indicating other elements that may have adversely influenced the performance of an undertaking and are not related to the infringement, such as a drop in marketing investment, a loss of competitiveness of the product, or an increase in the cost of inputs that is specific to the competitor claiming damages. Conversely, it could be shown that the harmed competitor's situation in the non-infringement scenario would have been better than it was before the infringement, for instance because it had a potential for growth. Generally, the reference to an earlier unaffected time period on the same market is likely to be more reliable the longer the competitor has been on that market and the more stable its market position has been. In other words, the reference to a pre-infringement scenario could benefit more from adjustments[164] if the harmed competitor was a recent entrant on the market, since its market share could have been more likely subject to fluctuations.

162 For an example of the application of a before and during comparison to estimate the harm from an exclusionary practice prohibited by Article 101 TFEU see *Corte d'Appello di Milano* (Court of Appeal, Milan), decision of 3 February 2000, case No I, 308 (*Inaz Paghe* v *Associazione Nazionale Consulenti del Lavoro*).

163 A product is subject to network effects if its value for each user increases as the number of users increases.

164 Such adjustments could be performed through the techniques described above at paragraphs 53 *et seq.*

In the example, Eusolv provides data on its overall actual revenues and costs from the production and sale of Betanol, as set out in the following chart:

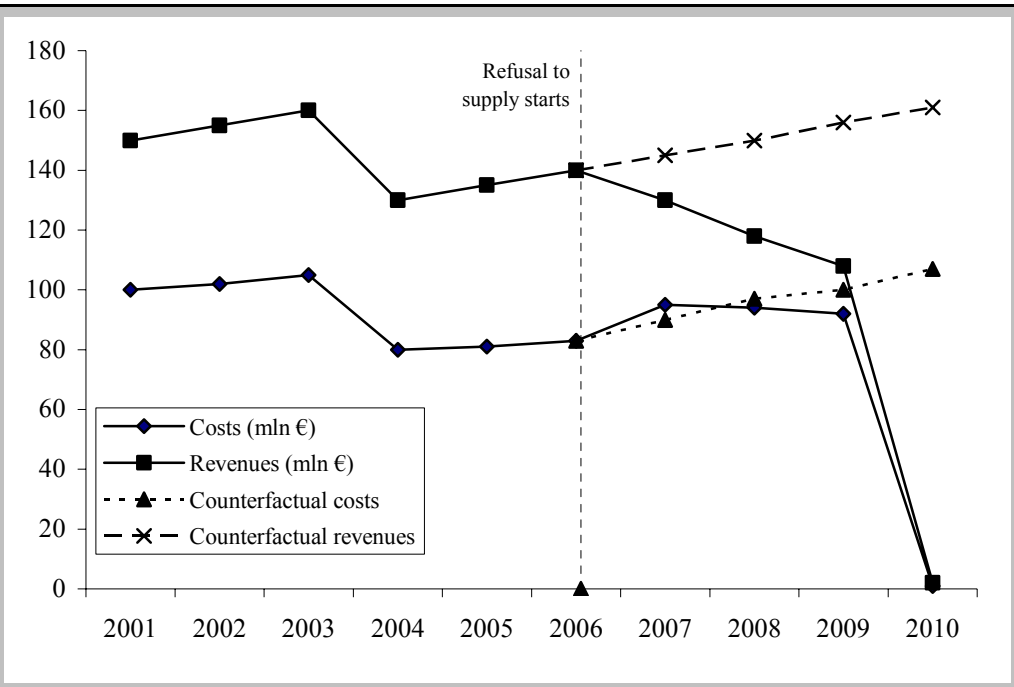


In order to establish a reliable non-infringement scenario, data from before 2004 are not taken into account because Subco, the most significant competitor of Eusolv, was not yet active on the market, whereas after 2004 and until 2006 Eusolv held a stable share of the market.

Eusolv, in accordance with national rules on the burden and the standard of proof, provides figures on the 'counterfactual' quantities, revenues and costs that would have occurred in the absence of the infringement.

Due to increasing industrial applications of Betanol, it is observed that the total demand for this product (thus, the size of the market) has grown steadily. The stability of Eusolv's market share after Subco's entry into the Betanol market is used by Eusolv to rely on the assumption that, absent the infringement, it would have maintained a similar market share. On this assumption Eusolv provides figures on its 'counterfactual' revenues for the years 2006–2010, calculated on the basis of the total value of the market and Eusolv's share of it. From its internal accounts, Eusolv provides figures on its unit costs for the years 2004 to 2006.[165] It is shown that costs closely followed the prices of the inputs for the production of Betanol, i.e. that, for instance, a rise in the input prices directly leads to a corresponding increase in costs. Using available industry data on input prices, Eusolv's experts estimate 'counterfactual' unit costs and, e.g. through regression analysis, account for the evolution in input prices and efficiencies related to the production of higher volumes. The figure for overall 'counterfactual' costs in the years 2006–2010 is then obtained by multiplying the estimated 'counterfactual' unit cost by the number of units it would have sold in the absence of the infringement.

165 These include sunk costs, distributed over time.



The figures obtained are compared with the actual revenues and costs faced by Eusolv as follows: the actual profits (actual revenues minus actual costs) are deducted from counterfactual profits (counterfactual revenues minus counterfactual costs). This constitutes the final estimate of the damages claimed by Eusolv.

However, Worldco and Subco argue that in order to be able to supply the expected increasing number of units in 2006-2010, Eusolv would have needed to expand its capacity, facing extra sunk costs that have not been included in the calculation. The defence is accepted by the court, and the compensation for lost profits is reduced accordingly (by deducting the expected extra sunk costs for the years in question, on a pro-rata basis, from the figure submitted by Eusolv).

177. In exclusionary practices cases, market shares can play an important role as an indicator in the calculation of lost profits through comparator-based methods such as time comparisons. For instance, a comparator-based method could be used to obtain the likely market share of the foreclosed competitor absent the infringement. Lost profits could then be quantified by multiplying the observed data on actual per-unit costs and revenues (or the actual average profit margin) by the extra quantities corresponding to the higher 'counterfactual' market share expected in the absence of the infringement. This relies on the assumption that costs and revenues per unit would not have significantly changed in the non-infringement scenario, and could be accepted by a legal system as an estimate of the harm suffered, possibly as *prima facie* evidence or as sufficient to shift the burden of proof.[166] A more refined estimate would assess the evolution of costs and revenues in the non-infringement scenario, provided that sufficient data are available.

166 For an example of a court estimation based on multiplying the total number of contracts concluded by the infringer by the market share held by claimants before the exclusionary practice started, see *Corte d'Appello di Roma* (Court of Appeal, Rome), decision of 20 January 2003, case No I, 2474 (*Albacom S.p.A.* v *Telecom Italia S.p.A.*).

178. When the market share is taken as an indicator in the estimation of lost profits, consideration should be given to the fact that it may be subject to fluctuations due to factors other than the infringement, such as the 2004 fall in Eusolv's market share in the Betanol example due to the entry of Subco as a competitor.[167] It may also be the case that if the infringement shrank the total size of the market, revenues for the excluded competitor estimated on the basis of actual market shares would result in an underestimate.

(2) Other comparator-based methods

179. Other geographic or product markets may also be used as a comparator in order to construct the non-infringement scenario.[168] Thus, costs and revenues of the same or a similar undertaking on a different market could be taken as a reference to estimate the costs and revenues that would have been yielded by the harmed competitor had the infringement not occurred. These methods can also be used as a means to assess the reliability of an estimation obtained by a comparison over time or other methods. For instance, if the pre-infringement performance of the sole competitor of a historically monopolistic undertaking indicates that it would have held a certain market share absent the infringement, the estimation could be comforted by the finding that the same or a similar undertaking which competes with the formerly monopolistic incumbent on a comparable geographic market actually holds a similar market share, taking into account possible differences between the undertakings or the markets concerned.

D. Prevented entry of competitors

180. Exclusionary practices can not only lead to the deterioration of the market position of an existing competitor, but also prevent the entry of a potential competitor that was not already active on the market. The foreclosure of new entrants can cause them a very significant harm for which they are entitled to compensation. Legal systems should take account of the inherent difficulties of quantifying such harm and should ensure that damages actions by prevented market entrants are not made practically impossible or excessively difficult.[169]

181. The situation of prevented entry presents some peculiar circumstances that can be taken into account when quantifying the harm. In particular, if the harmed undertaking was willing to enter a market where it was not active before, there is an inherent lack of observable data on its performance on that market.

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167 For this reason, in the example the market share considered for the quantification is the stable market share held by Eusolv after 2004.

168 See *Juzgado Mercantil numero 5 de Madrid* (Commercial Court, Madrid), decision of 11 November 2005, case No 85/2005 (*Conduit-Europe, S.A.* v *Telefónica de España S.A.*), confirmed by *Audiencia Provincial de Madrid* (Court of Appeal, Madrid), decision of 25 May 2006, case No 73/2006.

169 In some cases it is possible under applicable legal rules to quantify this harm through pragmatic approaches, such as calculation of the total value of the lost market in terms of profits, multiplied by a percentage expressing the share of the market that the foreclosed undertaking would have been likely to acquire. For instance if the total profits generated by undertakings active on the relevant market after the infringement amount to 200 million euros, and it is estimated that, in the absence of the infringement, the foreclosed competitor would have held a market share of 30 per cent, the lost profit could be estimated, under this approach, at 60 million euros.

182. The general approach to quantifying the profits lost by competitors in such situations is not essentially different from the situation of foreclosure of competitors that see their existing market position deteriorate, as it also involves an assessment of the profits that could have been yielded by the excluded competitor absent the infringement. These can then be compared with the actual situation. In cases of prevented entry, it is likely that the excluded competitor made no profits or even sustained losses (for instance where the competitor had to bear costs it did not recover through not being able to enter the market).

183. As mentioned above, foreclosed competitors may decide to seek damages only in relation to the costs borne in order to enter the market rather than the whole of the profits foregone. This approach can be more straightforward than claiming compensation for loss of profits as it only involves quantifying the sunk costs incurred by the claimant.

The medical equipment case

Newco is an undertaking that was committed to entering the market for a particular type of medical device in a Member State where Medco has a dominant position. In order to be profitable, Newco would have needed to achieve a minimum size on the market to take advantage of economies of scale.

Fearing to lose substantial sales to Newco, Medco concluded exclusive purchasing agreements with a number of customers in order to prevent Newco from achieving this minimum scale. As a result, Newco could not compete with Medco for these customers and was unable to profitably enter the market, which led to higher average prices for consumers than if Newco had entered the market. As Medco's conduct was considered to infringe Article 102 TFEU, Newco would be entitled to claim compensation for the profits it lost as a result of the infringement. However, in order to avoid carrying out a full loss of profit analysis, Newco only claimed compensation for the sunk costs it had already incurred to set up a new plant and enter the market (including e.g. financial costs and non-recoverable losses on purchased input material).

184. In cases where entry of competitors is prevented, there are no pre-infringement revenue and cost data for the market concerned, while post-infringement data could equally not lend themselves to be a reference for a time comparison because of the effects of the infringement. In such instances, reference to a comparable geographic or product market where the same or a comparable undertaking is active could prove a better means to construct a non-infringement scenario. Product or geographic markets concerned should offer a sufficient degree of similarity, although it may be possible to adjust for some differences between the markets.[170]

[170] This could be done, for instance, through regression analysis, provided that sufficient data are available. See above, paragraph 63 *et seq*. For an example of an exclusionary practice where the use of a different geographic market was, in principle, accepted as a comparator see *Juzgado Mercantil numero 5 de Madrid* (Commercial Court, Madrid), decision of 11 November 2005, case No 85/2005 (*Conduit-Europe, S.A.* v *Telefónica de España S.A.*), confirmed by *Audiencia Provincial de Madrid* (Court of Appeal, Madrid), decision of 25 May 2006, case No 73/2006.

185. In some cases, assessment of the competitor's financial performance may suffice to find data in order to estimate the profits in the non-infringement scenario.[171]

> In the situation referred in the example above, assume that Newco is willing to supply the three biggest private health centres in a Member State with an innovative type of films for X-ray machines. Assume that normally the market for this type of medical equipment for private health centres is a bidding market. Thanks to a technological improvement, Newco is capable of offering its products at a lower price than Medco. However, Medco, which holds a dominant position in the market for X-ray machines, ties the products by applying a higher price for X-ray machines to centres that do not purchase films from it. As a result, Newco does not obtain any contract. In such circumstances, Newco showed that it was actually capable of supplying the quantities demanded by the centres for the price offered, and provided detailed data on its own costs. On the basis of these data, and on the assumption that Newco would have been chosen as a contractor in those instances where it offered the lowest price, expected profit margins could be estimated without resorting to a comparison in time or with other geographic or product markets.

E. Compensation for future loss

186. When foreclosed competitors claim compensation, they may seek compensation not only for the profits lost during the infringement period, but also for the profits foregone after its termination.[172] This is relevant, in particular, where they could not re-enter the market or fully recover their market share because of lasting effects of the terminated infringement. Compensation would then be asked for future profits, i.e. profits that are likely to be lost after the claim for compensation is brought and adjudicated.

187. The challenges for quantifying such loss not only lie in the techniques to be deployed, but also have to do with the time frame during which a lost profit can still be identified and compensated. National law plays an important role in this context, for instance by determining under which circumstances a future loss can be recovered, or by establishing pragmatic rules to address this issue on a case-by-case basis.[173]

188. Factors likely to affect the choice of the relevant limit in time for claiming loss of future profit may encompass, for instance, the likely time needed to re-enter the market in question. In other cases, this assessment could be easier because of the circumstances of the case. For instance, in the X-ray machine example above, the duration of the contracts Newco was bidding for could constitute a reasonable lapse of time over which loss of future profits should be compensated under applicable national rules. In other cases, the time over which the undertaking could reasonably

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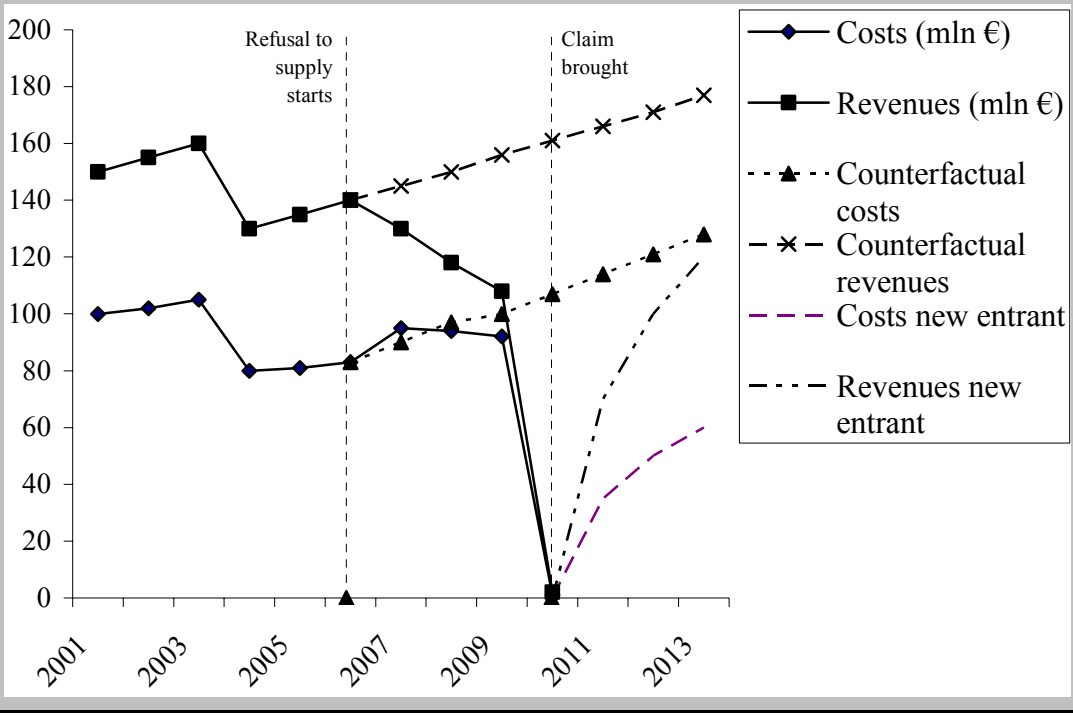
171 For an illustration of the quantification of harm to a foreclosed new entrant in a bidding market see *Oberlandesgericht Düsseldorf* (Higher Regional Court, Düsseldorf), decision of 16 April 2008, case No VI-2 U (kart) 8/06, 2 U 8/06 (*Stadtwerke Düsseldorf*).

172 For an example of a damages award also for the period subsequent to the end of an infringement see *Østre landsrets* (Eastern High Court, Denmark), decision of 20 May 2009, case No B-3355-06 (*Forbruger-Kontakt a-s* v *Post Danmark A/S*).

173 When future profits are estimated, it is normally appropriate to discount their value in order to reflect the loss in the value of money over time.

have continued producing goods or providing services in the absence of new investments could also be considered.

In the Betanol example, Eusolv may claim compensation also for the profits it could have obtained after 2010, when it was driven out of the market and brought an action for damages. In such a case, it would be possible to use the same techniques employed to reconstruct the non-infringement scenario in the years 2006–2010 and project it further into the future. Of course, lost profits for the future cannot be claimed for an indefinite duration. Eusolv decided to take as a benchmark the likely lapse of time that would be needed for Eusolv to re-enter the market once the infringement was brought to an end.



III. QUANTIFYING HARM TO CUSTOMERS

189. Undertakings that collude or abuse their dominant position in order to foreclose a competitor might face costs or a temporary reduction in their profits in order to implement the infringement. This sacrifice is borne in order to achieve a distortion of the competitive process that will eventually place the infringers in a position where they gain higher profits thanks to the distorted market conditions achieved, thus allowing them to recoup, at the expense of their customers, the temporary loss or reduction in profits borne in order to attain that position. The following sections will address two typical situations of harm to customers caused by exclusionary practices. For the purposes of quantification, the harm caused to customers by exclusionary practices can be analogous to that caused by infringements leading to a rise in prices, which is discussed in more detail in Part 3 of the Guidance Paper.

A. Recoupment

190. The most straightforward example of the harm caused to customers in the recoupment phase of exclusionary practices is price predation, where an undertaking

abuses its dominant position by setting its prices at an artificially low level that cannot be matched by its competitors, who will eventually leave the market or suffer a reduction in their market share. Once the competitors have been excluded from the market, or once a higher market share has been achieved, infringers can enjoy higher profits due to the weaker competitive constraints.

191. Recoupment can be seen as a complementary phase of the infringement that can result in overcharge effects for the customers of the infringers. These overcharge effects constitute harm caused by the exclusionary practice, and compensation for them can be sought by customers.

Recoupment in a predatory pricing case

Consider, for example, the market for flights on a particular route between two cities. Operating on this market in a dominant position is Titan Airlines, an established undertaking which offers high quality in-flight service for a standard fare of 1 000 euros. Another player on this specific market is the smaller Bluesky Airlines, which recently started operating on the same route with prices of 800 euros.

Titan Airlines engages in predatory pricing by strategically lowering its fares to a standard price of 500 euros. Bluesky Airlines experiences difficulties in meeting these predatory fares, as a result of which it fails to remain profitable, and is eventually driven out of the market. The dominant Titan Airlines will in that case take advantage of the reduction of competition and increase its profits by raising fares to a level beyond pre-predation fares, i.e. exceeding its initial standard price of 1 000 euros. If Titan Airlines, until re-entry of a competitor, were to charge a price of 1 100 euros, its customers would, due to the infringement, pay an overcharge of 100 euros.

192. When overcharges resulting from recoupment are to be quantified, the conceptual framework that applies is in principle not different from that discussed in Part 3, namely regarding infringements leading more directly to a rise in prices. Since the harm caused by an exclusionary practice is not confined to competitors of the infringer but extends to all customers in a specific market, the issues discussed in the framework of overcharge harm are thus relevant also in this scenario.

193. The position achieved by an undertaking on the market due to an exclusionary infringement does not lead in all cases to a rise in price for customers of the infringing undertaking. However, also in such cases customers may still be harmed by the infringement, for instance if it results in reduced quality. In the example, it could happen that the dominant undertaking Titan Airlines reinstates the same standard price of 1 000 euros, not exceeding the fares it charged prior to the exclusion of Bluesky Airlines. Passengers travelling on this particular route are nevertheless adversely affected, for instance, if Titan Airlines seizes the opportunity of less competitive constraints to lower the standard of its in-flight service.

194. Customers of the foreclosed competitor could be in a different situation than customers of the infringers, because they may have to switch to the products sold by the infringing undertaking as the competitor is driven out of the market. Apart from the possibility of reduced quality, they may also have to pay to the infringing undertaking prices that are higher than the prices paid for the products sold by the foreclosed undertaking. Depending on applicable legal rules, they could be allowed

to show that, in the absence of the infringement, they would have purchased from the foreclosed competitor at a lower price. In such case, the effect to be considered is, in principle, similar to an overcharge. The overcharge can be calculated by comparing the price of the product sold by the infringing undertaking in the actual scenario with that charged by the foreclosed undertaking in the non-infringement scenario.

For instance, passengers travelling with Bluesky Airlines prior to its foreclosure may face an overcharge when, due to Bluesky Airlines' exclusion from the market, they are forced to fly at more expensive fares with Titan Airlines. The overcharge could be estimated as the difference between the actual price of 1 000 euros paid to Titan Airlines and the price of 800 euros which Bluesky Airlines would have charged, had it not been driven out of the market. In such case, the overcharge suffered by passengers constrained to switch from Bluesky Airlines to Titan Airline could be estimated at 200 euros.

B. Harm to competitors as customers of the infringers

195. In cases where a competitor is also a customer of the infringer, the exclusionary practice could damage the competitor in so far as it purchases from the infringer. In these situations, the foreclosed competitor can not only claim compensation for the increase in costs produced by the infringement, but also choose to claim compensation for the profits lost because the resulting volumes produced or sold are lower than if the infringement had not occurred.[174]

196. It can be observed that for the purposes of quantification, competitors that suffer an overcharge are in a position analogous to that of customers of the members of a cartel or another infringement leading to an overcharge. In order to explain this, it is possible to take the example of Betanol, and assume that rather than refusing to supply Rawbeta to Eusolv, the dominant firm Worldco decides to increase the price of Rawbeta charged to Eusolv so as to squeeze its profit margins. In such a situation, similar considerations arise as in the case of an increase in price generated by other types of infringements. In the example Eusolv would claim compensation for the overcharge represented by the difference between the price it paid as a result of the exclusionary practice and the price it would have paid in the absence of the infringement. If the overcharge has been passed on, claims for damages could be also brought by Eusolv's own customers, and Eusolv itself could claim compensation for the volumes lost because of the price increase.

[174] For an example of the estimation of damages in a discriminatory pricing affecting a competitor as a customer of the infringer, see *Højesteret* (Supreme Court, Denmark), decision of 20 April 2005, case No 387/2002 (*GT Linien A/S* v *DSB*).

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Juzgado Mercantil numero 2 de Barcelona (Commercial Court, Barcelona), decision of 20 January 2011, case No 45/2010 (Céntrica Energìa S.L.U./Endesa Distribuciòn Eléctrica S.A.)

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Public consultation "Quantification of harm in actions for damages based on breaches of Articles 101 or 102 of the Treaty"
(referred as "consultation" in the text)

1. Objective

The objective of this consultation is to receive the views of stakeholders or people concerned by the topic of the consultation and potentially to publish them on the Internet, under the responsibility of the Head of the Unit *"COMP.A1",* Directorate-General *Competition,* acting as the Controller.
As this consultation collects and further processes personal data, Regulation (EC) 45/2001, of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data, is applicable.

2. What personal information do we collect and through which technical means?

Identification Data

The personal data collected and further processed are data necessary for the participation in the consultation, such as name/surname/profession/ postal & e-mail addresses/phone number/fax number..., of the contributors, including their views on the topics concerned.
The processing operations on personal data linked to the organisation and management of this consultation are necessary for the management and functioning of the Commission, as mandated by the Treaties, and more specifically articles 5, 7 and 211 - 219 of the EC Treaty.

Technical information

Your reply and personal data will be collected through post or e-mail. The e-mail system of the European Commission abides by the Commission's security decisions and provisions established by the Directorate of Security.

3. Who has access to your information and to whom is it disclosed?

Received contributions, together with the identity of the contributor, will be published on the Internet, unless the contributor objects to publication of the personal data on the grounds that such publication would harm his or her legitimate interests. In this case the contribution may be published in anonymous form. Otherwise the contribution will not be published nor will, in principle, its content be taken into account. Any objections concerning publication of personal data should be sent to the service responsible for the consultation (see Contact information below).

4. How do we protect and safeguard your information?

Your replies, together with your chosen language used for drafting the reply, are recorded in a secured and protected database hosted by the Data Centre of the European Commission, the operations of which abide by the Commission's security decisions and provisions established by the Directorate of Security for this kind of servers and services. The database is not accessible from outside the Commission. Inside the Commission the database can be accessed using a UserId/Password.

5. How can you verify, modify or delete your information?

In case you want to verify which personal data is stored on your behalf by the responsible controller, have it modified, corrected or deleted, please contact the Controller by using the Contact Information below and by explicitly specifying your request.

6. How long do we keep your data?

All replies to the consultation will remain in the database until the results have been completely analysed, and they will be archived for reference purposes thereafter. Your personal data will be part of a list of contact details shared internally amongst the staff under the responsibility of the Controller for the purpose of contacting you in the future in the context of further activities related to the consultation. If you do not agree with this, please indicate this in your reply. If you have already sent your reply, please contact the Controller by using the Contact Information below specifying your request.

7. Contact Information

In case you wish to verify which personal data is stored on your behalf by the responsible controller, have it modified, corrected, or deleted, or if you have questions regarding the consultation, or concerning any information processed in the context of the consultation, or on your rights, feel free to contact the support team, operating under the responsibility of the Controller, using the following contact information:

European Commission
Directorate-General for Competition
Unit A1 – Private Enforcement
Reference: HT 2290
comp-damages-actions@ec.europa.eu

8. Recourse

Complaints, in case of conflict, can be addressed to the European Data Protection Supervisor.

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Kristin Terris, Ph.D.

Vice President – Los Angeles

Kristin.Terris@NERA.com

Location: Chicago, IL.

Date: June 13, 2013

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- **As in the US, Antitrust matters are before the antitrust enforcement agencies or civil matters**
- **Most international agencies employ economists, and are very interested in sophisticated analysis**
  - **Agency economists work closely with the experts to understand the data and test the results**
- **No real "Daubert" equivalent internationally**
- **International law firms seek experts who's work conforms to the US standard**

The Five *Daubert* Criteria

- **In the US – Daubert Standards apply to economic testimony in antitrust litigation after discovery**
  1. Be testable and replicable
  2. Be subject to peer review
  3. Have a known error rate
  4. Subject to standards governing application
  5. Be generally accepted by the scientific community

- **Lately, there is debate about the degree to which this standard should be applied in the class certification phase of the litigation**

Snapshots of International Experience

- **South Korea/Japan**
  - **Tests are on weight or credibility not admissibility**
  - **Many law firms employ in-house economists (non-testifying)**
- **Australia/New Zealand**
  - **Economic testimony highly valued in antitrust litigation**
  - **Again tests directed at weight and credibility**
- **Europe**
  - **Experience testifying, relevant industry knowledge and practical experience valued**
  - **No depositions or juries so admissibility not as big and issue as in the US**

Antitrust litigation outside of the U.S.

- **Increasing number of private competition claims now being litigated in the EU, Canada, Latin America and Asia Pacific**
- **Key differences:**
  - **Scope for indirect purchaser claims and passing on**
  - **Class actions**
  - **Discovery**
  - **Contribution claims between defendants**
  - **Forum shopping**
- **Arbitration possible but litigation likely to remain principal method of dispute resolution**

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Quantification of damages

- **Most jurisdictions allow for compensatory damages calculated on a “but for” basis**
- **Exemplary damages can be claimed in the UK but compensatory damage will be usual measure of recovery**
- **Some jurisdictions have adopted evidential presumptions, e.g. Hungary’s 10% overcharge**
- **Few published final damage awards to date, but**
  - **Courts likely to employ in-depth economic analysis**
  - **European Commission guidance on quantification of damages expected**

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Francesca Richmond

francesca.richmond@bakermckenzie.com

Global Guide to Competition Litigation



Private enforcement in the field of competition law is well established in North America and increasing in prominence in the EU, Asia Pacific and South America – making competition litigation a vital facet of any company's global legal strategy. In Europe, where private action is being encouraged to bolster states' efforts against anti-competitive practices, companies must define their strategies to face both sides of the coin – bringing forth actions and addressing claims.

But competition laws vary worldwide. France, Germany and Hungary, for example, allow stand alone damages actions. Turkey and India don't. In Russia, first instance proceedings may last three to six months. The same proceedings may take three to four years in Sweden.

From the availability of private enforcement to emerging trends, Baker & McKenzie's Global Guide to Competition Litigation provides a roadmap for navigating the fast growing and complex area of competition litigation in 24 jurisdictions.

Access the "Quick Reference" table for an overview of key questions related to bringing or defending a private claim for damages resulting from a breach of competition law. You may also access specific chapters by clicking on the jurisdiction below. The Guide is also available in eBook format.

Asia Pacific

Australia
China
India
Japan

Europe & the Middle East

Austria
Belgium
Czech Republic
England & Wales
France
Germany
Hungary
Italy
Netherlands
Poland
Russia
Spain
Sweden
Switzerland
Turkey

Latin America

Argentina
Brazil
Mexico

North America

Canada
United States of America

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LESSONS LEARNED FROM COMPLIANCE TO GLOBAL CARTEL INVESTIGATIONS

2012 GUIDELINES MANUAL

CHAPTER EIGHT - SENTENCING OF ORGANIZATIONS

PART B - REMEDYING HARM FROM CRIMINAL CONDUCT, AND EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

2. EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673).

§8B2.1. Effective Compliance and Ethics Program

(a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (b)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

(1) exercise due diligence to prevent and detect criminal conduct; and

(2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

(b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:

(1) The organization shall establish standards and procedures to prevent and detect criminal conduct.

(2) (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

(B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual (s) within high-level personnel shall be assigned

overall responsibility for the compliance and ethics program.

(C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual (s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.

(4) (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subparagraph (B) by

conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities.

(B) The individuals referred to in subparagraph (A) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.

(5) The organization shall take reasonable steps—

(A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and

(C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate

disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.

(c) In implementing subsection (b), the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth in subsection (b) to reduce the risk of criminal conduct identified through this process.

Commentary

Application Notes:

1. *Definitions.—For purposes of this guideline:*

"Compliance and ethics program" means a program designed to prevent and detect criminal conduct.

"Governing authority" means the (A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization.

"High-level personnel of the organization" and "substantial authority personnel" have the meaning given those terms in the

Commentary to §8A1.2 (Application Instructions - Organizations).

"Standards and procedures" means standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct.

2. Factors to Consider in Meeting Requirements of this Guideline.—

(A) In General.—Each of the requirements set forth in this guideline shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, factors that shall be considered include: (i) applicable industry practice or the standards called for by any applicable governmental regulation; (ii) the size of the organization; and (iii) similar misconduct.

(B) Applicable Governmental Regulation and Industry Practice.—An organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective compliance and ethics program.

(C) The Size of the Organization.—

(i) In General.—The formality and scope of actions that an organization shall take to meet the requirements of this guideline, including the necessary features of the organization's standards and procedures, depend on the size of the organization.

(ii) Large Organizations.—A large organization generally shall devote more formal operations and greater

resources in meeting the requirements of this guideline than shall a small organization. As appropriate, a large organization should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs.

(iii) Small Organizations.—In meeting the requirements of this guideline, small organizations shall demonstrate the same degree of commitment to ethical conduct and compliance with the law as large organizations. However, a small organization may meet the requirements of this guideline with less formality and fewer resources than would be expected of large organizations. In appropriate circumstances, reliance on existing resources and simple systems can demonstrate a degree of commitment that, for a large organization, would only be demonstrated through more formally planned and implemented systems.

Examples of the informality and use of fewer resources with which a small organization may meet the requirements of this guideline include the following: (I) the governing authority's discharge of its responsibility for oversight of the compliance and ethics program by directly managing the organization's compliance and ethics efforts; (II) training employees through informal staff meetings, and monitoring through regular "walk-arounds" or continuous observation while managing the organization; (III) using available personnel, rather than employing separate staff, to carry out the compliance and ethics program; and (IV) modeling its own compliance and ethics program on existing, well-regarded compliance and

ethics programs and best practices of other similar organizations.

(D) Recurrence of Similar Misconduct.—Recurrence of similar misconduct creates doubt regarding whether the organization took reasonable steps to meet the requirements of this guideline. For purposes of this subparagraph, "similar misconduct" has the meaning given that term in the Commentary to §8A1.2 (Application Instructions - Organizations).

3. Application of Subsection (b)(2).—High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

If the specific individual(s) assigned overall responsibility for the compliance and ethics program does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program.

4. Application of Subsection (b)(3).—

(A) Consistency with Other Law.—Nothing in subsection (b)(3) is intended to require conduct inconsistent with any Federal, State, or local law, including any law governing employment or hiring practices.

(B) Implementation.—In implementing subsection (b)(3), the organization shall hire and promote individuals so as to ensure that all individuals within the high-level personnel and substantial authority personnel of the organization will perform their assigned duties in a manner consistent with the exercise of due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law under subsection (a). With respect to the hiring or promotion of such individuals, an organization shall consider the relatedness of the individual's illegal activities and other misconduct (i.e., other conduct inconsistent with an effective compliance and ethics program) to the specific responsibilities the individual is anticipated to be assigned and other factors such as: (i) the recency of the individual's illegal activities and other misconduct; and (ii) whether the individual has engaged in other such illegal activities and other such misconduct.

5. Application of Subsection (b)(6).—Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

6. Application of Subsection (b)(7).—Subsection (b)(7) has two aspects.

First, the organization should respond appropriately to the criminal conduct. The organization should take reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct. These steps may include, where appropriate, providing restitution to identifiable victims, as well as other forms of remediation. Other reasonable steps to respond

appropriately to the criminal conduct may include self-reporting and cooperation with authorities.

Second, the organization should act appropriately to prevent further similar criminal conduct, including assessing the compliance and ethics program and making modifications necessary to ensure the program is effective. The steps taken should be consistent with subsections (b)(5) and (c) and may include the use of an outside professional advisor to ensure adequate assessment and implementation of any modifications.

7. Application of Subsection (c).—To meet the requirements of subsection (c), an organization shall:

(A) Assess periodically the risk that criminal conduct will occur, including assessing the following:

(i) The nature and seriousness of such criminal conduct.

(ii) The likelihood that certain criminal conduct may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of criminal conduct may occur, the organization shall take reasonable steps to prevent and detect that type of criminal conduct. For example, an organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its business, employs sales personnel who have flexibility to represent the material characteristics of a product shall establish

standards and procedures designed to prevent and detect fraud.

(iii) The prior history of the organization. The prior history of an organization may indicate types of criminal conduct that it shall take actions to prevent and detect.

(B) Prioritize periodically, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b), in order to focus on preventing and detecting the criminal conduct identified under subparagraph (A) of this note as most serious, and most likely, to occur.

(C) Modify, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b) to reduce the risk of criminal conduct identified under subparagraph (A) of this note as most serious, and most likely, to occur.

Background: This section sets forth the requirements for an effective compliance and ethics program. This section responds to section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002, Public Law 107–204, which directed the Commission to review and amend, as appropriate, the guidelines and related policy statements to ensure that the guidelines that apply to organizations in this chapter "are sufficient to deter and punish organizational criminal misconduct."

The requirements set forth in this guideline are intended to achieve reasonable prevention and detection of criminal conduct for which the organization would be vicariously liable. The prior diligence of an organization in seeking to prevent and detect criminal conduct has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense.

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673). Amended effective November 1, 2010 (see Appendix C, amendment 744); November 1, 2011 (see Appendix C, amendment 758).

EFFECTIVE November 1, 2012
United States Sentencing Commission

PETER K. HUSTON (Cal. Bar No. 150058)
MICHAEL L. SCOTT (Cal. Bar No. 165452)
HEATHER S. TEWKSBURY (Cal. Bar No. 222202)
BRENT SNYDER (Cal. Bar. No. 165888)
JON B. JACOBS (D.C. Bar No. 412249)
Antitrust Division
U.S. Department of Justice
450 Golden Gate Avenue
Box 36046, Room 10-0101
San Francisco, CA 94102-3478
Telephone: (415) 436-6660
Facsimile: (415) 436-6687
peter.huston@usdoj.gov

Attorneys for the United States

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA v. AU OPTRONICS CORPORATION; AU OPTRONICS CORPORATION AMERICA; HSUAN BIN CHEN, aka H.B. CHEN; HUI HSIUNG, aka KUMA; LAI-JUH CHEN, aka L.J. CHEN; SHIU LUNG LEUNG, aka CHAO-LUNG LIANG and STEVEN LEUNG; BORLONG BAI, aka RICHARD BAI; TSANNRONG LEE, aka TSAN-JUNG LEE and HUBERT LEE; CHENG YUAN LIN, aka C.Y. LIN; WEN JUN CHENG, aka TONY CHENG; and DUK MO KOO, Defendants.	No. CR-09-0110 SI DECLARATION OF HEATHER S. TEWKSBURY IN SUPPORT OF UNITED STATES' SENTENCING MEMORANDUM Date: September 20, 2012 Time: 10:00 a.m. Court: Hon. Susan Illston Place: Courtroom 10, 19th Floor

I, Heather S. Tewksbury, hereby declare as follows:

1. I am an attorney in the United States Department of Justice, Antitrust Division in San Francisco and am admitted to practice before this Court. I have personal knowledge of the matters set forth herein and, if called as a witness, could and would testify competently thereto.

2. Attached hereto as Exhibit A is a true copy of an article entitled, "Free exchange/Fine and punishment," which appeared in the July 21, 2012 issue of The Economist.

3. Attached hereto as Exhibit B is a what I am informed and believe is a true copy of an article entitled, "Sentenced to Serve in Prison!/Personal Letter Written in Tears by AUO Vice Chairman Exposed," which on Nikkei Technology On Line on April 17, 2012. Also attached as Exhibit B is a true copy of a translation of that article prepared by Mary Ma, the government's Chinese language document translator.

4. Attached hereto as Exhibit C is the government's proposed Corporate Antitrust Compliance Program for defendants AU Optronics Corporation and AU Optronics Corporation America.

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct to the best of my knowledge.

Executed this 11th day of September, 2012 at San Francisco, California.

/s/ Heather S. Tewksbury
Heather S. Tewksbury

Exhibit C

Corporate Antitrust Compliance Program

1. Pursuant to United States Sentencing Guidelines (USSG) §8D1.4(b)(1), AU Optronics Corporation ("AUO"), AU Optronics Corporation America, and their subsidiaries and affiliates (collectively "AUO/AUOA") are required to develop and submit to the Court an antitrust compliance program designed to prevent and detect violations of the United States antitrust laws (the "antitrust laws"), throughout their operations, including the pricing and sale of products in the United States or for integration into finished products sold in the United States.

2. In order to address any deficiencies in their internal policies and procedures regarding compliance with the antitrust laws, AUO/AUOA are required to undertake a review of their existing policies and procedures including without limitation regarding sales, pricing, communications with competitors, and participation in industry groups and trade associations. Where necessary and appropriate, AUO/AUOA will adopt new or modify existing policies and procedures in order to ensure that AUO/AUOA have a rigorous antitrust compliance program designed to detect and deter violations of the antitrust laws. The antitrust compliance program of AUO/AUOA will consist of the following elements, at a minimum:

a. A clearly articulated corporate policy against violations of the antitrust laws;

b. Promulgation of antitrust compliance standards and procedures to be followed by all directors, officers, employees of AUO/AUOA and, where appropriate, business partners including, but not limited to, agents, consultants, representatives, teaming partners, joint venture partners, and other parties acting on behalf of AUO/AUOA (collectively referred to hereinafter as "agents and

business partners"), that are reasonably capable of reducing the prospect that the antitrust laws will be violated;

c. The assignment of one or more senior corporate officials of AUO/AUOA, who shall report directly to the Audit Committee of the AUO Board of Directors, with responsibility for the implementation and oversight of compliance with policies and procedures established in accordance with the antitrust compliance program of AUO/AUOA;

d. The effective communication to all directors, officers, employees, and, where appropriate, agents and business partners, of AUO/AUOA's corporate antitrust compliance program. This shall include: (i) training concerning the requirements of the antitrust laws on a periodic basis to all directors, officers, and employees; (ii) periodic certifications by all directors, all officers, and all employees involved in the pricing, sale, or marketing of products in the United States or for integration into finished products sold in the United States, including the head of each AUO/AUOA business or division, and, where appropriate, agents and business partners, certifying compliance therewith; and (iii) periodic communications by senior management of AUO/AUOA that provide strong, explicit, and visible support and commitment to its corporate policy against violations of the antitrust laws and in support of its antitrust compliance program;

e. Where appropriate, AUO/AUOA will include standard provisions in agreements, contracts, and renewals thereof with all agents and business partners that are reasonably calculated to prevent violations of the antitrust laws, which may, depending upon the circumstances, include: (i) contract terms and provisions

requiring compliance with the antitrust laws; and (ii) rights to terminate an agent or business partner as a result of any breach of the antitrust laws;

f. A reporting system administered by the senior corporate official(s) described in paragraph 2(c) above, including an anonymous "Helpline" for directors, officers, employees, agents, and business partners to confidentially report suspected violations of the antitrust laws and/or the AUO/AUOA antitrust compliance code, and a procedure for investigating such reports;

g. Procedures to protect the identity of persons, agents, or business partners who make reports under paragraph 2(f) above and to prevent any retaliation against those persons, agents, or business partners;

h. Appropriate termination procedures for all individuals, agents, or business partners convicted of violations of the antitrust laws;

i. Appropriate disciplinary and termination procedures to address violations of the AUO/AUOA antitrust compliance program; and

j. Clearly articulated corporate procedures designed to ensure that individuals whom AUO/AUOA knows, or should know through the exercise of due diligence, are under outstanding indictment for violations of the antitrust laws or have engaged in other conduct inconsistent with an effective compliance and ethics program, are prohibited from holding positions that include any discretionary pricing, sales, or marketing authority.

3. In order to assist in the development of an effective compliance and ethics

program, AUO/AUOA are required to hire, at their expense, an independent monitor (Monitor) within sixty (60) calendar days of the date of sentencing, to assist in the development of, and to monitor, AUO/AUOA's antitrust compliance program for a period of three (3) years.

a. The Monitor shall be an attorney with substantial relevant legal practice experience related to price fixing, bid-rigging, and other criminal violations of the antitrust laws. Although some of the relevant legal practice experience may be from government practice, the Monitor should have significant experience representing and counseling business entities regarding criminal violations of the antitrust laws as well as extensive expertise in developing, implementing, and overseeing antitrust compliance programs on behalf of multinational business entities.

b. Within thirty (30) calendar days after the date of sentencing, AUO/AUOA shall recommend to the Probation Office and the United States Department of Justice, Antitrust Division, San Francisco Field Office (hereinafter "the Antitrust Division") a pool of three qualified monitor candidates and provide to the Probation Office and the Antitrust Division a description of each candidate's qualifications and credentials. After consultation with the Antitrust Division, the Probation Office, in its sole discretion, shall either select one of the candidates nominated by AUO/AUOA to serve as the Monitor, select an alternative-qualified Monitor of its own choosing, or instruct AUO/AUOA to propose three additional candidates for selection pursuant to the process set forth above.

c. At the time that AUO/AUOA recommend the pool of monitor candidates, AUO/AUOA shall provide the Probation Office with (1) a written certification

from each company that it will not employ or be affiliated with the monitor for a period of not less than one year after the termination of the monitorship and (2) a written certification by each of the monitor candidates that he/she is not an employee or agent of AUO/AUOA and holds no interest in, and has no relationship with, AUO/AUOA or their directors, officers, employees, agents, or business partners.

4. The Monitor will review and evaluate the effectiveness of any AUO/AUOA antitrust compliance code, policies, and procedures in existence at the time of his or her appointment. This review and evaluation shall include an assessment of those policies and procedures that have actually been implemented. AUO/AUOA shall cooperate fully with the Monitor and the Monitor shall have the authority to take such reasonable steps, in his or her view, as may be necessary to be fully informed about the operations of AUO/AUOA within the scope of his or her responsibilities under this Agreement. To that end, AUO/AUOA shall provide the Monitor with access in the United States to all information, documents, records, "Helpline" reports, directors, officers, employees, agents, and/or business partners that fall within the scope of responsibilities of the Monitor under this Agreement.

a. No attorney-client relationship shall be formed between AUO/AUOA and the Monitor.

b. In the event that AUO/AUOA seek to withhold from the Monitor access to any information, documents, records, "Helpline" reports, directors, officers, employees, agents, and/or business partners because of a claim of attorney-client privilege or the attorney work-product doctrine, or where AUO/AUOA reasonably believe production would otherwise be inconsistent with applicable

law, AUO/AUOA shall work cooperatively with the Monitor to resolve the matter to the satisfaction of the Monitor. If the matter cannot be resolved, at the request of the Monitor, AUO/AUOA shall promptly provide written notice of this determination to the Monitor, the Probation Office, and the Antitrust Division. Such notice shall include a general description of the nature of the records or individuals that are being withheld, as well as the basis for the claim. Any dispute regarding the privilege or work-product claim by AUO/AUOA shall be referred to the Court for resolution.

5. The Monitor shall assess whether any AUO/AUOA policies and procedures in existence at the time of his or her appointment are reasonably designed to detect and prevent violations of the antitrust laws and, during the three (3) year period, shall conduct an initial review and prepare an initial report, followed by two (2) follow-up reviews and follow-up reports as described below. With respect to each of the three (3) reviews, after initial consultations with AUO/AUOA and the Probation Office, the Monitor shall prepare a written work plan of proposed actions for each of the reviews, which shall be submitted to AUO/AUOA, the Probation Office, and the Antitrust Division for comment before the Monitor begins each review. In order to conduct an effective initial review and to fully understand any existing deficiencies in policies and procedures related to antitrust compliance, the Monitor's initial work plan shall include such steps as are necessary to develop an understanding of the facts and circumstances surrounding the violations that occurred. Any disputes between AUO/AUOA, the Monitor, and the Antitrust Division with respect to the work plan shall be decided by the Probation Office in its sole discretion.

6. In connection with the initial review, the Monitor shall issue a written report within one hundred twenty (120) calendar days of his or her retention setting forth the Monitor's assessment and making recommendations reasonably designed to improve the policies and procedures of AUO/AUOA for ensuring antitrust compliance. The Monitor shall provide the report to the Boards of Directors of AUO/AUOA and contemporaneously transmit copies to the Probation Office and the Antitrust Division. The Monitor may extend the time period for issuance of the report with the prior written approval of the Probation Office.

7. Within sixty (60) calendar days after receiving the Monitor's report, AUO/AUOA shall adopt all recommendations in the report; provided, however, that within thirty (30) calendar days after receiving the report, AUO/AUOA shall advise the Monitor, the Probation Office, and the Antitrust Division in writing of any recommendations that AUO/AUOA consider unduly burdensome, impractical, or costly. With respect to any recommendations to which AUO/AUOA object as unduly burdensome, impractical, or costly, AUO/AUOA need not adopt the recommendation within that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which AUO/AUOA and the Monitor do not agree, such parties shall attempt in good faith to reach an agreement within thirty (30) calendar days after AUO/AUOA serves written notice of objection. In the event AUO/AUOA and the Monitor are unable to agree on an alternative proposal, AUO/AUOA shall abide by the determination of the Probation Office, which will consult with the Antitrust Division before making its determination. With respect to any recommendation that the Monitor determines cannot reasonably be implemented within sixty (60) calendar days after AUO/AUOA receive the report, the Monitor may extend the time period for implementation with prior written approval of the Probation Office.

8. The Monitor shall undertake two (2) follow-up reviews to further monitor and assess whether the policies and procedures of AUO/AUOA are reasonably designed to detect and prevent violations of the antitrust laws and are being reasonably implemented to do the same. Within sixty (60) calendar days of initiating each follow-up review, the Monitor shall: (a) complete the review; (b) certify whether the antitrust compliance program of AUO/AUOA, including its policies and procedures, is appropriately designed and implemented to ensure compliance with the antitrust laws; and (c) report on the Monitor's findings in the same fashion as set forth in Paragraph 6 with respect to initial review. The first follow-up review shall commence one year after appointment of the Monitor. The second follow-up review shall commence 18 months after completion of the first follow-up review. The Monitor may extend the time period for these follow-up reviews with the prior written approval of the Probation Office.

9. In undertaking the assessments and reviews described in Paragraphs 3-8 herein, the Monitor shall formulate conclusions based on, among other things: (a) inspection of documents, including all policies and procedures relating to the antitrust compliance program of AUO/AUOA; (b) meetings with and interviews of employees, officers, directors, agents, and business partners of AUO/AUOA and all of their affiliates and subsidiaries, and any other relevant persons, who shall be brought to the United States at the expense of AUO/AUOA for such meetings; and (c) analyses, studies, and testing of the antitrust compliance program of AUO/AUOA and all of their affiliates and subsidiaries.

10. Should AUO/AUOA discover evidence, not already reported to the Probation Office, of any discussions or communications with competitors of AUO/AUOA involving directors, officers, employees, agents, or business partners of any AUO/AUOA entity regarding

the pricing, sale or marketing of products in the United States or for integration into finished products sold in the United States, AUO/AUOA shall promptly report such conduct to the Probation Office, the Monitor, and the Antitrust Division.

11. The charge of the Monitor, as described above, is to review the policies and procedures of AUO/AUOA and all of their affiliates and subsidiaries related to compliance with the antitrust laws. Should the Monitor during the course of his or her engagement discover evidence of any discussions or communications with competitors of AUO/AUOA involving directors, officers, employees, agents, or business partners of any AUO/AUOA entity regarding the pricing and sale of products in the United States or for integration into finished products sold in the United States, that the Monitor believes, in the exercise of his or her sole discretion, violate either the terms of AUO/AUOA's probation, AUO/AUOA's antitrust compliance program, or the antitrust laws, the Monitor shall promptly report such communications or conduct to the Probation Office and the Antitrust Division.

12. The Monitor shall report evidence of other violations of United States criminal or regulatory laws discovered in the course of performing its duties, in the same manner described in paragraph 11 above.

13. In the event that AUO/AUOA, or any entity or person working directly or indirectly for AUO or AUOA, refuses to provide information necessary for the performance of the Monitor's responsibilities, the Monitor shall disclose that fact to the Probation Office.

14. AUO/AUOA, and their directors, officers, employees, shareholders, agents and business partners, shall not take any action to retaliate against the Monitor for any recommendations, reports, or disclosures required hereby or for any other reason.

Department of Justice

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STATEMENT OF ASSISTANT ATTORNEY GENERAL BILL BAER ON CHANGES TO ANTITRUST DIVISION'S CARVE-OUT PRACTICE REGARDING CORPORATE PLEA AGREEMENTS

WASHINGTON – Assistant Attorney General Bill Baer in charge of the Department of Justice's Antitrust Division issued the following statement today on changes to the division's carve-out practice regarding corporate plea agreements:

"Over the years, the Antitrust Division's efforts to investigate and prosecute price fixing and other cartel conduct have produced outstanding results in holding both corporations and individuals accountable for their wrongdoing. We are committed to continuing these efforts and to build on the division's past successes.

"Going forward, we are making certain changes to the Antitrust Division's approach to corporate plea agreements. In the past, the division's corporate plea agreements have, in appropriate circumstances, included a provision offering non-prosecution protection to those employees of the corporation who cooperate with the investigation and whose conduct does not warrant prosecution. The division excluded, or carved out, employees who were believed to be culpable. In certain circumstances, it also carved out employees who refused to cooperate with the division's investigation, employees against whom the division was still developing evidence and employees with potentially relevant information who could not be located. The names of all carved-out employees were included in the corporate plea agreements, which were publicly filed in the district courts where the charges were brought.

"As part of a thorough review of the division's approach to corporate dispositions, we have decided to implement two changes. The division will continue to carve out employees who we have reason to believe were involved in criminal wrongdoing and who are potential targets of our investigation. However, we will no longer carve out employees for reasons unrelated to culpability.

"The division will not include the names of carved-out employees in the plea agreement itself. Those names will instead be listed in an appendix, and we will ask the court for leave to file the appendix under seal. Absent some significant justification, it is ordinarily not appropriate to publicly identify uncharged third-party wrongdoers.

"The Antitrust Division will continue to exclude from the non-prosecution protections of corporate plea agreements any employees whose conduct may warrant prosecution. The division

will continue to make these decisions on an employee-by-employee basis consistent with the evidence and the Principles of Federal Prosecution. We will continue to demand the full cooperation of anyone who seeks to benefit from the non-prosecution protection of a corporate plea agreement, and will revoke that protection for anyone who does not fully and truthfully cooperate with division investigations."

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resources and earning capacity to pay the fines called for by this guideline, at least over time on an installment basis." U.S.S.G. § 2R1.1(c)(1) (background to application notes).

The other § 3572 factors also support the requested fines. Given their substantial wealth, and the fact that their children are adults, the fines will not impose a significant burden on them or their dependents. 18 U.S.C. § 3572(a)(2). As noted above, their offense inflicted huge pecuniary losses on others. 18 U.S.C. § 3572(a)(3). The government is not requesting restitution. 18 U.S.C. § 3572(a)(4).

VI. RECOMMENDATION FOR PROBATION AND THE APPOINTMENT OF A COMPLIANCE MONITOR

Probation is prescribed by Section 8D1.1 and is necessary "to protect the public from further crimes of the defendant" and "to provide the defendant with needed educational or . . . other correctional treatment in the most effective manner." 18 U.S.C. §§ 3553(a)(2)(C) & (D). In order to protect the public from further antitrust violations by AUO, the government urges the Court to require as a condition of probation that AUO and AUOA hire a compliance monitor to develop and implement an effective antitrust compliance program. This condition of probation is recommended by Section 8D1.4(b)(1) and (2) and is critical for AUO and AUOA.

A. The Guidelines Support Placing AUO on Probation

The Guidelines set forth the circumstances under which probation "shall" be ordered. U.S.S.G. § 8D1.1(a). Several of the circumstances mandating probation are present here. First, AUO has more than 50 employees and clearly does not have an effective antitrust compliance program, mandating probation under U.S.S.G. Section 8D1.1(a)(3). While AUO apparently claims to have adopted (or to be in the process of developing) such a program, it is not effective. The company refuses to recognize the illegality of its conduct even after being convicted. Thus, whatever its antitrust compliance program might include, it apparently does not condemn the very conduct at issue here. AUO joined the conspiracy from the very beginning of its existence, has no history of lawful conduct or antitrust compliance, continues to employ convicted price fixers and indicted fugitives, some of whom are still employed as leaders of the company, and has made public statements in defiance of the Court's jurisdiction and the jury's

verdict in this case. Probation is necessary to ensure that changes are made to the corporate culture and operations of AUO to reduce the likelihood of future criminal conduct. *See* U.S.S.G. § 8D1.1(a)(6). Absent such a change, there is a meaningful risk that AUO and its many affiliated companies, including those involved in burgeoning industries such as the solar industry, will continue AUO's normal (and illegal) course of conduct.

B. AUO Should Be Required to Retain a Compliance Monitor and Develop an Effective Antitrust Compliance Program

When a convicted company is placed on probation, one of the recommended conditions is to require it to develop an effective compliance and ethics program and then notify its employees and shareholders about that program. U.S.S.G. § 8D1.4(b)(1) and (2). Rarely has a company needed an effective antitrust compliance program as much as AUO.

AUO was founded by a merger in September 2001, and AUO and its coconspirators started the TFT-LCD conspiracy that very same month. So, from its very inception, AUO's standard operating procedure has been collusion. AUO has never known any other way of doing business and has never willingly operated lawfully. That being the case, one cannot expect AUO to reinvent itself and begin to operate legitimately for the first time in its existence on its own, especially when it maintains to this day that it has done nothing wrong. A new corporate culture must be created, and AUO has neither the will nor the experience to institute these new business practices on its own. More importantly, AUO's defiant public statements demonstrate that the company has no intention or motivation to do so. While all of the other corporate conspirators recognized the illegality of their conduct and accepted responsibility for their participation in the illegal scheme, AUO refuses even to acknowledge that its participation in that same scheme is, or should be, illegal. As a result, there is no reason to assume that its conviction and the imposition of a criminal fine, alone, will cause AUO to cease engaging in collusive practices.

For this reason, U.S.S.G Section 8D1.4(b)(1) and (2) recommends that convicted companies be required to adopt an effective corporate compliance and ethics program. The government has proposed the elements for a comprehensive antitrust compliance program

consistent with those described in U.S.S.G. Section 8B2.1 that it recommends be imposed on AUO. Tewksbury Decl., Ex. C.

AUO cannot be expected to develop and implement an effective compliance program. Nor should the Court or the Probation Office be expected to do so. Accordingly, the government recommends that AUO be required to hire (at its own expense) an experienced, independent antitrust attorney as a compliance monitor to review its current compliance program and to ensure that AUO develops a program containing the recommended elements. This is the most reasonable, efficient, and effective way to accomplish the vital task of creating a legitimate, non-criminal business culture at AUO for the first time and thereby create a foundation for good corporate citizenship and a necessary safeguard against future collusion.

Requiring a compliance program will require some involvement by the Probation Office in the appointment of a compliance monitor, but thereafter would require minimal oversight by the Probation Office and actually relieve the Probation Office of much of the burden of directly monitoring AUO during the probation period. The appointment of compliance monitors to develop and implement compliance programs for companies engaged in illegal conduct is commonly required by the Department of Justice in deferred prosecution agreements, and the same considerations support that process here. *See also* U.S.S.G. §§ 8B2.1, 8D1.4(b)(1),(2).

C. AUOA Should Also Be Placed on Probation and Required to Appoint a Compliance Monitor to Develop an Effective Antitrust Compliance Program

The government recommends that this Court sentence AUOA to five years of probation conditioned on the same requirement that it implement a comprehensive antitrust compliance program. The probation is prescribed by U.S.S.G. Section 8D1.1(a)(6),(7). AUOA was engaged in this conspiracy for much of its existence, had no antitrust compliance program whatsoever during the relevant period, has an inherent business culture of collusion, and needs the oversight of probation to ensure that changes are made within the organization to prevent future criminal conduct. Certainly, AUOA cannot look to its parent, AUO, for lessons in how to conduct its operations lawfully. Moreover, nothing in its post-conviction conduct or statements suggests

that AUOA recognizes the seriousness and unlawful nature of its conduct or that it plans to change the way it conducts business.

More importantly, because AUOA cannot pay a significant criminal fine due to the way in which AUO and AUOA have structured their business operations, the imposition of probation, the retention of a compliance monitor, and the development and implementation of an effective antitrust compliance program are important for changing AUOA's corporate culture and preventing future misconduct. The government believes that applying the same compliance program to AUOA as recommended for AUO is sufficient. It also believes that appointing the same monitor for AUOA would be the most efficient use of resources, and would further ease the burden on the Probation Office by having only one monitor responsible for reporting to the Probation Office.

D. Additional Conditions of Probation

In addition to being required to retain a compliance monitor to develop and implement an effective antitrust compliance program, AUO should be required to print advertisements of at least one full page in size in three major trade publications in the United States and three major trade publications in Taiwan containing the information required by U.S.S.G. Section 8D1.4(a). This public acknowledgment of its conviction and punishment and the remedial steps the company has taken as a result of its conviction is necessary because, to date, AUO's public statements have been recalcitrant and have displayed a complete refusal to take responsibility for its criminal conduct.

Also, if the Court permits AUO to pay its criminal fine in installments pursuant to U.S.S.G Section 8C3.2(b), the company should be required to comply with the financial reporting and examination requirements of U.S.S.G. Section 8D1.4(b)(3)-(5).

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VII. CONCLUSION

The government recommends that the Court sentence defendant AUO to pay a $1 billion fine, and defendants H.B. Chen and Hui Hsiung to serve ten years in prison and pay $1 million fines. The government further recommends that AUO and AUOA be placed on probation and, as a condition of probation, be required to implement an antitrust compliance program and hire an independent compliance monitor.

Dated: September 11, 2012

Respectfully submitted,

/s/ Peter K. Huston

Peter K. Huston
Michael L. Scott
Heather S. Tewksbury
Brent Snyder
Jon B. Jacobs

Antitrust Division
U.S. Department of Justice

GUIDING PRINCIPLES OF ENFORCEMENT

What Does DOJ Consider When Deciding Whether to Open an Investigation or Bring Charges?

Whether and how DOJ will commence, decline, or otherwise resolve an FCPA matter is guided by the *Principles of Federal Prosecution* in the case of individuals, and the *Principles of Federal Prosecution of Business Organizations* in the case of companies.

DOJ *Principles of Federal Prosecution*

The *Principles of Federal Prosecution*, set forth in Chapter 9-27.000 of the U.S. Attorney's Manual,[288] provide guidance for DOJ prosecutors regarding initiating or declining prosecution, selecting charges, and plea-bargaining. The *Principles of Federal Prosecution* provide that prosecutors should recommend or commence federal prosecution if the putative defendant's conduct constitutes a federal offense and the admissible evidence will probably be sufficient to obtain and sustain a conviction unless (1) no substantial federal interest would be served by prosecution; (2) the person is subject to effective prosecution in another jurisdiction; or (3) an adequate non-criminal alternative to prosecution exists. In assessing the existence of a substantial federal interest, the prosecutor is advised to "weigh all relevant considerations," including the nature and seriousness of the offense; the deterrent effect of prosecution; the person's culpability in connection with the offense; the person's history with respect to criminal activity; the person's willingness to cooperate in the investigation or prosecution of others; and the probable sentence or other consequences if the person is convicted. The *Principles of Federal Prosecution* also set out the considerations to be weighed when deciding whether to enter into a plea agreement with an individual defendant, including the nature and seriousness of the offense and the person's willingness to cooperate, as well as the desirability of prompt and certain disposition of the case and the expense of trial and appeal.[289]

DOJ *Principles of Federal Prosecution of Business Organizations*

The *Principles of Federal Prosecution of Business Organizations*, set forth in Chapter 9-28.000 of the U.S. Attorney's Manual,[290] provide guidance regarding the resolution of cases involving corporate wrongdoing. The *Principles of Federal Prosecution of Business Organizations* recognize that resolution of corporate criminal cases by means other

than indictment, including non-prosecution and deferred prosecution agreements, may be appropriate in certain circumstances. Nine factors are considered in conducting an investigation, determining whether to charge a corporation, and negotiating plea or other agreements:

- the nature and seriousness of the offense, including the risk of harm to the public;
- the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management;
- the corporation's history of similar misconduct, including prior criminal, civil, and regulatory enforcement actions against it;
- the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents;
- the existence and effectiveness of the corporation's pre-existing compliance program;
- the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or improve an existing one, replace responsible management, discipline or terminate wrongdoers, pay restitution, and cooperate with the relevant government agencies;
- collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution;
- the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- the adequacy of remedies such as civil or regulatory enforcement actions.

As these factors illustrate, in many investigations it will be appropriate for a prosecutor to consider a corporation's pre-indictment conduct, including voluntary disclosure, cooperation, and remediation, in determining whether to seek an indictment. In assessing a corporation's cooperation, prosecutors are prohibited from requesting attorney-client privileged materials with two exceptions—when a corporation or its employee asserts an advice-of-counsel defense and when the attorney-client communications were in furtherance of a crime or fraud. Otherwise, an organization's cooperation may only be assessed on the basis of whether it disclosed the *relevant facts* underlying an investigation—and not on the basis of whether it has waived its attorney-client privilege or work product protection.[291]

What Does SEC Consider When Deciding Whether to Open an Investigation or Bring Charges?

SEC's *Enforcement Manual*, published by SEC's Enforcement Division and available on SEC's website,[292] sets forth information about how SEC conducts investigations, as well as the guiding principles that SEC staff considers when determining whether to open or close an investigation and whether civil charges are merited. There are various ways that potential FCPA violations come to the attention of SEC staff, including: tips from informants or whistleblowers; information developed in other investigations; self-reports or public disclosures by companies; referrals from other offices or agencies; public sources, such as media reports and trade publications; and proactive investigative techniques, including risk-based initiatives. Investigations can be formal, such as where SEC has issued a formal order of investigation that authorizes its staff to issue investigative subpoenas for testimony and documents, or informal, such as where the staff proceeds with the investigation without the use of investigative subpoenas.

In determining whether to open an investigation and, if so, whether an enforcement action is warranted, SEC staff considers a number of factors, including: the statutes or rules potentially violated; the egregiousness of the potential violation; the potential magnitude of the violation; whether the potentially harmed group is particularly vulnerable or at risk; whether the conduct is ongoing; whether the conduct can be investigated efficiently and within the statute of limitations period; and whether other authorities, including federal or state agencies or regulators, might be better suited to investigate the conduct. SEC staff also may

consider whether the case involves a possibly widespread industry practice that should be addressed, whether the case involves a recidivist, and whether the matter gives SEC an opportunity to be visible in a community that might not otherwise be familiar with SEC or the protections afforded by the securities laws.

For more information about the Enforcement Division's procedures concerning investigations, enforcement actions, and cooperation with other regulators, see the *Enforcement Manual* at http://www.sec.gov/divisions/enforce.shtml.

Self-Reporting, Cooperation, and Remedial Efforts

While the conduct underlying any FCPA investigation is obviously a fundamental and threshold consideration in deciding what, if any, action to take, both DOJ and SEC place a high premium on self-reporting, along with cooperation and remedial efforts, in determining the appropriate resolution of FCPA matters.

Criminal Cases

Under DOJ's *Principles of Federal Prosecution of Business Organizations*, federal prosecutors consider a company's cooperation in determining how to resolve a corporate criminal case. Specifically, prosecutors consider whether the company made a voluntary and timely disclosure as well as the company's willingness to provide relevant information and evidence and identify relevant actors inside and outside the company, including senior executives. In addition, prosecutors may consider a company's remedial actions, including efforts to improve an existing compliance program or appropriate disciplining of wrongdoers.[293] A company's remedial measures should be meaningful and illustrate its recognition of the seriousness of the misconduct, for example, by taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated.[294]

The *Principles of Federal Prosecution* similarly provide that prosecutors may consider an individual's willingness to cooperate in deciding whether a prosecution should be undertaken and how it should be resolved. Although a willingness to cooperate will not, by itself, generally relieve a person of criminal liability, it may be given "serious consideration" in evaluating whether to enter into a plea agreement with a defendant, depending on the nature and value of the cooperation offered.[295]

The U.S. Sentencing Guidelines similarly take into account an individual defendant's cooperation and voluntary disclosure. Under § 5K1.1, a defendant's cooperation, if sufficiently substantial, may justify the government filing a motion for a reduced sentence. And under § 5K2.16, a defendant's voluntary disclosure of an offense prior to its discovery—if the offense was unlikely to have been discovered otherwise—may warrant a downward departure in certain circumstances.

Chapter 8 of the Sentencing Guidelines, which governs the sentencing of organizations, takes into account an organization's remediation as part of an "effective compliance and ethics program." One of the seven elements of such a program provides that after the detection of criminal conduct, "the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program."[296] Having an effective compliance and ethics program may lead to a three-point reduction in an organization's culpability score under § 8C2.5, which affects the fine calculation under the Guidelines. Similarly, an organization's self-reporting, cooperation, and acceptance of responsibility may lead to fine reductions under § 8C2.5(g) by decreasing the culpability score. Conversely, an organization will not qualify for the compliance program reduction when it unreasonably delayed reporting the offense.[297] Similar to § 5K1.1

for individuals, organizations can qualify for departures pursuant to § 8C4.1 of the Guidelines for cooperating in the prosecution of others.

Civil Cases

SEC's Framework for Evaluating Cooperation by Companies

SEC's framework for evaluating cooperation by companies is set forth in its 2001 *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions,* which is commonly known as the *Seaboard Report.*[298] The report, which explained the Commission's decision not to take enforcement action against a public company for certain accounting violations caused by its subsidiary, details the many factors SEC considers in determining whether, and to what extent, it grants leniency to companies for cooperating in its investigations and for related good corporate citizenship. Specifically, the report identifies four broad measures of a company's cooperation:

- self-policing prior to the discovery of the misconduct, including establishing effective compliance procedures and an appropriate tone at the top;
- self-reporting of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins, and consequences of the misconduct, and promptly, completely, and effectively disclosing the misconduct to the public, to regulatory agencies, and to self-regulatory organizations;
- remediation, including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected; and
- cooperation with law enforcement authorities, including providing SEC staff with all information relevant to the underlying violations and the company's remedial efforts.

Since every enforcement matter is different, this analytical framework sets forth general principles but does not limit SEC's broad discretion to evaluate every case individually on its own unique facts and circumstances. Similar to SEC's treatment of cooperating individuals, credit for cooperation by companies may range from taking no enforcement action to pursuing reduced sanctions in connection with enforcement actions.

SEC's Framework for Evaluating Cooperation by Individuals

In 2010, SEC announced a new cooperation program for individuals.[299] SEC staff has a wide range of tools to facilitate and reward cooperation by individuals, from taking no enforcement action to pursuing reduced sanctions in connection with enforcement actions. Although the evaluation of cooperation depends on the specific circumstances, SEC generally evaluates four factors to determine whether, to what extent, and in what manner to credit cooperation by individuals:

- the assistance provided by the cooperating individual in SEC's investigation or related enforcement actions, including, among other things: the value and timeliness of the cooperation, including whether the individual was the first to report the misconduct to SEC or to offer his or her cooperation; whether the investigation was initiated based upon the information or other cooperation by the individual; the quality of the cooperation, including whether the individual was truthful and the cooperation was complete; the time and resources conserved as a result of the individual's cooperation; and the nature of the cooperation, such as the type of assistance provided;
- the importance of the matter in which the individual provided cooperation;
- the societal interest in ensuring that the cooperating individual is held accountable for his or her misconduct, including the severity of the individual's misconduct, the culpability of the individual, and the efforts undertaken by the individual to remediate the harm; and

- the appropriateness of a cooperation credit in light of the profile of the cooperating individual.

Corporate Compliance Program

In a global marketplace, an effective compliance program is a critical component of a company's internal controls and is essential to detecting and preventing FCPA violations.[300] Effective compliance programs are tailored to the company's specific business and to the risks associated with that business. They are dynamic and evolve as the business and the markets change.

An effective compliance program promotes "an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[301] Such a program protects a company's reputation, ensures investor value and confidence, reduces uncertainty in business transactions, and secures a company's assets.[302] A well-constructed, thoughtfully implemented, and consistently enforced compliance and ethics program helps prevent, detect, remediate, and report misconduct, including FCPA violations.

In addition to considering whether a company has self-reported, cooperated, and taken appropriate remedial actions, DOJ and SEC also consider the adequacy of a company's compliance program when deciding what, if any, action to take. The program may influence whether or not charges should be resolved through a deferred prosecution agreement (DPA) or non-prosecution agreement (NPA), as well as the appropriate length of any DPA or NPA, or the term of corporate probation. It will often affect the penalty amount and the need for a monitor or self-reporting.[303] As discussed above, SEC's *Seaboard Report* focuses, among other things, on a company's self-policing prior to the discovery of the misconduct, including whether it had established effective compliance procedures.[304] Likewise, three of the nine factors set forth in DOJ's *Principles of Federal Prosecution of Business Organizations* relate, either directly or indirectly, to a compliance program's design and implementation, including the pervasiveness of wrongdoing within the company, the existence and effectiveness of the company's pre-existing compliance program, and the company's remedial actions.[305] DOJ also considers the U.S. Sentencing Guidelines' elements of an effective compliance program, as set forth in § 8B2.1 of the Guidelines.

These considerations reflect the recognition that a company's failure to prevent every single violation does not necessarily mean that a particular company's compliance program was not generally effective. DOJ and SEC understand that "no compliance program can ever prevent all criminal activity by a corporation's employees,"[306] and they do not hold companies to a standard of perfection. An assessment of a company's compliance program, including its design and good faith implementation and enforcement, is an important part of the government's assessment of whether a violation occurred, and if so, what action should be taken. In appropriate circumstances, DOJ and SEC may decline to pursue charges against a company based on the company's effective compliance program, or may otherwise seek to reward a company for its program, even when that program did not prevent the particular underlying FCPA violation that gave rise to the investigation.[307]

DOJ and SEC have no formulaic requirements regarding compliance programs. Rather, they employ a common-sense and pragmatic approach to evaluating compliance programs, making inquiries related to three basic questions:

- Is the company's compliance program well designed?
- Is it being applied in good faith?
- Does it work?[308]

This guide contains information regarding some of the basic elements DOJ and SEC consider when evaluating compliance programs. Although the focus is on compliance with the FCPA, given the existence of anti-corruption laws in many other countries, businesses should consider designing programs focused on anti-corruption compliance more broadly.[309]

Hallmarks of Effective Compliance Programs

Individual companies may have different compliance needs depending on their size and the particular risks associated with their businesses, among other factors. When it comes to compliance, there is no one-size-fits-all program. Thus, the discussion below is meant to provide insight into the aspects of compliance programs that DOJ and SEC assess, recognizing that companies may consider a variety of factors when making their own determination of what is appropriate for their specific business needs.[310] Indeed, small- and medium-size enterprises likely will have different compliance programs from large multi-national corporations, a fact DOJ and SEC take into account when evaluating companies' compliance programs.

Compliance programs that employ a "check-the-box" approach may be inefficient and, more importantly, ineffective. Because each compliance program should be tailored to an organization's specific needs, risks, and challenges, the information provided below should not be considered a substitute for a company's own assessment of the corporate compliance program most appropriate for that particular business organization. In the end, if designed carefully, implemented earnestly, and enforced fairly, a company's compliance program—no matter how large or small the organization—will allow the company generally to prevent violations, detect those that do occur, and remediate them promptly and appropriately.

Commitment from Senior Management and a Clearly Articulated Policy Against Corruption

Within a business organization, compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company. Managers and employees take their cues from these corporate leaders. Thus, DOJ and SEC consider the commitment of corporate leaders to a "culture of compliance"[311] and look to see if this high-level commitment is also reinforced and implemented by middle managers and employees at all levels of a business. A well-designed compliance program that is not enforced in good faith, such as when corporate management explicitly or implicitly encourages employees to engage in misconduct to achieve business objectives, will be ineffective. DOJ and SEC have often encountered companies with compliance programs that are strong on paper but that nevertheless have significant FCPA violations because management has failed to effectively implement the program even in the face of obvious signs of corruption. This may be the result of aggressive sales staff preventing compliance personnel from doing their jobs effectively and of senior management, more concerned with securing a valuable business opportunity than enforcing a culture of compliance, siding with the sales team. The higher the financial stakes of the transaction, the greater the temptation for management to choose profit over compliance.

A strong ethical culture directly supports a strong compliance program. By adhering to ethical standards, senior managers will inspire middle managers to reinforce those standards. Compliant middle managers, in turn, will encourage employees to strive to attain those standards throughout the organizational structure.[312]

In short, compliance with the FCPA and ethical rules must start at the top. DOJ and SEC thus evaluate whether senior management has clearly articulated company standards, communicated them in unambiguous terms, adhered to them scrupulously, and disseminated them throughout the organization.

Code of Conduct and Compliance Policies and Procedures

A company's code of conduct is often the foundation upon which an effective compliance program is built. As DOJ has repeatedly noted in its charging documents, the most effective codes are clear, concise, and accessible to all employees and to those conducting business on the company's behalf. Indeed, it would be difficult to effectively implement a compliance program if it was not available in the local language so that employees in foreign subsidiaries can access and understand it. When assessing a compliance program, DOJ and SEC will review whether the company

has taken steps to make certain that the code of conduct remains current and effective and whether a company has periodically reviewed and updated its code.

Whether a company has policies and procedures that outline responsibilities for compliance within the company, detail proper internal controls, auditing practices, and documentation policies, and set forth disciplinary procedures will also be considered by DOJ and SEC. These types of policies and procedures will depend on the size and nature of the business and the risks associated with the business. Effective policies and procedures require an in-depth understanding of the company's business model, including its products and services, third-party agents, customers, government interactions, and industry and geographic risks. Among the risks that a company may need to address include the nature and extent of transactions with foreign governments, including payments to foreign officials; use of third parties; gifts, travel, and entertainment expenses; charitable and political donations; and facilitating and expediting payments. For example, some companies with global operations have created web-based approval processes to review and approve routine gifts, travel, and entertainment involving foreign officials and private customers with clear monetary limits and annual limitations. Many of these systems have built-in flexibility so that senior management, or in-house legal counsel, can be apprised of and, in appropriate circumstances, approve unique requests. These types of systems can be a good way to conserve corporate resources while, if properly implemented, preventing and detecting potential FCPA violations.

Regardless of the specific policies and procedures implemented, these standards should apply to personnel at all levels of the company.

Oversight, Autonomy, and Resources

In appraising a compliance program, DOJ and SEC also consider whether a company has assigned responsibility for the oversight and implementation of a company's compliance program to one or more specific senior executives within an organization.[313] Those individuals must have appropriate authority within the organization, adequate autonomy from management, and sufficient resources to ensure that the company's compliance program is implemented effectively.[314] Adequate autonomy generally includes direct access to an organization's governing authority, such as the board of directors and committees of the board of directors (e.g., the audit committee).[315] Depending on the size and structure of an organization, it may be appropriate for day-to-day operational responsibility to be delegated to other specific individuals within a company.[316] DOJ and SEC recognize that the reporting structure will depend on the size and complexity of an organization. Moreover, the amount of resources devoted to compliance will depend on the company's size, complexity, industry, geographical reach, and risks associated with the business. In assessing whether a company has reasonable internal controls, DOJ and SEC typically consider whether the company devoted adequate staffing and resources to the compliance program given the size, structure, and risk profile of the business.

Risk Assessment

Assessment of risk is fundamental to developing a strong compliance program, and is another factor DOJ and SEC evaluate when assessing a company's compliance program.[317] One-size-fits-all compliance programs are generally ill-conceived and ineffective because resources inevitably are spread too thin, with too much focus on low-risk markets and transactions to the detriment of high-risk areas. Devoting a disproportionate amount of time policing modest entertainment and gift-giving instead of focusing on large government bids, questionable payments to third-party consultants, or excessive discounts to resellers and distributors may indicate that a company's compliance program is ineffective. A $50 million contract with a government agency in a high-risk country warrants greater

scrutiny than modest and routine gifts and entertainment. Similarly, performing identical due diligence on all third-party agents, irrespective of risk factors, is often counterproductive, diverting attention and resources away from those third parties that pose the most significant risks. DOJ and SEC will give meaningful credit to a company that implements in good faith a comprehensive, risk-based compliance program, even if that program does not prevent an infraction in a low risk area because greater attention and resources had been devoted to a higher risk area. Conversely, a company that fails to prevent an FCPA violation on an economically significant, high-risk transaction because it failed to perform a level of due diligence commensurate with the size and risk of the transaction is likely to receive reduced credit based on the quality and effectiveness of its compliance program.

As a company's risk for FCPA violations increases, that business should consider increasing its compliance procedures, including due diligence and periodic internal audits. The degree of appropriate due diligence is fact-specific and should vary based on industry, country, size, and nature of the transaction, and the method and amount of third-party compensation. Factors to consider, for instance, include risks presented by: the country and industry sector, the business opportunity, potential business partners, level of involvement with governments, amount of government regulation and oversight, and exposure to customs and immigration in conducting business affairs. When assessing a company's compliance program, DOJ and SEC take into account whether and to what degree a company analyzes and addresses the particular risks it faces.

Training and Continuing Advice

Compliance policies cannot work unless effectively communicated throughout a company. Accordingly, DOJ and SEC will evaluate whether a company has taken steps to ensure that relevant policies and procedures have been communicated throughout the organization, including through periodic training and certification for all directors, officers, relevant employees, and, where appropriate, agents and business partners.[318] For example, many larger companies have implemented a mix of web-based and in-person training conducted at varying intervals. Such training typically covers company policies and procedures, instruction on applicable laws, practical advice to address real-life scenarios, and case studies. Regardless of how a company chooses to conduct its training, however, the information should be presented in a manner appropriate for the targeted audience, including providing training and training materials in the local language. For example, companies may want to consider providing different types of training to their sales personnel and accounting personnel with hypotheticals or sample situations that are similar to the situations they might encounter. In addition to the existence and scope of a company's training program, a company should develop appropriate measures, depending on the size and sophistication of the particular company, to provide guidance and advice on complying with the company's ethics and compliance program, including when such advice is needed urgently. Such measures will help ensure that the compliance program is understood and followed appropriately at all levels of the company.

Incentives and Disciplinary Measures

In addition to evaluating the design and implementation of a compliance program throughout an organization, enforcement of that program is fundamental to its effectiveness.[319] A compliance program should apply from the board room to the supply room—no one should be beyond its reach. DOJ and SEC will thus consider whether, when enforcing a compliance program, a company has appropriate and clear disciplinary procedures, whether those procedures are applied reliably and promptly, and whether they are commensurate with the violation. Many companies have found that publicizing disciplinary actions internally, where appropriate under local law, can have an important deterrent effect, demonstrating that unethical and unlawful actions have swift and sure consequences.

DOJ and SEC recognize that positive incentives can also drive compliant behavior. These incentives can take many

forms such as personnel evaluations and promotions, rewards for improving and developing a company's compliance program, and rewards for ethics and compliance leadership.[320] Some organizations, for example, have made adherence to compliance a significant metric for management's bonuses so that compliance becomes an integral part of management's everyday concern. Beyond financial incentives, some companies have highlighted compliance within their organizations by recognizing compliance professionals and internal audit staff. Others have made working in the company's compliance organization a way to advance an employee's career. SEC, for instance, has encouraged companies to embrace methods to incentivize ethical and lawful behavior:

> [M]ake integrity, ethics and compliance part of the promotion, compensation and evaluation processes as well. For at the end of the day, the most effective way to communicate that "doing the right thing" is a priority, is to reward it. Conversely, if employees are led to believe that, when it comes to compensation and career advancement, all that counts is short-term profitability, and that cutting ethical corners is an acceptable way of getting there, they'll perform to that measure. To cite an example from a different walk of life: a college football coach can be told that the graduation rates of his players are what matters, but he'll know differently if the sole focus of his contract extension talks or the decision to fire him is his win-loss record. [321]

No matter what the disciplinary scheme or potential incentives a company decides to adopt, DOJ and SEC will consider whether they are fairly and consistently applied across the organization. No executive should be above compliance, no employee below compliance, and no person within an organization deemed too valuable to be disciplined, if warranted. Rewarding good behavior and sanctioning bad behavior reinforces a culture of compliance and ethics throughout an organization.

Third-Party Due Diligence and Payments

DOJ's and SEC's FCPA enforcement actions demonstrate that third parties, including agents, consultants, and distributors, are commonly used to conceal the payment of bribes to foreign officials in international business transactions. Risk-based due diligence is particularly important with third parties and will also be considered by DOJ and SEC in assessing the effectiveness of a company's compliance program.

Although the degree of appropriate due diligence may vary based on industry, country, size and nature of the transaction, and historical relationship with the third-party, some guiding principles always apply.

First, as part of risk-based due diligence, companies should understand the qualifications and associations of its third-party partners, including its business reputation, and relationship, if any, with foreign officials. The degree of scrutiny should increase as red flags surface.

Second, companies should have an understanding of the business rationale for including the third party in the transaction. Among other things, the company should understand the role of and need for the third party and ensure that the contract terms specifically describe the services to be performed. Additional considerations include payment terms and how those payment terms compare to typical terms in that industry and country, as well as the timing of the third party's introduction to the business. Moreover, companies may want to confirm and document that the third party is actually performing the work for which it is being paid and that its compensation is commensurate with the work being provided.

Third, companies should undertake some form of ongoing monitoring of third-party relationships.[322] Where appropriate, this may include updating due diligence periodically, exercising audit rights, providing periodic training, and requesting annual compliance certifications by the third party.

In addition to considering a company's due diligence on third parties, DOJ and SEC also assess whether the company has informed third parties of the company's

Compliance Program Case Study

Recent DOJ and SEC actions relating to a financial institution's real estate transactions with a government agency in China illustrate the benefits of implementing and enforcing a comprehensive risk-based compliance program. The case involved a joint venture real estate investment in the Luwan District of Shanghai, China, between a U.S.-based financial institution and a state-owned entity that functioned as the District's real estate arm. The government entity conducted the transactions through two special purpose vehicles ("SPVs"), with the second SPV purchasing a 12% stake in a real estate project.

The financial institution, through a robust compliance program, frequently trained its employees, imposed a comprehensive payment-approval process designed to prevent bribery, and staffed a compliance department with a direct reporting line to the board of directors. As appropriate given the industry, market, and size and structure of the transactions, the financial institution (1) provided extensive FCPA training to the senior executive responsible for the transactions and (2) conducted extensive due diligence on the transactions, the local government entity, and the SPVs. Due diligence on the entity included reviewing Chinese government records; speaking with sources familiar with the Shanghai real estate market; checking the government entity's payment records and credit references; conducting an on-site visit and placing a pretextual telephone call to the entity's offices; searching media sources; and conducting background checks on the entity's principals. The financial institution vetted the SPVs by obtaining a letter with designated bank account information from a Chinese official associated with the government entity (the "Chinese Official"); using an international law firm to request and review 50 documents from the SPVs' Canadian attorney; interviewing the attorney; and interviewing the SPVs' management.

Notwithstanding the financial institution's robust compliance program and good faith enforcement of it, the company failed to learn that the Chinese Official personally owned nearly 50% of the second SPV (and therefore a nearly 6% stake in the joint venture) and that the SPV was used as a vehicle for corrupt payments. This failure was due, in large part, to misrepresentations by the Chinese Official, the financial institution's executive in charge of the project, and the SPV's attorney that the SPV was 100% owned and controlled by the government entity. DOJ and SEC declined to take enforcement action against the financial institution, and its executive pleaded guilty to conspiracy to violate the FCPA's internal control provisions and also settled with SEC.

compliance program and commitment to ethical and lawful business practices and, where appropriate, whether it has sought assurances from third parties, through certifications and otherwise, of reciprocal commitments. These can be meaningful ways to mitigate third-party risk.

Confidential Reporting and Internal Investigation

An effective compliance program should include a mechanism for an organization's employees and others to report suspected or actual misconduct or violations of the company's policies on a confidential basis and without fear of retaliation.[323] Companies may employ, for example, anonymous hotlines or ombudsmen. Moreover, once an allegation is made, companies should have in place an efficient, reliable, and properly funded process for investigating the allegation and documenting the company's response, including any disciplinary or remediation measures taken. Companies will want to consider taking "lessons learned" from any reported violations and the outcome of any resulting investigation to update their internal controls and compliance program and focus future training on such issues, as appropriate.

Continuous Improvement: Periodic Testing and Review

Finally, a good compliance program should constantly evolve. A company's business changes over time, as do the environments in which it operates, the nature of its customers, the laws that govern its actions, and the standards of its

industry. In addition, compliance programs that do not just exist on paper but are followed in practice will inevitably uncover compliance weaknesses and require enhancements. Consequently, DOJ and SEC evaluate whether companies regularly review and improve their compliance programs and not allow them to become stale.

According to one survey, 64% of general counsel whose companies are subject to the FCPA say there is room for improvement in their FCPA training and compliance programs.[324] An organization should take the time to review and test its controls, and it should think critically about its potential weaknesses and risk areas. For example, some companies have undertaken employee surveys to measure their compliance culture and strength of internal controls, identify best practices, and detect new risk areas. Other companies periodically test their internal controls with targeted audits to make certain that controls on paper are working in practice. DOJ and SEC will give meaningful credit to thoughtful efforts to create a sustainable compliance program if a problem is later discovered. Similarly, undertaking proactive evaluations before a problem strikes can lower the applicable penalty range under the U.S. Sentencing Guidelines.[325] Although the nature and the frequency of proactive evaluations may vary depending on the size and complexity of an organization, the idea behind such efforts is the same: continuous improvement and sustainability.[326]

Mergers and Acquisitions: Pre-Acquisition Due Diligence and Post-Acquisition Integration

In the context of the FCPA, mergers and acquisitions present both risks and opportunities. A company that does not perform adequate FCPA due diligence prior to a merger or acquisition may face both legal and business risks.[327] Perhaps most commonly, inadequate due diligence can allow a course of bribery to continue—with all the attendant harms to a business's profitability and reputation, as well as potential civil and criminal liability.

In contrast, companies that conduct effective FCPA due diligence on their acquisition targets are able to evaluate more accurately each target's value and negotiate for the costs of the bribery to be borne by the target. In addition, such actions demonstrate to DOJ and SEC a company's commitment to compliance and are taken into account when evaluating any potential enforcement action. For example, DOJ and SEC declined to take enforcement action against an acquiring issuer when the issuer, among other things, uncovered the corruption at the company being acquired as part of due diligence, ensured that the corruption was voluntarily disclosed to the government, cooperated with the investigation, and incorporated the acquired company into its compliance program and internal controls. On the other hand, SEC took action against the acquired company, and DOJ took action against a subsidiary of the acquired company.[328] When pre-acquisition due diligence is not possible, DOJ has described procedures, contained in Opinion Procedure Release No. 08-02, pursuant to which companies can nevertheless be rewarded if they choose to conduct thorough post-acquisition FCPA due diligence.[329]

FCPA due diligence, however, is normally only a portion of the compliance process for mergers and acquisitions. DOJ and SEC evaluate whether the acquiring company promptly incorporated the acquired company into all of its internal controls, including its compliance program. Companies should consider training new employees, reevaluating third parties under company standards, and, where appropriate, conducting audits on new business units.

For example, as a result of due diligence conducted by a California-based issuer before acquiring the majority interest in a joint venture, the issuer learned of corrupt payments to obtain business. However, the issuer only implemented its internal controls "halfway" so as not to "choke the sales engine and cause a distraction for the sales guys." As a result, the improper payments continued, and the issuer was held liable for violating the FCPA's internal controls and books and records provisions.[330]

Other Guidance on Compliance and International Best Practices

In addition to this guide, the U.S. Departments of Commerce and State have both issued publications that contain guidance regarding compliance programs. The Department of Commerce's International Trade Administration has published *Business Ethics: A Manual for Managing a Responsible Business Enterprise in Emerging Market Economies*,[331] and the Department of State has published *Fighting Global Corruption: Business Risk Management*.[332]

There is also an emerging international consensus on compliance best practices, and a number of inter-governmental and non-governmental organizations have issued guidance regarding best practices for compliance.[333] Most notably, the OECD's 2009 Anti-Bribery Recommendation and its Annex II, *Good Practice Guidance on Internal Controls, Ethics, and Compliance*,[334] published in February 2010, were drafted based on consultations with the private sector and civil society and set forth specific good practices for ensuring effective compliance programs and measures for preventing and detecting foreign bribery. In addition, businesses may wish to refer to the following resources:

- Asia-Pacific Economic Cooperation—*Anti-Corruption Code of Conduct for Business*;[335]
- International Chamber of Commerce—*ICC Rules on Combating Corruption*;[336]
- Transparency International—*Business Principles for Countering Bribery*;[337]
- United Nations Global Compact—*The Ten Principles*;[338]
- World Bank—*Integrity Compliance Guidelines*;[339] and
- World Economic Forum—*Partnering Against Corruption–Principles for Countering Bribery*.[340]

Hypothetical: Third-Party Vetting

Part 1: Consultants

Company A, a U.S. issuer headquartered in Delaware, wants to start doing business in a country that poses high risks of corruption. Company A learns about a potential $50 million contract with the country's Ministry of Immigration. This is a very attractive opportunity to Company A, both for its profitability and to open the door to future projects with the government. At the suggestion of the company's senior vice president of international sales (Sales Executive), Company A hires a local businessman who assures them that he has strong ties to political and government leaders in the country and can help them win the contract. Company A enters into a consulting contract with the local businessman (Consultant). The agreement requires Consultant to use his best efforts to help the company win the business and provides for Consultant to receive a significant monthly retainer as well as a success fee of 3% of the value of any contract the company wins.

What steps should Company A consider taking before hiring Consultant?

There are several factors here that might lead Company A to perform heightened FCPA-related due diligence prior to retaining Consultant: (1) the market (high-risk country); (2) the size and significance of the deal to the company; (3) the company's first time use of this particular consultant; (4) the consultant's strong ties to political and government leaders; (5) the success fee structure of the contract; and (6) the vaguely-defined services to be provided. In order to minimize the likelihood of incurring FCPA liability, Company A should carefully vet Consultant and his role in the transaction, including close scrutiny of the relationship between Consultant and any Ministry of Immigration officials or other government officials. Although there is nothing inherently illegal about contracting with a third party that has close connections to politicians and government officials to perform legitimate services on a transaction, this type of relationship can be susceptible to corruption. Among other things, Company A may consider conducting due diligence on Consultant, including background

(cont'd)

and reference checks; ensuring that the contract spells out exactly what services and deliverables (such as written status reports or other documentation) Consultant is providing; training Consultant on the FCPA and other anti-corruption laws; requiring Consultant to represent that he will abide by the FCPA and other anti-corruption laws; including audit rights in the contract (and exercising those rights); and ensuring that payments requested by Consultant have the proper supporting documentation before they are approved for payment.

Part 2: Distributors and Local Partners

Assume the following alternative facts:

Instead of hiring Consultant, Company A retains an often-used local distributor (Distributor) to sell Company A's products to the Ministry of Immigration. In negotiating the pricing structure, Distributor, which had introduced the project to Company A, claims that the standard discount price to Distributor creates insufficient margin for Distributor to cover warehousing, distribution, installation, marketing, and training costs and requests an additional discount or rebate, or, in the alternative, a contribution to its marketing efforts, either in the form of a lump sum or as a percentage of the total contract. The requested discount/allowance is significantly larger than usual, although there is precedent at Company A for granting this level of discount in unique circumstances. Distributor further advises Company A that the Ministry's procurement officials responsible for awarding the contract have expressed a strong preference for including a particular local company (Local Partner) in the transaction as a subcontractor of Company A to perform installation, training, and other services that would normally have been performed by Distributor or Company A. According to Distributor, the Ministry has a solid working relationship with Local Partner, and it would cause less disruption for Local Partner to perform most of the on-site work at the Ministry. One of the principals (Principal 1) of the Local Partner is an official in another government ministry.

What additional compliance considerations do these alternative facts raise?

As with Consultant in the first scenario above, Company A should carefully vet Distributor and Local Partner and their roles in the transaction in order to minimize the likelihood of incurring FCPA liability. While Company A has an established relationship with Distributor, the fact that Distributor has requested an additional discount warrants further inquiry into the economic justification for the change, particularly where, as here, the proposed transaction structure contemplates paying Local Partner to provide many of the same services that Distributor would otherwise provide. In many cases, it may be appropriate for distributors to receive larger discounts to account for unique circumstances in particular transactions. That said, a common mechanism to create additional margin for bribe payments is through excessive discounts or rebates to distributors. Accordingly, when a company has pre-existing relationships with distributors and other third parties, transaction-specific due diligence—including an analysis of payment terms to confirm that the payment is commensurate with the work being performed—can be critical even in circumstances where due diligence of the distributor or other third party raises no initial red flags.

Company A should carefully scrutinize the relationship among Local Partner, Distributor, and Ministry of Immigration officials. While there is nothing inherently illegal about contracting with a third party that is recommended by the end-user, or even hiring a government official to perform legitimate services on a transaction unrelated to his or her government job, these facts raise additional red flags that warrant significant scrutiny. Among other things, Company A would be well-advised to require Principal 1 to verify that he will have no role in the Ministry of Immigration's decision to award the contract to Company A, notify the Ministry of Immigration and his own ministry of his proposed involvement in the transaction, and certify that he will abide by the FCPA and other anti-corruption laws and that his involvement in the transaction is permitted under local law.

(cont'd)

Assume the following additional facts:

Under its company policy for a government transaction of this size, Company A requires both finance and compliance approval. The finance officer is concerned that the discounts to Distributor are significantly larger than what they have approved for similar work and will cut too deeply into Company A's profit margin. The finance officer is also skeptical about including Local Partner to perform some of the same services that Company A is paying Distributor to perform. Unsatisfied with Sales Executive's explanation, she requests a meeting with Distributor and Principal 1. At the meeting, Distributor and Principal 1 offer vague and inconsistent justifications for the payments and fail to provide any supporting analysis, and Principal 1 seems to have no real expertise in the industry. During a coffee break, Distributor comments to Sales Executive that the finance officer is naïve about "how business is done in my country." Following the meeting, Sales Executive dismisses the finance officer's concerns, assuring her that the proposed transaction structure is reasonable and legitimate. Sales Executive also reminds the finance officer that "the deal is key to their growth in the industry."

The compliance officer focuses his due diligence on vetting Distributor and Local Partner and hires a business investigative firm to conduct a background check. Distributor appears reputable, capable, and financially stable and is willing to take on real risk in the project, financial and otherwise. However, the compliance officer learns that Distributor has established an off-shore bank account for the transaction. The compliance officer further learns that Local Partner's business was organized two years ago and appears financially stable but has no expertise in the industry and has established an off-shore shell company and bank account to conduct this transaction. The background check also reveals that Principal 1 is a former college roommate of a senior official of the Ministry of Immigration. The Sales Executive dismisses the compliance officer's concerns, commenting that what Local Partner does with its payments "isn't our problem." Sales Executive also strongly objects to the compliance officer's request to meet with Principal 1 to discuss the off-shore company and account, assuring him that it was done for legitimate tax purposes and complaining that if Company A continues to "harass" Local Partner and Distributor, they would partner with Company A's chief competitor. The compliance officer and the finance officer discuss their concerns with each other but ultimately sign off on the deal even though their questions had not been answered. Their decision is motivated in large part by their conversation with Sales Executive, who told them that this was the region's most important contract and that the detailed FCPA questionnaires and robust anti-corruption representations in the contracts placed the burden on Distributor and Local Partner to act ethically.

Company A goes forward with the Distributor and Local Partner agreements and wins the contract after six months. The finance officer approves Company A's payments to Local Partner via the offshore account, even though Local Partner's invoices did not contain supporting detail or documentation of any services provided. Company A recorded the payments as legitimate operational expenses on its books and records. Sales Executive received a large year-end bonus due to the award of the contract.

In fact, Local Partner and Distributor used part of the payments and discount margin, respectively, to funnel bribe payments to several Ministry of Immigration officials, including Principal 1's former college roommate, in exchange for awarding the contract to Company A. Thousands of dollars are also wired to the personal offshore bank account of Sales Executive.

How would DOJ and SEC evaluate the potential FCPA liability of Company A and its employees?

This is not the case of a single "rogue employee" circumventing an otherwise robust compliance program. Although Company A's finance and compliance officers had the correct instincts to scrutinize the structure and economics of the transaction and the role of the third parties, their due diligence was incomplete. When the initial inquiry identified significant red flags, they approved the transaction despite knowing that their concerns were unanswered or the answers they received raised additional concerns and red flags. Relying on due diligence questionnaires and anti-corruption representations is insufficient, particularly when the risks are readily apparent. Nor can Company A or its employees shield themselves from liability because it was Distributor and Local Partner—rather than Company A directly—that made the payments.

The facts suggest that Sales Executive had actual knowledge of or was willfully blind to the consultant's payment of the bribes. He also personally profited from the scheme (both from the kickback and from the bonus he received from the company) and intentionally discouraged the finance and compliance officers from learning the full story. Sales Executive is therefore subject to liability under the anti-bribery, books and records, and internal controls provisions of the FCPA, and others may be as well. Company A may also be liable for violations of the anti-bribery, books and records, and internal controls provisions of the FCPA given the number and significance of red flags that established a high probability of bribery and the role of employees and agents acting on the company's behalf.

European Commission



Compliance matters

What companies can do better to respect EU competition rules

Competition

Compliance matters

What companies can do better to respect EU competition rules

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Foreword



by Joaquín Almunia
Vice-President of the European Commission and Commissioner responsible for Competition

The European Union is an open market economy, based on principles of free competition: It relies to a large extent on market mechanisms, on the play of supply and demand.

Competition maximises incentives to innovate, engage in new promising activities, offer better services and wider choice at lower prices. The continuous quest for efficiency and improvement is not merely a result of the competitive process, it is the competitive process. Where companies – small, medium-sized or large – concentrate on becoming as efficient as possible, rather than on surviving by other (illegal) means, their competitiveness will increase whether they operate in their domestic market, in the European market, or on the worldwide stage.

If competition is to be an open contest, why should there be strict competition rules? Precisely because the competitive process must be protected. If no rules existed, the uncontrolled play of the market could eventually result in the distortion or even elimination of competition. A set of laws preventing collusion between companies or excessive use of market power are therefore necessary and they need to be respected for the benefit of consumers.

The EU and its Member States have such rules. They apply to large and small companies alike that sell to consumers or to intermediate (business) customers. They also apply to buyers, for instance when they collude to exploit their joint market power.

Time is money you may well be thinking — and it surely is. But just ask yourself the following questions:

- Am I managing a company that is doing business in the EU?
- Am I working in a company that does business in the EU?

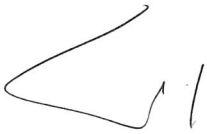
If your answer to either of these questions is yes, this brochure is directly relevant to your day-to-day work.

Although there are many obstacles on the path towards undistorted competition in the EU, companies (or 'undertakings' in the legal jargon) are key players in the drive to achieve genuine effective competition throughout the EU. This goes for larger companies operating on a European or worldwide scale, as well as for small and medium-sized companies operating in fewer Member States or within national boundaries.

This brochure focuses on helping companies to stay out of trouble and to ensure compliance with EU competition rules: it summarises the key rules companies need to respect, including the dangers involved in ignoring the law, and sets out practical steps that can be taken to ensure compliance with these rules. I hope this brochure will assist all companies, and in particular small and medium-sized companies, to understand better what the stakes are and how they can prevent their staff from crossing the line.

Look at this brochure as a road safety brochure ahead of the holiday period. You know that traffic rules are in your own best interest, you are well aware of the risk to which you expose yourself and others if you drive too fast or through a red light. Nevertheless the temptation is always there to ignore the speed limits or other traffic signs. This concise brochure is a sort of competition highway code which will help you comply with the applicable rules.

I wish you every success in your business endeavours. Drive safely!



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1 Complying with competition rules in Europe: a company's responsibility

EU competition rules concern everyone who does business in the EU, as they apply directly to all undertakings which are active within the EU. This means not only managers, who have choices to make in the interest of their companies, but also employees, who require guidance on how to implement these choices. Companies whose market behaviour fails to comply with EU competition rules run the risk of incurring high fines and facing other negative consequences.

Although under EU competition rules individuals are not penalised, their careers and jobs can be negatively affected by the wrong choices and even a company's existence may be threatened. In some Member States anti-competitive conduct may result in the individuals involved being penalised (including possible imprisonment), possibly in parallel to fines being imposed on companies.

1.1 General **obligation** to comply

The prime responsibility for complying with the law, as in any other field, lies with those who are subject to it. EU competition rules applying to undertakings are a fact of daily business life that has to be reckoned with, because ignorance of the law will not shield undertakings from the consequences of breaking it.

While it is clear that companies are under an obligation to comply with the rules, they are largely free to decide how to go about it. This is only natural, given that the size of companies, their resources for seeking advice, their field of activity and their exposure to the risk of becoming involved in infringements of EU competition rules vary considerably. It goes without saying that awareness of the rules is always a precondition for effective adherence to them.

1.2 **Benefits** of compliance

One important reason why a company should comply with competition rules, apart from being seen as doing business ethically, is the potentially high cost of non-compliance. But compliance can also — and indeed should — be approached positively.

An active and supportive strategy of compliance with the law and business ethics can certainly enhance a company's reputation and attractiveness for promotional and recruitment purposes, in much the same way as an explicit environmental or family-friendly agenda would do. It can help to raise job satisfaction of staff and contribute to a constructive sense of belonging, even pride, within the company. Staff who are aware of what constitutes illegal behaviour will also be more alert to wrongdoing by competitors or other commercial partners.

Your company can do more to help ensure that a level playing field is maintained by bringing potential malpractice to the attention of the competition authorities. First, it may inform the Commission[1] or a national competition authority[2] of any suspected infringement which comes to its attention. Second, it may apply

for immunity from and/or reduction of fines if it has been involved in an infringement. Finally, it may lodge a complaint if it is the victim of an infringement by other companies[3].

1.3 Effectiveness: the sole benchmark of success

Any effort by a company to ensure compliance with EU competition rules is laudable. But what matters ultimately is that the rules are actually complied with. When it comes to taking practical steps to ensure compliance, companies should keep in mind that their efforts will be assessed on the basis of results, in other words they will be judged by their success in avoiding infringements. Merely paying lip-service to an abstract or formalistic commitment to comply will get them nowhere. Any credible compliance programme must be built on a firm foundation of management commitment and supported by a 'top-down' compliance culture.

2 The costs of non-compliance for a company

2.1 Fines on companies

The fines which the European Commission imposes on companies that infringe EU competition rules can be very substantial, even as high as 10 % of a company's annual worldwide turnover. It should be noted that fines may be imposed even where the illegal purpose of an infringement was not actually achieved.

For example, members of a cartel that are found to have fixed prices will face high fines irrespective of whether or not the price levels rose as intended.

Several years ago the Commission set out its fining policy in writing[4], so as to make companies fully aware of the financial risk which they run if they do not comply with EU competition rules.

The risk of engaging in anti-competitive behaviour is thus considerable for a company, as evidenced particularly by the number of anti-cartel decisions in recent years, causing substantial fines to be imposed.

Cartels

Despite the Commission's and national competition authorities' determined fight against them, cartels still appear in many sectors, from basic industries to service markets, and companies of all sizes are involved in these infringements, from big multinational groups to small businesses.

In most of the cases investigated, unlawful behaviour had been encouraged and often directly perpetrated at the highest levels of responsibility. This shows that in certain circles, infringing the most essential rules of a market economy is still considered a rational way of doing business and maximising revenue.

In recent years, and in particular since 2001, the Commission has increased the frequency of its decisions prohibiting and fining cartels, imposing several billions of euros in fines overall. Most of these decisions have been upheld on appeal.

The *international removals* cartel

In 2008, the Commission fined international removal companies a total of more than € 31 million for having participated in a cartel in Belgium.

Between 1984 and 2003 the companies fixed prices, shared the market and manipulated the procedures for submission of tenders, in particular by issuing false quotes ('cover quotes') to customers and through a compensation system for rejected offers.

The Commission started the investigation on its own initiative with surprise inspections which proved particularly successful and abundant evidence of cartel activities was obtained.

One company received a reduction of 50 % of its fine under the Commission's Leniency Notice for providing the Commission with evidence of significant added value.

The *industrial sewing thread* cartel

In 2005, the Commission fined thread producers from Germany, Belgium, the Netherlands, France, Switzerland and the United Kingdom over € 43 million for their participation in different cartels.

Industrial thread is used in a variety of industries to sew or embroider various products such as clothes, home furnishings, motor vehicle seats and seatbelts, leather products, mattresses, footwear and ropes.

Between 1990 and 2001, these companies took part in regular meetings and had bilateral contacts to agree on price increases and/or target prices, to exchange sensitive information on price lists or prices charged to various consumers, to avoid undercutting the incumbent supplier's prices, and to arrange customer allocation.

National competition authorities have also targeted similar types of cartel behaviour in such sectors as coffee roasters, bath and personal care products, contact lenses, and flour.

Abusive behaviour by dominant companies is also of great — and indeed growing — concern for the Commission. This has led to a number of decisions imposing fines in the last few years relating to the ICT sector and to recently liberalised or partially liberalised markets, such as the energy, telecommunication and postal sectors. However, other sectors are not devoid of abusive practices by dominant companies.

2.2 Sanctions on individuals

In addition to imposing fines on undertakings, a number of Member States provide for sanctions on individuals (e.g. fines, director disqualification). The laws of some countries even allow custodial sanctions for individuals involved in general competition law infringements and/or in certain pre-defined types of infringements (e.g. bid-rigging). Such sanctions can be separate or cumulatively applied on top of pecuniary sanctions. Company managers who behave in an unlawful way therefore run the risk of jail in certain Member States.

2.3 Illegal agreements are void and may attract damages

Restrictive agreements which are incompatible with EU competition rules are automatically void and therefore cannot be enforced in court by the parties involved.

This means that a party cannot be obliged to honour an agreement which is illegal. Negative consequences for business can be considerable.

If an infringement of EU competition rules causes or has caused harm to a third party, the victim may bring a claim for damages before a national court against the perpetrator. For example, in the airfreight cartel case[5], damages claims were filed even before the Commission had fined 11 air cargo carriers for fixing prices.

2.4 Bad press for law-breakers and other collateral consequences

The Commission issues a press release whenever it has made a finding of illegal conduct and has fined the companies involved.

The resulting media coverage, both general and specialised, could have a detrimental impact on the reputation of those companies. Moreover, they may face hostility from clients and consumers who feel cheated.

Investigations by competition authorities can be time-consuming and costly for companies. Managers may become embroiled in lengthy legal discussions, thereby distracting attention from the core business activity.

3 Compliance with EU competition rules — Are you certain you have covered the risk?

Two main provisions of the Treaty on the Functioning of the European Union (TFEU) deal with the market behaviour of companies. **Article 101** prohibits agreements between companies which restrict competition, unless they produce substantial benefits to customers and consumers, while **Article 102** outlaws abuses by dominant companies.

These fundamental rules and prohibitions are further clarified by legal texts adopted by the Council or the European Commission, as the case may be, spelling out how the basic principles are applied to particular sectors or to particular types of agreements or behaviour by companies. Note that at national level behaviour purely affecting competition within a Member State is similarly prohibited.

3.1 EU competition rules are **directly applicable** to your company

EU rules are about the competitive behaviour of companies and they apply directly in all EU Member States. No transposition into national law is required. This makes it all the more important for companies to be aware of them, as they are directly enforceable by both the European Commission and national competition authorities and courts.

It is worth noting that EU competition rules apply to 'undertakings', a term which encompasses any entity engaged in an economic activity. Groupings of undertakings, such as trade associations and other industry groupings, while generally pursuing legitimate purposes and operating as a useful business forum, also have an obligation to comply with EU competition rules.

As indicated above, there are two basic types of behaviour in which companies may feel tempted to engage in the marketplace, but which are prohibited by EU competition law:

Illegal contacts and agreements between companies

Anti-competitive contacts between companies which, irrespective of their form, may distort the normal play of competitive forces are prohibited. Such contacts can take many forms and do not require the formal acceptance by the companies involved through an agreement. Even informal arrangements among business representatives can be considered illegal.

The most striking examples of anti-competitive contacts between companies include price fixing, sharing markets or customer allocation, production or output limitation, whether through bid rigging or otherwise. Such practices are often kept secret and generally referred to as 'cartels'. They are qualified as 'hardcore' restrictions of competition in legal jargon as they are by their very nature most likely to restrict competition. These hardcore infringements are vigorously pursued by the Commis-

sion and can result in companies being heavily fined.

Private exchanges between competing companies of individualised information concerning their intended future prices or quantities can also amount to a hardcore infringement. More generally all exchanges of confidential, strategic information between competitors can give rise to competition concerns.

This concerns all types of information that reduces strategic uncertainty in the market, for example relating to production costs, customer lists, turnover, sales, capacities, qualities, marketing plans, etc.

Furthermore, even the unilateral disclosure of strategic information by one company via mail, email, phone calls or meetings to its competitor(s) can be considered problematic.

Agreements between companies at different levels of the supply chain, typically distribution agreements between suppliers and re-sellers, which aim at fixing prices or artificially partitioning the internal market, are also illegal.

For instance, a supplier may not oblige its distributors to refuse to sell goods to customers residing outside of a given territory. In addition, it may not impose on its distributors a resale price for a given product.

In short, the following basic 'DON'Ts' should always be kept in mind by managers and employees of companies when they deal with competitors:

DON'T fix purchase or selling prices or other trading conditions;

DON'T limit production, markets, technical development or investment;

DON'T share markets or sources of supply;

DON'T exchange individualised information on intended future prices or quantities or other strategic information.

It is important to keep in mind that agreements between competitors and companies at different levels of the supply chain can also have anti-competitive effects even if they do not contain any of the above-mentioned hardcore restrictions.

For example, the agreement might have a negative impact on one of the parameters of competition, namely price, output, innovation, or the quality or variety of goods and services.

Such restrictive effects also need to be assessed by companies. A detailed framework for analysing the competitive impact of such agreements is provided by the Commission in specific guidelines.

Abuse of a dominant position

If companies have a large proportion of the business in a particular market, they are likely to hold a dominant position in that market. Such companies have a special responsibility not to engage in behaviour which is considered abusive. They should not act in a way that prevents competitors from competing effectively or drives them out of the market.

Examples of abusive conduct on the part of dominant companies are: charging unreasonably high prices which may exploit customers; charging unrealistically low prices which may be used to drive competitors out of the market; unjustified discrimination between customers; and forcing unjustified trading conditions on trading partners.

What about Small & Medium Enterprises?

All companies are subject to competition rules, with no differentiation according to their size. Being small is no excuse for not complying with the applicable EU or national competition rules.

3.2 Activities by public authorities

It falls to both European and national competition authorities and courts to ensure that EU competition rules are complied with.

Enforcement against illegal practices

The European Commission ensures effective application of these rules throughout the EU. It investigates suspected infringements and addresses binding decisions to companies in order to bring established infringements to an end. The Commission also has the power to impose fines on companies which have been found to infringe EU competition law.

The enforcement activity by national competition authorities, which are equally empowered to apply EU competition rules, needs to be added to that of the Commission.

National courts also play an important role. They may declare an agreement void if it is in breach of EU competition rules. They may also hear claims for damages resulting from a company's infringement of EU competition rules and award compensation to plaintiffs.

Further explaining the rules

The Commission endeavours to make it easier for companies to acquaint themselves with and know the rules which they must respect.

Certain types of agreements are exempted from general prohibition if their restrictive nature can be justified by benefits for consumers and the economy as a whole. The hardcore practices mentioned above are very unlikely to bring such benefits.

Companies have to assess for themselves whether their behaviour complies with competition rules and in doing so they might consider seeking legal advice.

General guidance as to whether an agreement is deemed exempted or not is provided by the Commission in particular by way of so-called Block Exemption Regulations. Mostly, such Regulations exempt restrictions in certain categories of agreements (e.g. Research & Development, Specialisation or Distribution agreements) up to a certain level of market power, defined in terms of market share, providing there are no 'hardcore' restrictions and certain conditions are met.

Outside the 'safe harbour' of the block exemption, guidelines such as those on horizontal cooperation agreements[6] or on vertical restraints[7] also set out the Commission's policy and decision-making practice on a variety of competition issues.

As regards abusive behaviour, the Commission has published guidance on its enforcement priorities in applying Article 102 TFEU[8].

Furthermore, formal Commission decisions[9] and Court judgments are publicly available, and the Commission publishes the formal opening and closing of proceedings on its website and/or by issuing a press release[10].

Finally, the Commission also publishes an annual report on competition policy and a number of informative brochures[11].

4 How can your company ensure compliance?

4.1 A clear strategy

In order to ensure effective compliance with EU competition rules, companies should think ahead, develop an approach tailor-made for their particular situation and set it out in writing, rather than react to problems only when they occur.

The ultimate goal of such a strategy is to raise awareness of potential conflicts with EU competition law and disseminate adequate knowledge of how to avoid them at all levels of the company, from employees to middle and top management.

Identifying the overall risk and individual exposure

A successful company's compliance strategy would be based on a comprehensive analysis of the areas in which it is most likely to run a risk of infringing EU competition rules.

These areas will depend on factors such as:

- the sector of activity; for example a history of previous infringements in the sector indicates a need for particular attention.
- (frequency/level of) the company's interaction with competitors; for example in the course of industry meetings or within trade associations, but also in day-to-day commercial dealings.
- the characteristics of the market: position of the company and its competitors, barriers to entry... If a company holds a dominant position in a market, the preventive measures to be taken will differ from those where the risk factor is more in the nature of 'cartelisation'.

But the exposure to that risk may vary greatly according to the position held by each member of staff. Employees whose specific areas of responsibility cause them to be particularly exposed (for example, employees who frequently interact with competitors as part of their job or through trade associations) would be made aware of what is at stake and of the basic principles to keep in mind.

Making the strategy explicit

In the interest of genuine compliance it is also important to disseminate the company's compliance strategy throughout its entire organisational structure. For the sake of internal clarity the strategy would preferably be laid down in writing, plainly worded and in all the working languages of the company, so that it is understood by everyone. It could for example take the form of a manual.

Such internal guidance would ideally contain a general description of EU competition law and its purpose, explain the way it is enforced and highlight the potential costs of non-compliance for the company. In this way, employees will better understand the reason behind the compliance strategy and its importance.

In addition, guidance in particular risk areas would be provided. For instance, a company which mainly deals in homogeneous products or has management or employee level contacts with competitors on a regular basis could stress the ban on cartels.

A practical set of 'DON'Ts' and 'RED FLAGS' can be a useful tool:

- A list of 'DON'Ts' could include clearly illegal conduct such as price-fixing agreements, the exchange of future pricing intentions, allocation of production quotas and the fixing of market shares;

- 'RED FLAGs' are warning signs which serve to identify situations in which infringements of competition rules can be suspected. They would encourage managers and employees to exercise particular caution in seeking to avoid any infringement on the part of their own company.

Visible and lasting commitment to the compliance strategy by senior management

Apart from choosing the right strategy and making it accessible to all staff, unequivocal senior management support is vital. The message that compliance with the law is a fundamental policy of a company needs to be clearly endorsed. This is an essential element of creating a culture of respect for the law within the company.

Designating an individual member of the senior management to take overall responsibility for compliance is considered advisable to ensure lasting commitment to and visibility for this objective.

Small and medium-sized companies have the advantage that the 'tone from the top' can more easily be disseminated to the employees, who are fewer in number.

Whilst the Commission does not wish to be prescriptive, a company should devote sufficient resources – appropriate to its size and the risks it faces – to ensure it has a credible programme.

4.2 Formal acts of acknowledgement by staff and consideration of compliance efforts in staff evaluation

Backup measures taken by companies as regards adherence of their staff to the adopted compliance strategy might include:

- asking staff for written acknowledgement of receipt of relevant information on compliance with EU competition law, for example when providing them with a manual or after dedicated training sessions. This form of explicit recognition helps to make individual staff members more aware that compliance concerns each and every one of them;

- putting in place positive incentives for employees to consider this objective with utmost seriousness. Compliance duties could for instance be part of job descriptions. A particularly vigilant attitude in that respect may also form part of the staff evaluation criteria.

- penalties for breach of the internal compliance rules. Such penalties would however have to be consistent with national employment law and double-checked with legal advisers first.

Proper internal reporting mechanisms

A further essential feature of a successful compliance strategy is the inclusion of clear reporting mechanisms. Staff must not only be aware of potential conflicts with EU competition law, but also need to know whom to contact and in what form when concrete situations of conflict arise.

A company may for example consider appointing a compliance officer who directly reports to the company's management. The communication channels should in any event allow management to take swift action. Time is usually of the essence, irrespective of whether or not competition authorities are already aware of the particular problem.

If an employee or manager discovers or even suspects an infringement, the compliance strategy should provide her/him with concrete guidance on how to proceed.

An environment that encourages employees to speak up when they are confronted with questionable situations can be decisive for the effectiveness of the compliance strategy.

4.3 Constant **update**, contact points for advice and training

Obviously it is not enough just to put down a strategy on paper. Where a manual is made available to staff, it should be reviewed regularly. There should also be a clearly identified contact point where advice can be sought by staff in case of doubts about the compatibility of certain types of behaviour or agreements with EU competition law.

Training on applicable EU competition rules also plays an important role. Many companies already offer their staff, in particular newcomers, an ambitious training programme. In such cases the development of a module on competitive behaviour would be advisable. Where a company's analysis has indicated particular risk areas, training should be provided to those staff members who are most likely to be confronted with situations that could lead to the company becoming involved in infringements, for example sales personnel and sales managers as regards price agreements between competitors and anyone attending trade associations or industry events.

The specific details will vary from one business to another, depending on available resources and expertise. In any case, a compliance strategy will be more effective if it incorporates a clear mechanism for ensuring that updates of the written policy can be obtained by staff at any time and that all employees and managers are kept informed about new developments.

4.4 Monitoring / Auditing

Monitoring and auditing can serve as effective tools to prevent and detect anti-competitive behaviour inside the company. Monitoring, for instance by verifying the company's own behaviour in the competitive process in bidding markets, would mean a more preventive approach.

Auditing would tend to discover anti-competitive behaviour only after it had already occurred.

Both mechanisms can also be combined. The appropriate procedure depends on the spe-

cific needs of the undertaking, but some form of control is surely important to underpin the internal credibility of a compliance strategy.

4.5 The strategy has failed to ensure full compliance? It may still serve to **limit exposure**!

An effective compliance strategy will be expected to simply prevent any infringement from happening. Yet it may prove insufficient to ensure compliance, and there may nevertheless be instances of wrongdoing.

Stopping the infringement at the earliest possible stage

In such a case, the existence of a compliance strategy – on condition that it incorporates appropriate reporting mechanisms – will allow mishaps to be nipped in the bud.

It will enable the company to take appropriate measures without delay, so that any potential infringement is swiftly brought to an end. This will contribute to limiting damage to competition and minimising the company's exposure.

Cooperating under the leniency programme and the settlement procedure: limiting the damage of cartel behaviour

The detection mechanisms provided by an effective compliance strategy can also help to get the best out of the Commission's leniency programme. Aimed at enabling the detection of secret agreements between competitors – some of the most egregious infringements of competition law – it offers a unique opportunity, for companies willing to cooperate with the Commission (or with the national competition authorities), to receive immunity from fines or to get a fine reduced.

Full immunity can be granted to the company that is the first to denounce a secret cartel to the Commission or to provide the Commission with sufficient corroborative evidence. Companies which, despite their willingness to cooperate, file their leniency application after another competitor has qualified for immunity, can only hope to obtain a reduction of up to 50% of any fine imposed on them.

However, remember that competition authorities are also on constant lookout for markets showing signs of distorted competition. When such signs appear, they may launch investigations themselves.

The exact conditions under which immunity from or reduction of fines in cartel cases is granted are explained in the corresponding Commission Notice[12].

Therefore, if you believe your company is or has been involved in a cartel, you might consider filing an application under the Commission's leniency programme and seeking legal advice in that respect.

Initial contact with the Commission should be made through the following dedicated fax number:

+ 32 2 299 45 85

Or through the following dedicated telephone numbers:

+ 32 2 298 41 90
+ 32 2 298 41 91

Further information on the Commission's leniency programme is available on the Internet at

http://ec.europa.eu/competition/cartels/leniency/leniency.html[13]

Finally, if companies are prepared to acknowledge their participation in a cartel, the Commission may invite them to participate in a swifter conclusion of the procedure. The companies' cooperation in this "settlement" procedure is rewarded with a 10 % reduction of the fine in addition to any reductions for leniency.

4.6 The Commission welcomes compliance efforts by companies

The Commission welcomes and supports all compliance efforts by companies as they contribute to the firm rooting of a truly competitive culture in all sectors of the European economy.

Companies, supported by the legal profession, have already contemplated and indeed implemented schemes to ensure compliance with EU competition law. These schemes are usually referred to as 'business compliance programmes' or just 'compliance programmes'.

In practice, they are often developed in reaction to past infringements or even after fines have been imposed. Increasingly such programmes are seen as an essential element of good corporate governance.

The Commission would advocate a more proactive approach that avoids infringements of EU competition rules from the outset. It cannot be overemphasised that a compliance programme worthy of the name must ensure that companies do not infringe competition law.

As has already been pointed out, it is not so much the effort made, but the result achieved, which counts once competition authorities become involved and launch an investigation. The quality of a compliance programme stands or falls by its effectiveness.

The Commission's attitude towards compliance programmes can, therefore, be summarised as follows:

- **Compliance programmes need to be tailor-made to the company concerned**. The range of situations that a compliance programme may need to address is wide. Equally the type, size and resources of companies which may find it useful to adopt a compliance programme vary considerably.

  Consequently, there is **no 'one size fits all' model**: an exhaustive all-encompassing model would not be adequate. It is for each company to reflect on its needs to ensure compliance and develop its own strategy. Further legal advice can be sought if considered appropriate.

- **Access to useful information can be provided by the Commission but there will be no endorsement of any individual compliance programme**. While the Commission constantly seeks to improve the accessibility of relevant legislation and information on EU competition rules, it considers it not to be the task of competition authorities to formally

advise on or approve individual compliance programmes.

Indeed, companies know best what is required for their own compliance strategy. This brochure provides companies with food for thought about the nature of their own compliance strategy. This includes for example creating the necessary positive and negative incentives to ensure compliance.

- Although all compliance efforts are welcomed, **the mere existence of a compliance programme is not enough to counter the finding of an infringement of competition rules**[14] — companies and their employees must, in fact, comply. If a company which has put a compliance programme in place is nevertheless found to have committed an infringement of EU competition rules, the question of whether there is any positive impact on the level of fines frequently arises. The answer is: No

  Compliance programmes should not be perceived by companies as an abstract and formalistic tool for supporting the argument that any fine to be imposed should be reduced if the company is 'caught'. The purpose of a compliance programme should be to avoid an infringement in the first place.

For the purpose of setting the level of fines, the specific situation of a company is duly taken into account. But **the mere existence of a compliance programme will not be considered as an attenuating circumstance**[15]. Nor will the setting-up of a compliance programme be considered as a valid argument justifying a reduction of the fine in the wake of investigation of an infringement. It would nevertheless be encouraged by competition authorities as a preventive means to avoid the occurrence and possible repetition of illegal behaviour in the first place.

It goes without saying that **the existence of a compliance programme will not be considered an aggravating circumstance** if an infringement is found by the enforcement authorities: if the programme has failed to deliver results, the sanction will come in the form of the fine imposed. In other words: a credible competition compliance programme can only deliver benefits to a company.

5 Where to find further relevant information

Competition website on 'Europa', the Internet site of the European Commission:

http://ec.europa.eu/competition

On this site, easy access to relevant legislative texts, Commission decisions, Press Releases, Annual Reports, sector-specific and other background information is provided. Links to other important sources of information, like the website of the Court of Justice of the European Union and the General Court, are equally available.

Publications on competition matters published by the European Commission:

http://ec.europa.eu/competition/publications/

Contact details of European Competition Authorities/members of the European Competition Network, available via:

http://ec.europa.eu/competition/ecn/competition_authorities.html

Website on compliance:

http://ec.europa.eu/competition/antitrust/compliance/

Endnotes

1 Concerns can by reported to the Commission by email to comp-market-information@ec.europa.eu. Please indicate your name and address, identify the companies and products concerned and describe the practice you have observed. This will help the European Commission to detect problems in the market and can be the starting point for an investigation.

2 The link to contact details of the national competition authorities of the EU Member States, members of the European Competition Network, is provided at the end of this brochure.

3 Citizens and/or companies may want to lodge a formal complaint if they are directly affected by a practice which they suspect restricts competition and are able to provide specific information. Certain requirements which must be fulfilled are explained in detail in the Commission Notice on the handling of complaints (OJ C101/65 of 27.04.2004), a summary of which can be found at http://europa.eu/legislation_

summaries/competition/firms/l26111_en.htm. You can also send an email to comp-market-information@ec.europa.eu if you want more information on how to lodge a formal complaint.

4 Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, published in the Official Journal of the EU under number OJ C 210 of 1.9.2006, p. 2.

5 See also Commission *Press Release IP/10/1487 of 9.11.2010*.

6 Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, OJ C11 of 14.1.2011, p.1.

7 Commission Guidelines on vertical restraints, OJ C 130 of 19.5.2010, p.1.

8 Communication from the Commission, OJ C 45 of 24.2.2009, p. 7.

9 Article 30 of Council Regulation 1/2003.

10 The same applies in cases where proceedings have not been formally opened but DG Competition has already made public the fact that it is investigating a case (e.g. by having publicly confirmed certain inspections). See Commission Notice on Best Practices for the conduct of proceedings concerning Articles 101 and 102 TFEU, OJ C 308 of 20.10.2011, p. 6.

11 See last section of this brochure «Where to find further relevant information».

12 OJ C 45 of 19.2.2002.

13 See also Commission *Press Release IP/06/1705* and *Memo MEMO/06/469 of 7.12.2006*.

14 See, for example, Case C-189/02 P Dansk Rørindustri, paragraph 373.

15 See, for example, Joined Cases T-101/05 and T-111/05, BASF and UCB, paragraph 52, and Case T-138/07, Schindler Holding, paragraph 282.

European Commission

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RÉPUBLIQUE FRANÇAISE
Autorité de la concurrence

Framework-Document of 10 February 2012 on Antitrust Compliance Programmes

Compliance programmes are instruments that enable economic players to increase their chances of avoiding breaches of all kinds of rules that are applicable to their activity, including competition rules. These programmes rely not only on informational measures intended to create a compliance culture (training, awareness), but also on operational initiatives (such as whistle-blowing and advice and audit systems) that are indispensable in helping companies to prevent, detect and solve cases of potential misconduct. The *Autorité* encourages companies to set up antitrust compliance programmes, either on a standalone basis or within the framework of their overall compliance policy, and to allocate sufficient resources to these programmes to ensure they are successful. A list of "best practices" that can contribute to the efficiency of antitrust compliance programmes is laid out in the current framework-document.

Companies committing to set up or to upgrade an existing compliance programme according to the aforementioned best practices, in the context of a settlement with the *Autorité*, may expect a reduction of their fine of up to 10%, under the conditions provided by the current framework-document. This reduction will be added to the 10% reduction corresponding to the settlement proper, and to the further 5% reduction that may be awarded in return of other commitments undertaken in accordance with the procedural notice of the *Autorité* of 10 February 2012.

I. Objectives and tools of competition law enforcement

1. Under Article L. 461-1 of the Commercial Code, the *Autorité de la concurrence* (hereinafter the "*Autorité*") is responsible for ensuring the competitive functioning of the economy. This mandate consists of making sure that economic players are free to innovate, produce and distribute quality goods and services at the best possible price without being impeded by anticompetitive practices or abuses that harm the general economy or other companies, consumers and, ultimately, the growth and well-being of society as a whole. This mission requires a policy of market monitoring, but also efforts aimed at preventing, detecting, correcting and punishing antitrust infringements.

2. The Commercial Code provides the *Autorité* with various resources to implement this policy. They are not all of the same type, although their common purpose is to encourage economic players to conduct their businesses in accordance with the objectives founding competition rules as laid down by French law and the Treaty on the Functioning of the European Union (hereinafter, the "TFEU"), as well as to dissuade them from infringing these rules. Some of

these instruments are essentially punitive or corrective. Others take into account, under the conditions they specify, certain initiatives taken by economic players to prevent infringements to antitrust law, remedy them and assist the *Autorité* in detecting and punishing them.

3. The second paragraph of Section I of Article L. 464-2 of the Commercial Code thus empowers the *Autorité* to order companies and organisations that implement anticompetitive practices prohibited by Articles L. 420-1, L. 420-2 and L. 420-5 of the Commercial Code, as well as by Articles 101 and 102 of the TFEU, to cease such practices and to impose financial penalties on them[1]. Section IV of the same article enables the *Autorité*, under its leniency programme, to grant total or partial immunity from financial penalties to an organisation or company that chooses to unveil information about an anticompetitive agreement in which it was involved and to cooperate with the *Autorité* during the entire investigation process[2]. Section III of the same provision empowers the *Autorité* to reduce financial penalties in order to take into account the fact that a company or an organisation has waived its right to challenge a statement of objections, and to grant an additional reduction if this person also undertakes to change its future behaviour[3].

4. This latter provision, which was introduced by Article 73 of Law No. 2001-420 of 15 May 2001 relating to New Economic Regulations (NER) and amended by Article 2 of Ordinance No. 2008-1161 of 13 November 2008 for the Modernization of Competition Regulation, authorizes the *Autorité* to take into account the fact that a company or organisation that waives its right to challenge a statement of objections also undertakes to set up measures intended to ensure that its business activities comply with competition law, in particular compliance programmes. Since the adoption of this provision, the *Conseil de la concurrence*, replaced by the *Autorité*, has gradually developed a practice whereby it accepts such commitments, renders them mandatory and takes them into account by granting a reduction in financial penalties, after having determined in each case if such commitments are relevant, credible and verifiable.

5. The notice issued by the *Autorité* on 16 May 2011 on the method relating to the setting of financial penalties states in this respect that: "*The Autorité encourages companies to set up antitrust compliance programmes. It will soon provide guidance on its general approach to compliance, in order to assist business on in this matter. In parallel, the conditions in which it may take into account proposals of commitments to set up antitrust compliance programs, in the context of the settlement procedure provided by Section III of Article L. 464-2 of the Commercial Code, by granting a reduction of the financial penalty if it deems those programs to be relevant, trustworthy and verifiable, will be explained in a forthcoming procedural notice on that procedure.*"

6. In accordance with this commitment, the current framework-document describes the *Autorité's* approach to compliance programmes. It summarizes key elements originating from its case law

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[1] The practical conditions relevant to the setting of financial penalties are described in the notice issued by the *Autorité de la concurrence* on the method relating to the setting of financial penalties on 16 May 2011. That document is available on the *Autorité's* website.

[2] The practical conditions relevant to this procedure are described in the procedural notice issued by the *Autorité de la concurrence* relating to the French leniency programme on 2 March 2009. That document is available on the *Autorité's* website.

[3] The practical conditions relevant to this procedure are described in the procedural notice issued by the *Autorité de la concurrence* on the antitrust settlement procedure on 10 February 2012. That document is available on the *Autorité's* website.

in that regard and incorporates the outcome of its ongoing study of the subject. The framework-document also takes into account existing international standards and practices, as well as current foreign experience concerning compliance programmes[4] and ongoing exchanges between the *Autorité* and various stakeholders on this subject. The *Autorité* is bound by the specifications of the current document. However, the Autorité reserves the right to diverge from these specifications if it is justified by specific circumstances of the case or general policy considerations.

7. The framework-document explains the reasons that have led the *Autorité* to encourage companies, organisations and other interested parties to set up competition law compliance programmes (II), the requirements it considers such programmes should meet in order to be effective and (III) the operational results it expects therefrom (IV).

II. The benefits of competition law compliance programmes

8. Corporate compliance programmes are programmes whereby companies or organisations express their commitment to certain rules and to the values or objectives on which they are based. Those programs generally also include a set of actions intended to assist companies in building a genuine culture of compliance with those rules, but also in detecting likely misconducts, in remedying them and in preventing recidivism.

9. Such programmes are a tangible illustration of proactive strategies of governance whereby economic players express their determination not only to ensure that their behaviour complies with the law, which they are subject to regardless, but also to avoid the risks they could face in the event of non-compliance and to deal promptly with any infringement that they would uncover.

10. Compliance programmes may deal with a number of issues, such as corruption, securities and tax law, consumer health and safety, environmental protection or antitrust law. Disregarding certain of these rule exposes economic players to financial or criminal penalties as well as to adverse effects on their reputation and to risks of private litigation. This is particularly true in the antitrust field: infringing the rules laid down by the French Commercial Code and/or the TFEU may expose companies to financial penalties, without prejudice to the right granted to the victims of an anticompetitive agreement or an abuse of a dominant position to seek damages. Furthermore, Article L. 420-6 of the Commercial Code provides for imprisonment and fines for individuals who fraudulently play a personal and significant role in designing, organising or implementing anticompetitive practices. Compliance programmes are an important tool for anticipating, controlling and managing these different risks.

11. The *Autorité* considers that compliance programmes, in order to be effective, must seek two objectives: firstly, prevent the risk of committing infringements and, secondly, provide the means of detecting and handling misconducts that have not been avoided in the first place. Therefore, these programmes cannot be limited to measures that aim at teaching the company's

[4] See, for example, the Good Practice Guidance on Internal Controls, Ethics and Compliance of 18 February 2010, appended to the OECD Recommendation for Further Combating Bribery of Foreign Public Officials in International Business Transactions of 26 November 2009, adopted with the support of the 38 countries, including France, that are signatories of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 21 November 1997. That document is available on the OECD's website.

corporate officers, managers, supervisors and other employees or agents about existing rules and making them aware of the need to comply with such rules. Creating and maintaining a culture of compliance is, of course, a fundamental part of compliance programmes. However, a set of concrete measures must complement this dimension of compliance programmes so that a company can display that it is effectively committed, at every level, to develop and maintain a culture of compliance with antitrust rules. Such an effort should lead to the detection of potential situations of non-compliance, for example through legal audits, and to take the necessary responses. Without such measures, the internal incentives for the company's staff to act in accordance with the law would remain weak and the compliance programme would end up being considered ineffective, if not artificial. Therefore, compliance programmes' value added is contingent on the combination of both the aforementioned preventive and corrective components.

12. Thus, the reasons for setting up antitrust compliance programmes go well beyond the mere hope of obtaining a reduction in the financial penalties that may be imposed if an anticompetitive agreement or an abuse of a dominant position is committed and challenged by the *Autorité*. Although such a reduction is possible under certain conditions and within certain limits (see section IV below), a company or an organisation that would set up a compliance programme solely for this purpose would deprive itself of the primary benefits of such a programme: focusing on a merit-based strategy on the marketplace and reducing its exposure to the risk of breaching antitrust law in the first place.

13. The *Autorité* considers that it is the duty of economic players themselves, as well as in their best interest, to take all possible measures to conduct their business in compliance with antitrust law and to prevent potential breaches of these rules. The *Autorité* considers that setting up an effective compliance programme can play a key role in this respect, while at the same time providing added guarantees of responsible behaviour and security to shareholders and to the general public, particularly if the company or the group it belongs to is quoted on the stock exchange or is a government-owned company. Lastly, the *Autorité* is convinced that the advantages of compliance programmes far offset their costs if they are designed and implemented properly. Section III below describes the various features the *Autorité* considers essential to the efficiency of these programs.

14. In this context, the *Autorité*, which places a great deal of importance on the educational and preventive aspects of its competition law enforcement mandate, invites economic players that already have a compliance programme in place to ensure that it includes a complete set of measures regarding antitrust compliance. The *Autorité* encourages economic players that do not yet have compliance programmes in place to set up such programmes, while stressing that antitrust is but one aspect of compliance and that it could, as such, call for an integrated approach within the company's broader compliance policy.

15. Compliance programmes can help undertakings to reduce the risk induced by taking part in anticompetitive conducts. Such conducts include secret horizontal agreements, called "cartels", which consist in price fixing, coordinated restrictions of production, or allocation of market segments or customers. Anticompetitive behaviours also include other types of agreements, such as the exchange of sensitive information between competitors or retail price management. Abuses of a dominant position, i.e. strategies of eviction or abuses of the weaker position of business partners or customers are also prohibited.

III. Requirements for effective competition law compliance programmes

16. Adopting measures to provide information and training and to increase awareness with respect to antitrust rules may help companies to reduce the risk of infringements attributable to the inadequate awareness or understanding of those rules by their managers, supervisors and other employees or agents. Combining learning measures with supervisory, control and punishment systems may increase the effectiveness of these efforts and may as well facilitate the discovery of potential infringements. However, in all likelihood, all of these initiatives combined may not entirely prevent infringements from being committed.

17. The fact that, as a result of its compliance programme, a company or organisation itself discovers that it has committed an infringement is a first after-the-fact indicator of the programme's effectiveness. However, this indicator is insufficient in itself. The follow-up by the company or organisation on this discovery is a second after-the-fact, and more decisive, indicator of the effectiveness of its programme.

18. For this reason, the *Autorité* considers that, in addition to measures taken to inform and train corporate officers, managers, supervisors and other employees or agents of the company or organisation with respect to antitrust rules, programmes intended to promote compliance with such rules must include a certain number of other features.

19. The way these features are implemented may vary from one compliance programme to another. There is no "one size fits all" programme. On the contrary, compliance programmes benefit from being tailored to suit each company's particular situation in terms of risks and individual characteristics, depending on:
– its size;
– its activity and markets;
– its organization, governance and culture.

20. In particular, the *Autorité* considers that the fact that a company is a small- or medium-sized enterprise (SME) may allow several features of its compliance programme to be significantly adapted.

21. However, the conjunction of the features described hereinafter is necessary in all cases, from the *Autorité*'s point of view, to ensure the programme's effectiveness.

22. These features, which should be recalled in a readily available and understandable documentation, on paper or as electronic documents, are as follows:

    1) <u>the existence of a clear, firm and public position adopted by the company's management bodies and, more broadly, by all managers and corporate officers</u>:
        a) stressing that compliance with antitrust rules is not only a legal obligation, but also a key element of the company's corporate liability, in light of the negatives consequences that antitrust infringements may have on the economy and on consumers;
        b) making a general and permanent commitment to comply with antitrust rules and to support the programme set up for the purpose of encouraging all managers, supervisors and other employees or agents to comply with these rules, to prevent infringements, to detect them and to remedy them as quickly as possible, in light of the legal, financial, commercial and reputational risks they could generate;

2) the commitment to appoint one or more persons empowered, within the company or organisation, to develop and monitor all aspects of the compliance programme. Such persons must in all cases:
   a) be appointed by the company's management bodies and chosen for his/her/their unquestionable skills and authority within the company;
   b) effectively devote themselves to the supervision of the programme's implementation;
   c) have the ability to directly access the company's supervisory bodies (board of directors or supervisory board, etc.), when justified by a question or issue relating to the company's compliance programme or policy (for instance, discovery of an infringement);
   d) have the necessary powers to ensure the effective implementation of the compliance programme;
   e) be provided with sufficient human and financial resources to design and implement the programme, in light of the size of the company or organisation;

3) the commitment to put in place effective information, training and awareness measures, in ways compatible with labour legislation, including:
   a) drafting documents or other materials and regularly distributing them to all corporate officers, managers, supervisors and other relevant employees or agent of the company or organisation, in order to:
      – explain the meaning and practical scope of antitrust law;
      – make them aware of the importance and benefits to the company or organisation, as well as to each one of them personally, of compliance with these rules in connection with their business activities;
      – inform them of the internal systems that enable them to obtain advice or report the existence of proven or possible infringements of such rules;
   b) general internal communication measures regarding the existence of and reasons for the compliance programme;
   c) regular mandatory training sessions on antitrust rules and the concrete implications thereof for the company or organisation for managers, supervisors and other employees or agents with specific antitrust risk profiles (for example, persons responsible for pricing or sales, persons who take part in the work of professional associations); as well as, when needed, one-off training sessions in case of specific events (for example, when a new employee is hired at a position where compliance to antitrust rules matters, or if an infringement is discovered);
   d) providing information regarding the existence of and reasons for the compliance programme, shortly after it is set up, to the major regular commercial partners of the company or organisation (for example, its suppliers or distributors, in particular in the case of small- and medium-sized companies), as well as to its shareholders, may also be considered;

4) the commitment to set up effective control, audit and whistle-blowing systems, including:
   a) adopting measures to ensure and evaluate individual conformity with the compliance policy of the company or organisation (for example, such measures could take the form of provisions added to the company's internal rules and regulations, clauses inserted in employment contracts, issuance of regular certificates of compliance for staff members);
   b) setting up a system enabling all employees or agents of the company or organisation who do not wish to be put in the position of infringing antitrust rules:
      – to request advice, even in the case of an emergency, from the person(s) in charge of the compliance programme or its/their local representative(s) regarding appropriate action in a matter that raises an issue of compliance with antitrust rules;

– to report in good faith[5] a proven or possible infringement of antitrust rules of which they are aware, if possible confidentially, and with the assurance of being protected against retaliatory measures. If such whistle-blowing system requires electronic processing of personal data, it must be set up in accordance with the requirements laid down by the *Commission nationale de l'informatique et des libertés* (the French authority in charge of data protection and privacy, known as "CNIL")[6];

c) carrying out regular evaluations of the various aspects of the compliance programme, as well as legal and commercial audits (due diligence), in particular during events that may create new risks for the company or organisation (for example, the acquisition of a new company or the development of a new business line). These evaluations and audits, which should be documented, are indispensable to assist the company or organisation in assessing the effectiveness and efficacy of its compliance programme and to improve it, if required. Appointing independent third parties may be necessary to ensure objectivity;

5) the commitment to set up an effective oversight system, including:
   a) a procedure for handling requests for advice, reviewing reports of infringements and studying subsequent action to be taken;
   b) a set of penalties, in particular disciplinary sanctions, for serious infringements of the policy of the company or organisation with respect to compliance with antitrust rules. Implementation of such penalties should be effective and proportionate to the individual situation and conduct of the concerned person.

IV. The consequences attached to competition law compliance programmes

23. The existence of an effective compliance programme is beneficial because it enables infringements to be avoided in the first place, but also because it makes it possible to discover infringements that have not been avoided and allows the concerned company or organisation to tackle the consequences thereof.

24. That said, when an infringement has indeed been committed, the *Autorité* considers that it is not appropriate to take the mere existence of a compliance programme into account when determining the company or organisation's financial penalty.

25. In particular, there is no reason to treat a compliance programme, *per se*, as a mitigating circumstance. If an infringement is committed despite the existence of a compliance programme, this very circumstance does not affect the objective reality of the infringement[7]. In particular, the fact that the company has set up a compliance program has no bearing on the seriousness of the facts or on the importance of the economic harm they may have caused to the economy. Furthermore, although it is true that the existence of a compliance programme may be an element that differentiates the relevant company or organisation from other participants to the infringement, the *Autorité* considers that this fact should not be taken into consideration

[5] Article 226-10 of the Criminal Code provides that false accusations are punishable by five years' imprisonment and a fine of €45,000.

[6] CNIL Decision No. 2005-305 of 8 December 2005 involving the single authorization for electronic processing of personal data in connection with whistleblowing systems (single authorisation decision No. AU-004), amended by Decision No. 2010-369 of 14 October 2010 amending single authorization No. 2005-305 of 8 December 2005, No. AU-004, on electronic processing of personal data in connection with whistleblowing systems.

[7] Court of Justice of the European Union, 28 June 2005, *Danske Rørindustri e.a. / European Commission* (joined cases C-189/02 P *et al.*), paragraph 373.

in itself when making an individual decision on the amount of the financial penalty to be imposed, insofar as it did not prevent the occurrence of the infringement.

26. Similarly, the *Autorité* will not treat the existence of a compliance programme as an aggravating factor, even if it turns out that corporate officials or managers took part in the infringement despite their commitment to comply with competition law and support the company or organisation's programme. The *Autorité* considers that this type of situation would be better served by holding the persons concerned criminally liable if the conditions for applying Article L. 420-6 of the Commercial Code are met, without prejudice to the possibility of imposing a financial penalty on the relevant company or organisation, pursuant to Article L. 464-3 of the same Code, if the compliance programme was set up pursuant to commitments made under the antitrust settlement procedure provided for in Section III of Article L. 464-2 of the same Code.

27. However, in the event that companies or organisations that have set such a compliance programme discover, thanks to this programme, the existence of a cartel between competitors, the *Autorité* considers that it is their responsibility, not only to cease their participation in this misconduct, but also to submit an application for leniency pursuant to Section IV of Article L. 464-2 of the Commercial Code as quickly as possible, after seeking appropriate counselling. Given the secret nature of those infringements and their extreme severity – they are considered as "*the most egregious violations of competition law*"[8] by the OECD – such an application is the action that is the most consistent with an ethical commitment with respect to compliance. Furthermore, such a procedural choice may provide the company or the organisation with total or partial immunity from financial penalties, in accordance with the requirements of the Commercial Code and the conditions described in the procedural notice of the *Autorité* on that subject[9]. If no such request is made by the undertaking, it may choose to settle, upon receiving the statement of objections, pursuant to Section III of article L. 464-2 of the Commercial Code. The complete or partial immunity that can be granted when an undertaking chooses one or the other of these procedures is exclusive of any other fine reduction that may be granted on the grounds of the existence of its compliance programme.

28. In the event that a company that has implemented a compliance programme fitting the good practices laid out above comes to discover on its own a misconduct that is not eligible to the leniency programme, before any inspection or investigation is conducted by a competition authority, the *Autorité* considers it is the undertaking's responsibility to cease and redress this misconduct immediately (e.g. by amending a strategy or contracts that could be considered an abuse of dominance or a anticompetitive vertical agreement). If the undertaking can prove, based on objective and verifiable evidence, that it has ceased and redressed the practice on its own volition before any inspection or investigation is conducted by a competition authority, such a circumstance may considered a mitigating circumstance in the event that the *Autorité* comes to handle the case and impose a penalty.

29. If an organisation or company that does not have a compliance programme in place is issued with a statement of objections, it may waive its right to challenge the objections in accordance with the requirements of the Commercial Code and in accordance with the conditions described

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[8] Recommendation of the OECD Council concerning Effective Action against Hard Core Cartels, n° C(98)35/Final, 25th of March 1998. This document is available on the OECD's website.
[9] See footnote 2 above.

in the procedural notice of the *Autorité* on that subject[10]. In addition, it may commit to change its future behaviour, in particular by setting up a compliance programme[11]. In such a case and provided the General Rapporteur deems it relevant to recommend that the *Autorité* goes ahead with the settlement and with the commitments proposed by the undertaking, the *Autorité* will consider that the commitment is relevant, credible and verifiable if it meets the best practices mentioned in the present framework-document. The commitments will be assessed on a case by case basis.

30. If, before the statement of objections was issued, the organisation or company involved had already set up a compliance programme, but that did not meet the best practices mentioned above, if it offers to improve this programme to the extent necessary to meet them, and if the Rapporteur General deems it relevant to recommend that the *Autorité* take such a commitment into account within the framework of the settlement procedure, the *Autorité* will consider that the commitment is relevant, credible and verifiable, subject to the same reservation.

31. If the *Autorité* accepts a commitment to set up a compliance programme that meets the best practices set forth in the present framework-document or to improve an existing programme to the extent necessary to that effect, the *Autorité* will reduce the financial penalty of the concerned company or organisation by up to 10%. To this reduction may be added other discounts available in the framework of the settlement procedure, for a total of up to 25 %, as mentioned by the *Autorité*'s procedural notice on that matter.

32. If the *Autorité* accepts a commitment to set up a compliance programme and renders it mandatory, it will subsequently check that it is actually implemented. At the *Autorité's* request, the relevant company or organisation must therefore be ready to provide it with a complete and precise report enabling it to check compliance with the commitment, and to respond to all requests or questions in this regard.

[10] See footnote 3 above.
[11] The *Autorité* has no legal basis for rendering mandatory a commitment to set up such a programme, after a statement of objections has been issued, other than pursuant to the antitrust settlement procedure.

Theodore Banks (dir.)
tbanks@schoeman.com

President, Compliance and Competition Consultants, LLC; Attorney at law, Schoeman, Updike &Kaufman, Chicago

Nathalie Jalabert-Doury (dir.)
njalabertdoury@mayerbrown.com

Avocat à la cour, Mayer Brown, Paris

Competition law compliance programs and government support or indifference

Theodore Banks
President, Compliance and Competition Consultants, LLC; Attorney at law, Schoeman, Updike &Kaufman, LLP, Chicago

Nathalie Jalabert-Doury
Avocat à la cour, Mayer Brown, Paris

Abstract

All companies should employ competition law compliance progams in an attempt to ensure their their employees will follow these complicated laws. Yet , enforcers' support for competition law compliance programs is wildly inconsistent. A few provide guidance about compliance, and will consider a sincerely implemented compliance program to be a mitigating factor. But many will not give credit to a "failed" compliance program. We survey the enforcement policies of 16 countries and the European Union with regard to competition law compliance programs.

Les entreprises devraient toutes mettre en place des programmes de conformité au droit de la concurrence pour assurer le respect de ces règles complexes par leurs salariés. Ceci étant, il n'y a guère de cohérence dans la manière dont ces efforts de conformité sont percus par les autorités. Quelques unes fournissent des guides en la matière et considèrent qu'un programme sincère constitue une circonstance atténuante mais beaucoup ne font aucun cas de programmes de conformité "qui n'ont pas fonctionné". La présente étude porte sur la prise en compte de ces programmes de conformité dans 16 pays et dans l'Union européenne.

1. Companies employ compliance programs for a simple reason: to prevent the company from violating the law. However, it immediately gets more complicated, since a company exists only on paper. The people in a company are the ones that actually take the actions that violate the law, and in the course of so doing may get themselves and the company into legal trouble.

2. The competition laws exist because we have learned that society benefits from competition. But achieving competition is not easy. We have known for a long time that collusion is perhaps a more natural state for the competitors than competition:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary[1].

3. Faced with this inexorable tendency, laws have been enacted that seek to punish conspirators. The theory is that if you make the cost of conspiracy high enough, that will counteract the natural tendency for people to seek collusion as the easier way to profit than competition. Yet, as we all know, for a variety of reasons, these laws have not succeeded in stopping collusion.

I. The drivers of competition compliance

4. So what does it take to stop violations of competition law in a company? Assuming that the violations are not officially approved by a government, then we need to look inside the company at their commitment to competition. This commitment is reflected through a number of elements that comprise what we refer to today as the compliance program. The compliance program makes it clear that the company is committed to competition, and communicates that commitment to all employees. There are a number of additional elements that are necessary to ensure that a compliance program actually works, and these are set out in various compliance program standards that are discussed herein. But, in short, a compliance program should have the following attributes:

→ An assessment of the legal risks faced by a company, and development of a compliance program to address those risks as part of an overall culture that supports legal and ethical conduct as a key business strategy.

1 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776).

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→ As part of that program, a clear policy regarding competition.

→ Internal procedures designed to implement the policy.

→ Support for competition at the board and senior officer level, and a commitment by directors and officers to enforce that policy.

→ A compliance program with sufficient resources and senior officer leadership, with direct connection to the board.

→ Communication and training to employees, along with appropriate incentives to follow the program, and punishment for failing to follow the program.

→ Auditing, monitoring and other steps to detect violations.

→ Periodic evaluation of the effectiveness of the compliance program, and correction of any deficiencies.

→ A method for employees to have questions answered, or report possible wrongdoing, with appropriate protection of the privacy rights of all involved.

5. If a company follows these steps and enacts, in good faith, an effective compliance program, there are two desired outcomes: 1) violations will be curtailed, and 2) if a violation occurs, a government enforcer will make a distinction between the unauthorized activities of a rogue employee and the good intentions of the company. In other words, a company would naturally hope that a compliance program would serve as a defense or a mitigating factor when faced with prosecution for a compliance law violation.

6. On this last point, there is a fairly wide divergence of approach by competition law enforcement agencies. Some agencies have recognized that no compliance program can be perfect, given the imperfections of human nature, and will consider a good faith implementation of a compliance program as indicative of a lack of intent to violate the law, thereby deserving of credit[2]. Other agencies take the approach that a compliance program that does not stop a violation is a "failed program" and is thereby not deserving of credit[3], or is only deserving of minimal credit[4].

7. The review of national laws that follows provides an interesting overview of the approach in many countries. It first might be instructive to take a look at the role of organized compliance programs in competition law/antitrust, which has an interesting history in the United States and in the European Union.

2 This is the approach adopted by the Organizational Sentencing Guidelines of the United States Sentencing Commission and the rest of the US Department of Justice for areas of law other than antitrust, as discussed herein.

3 The current position of the Antitrust Division of the United States Department of Justice.

4 The current position of the U.K., allowing a 10% credit.

II. Compliance programs and the Antitrust Division

8. We go back to one of the early cartel cases, the Electrical Equipment Conspiracy, which involved price fixing by the major manufacturers of electrical generating equipment in the 1950s. One of the participants, General Electric, had adopted a very specific antitrust policy in 1954:

No employee shall enter into any understanding, agreement, plan, or scheme, expressed or implied, formal or informal, with any competitor, in regard to prices, terms, or conditions of sale, production, distribution, territories, or customers, nor exchange or discuss with a competitor prices, terms, or conditions of sale, or any other competitive information, nor engage in any other conduct which, in the opinion of company's counsel, violates any of the antitrust laws[5].

9. However, General Electric and other companies were engaging in a price-fixing conspiracy, famously coordinated according to the phases of the moon. In trying to prevent corporate liability, the defense counsel argued that the conspirators would not have been involved if they had obeyed the policy. But the judge was not persuaded, and noted that the antitrust policy "was observed in its breach rather than in its enforcement... I am not naïve enough to believe that [the defendant] didn't know about it and it didn't meet with their hearty approbation"[6]. In Congressional hearings after the cartel participants were convicted, F. F. Loock, President of the Allen-Bradley Company (one of the conspirators), said "No one attending the [price-fixing meetings] was so stupid that he didn't know the meetings were in violation of the law. But it is the only way a business can be run. It is free enterprise"[7].

10. Clearly, a policy alone was not sufficient to stop this conduct[8]. In fact, there was evidence that the policy was entirely a sham, and the company's intent was to continue to fix prices, but maintain an appearance of compliance[9]. Part of the reason for this attitude may have been the relatively low criminal fines that could be imposed prior to 1955 ($5000 per count), so antitrust fines were viewed as a minor cost of doing business[10]. Companies could plead *nolo contendere* (no contest), and avoid a guilty plea that could be used as evidence in a subsequent civil suit. But statutory penalties were steadily increased, and in 1974 a violation of the Sherman Act was declared to be a felony, with longer prison time for individuals and larger fines for corporations.

5 General Electric Policy 20.5.

6 "Corporations: The Great Conspiracy", *Time* (Feb. 17, 1961); United States v. Westinghouse Electric Corp., General Electric Co., I-T-E Circuit Breaker Co., Ohio Brass Co., McGraw-Edison Co., A.B. Chance Co., and Lapp Insulator Co., Inc.,, Crim. Nos. 20234, 20235, 20236, 20238, 20239, 20240, 20241 (E.D. Pa. 1960).

7 J. Fuller, *The Gentlemen Conspirators* (1962); J. Herling, *The Great Price Conspiracy* (1962).

8 We do know now that a policy is only a part of a complete compliance program, with the elements as outlined above.

9 W.S. Ginn, a convicted officer of General Electric stated at his sentencing hearing that he was directed to fix prices by the top three officers of General Electric, who were not indicted. The intent was to insulate senior management from direct participation through the use of winks and nods. Id.

10 Although only a misdemeanor at the time, the concept of going to jail for a "mere" antitrust violation was a shocking prospect for corporate executives.

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11. In view of the increasing penalties, and, without being cynical, perhaps due to a genuine commitment to the benefits of competition, some companies tried to install sincere compliance programs. The U.S. Supreme Court recognized in *United States v. U.S. Gypsum Co*[11]. that intent to achieve an anticompetitive effect is a necessary element of a criminal violation[12]. Shortly thereafter, in *United States v. International Paper Co*.[13], the court instructed the jury that "the mere existence of an antitrust compliance policy does not automatically mean that a corporation did not have the necessary intent. If, however, you find that a corporation acted diligently in the promulgation, dissemination, and enforcement of an antitrust compliance program in an active good faith effort to ensure that the employees would abide by the law, you may take this fact into account in determining whether or not the corporation had the required intent."

12. The prosecutors hated this instruction, of course. They asserted that the mere existence of a compliance program was irrelevant, and that corporate liability was vicarious, and was based on the intent of the employee[14]. And this has been the position of the Antitrust Division of the Department of Justice ever since. Their position has been part of the their "amnesty" program where they give complete immunity to the first cartel member to confess, regardless of whether a compliance program was in place, or one was put in place later. The amnesty approach to antitrust enforcement has been enthusiastically adopted in at least fifty countries in recent years. The official position on compliance programs (i.e., they do not count for anything) also seems to be very influential.

13. Is this the proper approach to support compliance with the antitrust laws? We think not. The role of government is to encourage compliance, not merely to punish. Our learning about compliance programs has advanced in the last 35 years. We know more about why employees do the things they do, and how one can distinguish a legitimate compliance program from one that exists only on paper. There should be credit given for cooperation with government investigations and self-disclosure, but good faith attempts to comply need to be given more recognition. Enforcement agencies can take a role in helping companies improve their programs, but if they want companies to listen to their advice, there needs to be some recognition that following the advice will have some benefit when it comes to enforcement.

14. Prior to the *Electrical Equipment* cases in the United States, companies could take a cynical attitude toward antitrust compliance. If they were caught violating the law, minor fines would be paid, and the business would continue. There was nothing to encourage companies to comply, since greater profits were to be had by conspiring. It took a change of the law and aggressive enforcement to change that perception. Today, one might say that we are in an analogous situation. You could argue that there is no reason to invest in a compliance program since they are all imperfect and a government enforcer would give no credit for a program that was not perfect. Instead, a company might be better served by achieving greater profits through conspiracy, and investing efforts in making certain that it knew when the cartel was breaking down so that it could be the first in the door to confess – and get complete amnesty[15].

15. Of course we do not suggest this seriously. It behooves every company to understand the competition laws in every jurisdiction where it does business, and understand the government position with regard to compliance programs – and the amnesty programs. Antitrust compliance programs are an important part of an overall ethical corporate culture which yields tangible (e.g., higher returns on investment) and intangible (e.g., increased employee pride and motivation) benefits. In an era where companies in every country will depend on innovation for growth and survival, this can only come from aggressive competition.

III. Compliance programs and the EU Commission

16. It is also important to examine the history of the approach of the EU Commission over the years with regard to compliance efforts by companies, and this history is not far from the US history.

17. In 1980 and 1983, the European Commission received complaints from UK sugar merchants alleging that British Sugar was abusing its dominant position in the UK retail sugar market. After investigating these complaints, the European Commission was considering ordering interim measures until a final decision could be adopted and sent a Statement of objections to British Sugar. The latter then offered undertakings, which were accepted by the Commission on 7 August 1986. Interim measures were abandoned, while the Commission decided to continue the investigation on the case.

18. In October 1986, British Sugar informed the European Commission that it intended to implement a comprehensive compliance programme in order to ensure that the company fulfilled all its obligations under EU competition rules, covering the rules on abuses of dominance, but also the prohibition of restrictive agreements.

19. This undertaking stressed that "*in line with its policy of complying with all applicable laws the company is therefore committed to compliance with the EEC competition rules and will take every step to ensure observance of that policy. It is also the company's policy not only to observe the law but to go*

11 438 U.S. 422 (1978).

12 For a more detailed discussion of this history, see J. Cross, *Corporate Antitrust Liability and Compliance Programs in Corporate Legal Compliance Handbook* (Wolters-Kluwer 2d ed. 2011).

13 Crim. Nos. 78-H-11, 78-H-12 (S.D. Tex. 1978).

14 J. Shenefield & R. Favretto, "Compliance Programs as Viewed from the Antitrust Division", 48 *Antitrust L.J.* 73, 79 (1979).

15 See Murphy, "Introducing the FAST RAT Program" http://lawprofessors.typepad.com/antitrustprof_blog/2011/10/introducing-the-fast-rat-program.html.

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beyond mere compliance with the strict letter of the law and seek to avoid any conduct which may give rise to bout as to whether or not it has acted lawfully"[16].

20. The European Commission adopted an infringement decision on 18 July 1988, expressly referring to the compliance programme showing *"the exemplary manner in which British Sugar has conducted itself following its receipt of the interim measures Statement of Objections"*. As a result, a mitigating factor was applied[17] and the final fine was set at ECU 3 million[18].

21. Subsequently, the European Commission discovered that British Sugar participated in collusive arrangements with competitors and some merchants in the same markets between 20 June 1986 and 2 July 1990. At the time British Sugar submitted its compliance programme, several meetings with its main competitor Tate & Lyle had already taken place, and British Sugar continued these contacts for 4 years afterwards.

22. The response came loud and clear: "*British Sugar acted in a manner contrary to the clear wording contained in its compliance programme, which it announced to the Commission in October 1986 and introduced in December 1986* (…) *As was set out in detail, the compliance programme covered the whole range of the company's obligations under article 85 and 86, and specifically mentioned agreements and/or concerted practices concerning pricing. Moreover, British Sugar promised in its compliance programme to take every step to ensure compliance with the Community competition rules, even to go beyond its strict legal obligations and avoid any doubtful behavior, and to pass the message on to every level of the company's hierarchy. The infringement found in this Decision shows that this promise has not been fulfilled*"[19].

23. Considering such an aggravating circumstance, the fine imposed on British Sugar was increased by 75%, resulting in a fine of ECU 39.6 million instead of ECU 22.6 million. The Court of First Instance and the Court of Justice rejected the appeals introduced by British Sugar stating that an increase of 75% is not to be regarded as disproportionate taking into account the circumstances referred to by the Commission[20].

24. This case definitely sheds light on statements made since then on compliance programs by EU Commissioners, and notably by Commissioner Joaquin Almunia: "*When I talk about these things, I am often asked whether companies should be rewarded for operating compliance programmes when they are found to be involved in illegal commercial practices. The answer is no. There should be no reduction of fines or other preferential treatment for these companies. As already mentioned, we reward cooperation in discovering the cartel, we reward cooperation during the proceedings before the Commission, we reward companies that have had a limited participation in the cartel, but that, I think is enough. To those who ask us to lower our fines where companies have a compliance programme, I say this: if we are discussing a fine, then you have been involved in a cartel; why should I reward a compliance programme that has failed? The benefit of a compliance programme is that your company reduces the risk that it is involved in a cartel in the first place. That is where you earn your reward*"[21].

25. But examples of more proactive policies towards genuine compliance efforts by some National Competition Authorities (notably the UK and French regimes detailed below) as well as by Competition Authorities outside the EU (Canada, Australia, Israel and others detailed below) now invite the European Commission to adopt a more positive approach towards compliance efforts.

26. The European Parliament itself voiced the concern that the EU competition policy is not sufficiently considering compliance programs as an instrument in the fight against anti-competitive behavior.

27. In its Resolution of 9 March of the Report on Competition Policy 2008, the Parliament called "*for the development of a wider range of more sophisticated instruments, covering such issues as* (...) *corporate compliance programs* (…) *favour*[ing] *a 'carrot-and-stick' approach with penalties that serve as an effective deterrent, in particular for repeat offenders, while encouraging compliance*" [22]. In its Resolution dated 2 February 2012, the Parliament expressed again that it "*favours an approach that serves as an effective deterrent while encouraging compliance*" and encouraged the European Commission to review its fining guidelines "*taking into account that the implementation of robust compliance programmes should not have negative implications for the infringer beyond what is a proportionate remedy to the infringement" and "introducing a distinction on the level of fines for undertakings who have acted intentionally or negligently*"[23].

28. The information brochure "*Compliance Matters*" released by the Commission on 23 November 2011[24] is a first step to recognize that compliance effort matter and that the existence of a compliance program will not be considered as an aggravating factor.

29. However, this information brochure is not sufficient to provide the level of guidance which can be expected from the European Commission on the components of a genuine compliance program and it does not address all the recommendations of the European Parliament. It is

16 Reproduced in the Commission decision of 14 October 1998 relating to a proceeding pursuant to article 85 of the EC Treaty case IV/F-3/33.708 British Sugar plc, case IV/F-3/33.709 Tate & Lyle, case IV/F-3/33.710 Napier Brown & Company, case IV/F-3/33.711 James Budgett Sugar Ltd, para 27.

17 The exact mitigating factor applied does not appear in the decision.

18 Commission Decision of 18 July 1988 relating to a proceeding under article 86 of the EEC Treaty, case IV/30.178 Napier Brown – British Sugar.

19 Decision dated 1998 mentioned above, para 208.

20 CFI, 12 July 2001, Tate & Lyle plc, British Sugar plc and Napier Brown & Co. Ltd v. Commission, Joined cases T-202/98, T204/98 and T-207/98; ECJ, 29 April 2004, British Sugar plc v. Commission, Case C-359/01 P.

21 Joaquín Almunia Vice President of the European Commission responsible for Competition Policy Compliance and Competition policy Businesseurope & US Chamber of Commerce. Competition conference Brussels, 25 October 2010.

22 2009/2173(INI).

23 P7_TA(2012)0031.

24 http://ec.europa.eu/competition/antitrust/compliance/index_en.html.

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notably to be stressed that even if the Commission states in this brochure that "*the existence of a compliance programme will not be considered an aggravating circumstance if an infringement is found by the enforcement authorities*", not a word is said of other negative consequences and notably of the decisional practice on parental liability implications of compliance programs. Indeed, as detailed below, the adoption of a compliance program at the group level is used as evidence that the group exercises decisive influence over its subsidiaries and therefore may contribute to hold the group jointly and severally liable with such subsidiaries, absent any participation of the mother company or group holding to the practices.

30. The brochure also fails to propose any positive incentive for companies to enter into compliance programs whereas a number of grounds are available:

→ In any system based on quasi-criminal penalties, such penalties shall be adapted to the personal situation of the offender: the situation of an offender who has taken appropriate steps to avoid such an infringement is necessarily very different.

→ Regulation 1/2003 provides that fines can be imposed only where infringements are committed intentionally or negligently and mitigating circumstances are available when a company only participated negligently: one may question whether a company having adopted a genuine compliance program has intentionally or negligently participated to an infringement entered into by employees or executives not complying with its procedures.

→ The Guidelines on the method of the setting fines stress that the level of fines shall be determined taking into account gravity and duration, but also with a view to ensure a deterrence effect both towards the companies concerned (specific deterrence) and other companies (general deterrence): the company having entered into a robust compliance program is perfectly aware of the need to ensure compliance and therefore does not need to be deterred.

→ Reductions in fine are available under the leniency and settlement procedures: the benefit for general interest of the adoption of compliance programs is not least that bringing elements allowing to uncover a cartel or enabling the Commission to handle cases faster and more efficiently.

31. The purpose of the present survey is to provide an overview of various examples of regimes[25] providing (i) detailed guidance (ii) real incentives to enter into compliance programs, whatever the precise institutional framework under which those Authorities or Courts operate. Other Competition Authorities have recently announced or are presently considering the adoption of guidance. The Swiss Federal Council has just announced a major competition reform which will include a reduction in fine for companies showing they have implemented a genuine compliance program[26]. These new examples will certainly usefully add up to the existing initiatives to obtain a better recognition of genuine compliance efforts. ■

25 See also J. Murphy, "Promoting Compliance with Competition law: Do compliance and ethics programs have a role to play", OECD Roundtable on Promoting Compliance with Competition Law, 7 October 2011, DAF/COMP(2011)5.

26 http://www.admin.ch/aktuell/00089/index.html?lang=fr&msg-id=43503.

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Best practices for compliance programs: Results of an international survey

I. Introduction

Please briefly describe how antitrust enforcement is organized in your jurisdiction:

- → *What are the various types of penalties which can be imposed on companies and/or individuals for antitrust breaches (fines, prison, disqualification orders, damage claims etc.) etc.?*
- → *Are such penalties imposed by the competition authority/agency or by the courts (in such a case, please indicate the role of the competition authority/agency as to the principle and amount of the penalties)?*
- → *Please provide any relevant statistics on the level of enforcement in your jurisdiction (i.e. number of cartel cases handled, total fines/prison sentences in 2011, etc.).*

Australia

1. Australia's antitrust laws are set out in the *Competition and Consumer Act 2010* (Cth) ("CCA"), which is administered and enforced by the Australian Competition and Consumer Commission ("ACCC"), an independent federal authority.

2. The ACCC has extensive powers to investigate where it is concerned that a contravention of the CCA has occurred. Where it discovers evidence of conduct it believes to be unlawful, the ACCC can launch legal proceeding in the Federal Court of Australia ("Federal Court"). **3.**
The ACCC can seek a range of sanctions from the Federal Court, including pecuniary penalties of up to $10 million (per contravention) for corporations or $500,000 for individuals. It can also seek injunctions, bring representative actions for third-party damages, or seek other remedies such as community service orders, probation orders, adverse publicity orders or orders disqualifying persons from managing corporations (directors' disqualification orders).

4. In addition, third parties may also institute proceedings for breaches of the CCA where they believe they have suffered loss or damage as a result of unlawful anticompetitive conduct.

5. The Federal Court has exclusive jurisdiction over civil proceedings brought under the CCA.

6. In the case of the cartel provisions of the CCA, a civil or criminal action may be brought against corporations and/or individuals. Civil cartel proceedings are brought by the ACCC before the Federal Court, while criminal cartel cases are prosecuted by the Commonwealth Director of Public Prosecutions in either the Federal Court or a State Supreme Court.Sanctions for criminal cartels include fines of up to $10 million for companies and fines of up to $220,000 and/or up to 10 years' imprisonment for individuals.

7. The ACCC is vigorous in its enforcement of the CCA and in recent years the Federal Court has imposed record fines for cartel infringements. In 2010 – 2011 the ACCC instituted civil proceedings in 28 cases before the Federal Court and accepted administrative undertakings in a further 43 instances[27].

27 ACCC Annual Report 2010-2011 at page 28.

Brazil

8. The Brazilian antitrust legal framework is currently under restructure. The new Brazilian antitrust law No. 12,529/2011 ("New Antitrust Law") was enacted after several years of discussion in the Congress and will revoke as of May 2012 the previous framework designed by Law No. 8,884/1994 ("Antitrust Law").

9. The Antitrust Law structured the Brazilian antitrust system with three administrative entities that are jointly responsible for the antitrust enforcement: (i) Secretariat for Economic Law of the Ministry of Justice ("SDE"); (ii) Secretariat for Economic Monitoring of the Ministry of Finance ("SEAE"); and (iii) Administrative Council for Economic Defense ("CADE").

10. SDE, a department under the Ministry of Justice, is the chief investigative body in matters related to anticompetitive practices and can be identified as the prosecutor of the Brazilian system. SDE conducts investigation of competition practices and, before the end of an investigation, may issue non binding preliminary reports and, at the end of an investigation, issues a non-binding opinion to be reviewed by CADE. SEAE performs the role of economic advisor of the Brazilian antitrust system. It issues non-binding economic opinions in merger review cases and may also analyze anticompetitive practices from an economic viewpoint, being a department under the Ministry of Finance.

11. CADE is the administrative tribunal, composed of seven members (one Chairman and six Commissioners), which issues the final administrative decision in connection with anticompetitive practices and merger reviews. It is an autonomous federal agency related to the Ministry of Justice.

12. According to the new law, the system will now be composed only by CADE and SEAE. SDE will be merged into the new CADE and SEAE will only handle competition advocacy issues. For the purposes of this publication, we will consider the framework set forth by the Antitrust Law (and refer to the New Antitrust Law provisions, if possible) , since (i) it is still effective; (ii) the new regulation from CADE was not released yet; and (iii) the rules regarding compliance guidance shall not be significantly amended.

13. Article 36 of the New Antitrust Law (equivalent to article 20 of the Antitrust Law) establishes a strict liability rule under which any act that, by any means, intended or otherwise, produced the following effects is deemed a violation of the economic order: (i) limiting, restraining or otherwise injuring competition; (ii) controlling a relevant market[28]; (iii) arbitrarily increasing profits; or (iv) abusing a dominant position[29].

28 The achievement of market control through superior efficiency is not considered a violation under the Antitrust Law.

29 The dominant position is presumed when a company or group of companies controls at least twenty percent (20%) of a relevant market. However, this reference can be changed for specific sectors of the economy.

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14. There is also an indicative list of practices (article 36, Third Paragraph, of the New Antitrust Law, equivalent to article 21 of the Antitrust Law) that may be considered antitrust violations in case one of the four situations described above takes place. CADE can assess penalties to the companies involved in a violation and their officers and directors.

15. In recent years, the Brazilian antitrust authorities have been increasing their enforcement activities against anticompetitive practices. The number of investigations carried out by SDE and the amount of fines imposed by CADE are systematically increasing. In 2010, CADE imposed the largest fine in its history – nearly R$1.7 billion (approximately US$1 billion) – on a single company condemned for cartel formation.

16. The New Antitrust Law (articles 37 and 38) sets forth the list of various types of penalties which can be imposed on companies and/or individuals for antitrust breaches:

→ *Fines*: The following fines may be imposed by CADE on companies that infringe Brazilian competition rules: (i) for companies, 0.1% to 20% of the economic group gross revenue in the last financial year, registered in the market sector where the anticompetitive act occurred; (ii) for other legal entities, associations and unions, R$50,000.00 to R$2 billion; and (iii) for individuals, 1% to 20% of the fine imposed to the respective company, legal entity, association or union.

→ *Reputation damage*: CADE can order the company to publish in popular newspaper, for several days, an abstract of the decision.

→ *Disqualification*: CADE can decide to ban the company from any business with public banks and from entering any public bid for at least five (5) years.

→ *Corporate restructure*: The shareholders of company may be forced to spin-off, have its corporate control transferred to third parties, sell its assets or partially stop its commercial activities.

→ *Recommendations to other governmental agencies*: CADE can also recommend (a) compulsory license of an intellectual property right hold by the company to the Brazilian Patent and Trademark Office; and (b) the restriction of tax benefit to the Brazilian federal tax authority.

17. These penalties shall be imposed by CADE, according to the Antitrust Law and the New Antitrust Law. Please note that the Brazilian Constitution grants the right to any company or individual to appeal to the judicial courts against any decision issued by an administrative authority (e.g., CADE) and this is frequently the case. Recently, CADE has faced several challenges against its decisions condemning parties for antitrust violation before the Brazilian courts.

18. The Brazilian criminal law also sets forth that individuals from the companies directly involved in a cartel are subject to criminal penalties (to be decided by criminal courts), including two (2) to five (5) years of jail time.

19. In addition, if an infringement of the Antitrust Law causes or has caused harm to a third party, the victim may bring a claim for damages before court against the undertaking.

20. The antitrust penalties in connection with a violation shall be imposed by CADE. In case of cartel enforcement, the individuals directly involved in the collusion may be also subject to custodial sanctions to be decided by criminal courts.

21. The increased prosecution of anticompetitive practices imposed higher costs on the Brazilian antitrust authorities. From 2009 to 2011, the time spent by CADE in the analysis of preliminary inquiries increased from 267 to 360 days, and the analysis period for administrative proceedings increased from 267 to 474 days. From 2009 to 2011, CADE has judged 148 preliminary inquiries and 53 administrative proceedings.

22. The New Antitrust Law shall allow a better and more efficient enforcement against cartel and other violations, since the efforts will be concentrated in CADE, which is the decision-making body.

Canada

23. The Competition Act ("Act") contains both criminal offences, which are prosecuted before the courts, and non-criminal provisions dealing with conduct which can be reviewed by the Competition Tribunal ("Tribunal"), a specialized tribunal that combines expertise in economics and business with expertise in law.

24. Prosecution under the criminal provisions of the Act can result in fines and prison terms. For conspiracies relating to price-fixing, market allocation or output restriction, the Act provides for a maximum fine of C$25 million, and imprisonment for a maximum of fourteen years[30]. All other criminal offences under the Act are punishable by a fine in the discretion of the Court and by a term of imprisonment of up to fourteen years.

25. The Act also allows the courts to issue prohibition orders. Such orders may be issued either in the absence of prosecution, or after a conviction is entered. The court can issue an order prohibiting any act or thing directed towards the continuation or repetition of an offence. In addition, the court may also require an individual or a company to take any steps which it considers necessary in order to prevent the commission, continuation or repetition of an offence, and to take any steps agreed to with the prosecution. For example, this provision has been used to order the implementation of a compliance program and, in another case, the removal or demotion of key employees from their management position. The order is effective for a period of ten years, unless the court specifies a shorter period.

30 There is, however, no statutory limit to the number of counts which can be included in the charge, and multiple counts under the conspiracy provision can result in fines against a corporation which exceed the statutory maximum.

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26. The Act also allows private plaintiffs to sue for damages suffered as a result of conduct that is contrary to the criminal provisions of the Act.

27. Breaches of the non-criminal provisions involving conduct such as abuse of dominance, refusal to deal, exclusive dealing, tied selling, market restrictions and price maintenance, are sanctioned by prohibition orders or, in certain cases[31], by orders compelling other actions such as the divestiture of assets or shares. For abuse of dominance, the Tribunal may also impose an administrative monetary penalty for any amount up to C$10 million for a first order, and up to C$15 million for subsequent order.

28. All mergers or proposed mergers may be subject to review by the Commissioner of Competition (the "Commissioner"). In addition, all mergers that exceed certain financial thresholds must be notified prior to completion. Failure to notify is a criminal offence and can also lead to the imposition of an administrative penalty or other remedy by the court. From a substantive point of view, when the Commissioner believes that a merger or proposed merger is likely to prevent or lessen competition substantially in one or more relevant markets, the Commissioner can either apply to the Tribunal to challenge the merger under the applicable provisions of the Act, or negotiate remedies with the merging parties in order to resolve the competition concerns by way of a consent agreement.

29. The Act is enforced by the Commissioner, who is the head of the Competition Bureau ("Bureau"). The Commissioner is responsible for investigating any suspected anti-competitive activity which may be captured under the provisions of the Act.

30. If the Commissioner is of the view that a criminal offence has been committed, the matter is referred to the Director of Public Prosecutions ("DPP") with a recommendation on the charges to be laid and the appropriate sentence to be imposed. The DPP is responsible for instituting and conducting all criminal prosecutions under the Act which are heard by the courts. Although the DPP can make recommendations as to appropriate sentences, the decision ultimately rests with the courts.

31. With respect to the non-criminal provisions of the Act, the Commissioner investigates alleged violations and decides whether to apply to the Tribunal for review. When all parties agree on a resolution, the Commissioner can enter into a consent agreement with the parties. Such consent agreement is filed with the Tribunal and, upon registration, has the same effect as an order of the Tribunal.

32. Where voluntary compliance cannot be achieved, the Commissioner may file an application seeking remedial orders and, in certain circumstances, monetary penalties. The Commissioner can make representations to the Tribunal in relation to the amount of the penalty in a given case, but the Tribunal can impose any penalty which it considers appropriate, taking into account the aggravating and mitigating factors set out in the Act.

31 Where an order prohibiting the practice would not be sufficient to restore competition, the Tribunal has wide discretion to issue an order compelling other actions.

33. Private parties can also seek leave to apply directly to the Tribunal with respect to non-criminal matters involving refusal to deal, exclusive dealing, tied selling, market restrictions and resale price maintenance. If a party is granted leave to bring an application to the Tribunal, the Tribunal can either make a variety of orders or register a consent agreement made by the parties.

34. The Bureau conducts its investigations in private, which means that information relating to the number of cartel cases handled for the year 2011 is not publicly available. However, for the year 2011, charges were laid in four cartel cases, and eight corporations and nine individuals entered into guilty pleas. Total fines imposed amounted to $45,000 for individuals and to $750,000 for corporations.

Czech Republic

35. The authority responsible for applying antitrust rules in the Czech Republic is the Office for the Protection of Competition (Úrad pro ochranu hospodárské souteže) (the "Office"; www.compet.cz). The Office, for a breach of antitrust rules, can impose a fine on undertakings up to 10% of the total turnover. In addition, individuals actively participating in concluding or maintaining horizontal or vertical cartel agreements may face imprisonment up to eight years, disqualification and financial penalties. So far no individual has ever faced criminal sanction for participation in a cartel agreement in the Czech Republic.

36. In 2010 the Office initiated one cartel proceeding and imposed total fines of CZK 88 million (approximately EUR 3.5 million).

Egypt

37. The Egyptian competition law was adopted in February 2005 (Law no. 3 of 2005).

38. The law provides in article 22 (as amended in June 2008) that any person in breach of an anticompetitive practice will be subject to a fine that ranges between 100.000 (one hundred thousand) EGP (USD 18000) and 300.000.000 (three hundred Million) EGP (USD 50.000.000).

39. Any person can claim damages either in competition cases before criminal courts or bring a separate case before the civil court.

40. According to the law, all anti competitive breaches are criminal in nature. Therefore, the Competition Authority cannot impose fines directly. The case is referred to the prosecution office and then to the court which has the jurisdiction to impose fines through a criminal court judgment.

41. The role of the competition authority is like an expert witness to the court.

42. The only court judgment was rendered in the Cement Cartel Case in 2010 with a fine of 200.000.000 (Two Hundred Million) EGP (USD 35.000.000).

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43. An abuse of dominance case was settled with the person in breach in 2009. He paid 60.000 (sixty thousand) EGP (USD 10.000) and amended all his contracts with distributors to comply with the Competition Law and the Competition Authority decisions.

European Union

44. The European Commission can impose fines on companies infringing EU competition rules, either intentionally or negligently, up to 10% of their annual global turnover[32]. Such fines have to be fixed with regard to the gravity and the duration of the infringement and fines are also set by the European Commission so as to ensure that they have a sufficiently deterrent effect.

45. EU competition rules apply to "undertakings", i.e. economic entities, not to individuals. Individuals personally involved in EU competition rules violations may be subject to personal criminal prosecution at Member State level, based on national rules, but not at the EU level.

46. The European Commission, acts as an integrated public authority which investigates possible infringements and has the power to order infringements to be brought to an end and to impose sanctions. Decisions imposing fines are more precisely adopted by the College of Commissioners, after consultation of the Advisory Committee, composed of representatives of the competition authorities of the Member States.

47. These decisions are subject to legal review by the General Court and the Court of Justice. The General Court undertakes an exhaustive review of both the Commission's substantive findings of facts and its legal appraisal of these facts. Appeals on points of law only may be brought before the Court of Justice against judgments of the General Court.

48. The European Commission frequently publishes statistics concerning antitrust enforcement. The latest available statistics[33] show that, in 2011, the Commission imposed fines for a total amount of € 614 million in cartel cases, to be compared to € 2,869 million in 2010. Indeed, in 2011, the Commission only took decisions in 4 cartel cases, involving 14 companies (7 in 2010, involving 69 companies).

49. Since the entry into force of the 2006 Guidelines on fines[34], 151 undertakings were fined by the Commission, among which 76 were fined less than 1% of their annual global turnover and 22 were fined between 9 and 10% of it.

France

50. The French Competition Authority can impose fines on companies infringing French competition rules up to 10% of their annual global turnover[35]. Entities which are not companies can be fined up to € 3 million. Such fines have to be proportionate to the seriousness of the infringement, to the importance of the damage to the economy and to the situation of the company or group of companies concerned.

51. The French Authority is an independent administrative authority. Decisions are adopted by the College of Members of the Authority and they are subject to the legal review of the Paris Court of Appeals and of the French Supreme Court.

52. Individuals participating to anticompetitive practices also incur personal criminal liability when they have fraudulently taken a personal and decisive part in the conception, organization or implementation of an infringement to competition rules. Criminal courts may impose fines up to € 75,000 and up to 4 years of prison[36]. Such criminal actions can be initiated either independently or after the action against companies initiated by the Competition Authority.

53. The French Competition Authority counts among the European Competition Authorities which are particularly active enforcing EU and French rules. The Authority's official statistics for 2011 have not been published yet[37] but, in 2011, total fines amounted to € 420 million, a level of fines consistent with 2010 (€ 442 million[38]).

India

54. The Indian competition regime is regulated by the Competition Act, 2002 (*Act*) and the regulations and notifications framed thereunder. The Act deals with three substantive areas of law:

→ anti-competitive agreements;

→ abuse of dominance; and

→ merger control.

55. The substantive provisions of the Act dealing with anti-competitive agreements and abuse of dominance came into effect in May 2009, and the provisions governing merger control were made effective only in June 2011.

56. The enforcement authority under the Act is the Competition Commission of India (*CCI*). The CCI is assisted by an investigative arm, led by the Director General (*DG*).

32 Article 23 of Council Regulation N° 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

33 Which were published on 7 December 2011 and are available at: http://ec.europa.eu/competition/cartels/statistics/statistics.pdf.

34 European Commission's Guidelines of 1 September 2006 on the method of setting fines imposed pursuant to article 23(2)(a) of Regulation No 1/2003.

35 Article L 464-2 I of the Code de commerce.

36 Article L 420-6 of the Code de commerce.

37 The French competition authority's annual report is generally published in June of the following year.

38 Autorité de la concurrence's annual report for 2010, available at: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=406.

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57. The CCI has wide discretion in the passing of orders, including *ex parte* interim orders, and is also empowered to impose significant penalties by way of fines.

58. Orders of the CCI may be appealed against before the Competition Appellate Tribunal (*CompAT*) within a period of 60 days from the receipt of the order.

59. Any person aggrieved by any direction, decision or order of the CompAT may file an appeal to the Supreme Court within a period of 60 days from the date of receipt of an order of the CompAT.

60. With respect to anti-competitive agreements, the CCI may pass such orders as it deems fit, including:

– directing the enterprises to terminate the agreement and to refrain from re-entering such an agreement; or

– directing modification of the agreement.

61. The CCI may also impose penalties not exceeding 10% of the average turnover of the preceding 3 financial years of a contravening enterprise. Further, in case of a cartel, the CCI may impose upon each member of the cartel a penalty of up to 3 times the profits for each year of the continuance of the agreement, or 10% of turnover for each year of continuance of the agreement, whichever is higher.

62. In cases of abuse of dominance by an enterprise, the CCI may pass any or all of the following orders:

→ direct the enterprises involved to discontinue abusive activities;

→ direct the division of a dominant enterprise, and issue appropriate directions with regard to:

- the transfer of property, rights, liabilities or obligations;
- the modification of contracts and charter documents;
- the creation, allotment, surrender or cancellation of securities;
- the formation or winding up of the enterprise;

→ impose penalties not exceeding 10% of the average turnover of the preceding 3 financial years of the offender;

53. Under the provisions governing relating to merger control (or "combinations" as referred to under the Act), the CCI is empowered to:

→ approve a combination;

→ direct that a combination shall not take effect;

→ propose a modification of a combination.

→ impose the penalties in the following circumstances:

- upon the failure to notify, a penalty of up to 1% of the turnover or assets of the combination, whichever is higher;
- if any party to the combination makes a statement which is false in any material particular, or knowing it to be false; or omits to state any material particular knowing it to be material, such person shall be liable to a penalty between INR 50 lakhs (approximately EUR 76,923[39]) to INR 1 crore (approximately EUR 153,846).

64. Additionally, failure to comply with the orders of the CCI is punishable with a fine which may extend to INR 1 lakh (approximately EUR 1,538) for each day during which such non-compliance occurs, subject to a maximum of INR 10 crores (approximately EUR 1.5 million).

65. No criminal liability arises from the violation of the substantive provisions of the Act.

66. However, non-compliance with the orders issued by the CCI (directing a person to comply with its earlier orders) could result in criminal liability by way of a fine up to INR 25 crores (approximately EUR 3.8 million) and / or a prison sentence (up to a maximum of 3 years). Also, non-compliance with the orders issued by the CompAT could result in criminal liability by way of a fine of up to INR 1 crore (approximately EUR 153,846) and / or a prison sentence (up to a maximum of 3 years).

67. The CCI or the CompAT do not have the power to impose such penalty or criminal sentence. The punishment is to be imposed by the Chief Metropolitan Magistrate, Delhi, pursuant to a complaint filed by the CCI or the CompAT, as the case may be.

68. The DG is vested with the powers to:

→ summon and examine persons on oath;

→ require production of documents and receive evidence; and

→ obtain warrants/authorisation for search and seizure at offices and residences.

69. Anti-competitive behaviour could also separately, potentially attract provisions of the Indian Penal Code (*IPC*) and could lead to charges being made under the provisions of the IPC.

70. With respect to damages claimed by private parties affected by anti-competitive actions, the award of damages by way of compensation can be granted by the CompAT. The CompAT is empowered to hear compensation claims for damages or losses arising out of findings of the CCI or the CompAT regarding anti-competitive practices.

39 For the purpose of this article, the rate of conversion has been calculated at 1 Euro = 65 INR.

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71. There have been approximately 160 cases brought before the CCI since its inception, dealing with allegations of anti-competitive agreements and abuse of dominance. An overwhelming majority of the cases were dismissed for lack of *prima facie* evidence. A number of other complaints were dismissed on account of the claims relating to deficiency in services and other consumer complaints, and not complaints relating to anti-competitive activities.

72. However, the CCI has imposed stiff penalties in a few cases. The highest penalty levied so far has been where the CCI arrived at a finding of abuse of dominance by a major real estate developer and imposed a penalty of INR 650 crores (approximately EUR 100 million). This order of the CCI is currently under appeal before the CompAT and has been conditionally stayed.

73. Prior to this decision, the highest fine imposed by the CCI was in a case where the accused party was found to have indulged in cross subsidizing of one of its businesses (the relevant market) by leveraging its dominant position in other businesses, with a view to enter and protect its position in the relevant market. In addition to passing an order of cease and desist from unfair pricing, the penalty levied was INR 55.5 crores (approximately EUR 8.5 million) which amounted to 5% of the party's average annual turnover.

Israel

74. Any violation of the Israeli Restrictive Trade Practices Law 1988 (the "Antitrust Law") is a basis for criminal, administrative and civil liability.

75. Criminal liability in Israel applies not only to the corporation. A violation of the Antitrust Law might also impose direct personal liability upon corporate officers involved in the antitrust wrongdoing (section 47 of the Antitrust Law). Moreover, section 48 of the Antitrust Law imposes indirect criminal liability on senior officers of a corporation, even if they were unaware of the offence committed, unless they can prove that they had taken all reasonable measures to prevent antitrust violations. In practice, this defense may be best served by a compliance program that meets the IAA guidelines.

76. Criminal penalties include a possible imprisonment of up to 3 years (5 years in aggravating circumstances) and a fine of up to 2,260,000 NIS (about US$600,000) plus an additional amount of 14,000 NIS (about US$3,800) for each day the infringement continues (section 47 of the Antitrust Law).

77. The IAA is the prosecutorial body responsible for criminal enforcement of the Antitrust Law. While the IAA is authorized to indict corporations and individuals for any violation of the Antitrust Law, it had normally reserved criminal enforcement for hard core cartel offences, bid rigging and other blunt violations of the Antitrust Law. For such violations, the IAA's practice was to normally seek imprisonment of any person directly involved in the violations as well as senior officers indirectly liable for such violations under Section 48 of the Antitrust Law. All criminal proceedings are adjudicated in the Jerusalem District Court, which ultimately decides the verdict and the penalties to be imposed. The District Court's verdict is subject to appeal to the Israeli Supreme Court.

For other violations of the Antitrust Law the IAA normally applies one or more of the following administrative tools:

→ A Declaration of breach – under section 43(a) of the Antitrust Law, the Antitrust Commissioner can declare that a certain agreement, merger or practice is in breach of the Antitrust Law (e.g., that a person was part to an illegal restrictive arrangement/illegally merged with another corporation/abused its dominant position). Such Declaration serves as prima facia evidence in any court proceeding, thereby facilitating private lawsuits against the parties to such agreements or practices. The Declaration may also facilitate subsequent civil proceedings initiated by private plaintiffs or criminal proceedings brought by the IAA. The declaration is subject to appeal process at the Antitrust Tribunal.

→ A consent decree – under section 50(b) of the Antitrust Law, the IAA may enter into a consent decree with an alleged antitrust offender. Such decree is an alternative to a criminal or administrative action and it may include fines and undertakings by the alleged offender. The decree is subject to approval by the Antitrust Court.

→ Injunctive relief – the IAA can apply to the Antitrust Tribunal under section 50(a) of the Antitrust Law seeking a restraining order aimed at preventing or terminating violations of the Antitrust Law.

78. The IAA can also issue directives to monopolies and to members of an oligopoly under certain conditions, as well as seek a divestiture of a merger that was illegally consummated, if such merger reasonably demonstrates a significant harm to competition. These proceeding are subject to judicial review by the Antitrust Court.

79. Monetary Payments – in recent years the IAA has been advocating for an amendment to the Antitrust Law, which will enable it to impose significant monetary payments on antitrust violators. As part of wide reforms to increase competition that are currently underway in Israel, it is expected that such an amendment will be approved by the Israeli parliament during 2012.

80. Civil proceedings – The Law states that any breach of the Law is a civil tort under the Israeli Torts Ordinance. Accordingly, private parties may file a lawsuit against antitrust offenders seeking compensation for damages incurred as a result of an antitrust violation or apply for an injunction order to prevent such damages. Consumers may also file class actions under the Class Actions Law, 2006 for harm incurred as a result of an antitrust violation. Civil tort proceedings may be issued by any person in any court

84. *Criminal Enforcement:* In 2011, the IAA launched 5 new criminal investigations, including with respect to an alleged failure by Tnuva, Israel's leading dairy firm, to comply with an IAA data request. The IAA completed several other investigations resulting in a possible prosecution in three

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cases, one of which was a high profile investigation into possible cartel between major Israeli bakeries. The IAA brought one case before the Jerusalem District Court this year, relating to alleged bid-rigging in the water counters market. The Jerusalem District Court issued one verdict this year regarding a cartel between amplifier companies. Accepting a plea bargain, the Court sentenced one defendant for a two months imprisonment and a fine of about U.S.$12,000, while two other defendants were sentenced for a few months community service and various fines.

85. *Administrative Enforcement:* The IAA entered into one consent decree in 2011, regarding an alleged breach of the pre-merger notification regime. The consent decree included a monetary payment of about U.S.$100,000 by the merging parties. The IAA announced its intention to publish several declarations of breach, pending a hearing process.

Japan

86. The Japanese Anti-Monopoly Act sets forth imprisonment and fines as criminal penalties, payment order and cease-and-desist order as administrative penalties, and damage claims and injunction as civil liabilities.

87. Imprisonment may be imposed only on individuals, but fines may be imposed on both companies and individuals. Administrative penalties are imposed on companies in principle. Liabilities for damages are likely to be assumed by not only companies but also individuals such as their directors, but injunction is claimed only against companies in principle.

88. Imprisonment, fines, damage claim and injunction are imposed by the courts, while a payment order and a cease-and-desist order are imposed by the Fair Trade Commission ("FTC") which is the competition authority.

89. If an entrepreneur violates the Anti-Monopoly Act, criminal penalties are not usually imposed. However, if the violation is malicious, criminal penalties are imposed by courts in addition to the administrative penalties and civil liabilities. The proceedings in court to impose certain criminal penalties are commenced after FTC files an accusation with the prosecutor general.

90. FTC took legal measures against 12 cases violating the Anti-Monopoly Act (including 10 cartel cases) in 2010, while FTC deals with 142 cases in 2010. The total amount of payment order which FTC imposed in 2010 is around JPY72 billion. No accusation was filed with the prosecutor general by FTC in 2010.

Netherlands

91. The Dutch Competition Act entered into force on 1 January 1998 and is modelled closely on European Union competition law. The cartel prohibition contained in the Act (article 6) is almost an exact copy of article 101 of the Treaty of the Functioning of the European Union, excluding the effect on interstate trade criterion. The Act also contains a prohibition on the abuse of a dominant position (article 24). The Dutch Competition Authority (NMa) has the task of applying and enforcing the Act.

92. In 2013, the NMa is scheduled to merge with the Independent Post and Telecommunications Authority (OPTA) and the Consumer Authority (CA) to create a single regulator. The three authorities currently cooperate on the basis of "cooperation protocols".

93. Pursuant to the Competition Act, NMa can impose fines for breach of the cartel prohibition which may not exceed EUR 450,000 or 10 per cent of the company's turnover, whichever is higher. Principals and de facto managers can be made subject to fines of up to EUR 450,000 for involvement in a cartel. Under amendments already in effect from 1 August 2004, maximum fines of EUR 450,000 can be imposed on individuals for non-cooperation with NMa investigations. Similarly, maximum fines of EUR 450,000 or 1 per cent of turnover can be imposed on companies for non-cooperation.

94. There are no criminal sanctions under the Act. The ministers for economic affairs and justice are currently preparing a bill to introduce the possibility of imposing prison sentences on individuals infringing the cartel rules, as well as disqualification possibilities. However, rumour has it that these plans have been shelved.

95. Penalties are imposed by the NMa. In December 2001 the NMa published Guidelines for the Setting of Fines. These Guidelines were replaced in 2009 by the policy guidelines on the setting of fines. The policy guidelines state that the fine is based on the relevant turnover of the undertaking. This is understood to be the value of all the transactions realised by the undertaking for the duration of the infringement from the sale of goods or the provision of services to which the infringement relates. The fine for offenders other than individuals is set according to the following formula (as stated in the guidelines): Starting point × seriousness factor (× duration factor) + increase/decrease for additional circumstances.

96. The NMa will set a starting point equal to 10 per cent of the offender's relevant turnover. The seriousness factor has a maximum of five and is determined by the gravity of the infringement, considered in combination with the economic context in which the infringement occurred. The NMa distinguishes between three types of infringements: very grave, grave and less grave infringements. The basic amount of the fine consists of 10 per cent of the relevant turnover multiplied by the seriousness factor. In the case of very grave infringements, the NMa may increase the basic amount up to 25 per cent. In addition, in the case of a repeat infringement, the basic amount will be increased to 100 per cent.

97. The starting point for individuals is determined within the range of EUR 10,000 to EUR 200,000 for giving instructions or exercising de facto leadership with regard to inter alia "procedural" infringements such as breaking of seals affixed by the NMa during dawn raids. A range of EUR 50,000 to EUR 400,000 applies in regard of infringement of the cartel prohibition.

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98. In 2012, the NMa imposed fines in six cases for a total amount of EUR 39.7 million. In two cases, fines were imposed on individuals.

Pakistan

99. The Commission may:

- → issue orders pursuant to section 31 of the Competition Act 2010 (Act) specifying remedial measures:
- → impose fines and penalties under section 38 of the Act
- → initiate proceedings for imprisonment

100. Orders under Section 31

101. Section 31 of the Act provides that the Commission may issue orders in the case of:

102. (a) an abuse of dominant position: require the undertaking concerned to take such actions specified in the order as may be necessary to restore competition and not to repeat the prohibitions specified in Chapter II or to engage in any other practice with similar effect; and

(b) prohibited agreements, annul the agreement or require the undertaking concerned to amend the agreement or related practice and not to repeat the prohibitions specified in section 4 or to enter into any other agreement or engage in any other practice with a similar object or effect; or

(c) a deceptive marketing practice, require:

(i) the undertaking concerned to take such actions specified in the order as may be necessary to restore the previous market conditions and not to repeat the prohibitions specified in section 10; or

(ii) confiscation, forfeiture or destruction of any goods having hazardous or harmful effect.

(d) a merger, in addition to the provisions contained in section 11

(i) authorize the merger, possibly setting forth the conditions to which the acquisition is subject, as prescribed in regulations;

(ii) decide that it has doubts as to the compatibility of the merger with Chapter II, thereby opening a second phase review; or

(iii) undo or prohibit the merger, but only as a conclusion of the second phase review.

103. Penalties under Section 38

104. The Competition Commission (Commission) may impose the penalties listed below, after giving the undertaking concerned an opportunity to be heard, if an undertaking, or any director, officer or employee is found to have contravened the provisions of the Act.

105. Contravention of any provision of Chapter II of the Act which pertains to abuse of dominant position, prohibited agreements, deceptive marketing practices and mergers, results in a penalty of an amount not exceeding 75 million Pakistani Rupees (PKR) or an amount not exceeding 10% of the annual turnover of the undertaking, as may be decided in the circumstances of the case by the Commission.

106. For non compliance of orders, notices, requisitions of the Commission, a penalty of an amount not exceeding 1 million PKR.

107. Where an undertaking knowingly abuses, interferes with, impedes, imperils or obstructs the process in any manner an amount not exceeding one million rupees

108. Section 38(3) of the Act provides that if the violation of the order of the Commission is a continuing one, the Commission may also direct the undertaking guilty of such violation shall pay by way of penalty a further sum which may extend to one million rupees for every day after the first such violation.

109. Section 38(5) of the Act states that notwithstanding anything contained in this Act or any other law for the time being in force, failure to comply with an order of the Commission shall constitute a criminal offence punishable with imprisonment for a term which may extend to one year or with fine which may extend to 25 million PKR and the commission in addition or in lieu of the penalties prescribed in the Act, initiate proceedings in a Court of competent jurisdiction.

110. The Commission has to power to impose penalties.

111. The following statistics are available in the Annual Report 2010, available on the Commission's website (www.cc.gov.pk):

Proceedings Resolved 09-10	
Abuse of dominance cases	5
Prohibited Agreement cases	4
Deceptive marketing cases	3

Total Cases Resolved	12
Total Appeals Heard	2
Total Penalties levied in 09-10 - =6 – 8 billion PKR	

Singapore

112. The various penalties which can be imposed on companies are:

- → Fines of up to 10% turnover of the business of the undertaking in Singapore for each year of infringement for a maximum of 3 years. This is provided for in section 69(4) of the Singapore Competition Act Cap. 50B ("Act"); and
- → Directions given to the undertaking by the Competition Commission of Singapore ("CCS"), which it considers appropriate to bring the infringement to an end, or to remedy mitigate or eliminate any adverse effects. This is provided for in section 69(1) of the Act.

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113. Officers of the affected company may also face a fine of up to S$10,000 and/or imprisonment for a term not exceeding 12 months, not for the violation of cartel behavior or an abuse of dominance, but for example, for misleading, failing to provide information or documents to the CCS. This is provided for in section 83 of the Act.

114. Section 86 of the Act also provides for parties who have suffered loss or damage directly as a result of an infringement to have a right of private action against any undertaking who was at the material time a party to such infringement. No action may be brought until a final decision has been reached as per section 86(2) of the Act. There is a two year limitation period for such actions to be brought.

115. Such penalties are imposed by the competition authority, which amount can then be revised on appeal to the Competition Appeal Board or the courts on certain grounds being proven.

116. The High Court and Court of Appeal of Singapore has the power to confirm, modify or reverse the decision of the Competition Appeal Board, including the amount of financial penalty. This is provided for in section 74(3)(a) of the Act.

117. While this suggests that the High Court and Court of Appeal can only review the amount of penalty issued, section 74(3)(b) states that the High Court and Court of Appeal can make such further or other order, whether as to costs or otherwise, suggesting that the High Court and Court of Appeal has the power to make any order. There has been no case precedent regarding this position.

118. The enforcement of penalties and/or directions of the CCS are enforced by the district court of Singapore, as per section 85(1).

119. There have been a total of 12 cartel cases reported in Singapore. 7 were notifications, and 5 were investigations. For notifications, there were 2 in 2011, 2 in 2010 and 3 in 2007. For investigations, there were 2 in 2011, and 1 each in 2010, 2009 and 2008. 4 were handled in 2011, 3 in 2010, 1 in 2009, 1 in 2008 and 3 in 2007. Fines were handed in 5 of these cases. No prison sentences were issued.

120. There has only been one case relating to abuses of dominance, and this was the result of an investigation. The infringement decision was issued in 2010, along with a fine issued. No prison sentences were issued, as violations of the Competition Act are not subjected to criminal penalties. The case is currently under appeal.

121. A total of 29 merger cases have been notified. 2 cases have been notified thus far in 2012. 5 cases were notified in 2011, 7 in 2010, 4 in 2009, 7 in 2008 and lastly 4 in 2007. No fines or prison sentences have been issued.

South Korea

122. The primary law governing competition and antitrust matters in Korea is the Monopoly Regulation and Fair Trade Law ("FTL"). The Korea Fair Trade Commission (the "KFTC") is a ministerial-level central administrative agency charged with enforcing the FTL.

123. If the KFTC's committee consisting of nine Commissioners (the "Committee") finds the companies subject to its investigation to be in violation of the FTL, the Committee usually issues a corrective order wherein the offending parties are ordered not to do the prohibited activity. The Committee may also order the offending parties to publish a public announcement concerning the violation of the FTL. In addition, they may impose the sanctions described below on the relevant entities[40].

124. If the KFTC finds an entity to be in violation of the FTL, it may impose the sanctions set out below; the degree and range of sanctions imposed will depend upon the type and severity of the FTL violation. Moreover, the KFTC may file a criminal complaint against those individuals who actually conducted the acts in violation of the FTL.

A. Cease and Desist Order

125. The KFTC usually issues a corrective order ordering the offending parties to cease the illegal activity.

B. Public Announcement of the Violation

126. The KFTC may also order the offending parties to publish an announcement with details of the violation of the FTL. The KFTC will designate the number of daily newspapers in which the announcement must be carried and the size of the announcement, and will usually dictate its contents as well.

C. Surcharges

127. The KFTC generally has the authority to impose surcharges on enterprises in violation of the FTL. For instance, an abuse of a market dominant position will be subject to a surcharge of up to 3% of the relevant sales of the enterprise[41]. In the case of an unfair business practice, the KFTC may impose a surcharge of up to 2% of the relevant sales amount. The actual rate of the surcharge imposed will be decided by the KFTC on the basis of various factors (the primary factor is generally the severity of the anticompetitive effect of the violation, but the KFTC will also consider, for example, the duration or number of occurrences of the violation and/or the amount of unjust gain accrued as a result of the violation) up to the maximum applicable.

40 In addition, those individuals who actually conducted the acts in violation of law may also be subject to criminal sanctions.

41 Under the FTL, its Enforcement Decree and the KFTC Guidelines, "relevant sales" includes the revenues from sales of the "products related to the violation" during the period of the violation. The "products related to the violation" will generally correspond to the definition of the relevant product and geographic markets.

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D. Complaint for Criminal Sanctions

128. Criminal sanctions are the most severe penalties available under the FTL. If the KFTC decides to pursue a criminal sanction, it will file a criminal complaint with the Prosecutor's Office for an indictment under the FTL against the company and/or any responsible individual. If convicted, the offender may be subject to criminal liability including fines or imprisonment, although imprisonment is reserved for only the most exceptional cases. For acts constituting abuse of market dominant position, for example, the FTL sets forth criminal sanctions of up to three years' imprisonment and/or criminal fines of up to 200 million Korean Won.

Turkey

129. In the case of a proven cartel activity, the companies concerned shall be separately subject to fines of up to 10 per cent of their Turkish turnover generated in the financial year preceding the date of the fining decision (if this is not calculable, the turnover generated in the financial year nearest to the date of the fining decision will be taken into account). Employees and/or managers of the undertakings/association of undertakings that had a determining effect on the creation of the violation are also fined up to 5 per cent of the fine imposed on the undertaking/association of undertaking. After the amendments, the new version of the Law on Protection of Competition No. 4054, dated 13 December 1994 ("Competition Law") makes reference to article 17 of the Law on Minor Offenses to require the Competition Board to take into consideration factors such as the level of fault and the amount of possible damage in the relevant market, the market power of the undertaking(s) within the relevant market, duration and recurrence of the infringement, cooperation or driving role of the undertaking(s) in the infringement, financial power of the undertaking(s), compliance with the commitments etc., in determining the magnitude of the monetary fine.

130. In line with this, the Regulation on Monetary Fines for Restrictive Agreements, Concerted Practices, Decisions and Abuses of Dominance ("Regulation on Fines") was also enacted by the Turkish Competition Authority. The Regulation on Fines sets out detailed guidelines as to the calculation of monetary fines applicable in the case of an antitrust violation. The Regulation on Fines applies to both cartel activity and abuse of dominance, but illegal concentrations are not covered by the Regulation on Fines. According to the Regulation on Fines, fines are calculated first by determining the basic level, which in the case of cartels is between 2 and 4 per cent of the company's turnover in the financial year preceding the date of the fining decision (if this is not calculable, the turnover for the financial year nearest the date of the decision); aggravating and mitigating factors are then factored in. The Regulation on Fines also applies to managers or employees that had a determining effect on the violation (such as participating in cartel meetings and making decisions that would involve the company in cartel activity), and provides for certain reductions in their favour.

131. In addition to the monetary sanction, the Competition Board is authorised to take all necessary measures to terminate the restrictive agreement, to remove all de facto and legal consequences of every action that has been taken unlawfully, and to take all other necessary measures in order to restore the level of competition and status as before the infringement. Furthermore, such a restrictive agreement shall be deemed as legally invalid and unenforceable with all its legal consequences. Similarly, the Competition Law authorises the Competition Board to take interim measures until the final resolution on the matter, in case there is a possibility for serious and irreparable damages.

132. The sanctions that could be imposed under the Competition Law are administrative in nature. Therefore, the Competition Law leads to administrative fines (and civil liability) but no criminal sanctions. That said there have been cases where the matter had to be referred to a public prosecutor after the competition law investigation was completed. On that note, bid-rigging activity may be criminally prosecutable under sections 235 et seq. of the Turkish Criminal Code. Illegal price manipulation (i.e. manipulation through disinformation or other fraudulent means) may also be condemned by up to two years of imprisonment and a civil monetary fine under section 237 of the Turkish Criminal Code.

133. Similar to US antitrust enforcement, the most distinctive feature of the Turkish competition law regime is that it provides for lawsuits for treble damages. That way, administrative enforcement is supplemented with private lawsuits. Articles 57 et seq. of the Competition Law entitles any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws to sue the violators for three times their damages plus litigation costs and attorney fees. The case must be brought before the competent general civil court. In practice, courts usually do not engage in an analysis as to whether there is actually a condemnable agreement or concerted practice, but wait for the Competition Board to render its opinion on the matter, therefore treating the issue as a prejudicial question. Since courts usually wait for the Competition Board to render its decision, the court decision can be obtained in a shorter period in follow-on actions.

134. The sanctions specified above may apply to individuals if they engage in business activities as an undertaking. Similarly, sanctions for cartel activity may also apply to individuals acting as the employees and/or board members/executive committee members of the infringing entities in case such individuals had a determining effect on the creation of the violation. Other than these, there is no sanction specific to individuals. The Competition Law does not provide any specific rules regarding the liability of implicated employees for the legal costs and/or financial penalties imposed on the employer. On the other hand, much would depend on the internal contractual relationship between the employer and the implicated employee, as there is no roadblock against the employer claiming compensation from the implicated employee under the general principles of Turkish contracts or labour laws. In fact, the Competition Law Compliance Program which was recently released by the

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Turkish Competition Authority explicitly states that one of the ways to ensure the success of a compliance program is to provide clear intercompany disciplinary measures to hold the implicated employees personally liable.

135. Moreover, the Competition Board may request all the information it deems necessary from public institutions and organisations, undertakings and trade associations. Officials of these bodies, undertakings and trade associations are obliged to provide the necessary information within the period fixed by the Competition Board. Failure to comply with a decision ordering the production of information may lead to the imposition of a turnover-based fine of 0.1 per cent of the turnover generated in the financial year preceding the date of the fining decision (if this is not calculable, the turnover generated in the financial year nearest to the date of the fining decision will be taken into account). The minimum fine is TL 13,591 (approx. EUR 5,852 according to the applicable Turkish Central Bank average rate for 2011). In cases where incorrect or incomplete information has been provided in response to a request for information, the same penalty may be imposed. Similarly, refusing to grant the staff of the Turkish Competition Authority access to business premises may lead to the imposition of a daily-based periodic fine of 0.05 per cent of the turnover generated in the financial year preceding the date of the fining decision (if this is not calculable, the turnover generated in the financial year nearest to the date of the fining decision will be taken into account). Again, the minimum fine is TL 13,591 (approx. EUR 5,852 according to the applicable Turkish Central Bank average rate for 2011).

136. The national competition authority for enforcing the cartel prohibition and other provisions of the Competition Law in Turkey is the Turkish Competition Authority. The Turkish Competition Authority has administrative and financial autonomy. It consists of the Competition Board, Presidency and Service Departments. As the competent body of the Competition Authority, the Competition Board is responsible for, inter alia, investigating and condemning cartel activity. The Competition Board consists of seven independent members. The Presidency handles the administrative works of the Turkish Competition Authority.

137. A cartel matter is primarily adjudicated by the Competition Board. As mentioned above, administrative enforcement is supplemented with private lawsuits as well. In private suits, cartel members are adjudicated before regular courts. Due to a treble damages clause allowing litigants to obtain three times their loss as compensation, private antitrust litigations increasingly make their presence felt in the cartel enforcement arena. Most courts wait for the decision of the Competition Board, and build their own judgements judgments on that decision.

138. In 2011, the Competition Board has issued a total of 617 decisions. Amongst these, 283 decisions (approx. 46%) were related to cartel/dominance cases whereas 239 decisions (approx. 39%) were related to mergers/acquisitions/joint venture cases, 14 decisions (approx. 2%) were related to privatization cases and 54 decisions (approx. 9%) were related to exemption/negative clearance cases.

139. Within 283 cartel/dominance decisions, 238 of the claims (approx. 84%) were dismissed by the Competition Board in 2011 whilst fines were imposed on 9 cases (approx. 3%). The Competition Board has 18 ongoing investigations regarding cartels and abuse of dominance.

140. In 2011, the Competition Board has imposed a total amount of TL 462,862,794 (approx. EUR 199,303,648 according to the applicable Turkish Central Bank average rate for 2011) in fines. A great majority of these fines (99.8% or TL 461,989,251, approx. EUR 198,927,510 according to the applicable Turkish Central Bank average rate for 2011) were imposed on the undertakings regarding cartels, abuse of dominance and illegal concentrations.

141. As for the highest monetary fines imposed by the Competition Board as a result of a cartel investigation, two decisions stand out:

→ The highest monetary fine imposed by the Competition Board on a single company as a result of a cartel investigation was 68,844,704.73 TL (approx. EUR 29,643,775 according to the applicable Turkish Central Bank average rate for 2011). This monetary fine was imposed by the Competition Board on Ford Otomotiv San. A.Ş ("Ford") in its decision dated 18.04.2011 and numbered 11-24/464-139. This amount represented 9‰ of Ford's annual gross revenue for the year 2010.

→ The highest monetary fine imposed by the Competition Board for an entire case (i.e. total fine on all companies covered by the cartel conduct) as a result of a cartel investigation was TL 277.4 million (approx. EUR 119,445,401 according to the applicable Turkish Central Bank average rate for 2011) for various companies in automotive sector. The total fine was imposed on 15 undertakings (active in the new private cars and vans market) by the Competition Board in its decision dated 18.04.2011 and numbered 11-24/464-139.

United Kingdom

1. Antitrust penalties

142. Companies: The UK antitrust enforcement agencies may impose penalties for breach of the EU and UK rules prohibiting anti-competitive agreements and abuse of market dominance of up to 10% of global group turnover in the previous financial year[42]. They may order termination of the infringing conduct and, particularly in the context of a finding of abuse of market dominance, may require the infringing company to alter its business structure and/or terms. Third parties that have suffered loss as a result of the infringement may bring proceedings for damages and/or an injunction against the infringers in the English courts. They may rely on the factual findings of the UK competition regulators and the European Commission where the deadline for final appeal has expired. There has been some case law involving non-British claimants with UK subsidiaries "forum shopping" in the English courts to take advantage

42 S. 36(8) Competition Act 1998.

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of the more onerous rules on discovery to force disclosure of potentially problematic material[43].

143. Individuals: There are two consequences. Firstly, the UK competition regime is one of the few European systems that allows for prosecution of individuals who breach competition law. The Enterprise Act 2002 introduced the cartel offence from 20 June 2003[44]. Individuals who dishonestly participate in specified cartel conduct can be prosecuted and fined unlimited sums and / or sent to prison for up to five years[45]. The existence of a criminal offence in the UK means that UK citizens may be extradited to the US under the UK/US extradition treaty[46]. UK citizens convicted of cartel offences in the US have also returned to serve their sentences in UK prisons[47]. Secondly, where companies have infringed competition law, the directors of those companies may be disqualified from being a director for up to 15 years, if the director:

- → "ought" to have known of the breach; or
- → had reasonable grounds to suspect a breach but took no steps to prevent this and his conduct contributed to that breach[48].

144. Penalties on companies and individuals are generally imposed by the Office of Fair Trading ("OFT") as the primary UK investigatory competition agency[49]. The sectoral regulators in the UK have concurrent powers with the OFT in their sectors (electricity, gas, water, rail) and can also impose penalties. The OFT and sectoral regulators use their discretion under the relevant legislation to determine the appropriate amount of a penalty, taking into account a number of factors. In cartel cases they also take account of the leniency process, which allows companies and individuals to seek immunity from prosecution / fines or leniency (i.e. immunity or reductions in penalties for co-operation and information provision)[50].

43 See for instance *Provimi Ltd v Aventis Nutrition and others* [2003] EWHC 961 (Comm).

44 S. 188 Enterprise Act 2002, in force from 20 June 2003.

45 S. 190 (1) (a) Enterprise Act 2002. On 15 March 2012, the British Government announced its proposals for the reform of the UK competition regime. The centrepiece is the merger of the OFT and CC into a new, unified Competition & Markets Authority, by April 2012. The most striking proposed reform is re-writing the cartel offence in the Enterprise Act 2002 by deleting the 'dishonesty' element. To undermine the most damaging secret arrangements between conspirators, the offence will no longer include those cartels which the parties have agreed to publish in a suitable format (e.g. in the London Gazette) before they are implemented, so that customers and others are aware of them. The official explanation is that 'dishonesty' offences are particularly difficult to prosecute in a white collar criminal environment and the reform will increase the number of prosecutions. However, publishing restrictive arrangements may take the law back to the era of the Restrictive Trade Practices Act 1976, before the modernisation of UK law with the Competition Act 1998. In addition, the European Commission ended the notification of restrictive agreements in 2004, encouraging parties to self-assess with their legal advisors. The question is therefore whether this will unduly overburden the CMA's resources.

46 See the UK Supreme Court case *Norris (Appellant) v Government of the United States of America (Respondent) [2010] UKSC 9*. http://www.supremecourt.gov.uk/decided-cases/docs/UKSC_2009_0052_PressSummary.pdf.

47 S. 191 Enterprise Act 2002. See for instance the *Marine Hose* case: http://oft.gov.uk/about-the-oft/legal-powers/enforcement_regulation/prosecutions/marine-hose.

48 S. 204 Enterprise Act 2002.

49 S. 36 Competition Act 1998 and S.190(2) Enterprise Act. See OFT 423 Guidance as to the appropriate amount of a penalty, December 2004: http://oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft423.pdf.

50 See OFT803 Leniency and no-action: OFT's guidance note on the handling of applications, December 2008. http://oft.gov.uk/shared_oft/reports/comp_policy/oft803.pdf.

145. The only OFT infringement decision in 2011 involved the dairy sector and carried fines of nearly £50m.

2. Decisions of the UK regulators

146. The OFT had a mixed year in 2011. In August 2011, it imposed fines of nearly £50m in its Dairy investigation on a number of supermarkets and dairy manufacturers for coordinating increases in the prices consumers paid for certain dairy products in 2002 and/or 2003[51]. Initially the OFT had attempted to impose fines of over £120m in December 2007 and February 2008[52].

147. In November 2011 the OFT issued a Statement of Objections in the *British Airways / Virgin civil* price fixing case. This is a necessary step towards issuing a final penalty decision, and was taken because the OFT alleged that British Airways breached a settlement agreement with the OFT which had been previously agreed in August 2007, involving an agreed fine of £121.5m[53]. However, the criminal prosecution brought by the OFT against a number of BA executives collapsed in May 2010 after the OFT discovered that it had not shared crucial material with the defence. It has now been reported that the OFT and BA are in talks to agree a fine much reduced from £121.5m[54].

148. In March 2011 the Competition Appeal Tribunal ("CAT") reduced the fines imposed by the OFT on a number of construction companies by over 90% in some cases. This followed a very high profile OFT investigation into the UK construction industry, lasting some five years, fining 103 companies a total of £129m for engaging in "cover pricing", a form of bid-rigging. The OFT had issued a record-breaking 2000 page infringement decision but the CAT criticised the methodology used by the OFT to calculate the fines, calling the sums involved "excessive and disproportionate"[55].

149. In April 2011 the CAT similarly reduced on appeal the fines which had been imposed on a number of specialist construction recruitment companies by the OFT in September 2009. The Construction Recruitment Forum case had involved total OFT fines of £39.27m on six recruitment agencies for price-fixing and organising a collective boycott of another company. The CAT dramatically reduced the amounts payable by the companies in question, in one case from £30.3m to £5.8m[56].

51 See http://oft.gov.uk/news-and-updates/press/2011/89-11 Press release 89/11, 10 August 2011, *OFT fines certain supermarkets and processors almost £50 million in dairy decision*.

52 See http://oft.gov.uk/news-and-updates/press/2008/22-08.

53 See http://oft.gov.uk/news-and-updates/press/2011/120-11.

54 See http://www.telegraph.co.uk/finance/newsbysector/transport/9090804/British-Airways-in-talks-over-OFT-price-fixing-fine.html.

55 Case Numbers: 1114/1/1/091119/1/1/091127/1/1/091129/1/1/091132/1/1/091133/1/1/09 Kier Group Plc; Kier Regional Limited; Ballast Nedam N.V.; Bowmer And Kirkland Limited; B&K Property Services Limited; Corringway Conclusions Plc; Thomas Vale Holdings Limited; Thomas Vale Construction Limited; John Sisk & Son Limited; Sicon Limited -v- Office Of Fair Trading [2011] CAT 3.

56 Cases 1140/1/1/09, 1141/1/1/09 (1), 1142/1/1/09 (1) Eden Brown Limited; CDI Anders Elite Limited (2) CDI Corp; Hays PLC and others v Office of Fair Trading [2011] CAT 8.

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150. In both of the above cases, the CAT discussed the presence of compliance programmes introduced after the infringements. The CAT agreed that the OFT should take this into account when calculating the fines applicable to the companies in question.

151. In December 2011 the CAT quashed an OFT infringement decision in the Tobacco cases[57], in which a number of retailers and tobacco manufacturers had been fined a total of £225m in April 2010[58]. The OFT has expressed its "disappointment" at this verdict[59].

152. As at the time of writing in March 2012, there are no current criminal cartel cases in the public domain[60].

3. Ongoing cases

153. There is an ongoing civil investigation alleging an infringement of the Competition Act 1998 and article 101 in relation to passenger services on the London to Hong Kong route. In April 2010 the OFT issued a statement of objections alleging that Cathay Pacific Airways and Virgin Atlantic had infringed competition law in relation to passenger services on the London to Hong Kong route between September 2002 and July 2006. The matter was brought to the OFT's attention by Cathay Pacific under the OFT's leniency policy. Provided it continues to cooperate, Cathay will be immune from any penalty imposed in this case[61].

154. Another ongoing civil investigation involves suspected cartel activity in the UK involving commercial vehicle manufacturers. The investigation is being carried out under the Competition Act 1998 but has not reached any decision[62].

United States

155. In the United States, antitrust/competition law violations are enforced at both the state and federal level, by both public prosecution and private litigation.

156. Violation of the Sherman Act[63], the main federal antitrust law, can be enforced as a criminal violation by the Antitrust Division of the United States Department of Justice. This enforcement is usually limited to cartel participants, and includes large fines for enterprises and individuals, and prison terms (up to 10 years) for individuals. An individual may be subject to a fine of up to $1 million, and an organization may be subject to a fine of up to $100,000,000, or twice the gain or loss attributable to the violation. The largest fine so far is the $500 million imposed on Hoffman-LaRoche as part of the vitamin cartel case. Companies convicted of violating the antitrust laws may also be debarred from serving as federal contractors.

157. Private parties and the government may seek to recover losses attributable to antitrust violations through treble damages actions[64]. Equitable (injunctive) relief is available to the government to prevent or cause actions to be taken (e.g., to stop a merger or undo a merger that has been consummated), and to private litigants (e.g., to prevent termination of a business relationship). Attorneys General of the states may bring an action on behalf of the citizens of that state ("parens patriae") to recover treble damages.

158. The Federal Trade Commission also has jurisdiction to civilly enforce the antitrust laws, including the Federal Trade Commission Act[65], which provides that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful".

159. The individual states of the United States also have antitrust laws governing violations that occur within the borders of their states. In general, these laws very closely parallel the federal laws, and may be enforced by a state attorney general or a private party.

160. Damages and criminal fines are imposed by courts. The FTC has certain administrative authority to impose fines for violation of its orders or rules, but these may be challenged in court.

161. Statistics relating to the activities of the Antitrust Division of the Department of Justice and the Federal Trade Commission are available on their web sites.

II. Compliance advocacy and guidance

Please provide an overview of the compliance guidance, if any, released by your competition authority/agency or court in your program:

→ *Have authorities/agencies in your jurisdiction released detailed guidance on compliance programs? In the affirmative, please provide a link to view the documents (if available, in English) and full publication references; please briefly explain the guidance provided and the tools proposed.*

→ *Are any other form of public statement on antitrust compliance programs available (i.e. press releases, speeches, FAQ, case law etc.)?*

57 Case No. 1160/1/1/10 (1) Imperial Tobacco Group plc (2) Imperial Tobacco Limited and others v Office of Fair Trading [2011] CAT 41.

58 See http://oft.gov.uk/news-and-updates/press/2010/39-10.

59 See http://oft.gov.uk/news-and-updates/press/2011/134-11.

60 In December 2011 the OFT closed its criminal investigation into commercial vehicle manufacturers, stating that: "Following a thorough investigation it has been determined that there is insufficient evidence for any individual to be charged with the cartel offence". See http://oft.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/commercial-vehicle-criminal.

61 See http://oft.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/virgin-cathay.

62 See http://oft.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/commercial-vehicle-civil.

63 15 U.S.C. § 1. Violation of § 2 of the Sherman Act, which deals with monopolies, is also a criminal violation, but is rarely enforced as such.

64 15 U.S.C. § 15.

65 15 U.S.C. § 45.

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→ *Are competition authorities/agencies in your jurisdiction likely to review draft compliance programs for approval/ advice?*

Australia

162. The ACCC's guidance on compliance programs is available on its website[66] and in its publication, *Corporate trade practices compliance programs*[67], which set out the ACCC's position in detail.

163. In summary, the ACCC considers that substantial and properly implemented competition compliance programs are important preventative tools. They should help to facilitate a culture of compliance within corporations, as well as enabling them to identify and reduce the risk of a breach of the CCA before it occurs.

164. The ACCC considers a culture of compliance exists where a positive attitude towards legal compliance is promoted at all levels within the organisation, and where this is demonstrated by people proactively seeking to understand and act in compliance with legal obligations affecting their work[68].

165. With respect to compliance programs, notably, the ACCC does not prescribe a generic regime. Rather, it recognises that each organisation's requirements will be different depending on factors such as the size and complexity of the organisation, and its risk profile. Consequently, an effective compliance regime may range from the relatively simple, such as employee training, to something far more extensive in the case of a large organisation.

166. However, in its guidance the ACCC identifies a number of elements which it considers should be present in all compliance programs. They should be well-managed, adequately resourced, properly documented and actively supported by the board and senior management.

167. Moreover, the ACCC considers that an effective compliance program will have strategic vision, there will be risk assessment processes in place, control points will exist within the organisation, the program will be adequately documented, appropriate personnel will be accountable for its management and it will be subject to continuous improvement[69].

168. While it provides high-level guidance as to what should be included, the ACCC is not itself actively involved in the design or implementation of compliance programs. Generally, this is the responsibility of individual corporations and currently there is no process in place whereby the ACCC offers specific advice to corporations in this regard.

66 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/54418.

67 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/717078.

68 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/54418.

69 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/54418?pageDefinitionItemId=86167.

Brazil

169. Although the Brazilian antitrust authorities do not have any formal compliance guidance in order to clarify how companies can drive antitrust compliance, SDE has issued Ordinance No. 14 of March 9, 2004 ("SDE Ordinance") in order to establish the Program for Prevention of Infractions to the Economic Order ("SDE Compliance Program")[70]. The SDE Compliance Program is endorsed by SDE, after analysis of the company's proposal, according to the Ordinance provisions. Alternatively, the undertakings can prepare and implement compliance programs in Brazil without any consent or review by the authorities.

170. The procedures and structure of the SDE Compliance Program is determined by items IV, V, VI, VII and VIII of article 4,[71] however the content and enforcement are applicant's obligation, as set forth by article 3 of SDE Ordinance.Therefore, the applicant must provide in its proposal: (i) standards and procedures in connection with the compliance of the Antitrust Law by the employees; (ii) appointment of a person with authority to coordinate and monitor the enforcement of the SDE Compliance Program ("SDE Compliance Program Officer"); (iii) indication of the limits for the SDE Compliance Program Officer to grant its powers to other employees; (iv) the degree of supervision over the activities of those to whom the SDE Compliance Program Officer granted his powers, as well as those who have contact with competitors; (v) mechanisms to identify and punish the employees that were responsible for anticompetitive practices; (vi) description of the resources to be used, such as presentations, manuals, lectures, software, rules, reports, document destruction policy and system of supervision of infractions; (vii) agreement with independent audit for competition purposes, which must be performed at least every 2 (two) years; (viii) statement from the officers, directors, managers, heads of the sales teams and any employees that participate in associations or unions meetings with competitors, declaring that they acknowledge the SDE Compliance Program; and (ix) statement from associations, unions, or similar, that its members do not adopt anticompetitive practices.

171. The content of the SDE Compliance Program must be guided by the characteristics of the market in which the applicant has activities (i.e., tailor-made). For example, CADE usually presents concerns on the degree of vertical integration in the concreting services market[72]. Therefore, a proposal of SDE Compliance Program submitted by a company from this market must address these concerns. If a producer of concrete produces cement in excess and supplies the surplus to some of its competitors, it may determine in its SDE Compliance Program that its sales team will provide the input at reasonable price and conditions and will not incur in any practice to foreclose part of the market or create barriers to entry.

70 The SDE Ordinance No. 14/2004 is available at www.mj.gov.br/sde

71 Please note that the company can add other procedures if it finds necessary.

72 See, for example, concentration act No. 08012.002467/2008-22.

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172. The Brazilian antitrust authorities frequently emphasize the importance of the SDE Compliance Program for the competition policy. For example, CADE highlighted the importance of the SDE Compliance Program in its presentation in the II Lusophone Meeting of Competition Policy[73]. SDE has also made presentations regarding the SDE Compliance Program and its effectiveness[74].

173. CADE has also imposed to companies the adoption of compliance programs as a result of an investigation or as a restriction for merger clearance.

174. The proposed SDE Compliance Program is subject to SDE analysis. If it complies with the requirements set forth by SDE Ordinance, SDE will issue the Certificate of Compliance ("Certificate"), which will be valid for 2 (two) years.

175. Compliance programs can also be reviewed by CADE if it is a condition for settlement with defendants. In Brazil, defendants of administrative proceedings or preliminary investigations can execute Cease and Desist Commitment ("Settlement") with CADE. Also, in case of antitrust clearance, CADE and the parties can negotiate behavioral and structural restrictions in order to approve a transaction by the execution of a Performance Commitment. In both agreements, CADE may impose the obligation of implementing a compliance program[75] [76]. In these cases, the authority determines the mechanisms that the program shall provide in order to ensure its effectiveness. The results and enforcement of the compliance program are later analyzed by CADE, which will either declare that the companies fulfilled their obligation or breached the Settlement or Performance Commitment.

176. Aside from these hypothesis, the Brazilian antitrust authorities do not usually review compliance programs formulated by companies. Notwithstanding, considering that the New Antitrust Law will merge SDE into CADE, the procedure of registration of the SDE Compliance Program and issuance of the Certificate by SDE will no longer be in force. However, given the importance of compliance programs, it is reasonable to expect that CADE will issue new regulation regarding this matter.

Canada

177. The Bureau has published a detailed bulletin, the Corporate Compliance Programs Bulletin ("Bulletin"), which includes protocols to be followed for the implementation of competition law compliance programs[77].

73 Available at http://www.cade.gov.br/internacional/PAA-Lusofono-29-05-06.pps.

74 For example, see SDE's presentation to Febracan (Brazilian Federation of Anesthesiology Cooperatives), available at: www.mj.gov.br/sde.

75 See Settlements executed in the administrative proceeding No. 08012.005328/2009-31 and administrative proceeding No. 08012.011142/2006-79 and Performance Commitment executed in the concentration act No. 08012.002148/2008-17.

76 Please refer that these compliance programs proposed by CADE are not certificated by SDE (i.e., are not SDE Compliance Programs). As previously mentioned, the SDE Compliance Program are not mandatory and are rarely adopted by undertakings, which prefer to prepare and implement their own compliance programs without the review of any antitrust authority.

77 Competition Bureau, Corporate Compliance Programs Bulletin (2008). Available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02732.html.

178. The Bulletin describes measures that businesses should consider in order to prevent or minimize their risk of contravening the Act, and detect possible contraventions. The Bulletin also provides a framework of the essential components of a compliance program to help businesses develop their own program.

179. Relevant sources:

→ [Media Centre > Announcements] Competition Bureau Revises Two Bulletins to Reflect Amendments to the Competition Act, September 27, 2010 (http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03292.html).

→ [Media Centre > Announcements] Competition Bureau Publishes Updated Bulletin on Corporate Compliance Programs, October 24, 2008 (http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02731.html).

→ [Media Centre > Speeches] Competition Law and Trade Associations, 2008 Property & Casualty Industry Insurance Forum, Northwind Professional Institute, Langdon Hall, Cambridge, Ontario, May 23, 2008, John Pecman, Acting Senior Deputy Commissioner of Competition, Criminal Matters Branch, Competition Bureau (http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02718.html).

→ [Media Centre > Speeches] Speaking Notes for Sheridan Scott Commissioner of Competition, Competition bureau, Address to the Federation of the Industries of São Paulo State, May 12, 2008 (http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02678.html).

180. In 2007, the Tribunal registered a consent agreement[78] between the Commissioner and Premier Fitness Clubs with respect to allegations of misleading advertising. The consent agreement includes detailed information about the compliance program which Premier Fitness Clubs had to implement in order to comply with the negotiated agreement.

181. Although the Bureau will not sanction or approve compliance programs, in certain circumstances, the Bureau may provide advice and guidance with respect to the development of an acceptable program.

Czech Republic

182. In its Information Bulletin 4/2004 the Office outlined guidelines for a compliance programme. The guidelines are not binding. The Office underlined the importance of the compliance programme and stated that in order to be efficient the compliance programme has to be tailor-made and must rely on four main principles: (i) it must be supported by company management; (ii) it must include effective methods and action plan; (iii) it must involve regular training sessions and workshops; and (iv) it must be regularly evaluated and monitored. The Office denoted that the implementation of the compliance programme could be considered as a mitigating circumstance for imposition of the fine. The Czech version of

78 (2007), CT-009.

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the outlined guidelines is available at http://www.compet.cz/fileadmin/user_upload/Informacni_listy/2004/Infolist2004-04compliance.pdf.

183. The Office has not reviewed the guidelines since 2004 and there is a lack of public statements by the Office regarding compliance programmes.

Egypt

184. The Egyptian Competition Authority (ECA) has released in 2010 a compliance program. The compliance program is published on the ECA website: www.eca.org.eg

185. We are not aware of any form of public statement on antitrust compliance programs available.

186. The ECA is likely to review compliance programs for guidance, though this has not happened since the establishment of the ECA. In addition, it would NOT be considered as a legal advice from the ECA to the company.

European Union

187. In November 2011, the European Commission published a non-binding brochure on compliance – "Compliance Matters"[79] – which aims at helping companies develop a proactive compliance strategy. It summarizes EU competition rules and provides guidance to help companies ensure compliance. It is rather an information brochure than detailed guidance, compared to the materials which have been released by some National Competition Authorities (such as the UK and French Authorities).

188. The brochure outlines that an effective programme should notably include the following[80]:

→ a clear, explicit and tailor-made compliance strategy, involving the identification of the overall risk and individual exposure, function of the sector of activity, the frequency and level of the company's interaction with competitors and the characteristics of the market, and having it detailed in a written internal document, for the drafting of which the Commission provides practical guidance;

→ visible and lasting commitment to this strategy by senior management and sufficient resource to ensure the programme's credibility;

→ formal acts of acknowledgment by staff and consideration of compliance efforts in staff evaluation, by implementing positive incentives and taking measures raising awareness and responsibility (including by imposing penalties) and by setting up proper internal reporting mechanisms (e.g. designating of a compliance officer reporting directly to the company management, concrete guidance to the staff as to how to report a possible misconduct);

→ constant update of the compliance tools, contact points for advice and frequent training of staff and management;

→ adequate monitoring and auditing to prevent and detect anticompetitive behavior.

189. The Competition Commissioner, Joaquin Almunia, has given several speeches dealing with compliance programs, which are available on the Commission's website[81]. A few cases also dealt with compliance programs. They will be mentioned below, where relevant.

190. Although the European Commission may be consulted for informal advice on a wide range of competition issues, there is no indication that the Commission would be prepared to review draft compliance programs for guidance.

France

191. The French competition authority released on 10 February 2012 its Framework-Document on Antitrust Compliance Programmes (hereafter "the Framework-Document")[82] detailing the requirements the Authority considers such programmes should meet in order to be effective, as well as the conditions to obtain a fine reduction in that respect (see 4.3 below). Numerous decisions have addressed compliance programs proposed in that framework[83].

192. According to the Authority, an effective programme should notably include the following features[84]:

→ a clear, firm and public position adopted by the company's management bodies and, more broadly, by all managers and corporate officers;

→ the designation of one or more persons empowered to develop or monitor all aspects of the programme within the company;

79 European Commission, "Compliance Matters: what companies can do better to respect EU competition rules" of 23 November 2011.

80 "Compliance Matters" Brochure, pages 15 to 18.

81 See notably speeches by Joaquín Almunia: *Compliance and Competition policy* of 25 October 2010 at the Businesseurope & US Chamber of Commerce competition conference in Brussels and *Cartels: the priority in competition enforcement* of 14 April 2011 at the 15th International Conference on Competition: A Spotlight on Cartel Prosecution, held in Berlin.

82 The Framework-Document on Antitrust Compliance Programmes of 10 February 2012 is available in English at: http://www.autoritedelaconcurrence.fr/doc/framework_document_compliance_10february2012.pdf.

83 E.g., decisions 09-D-05, du 2 février 2009, relative à des pratiques mises en œuvre dans le secteur du travail temporaire ; 07-d-26, du 26 juillet 2007, relative à des pratiques mises en œuvre dans le cadre de marchés de fourniture de câbles à haute-tension ; 07-D-21, du 26 juin 2007, relative à des pratiques mises en œuvre dans le secteur de la location-entretien du linge ; 08-D-13, du 11 juin 2008, relative à des pratiques relevées dans le secteur de l'entretien courant des locaux ; 11-D-02, du 26 janvier 2011, relative à des pratiques mises en œuvre dans le secteur de la restauration des monuments historiques ; 10-D-39, du 22 décembre 2010, relative à des pratiques mises en œuvre dans le secteur de la signalisation routière verticale ; 07-D-40, du 23 novembre 2007, relative à des pratiques ayant affecté l'attribution de marchés publics de collecte des déchets ménagers dans le département des Vosges ; 07-D-02, du 23 janvier 2007, relative à des pratiques ayant affecté l'attribution de marchés publics et privés dans le secteur de l'élimination des déchets en Seine-Maritime ; 11-D-07, du 24 février 2007, relative à des pratiques mises en œuvre dans le secteur des travaux de peinture d'infrastructures métalliques.

84 Framework-Document, para. 22.

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→ the implementation of information and training measures;

→ the implementation of effective control, audit and whistle-blowing mechanisms;

→ the setting of an effective oversight system.

193. In 2008, the French Competition Authority also asked Europe Economics to prepare an independent report on effective compliance programmes and the various options to consider by the Authority in that respect[85].

194. The President of the Authority has given speeches discussing / mentioning compliance programmes on many occasions[86] and the Authority has released different publications related thereto[87].

195. The Framework-Document was submitted to a public consultation. Sixteen contributions were received[88].

India

196. Guidance in the form of a "suggested framework for compliance of the Act by enterprises" has been published by the CCI (*Guidelines*). It is available on the CCI website and can be accessed at the following address: http://www.cci.gov.in/images/media/Advocacy/CCP2012.pdf.

197. However, the Guidelines are a guide, forming part of the CCI's advocacy programme. The contents of the Guidelines cannot be regarded as the official views of the CCI.

198. While recognizing that each organization must customize its compliance programmes to suit its purpose, some broad elements have been put forward by the CCI in the Guidelines. The Guidelines recognize the need for enterprises, particularly those that are dominant in a relevant market, to adopt such compliance programmes to regulate their behavior. The recognition of the concept of "group dominance" also makes it important for corporate groups to adopt compliance programmes.

199. The essential features of the competition compliance programme proposed in the Guidelines are:

a) an explicit statement of the commitment of senior management to the compliance programme;

b) availability of an enterprise's compliance policy (compliance manual) in an easily understandable manner;

c) a compliance programme that is dynamic and regularly updated to reflect changes in the law;

d) active training and education of employees;

e) inclusion of provisions in the compliance policy that mandate seeking a written undertaking from employees to conduct their business dealings within the compliance framework;

f) inclusion of competition law compliance into the appraisal, human resources and disciplinary policies of the enterprise;

g) identification of employees and divisions of an enterprise that are more likely to be exposed to the competition law risks;

h) appointment of a compliance officer to ensure the effectiveness of the compliance programme, by overseeing the design and implementation of the programme;

i) relevant internal procedures enabling employees to seek advice on whether a particular transaction complies with competition law and report activities that they suspect infringe the law. These practices should be included in the "best practices" norms of every enterprise;

j) internal review mechanism for business agreements (particularly those entered into with competitors) for compliance with the act and developing guidelines;

k) guidelines for external discussions (especially relating to prices) and exchange of business information;

l) guidelines relating to price fixing (both direct and indirect);

m) guidance for dealing with complaints from customers as well as suppliers, particularly if the enterprise is dominant;

n) familiarizing employees with "dawn raids" that could potentially be conducted by the CCI;

o) behavioural guidelines for enterprises and their employees who participate in and are members of trade associations and industry association meetings;

p) development of a system of audit to evaluate the efficacy of the programme.

200. The CCI has framed a whistleblower policy under the Act, the same is contained under the Competition Commission of India (Lesser Penalty) Regulations, 2009 (*Lesser Penalty Regulations*).

201. Apart from the abovementioned framework provided by the CCI, there is no available guidance in the form of public statements, press releases, speeches, FAQs or case law with respect to competition compliance programmes.

85 Europe Economics, "Etat des lieux et perspectives des programmes de conformité", October 2008, available at: http://www.autoritedelaconcurrence.fr/doc/etudecompliance_oct08.pdf.

86 E.g.: Conference of Bruno Lasserre of 21 June 2011 at the MEDEF, where he invited companies to take an active part in the discussions on the future Framework-Document; Bruno Lasserre, *La non-contestation des griefs en droit français de la concurrence: bilan et perspectives d'un outil pionner*, at the General Assembly of the Association française d'étude de la concurrence ("AFEC") on 10 April 2008.

87 E.g.: "Entrée libre" letter of April 2009, official newsletter of the *Autorité de la concurrence.*

88 Both the draft document and the contributions can be found at: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=427.

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202. At present, there is no development in the law or any precedent of the CCI reviewing and providing guidance on draft compliance programmes developed by enterprises.

Israel

203. The IAA has published general format and guidelines for an Antitrust Compliance Plan – 1998 Model Internal Compliance Program ("Model Compliance Program" or "MCP"). An English version of the document is available at: http://eng-archive.antitrust.gov.il/ANTItem.aspx?ID=169&FromSubject=100232&FromYear=2012&FromPage=0

204. According to the MCP, a compliance program is an internal mechanism set up by the corporation for its own purposes, with a view to identifying and preventing violations of the provisions of the Antitrust Law in advance, and with a view of minimizing the damage caused by violations of the Antitrust Law that were already committed. Pursuant to the general format published by the Antitrust Authority, each corporation is instructed to create a "customized" compliance program, which accommodates its own needs and business activity patterns. At the same time, the internal compliance program should meet certain minimum requirements which are included in the MCP, including the following elements:

1. Appointment of a person in charge of compliance (compliance officer) – a senior executive employee, who reports directly to the CEO, that will be in charge of the application and implementation of the plan. Senior management must be actively involved in the compliance process, sending a clear signal to the corporation's employees of the importance attributed to antitrust compliance by the management.

2. Conducting an initial audit – a full blown internal review of the corporation's past and present conduct in light of the Antitrust Law. The purpose of such in-depth review is to identify the "weak spots" of the corporation in terms of possible exposure to violation of the Antitrust Law, and to serve as a foundation for the construction of an effective internal compliance program in line with the corporation's needs. The IAA defined the initial review as an essential and crucial stage in the compliance plan.

3. Establishing an internal compliance procedure – this requires making the relevant adaptation to the model format proposed by the IAA, to address the particular characteristics of the corporation and its needs.

4. Training program for employees and directors, adapt to their level of antitrust exposure. The training program has a minimum timeframe of 3 hours per half a year.

5. Establishing supervision, reporting and audit systems to be applied on an ongoing basis.

6. Determining procedures for disciplinary sanctions against employees or directors who have acted in contrast to the provisions of the Antitrust Law.

7. Adopting a document retention policy.

8. Submission of notices to the IAA to report significant milestones in the implementation of the compliance program. Additionally, a corporation shall submit annual notice to the IAA regarding the implementation of a compliance program.

205. The IAA has published two presentations regarding the Internal Compliance Program. Most of the materials, including those detailed below, are not available in English:

1. "Basic principles of an internal compliance program" (2008 IAA Website 5001244).

2. "An internal compliance program – Comparative law" (2008 IAA Website 5001211).

206. Also, the IAA has issued a press release regarding a seminar on internal compliance programs (2008 IAA Website 5001209).

207. Prior approval or submission of the compliance programs is not a prerequisite condition for future acknowledgement of the IAA in such program (though, as mentioned above, the IAA does require submission of specific notices concerning the implementation of the program). Moreover, the IAA does not approve in advance nor does it normally review draft compliance programs. The IAA will normally review compliance programs only ex-post, e.g. in the course of a criminal investigation to determine whether the plan was effective and genuine.

208. However, in the framework of its limited resources, the IAA offers to companies that adopt a compliance program an "open line" to seek the IAA's guidance in relevant issues concerning the compliance program. According to the 1998 Model Compliance Program, the IAA will also regularly update the compliance officers with the latest developments in the area of antitrust law.

Japan

209. The FTC has not released detailed guidance on compliance programs.

210. The report on the result of investigation regarding companies' compliance programs was released by FTC. However, the latest version of the report was released in 2010 only in Japanese (http://www.jftc.go.jp/pressrelease/10.june/10063002honbun.pdf).

211. The English version of the old edition was released in 2006: (http://www.jftc.go.jp/en/pressreleases/uploads/2006-May-24.pdf).

212. The FTC does not review draft compliance programs of companies if they ask it to do so.

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Netherlands

213. The NMa has not published any detailed guidance on compliance programmes. It has, however, underlined the importance for undertakings to have a compliance programme in place on several occasions and generally encourages undertakings to introduce compliance programmes[89].

214. In a speech of 16 March 2007, the (former) chairman of the NMa Board indicated the NMa's willingness to consider settlement of competition infringements by alternative means (to refrain from imposing substantial fines to competition law infringements). However, in order for the NMa to employ alternative enforcement instruments, five strict criteria should be met:

- → there is an immediate termination of the infringement;
- → alternative enforcement yields a consumer profit;
- → alternative enforcement does not harm third-party interests;
- → a structural solution is preferable to a change of behaviour; and
- → the infringement does not concern a hard-core cartel.

215. According to the NMa, compliance programmes are particularly relevant to sectors in which NMa enforcement policy has been successful (for example, the construction industry and insurance sector). Following NMa intervention, companies are willing to impose self-regulation. In doing so, they hope to ensure an enduring compliance with the Competition Act. It is up to the NMa to convince the companies involved that a system of checks and balances is most conducive to maintaining compliance.

216. The NMa may further decide to refrain from sanctions if an undertaking offers commitments – similar to article 9 of Regulation 1/2003. If the undertaking fails to comply with the commitment, the NMa can – without further investigation – impose a fine amounting to the higher of 10 per cent of turnover or EUR 450,000.

217. The NMa in most cases insists on receiving the compliance programme once it has been drafted in the context of commitment proceedings. The NMa was more closely involved in the setting up of an industry-wide compliance programme in two cases. In 2004 it drew up a compliance programme in cooperation with the insurance sector and in 2010 it aimed to set up a collective compliance programme together with the home care sector. This, however, failed because the compliance programme was rejected by the majority of the industry.

89 It has produced a very nice video about leniency in cartel cases, which can serve as a helpful compliance tool by itself. http://www.youtube.com/watch?v=6ksOVTCkmSg (Dutch version); http://www.youtube.com/watch?v=5diFAaJdwel (English version).

Pakistan

218. The Commission on its website has released guidance related to a Voluntary Competition Compliance Code (VCCC). The link to the document is as follows: www.cc.gov.pk/images/Downloads/vccc.pdf.

219. Overview of the guidelines:

A VCCC is a self correcting mechanism for undertakings. The Undertakings should ensure that the provisions of the Act along with the associated rules and regulations are not violated and if there is any violation committed, then an undertaking should detect it at an early stage and take appropriate corrective action. The elements of a compliance code are:

1. *Assessment of risk*

The undertaking should consider the risks it faces of violating competition laws. It should see its position in the market, scope of entering into arrangements in violation of the Act, the extent of contact of employees with competitor undertakings, number of competitors and the market as a whole.

2. *Establishment and Implementation of Compliance Policy*

The following of a code would require establishment of a competition policy and its implementation which would include the commitment of the undertaking, duty of the employees related to conduct of business in accordance with the competition laws, procedure of obtaining advice on compliance with the Act, consequences of non compliance etc.

3. *Commitment from Senior Management*

The commission has listed this as the most important factor in ensuring an effective compliance code. Senior management of an undertaking should take responsibility and keep guiding the rest of the employees. They should put commitment to follow compliance code in the mission statement of the company, let other employees know of its importance, make adherence to the code as one of the overall objectives of the undertaking, actively participate themselves in the implementation of the compliance code.

4. *Appointment of a Compliance Officer*

5. Training and education of employees regarding the adherence to and the importance of a compliance code and the need to always abide by competition laws during the course of any business of the undertaking. Training should be more rigorous for employees who work in business areas such as sales, purchasing, marketing, pricing decision etc.

6. The Compliance policy should always be made readily available for all the employees of an undertaking

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7. *Consequences of non compliance for employees*: The employees should be made aware of the consequences of non compliance with the code; compliance should be made one of the objectives of the undertaking. Employees should be motivated with bonuses and other benefits if they adhere to compliance with the code.

8. Regular evaluation should be made of the effectiveness of the compliance code by testing employees on their understanding of the compliance code put up by the undertaking.

9. For successful adoption and implementation of the compliance code the undertaking should ensure effective monitoring, auditing, and reporting.

Undertakings should establish their clear policies when dealing with trade associations and should ensure involvement of their legal counsel in any meetings with them. Furthermore Undertakings should avoid discussions with trade associations on pricing, profit levels, costs etc.

The guidelines in the end talk about the incentives of adopting a compliance code and why it is really helpful for an undertaking.

220. The Commission has a separate Advocacy and IT department which holds seminars, conferences etc over different aspects of competition law to increase awareness regarding compliance amongst undertakings and consumers. Public statements on antitrust compliance programs can be found there. The commission's website includes:

- news briefings for the years 2010 and 2012 at http://www.cc.gov.pk/index.php?option=com_content&view=article&id=166&Itemid=62.
- Interviews of the chairperson of the Commission and also of other notable persons at http://www.cc.gov.pk/index.php?option=com_content&view=article&id=29&Itemid=87.
- Press releases from the years 2008-2012 by the Commission informing about show cause notices being dispatched to various undertakings and other competition policies related statements from the commission including reviews, briefs of international conferences of the Commission at http://www.cc.gov.pk/index.php?option=com_content&view=article&id=97&Itemid=86.
- Conference/Seminar: includes detailed information on different conferences held in Pakistan related to Competition compliance with links to speeches made by officials of government departments and other related persons. Also includes public statements on antitrust compliance programs at http://www.cc.gov.pk/index.php?option=com_content&view=article&id=25&Itemid=49.
- The Research and Publications section includes reports by the Commission on assessment of various sectors of the economy and the state of competition in Pakistan at http://www.cc.gov.pk/index.php?option=com_content&view=article&id=92&Itemid=138.

221. The information received from an official at the Commission reveals that the Commission is ready to help undertakings implement compliance codes and drafts of such compliance programs will be reviewed by the Commission for guidance. An undertaking can inform the commission that they have a compliance code and then can submit it to the Commission for suggestions. The Advocacy and Legal departments of the Commission should be contacted in this regards. However the official stressed that the adoption of a compliance program is voluntary only.

Singapore

222. The CCS has issued detailed guidance on compliance programmes.

223. This is seen in the following link: http://www.ccs.gov.sg/content/ccs/en/Education-and-Compliance/Conducting-a-Compliance-Programme.html

224. In terms of guidance provided, the CCS website goes through the important provisions within the Act, as well as the procedures for filing a notification or guidance. The CCS also provided guidelines regarding the key provisions or the Act.

225. The CCS website provides answers to frequently asked questions. There is also a public register which lists the decisions the CCS has made, as well as the text of its actual decisions.

226. The CCS also conducts regular talks and issues speeches, which typically touch on several issues within competition law, including compliance matters and the importance of ensuring compliance. A comic strip relating to Competition Law has also been issued. Last, the CCS has organized a "CCS digital film animation competition" in order to improve antitrust awareness and correspondingly, compliance.

227. The CCS has expressed on its website that it does not endorse individual compliance programmes, but may refer to individual examples of best practice from time to time in its general communications. The CCS also encourages parties to obtain legal advice, or seek guidance/approval regarding conduct. In short, the CCS do not review draft programs for guidance.

228. However, the CCS is open to requests to give presentations to industries or associations to help them better understand the guidelines.

South Korea

229. In recognition of the essential need for and to further foster free and fair competition in the Korean market, in 2008, the KFTC promulgated a notification ("Notification") to test and qualify a company's compliance program and

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to provide incentives for those companies that adopted a qualified compliance program.

230. According to Korean Fair Trade Mediation Agency ("KOFAIR"), which is delegated from KFTC the authority to test and qualify a compliance program, 194 companies are operating a compliance program as of April 8, 2011.

231. In order to receive the aforementioned benefits under the FTL, a compliance program should first satisfy the following requirements:

(i) Proclamation of a compliance policy by the chief executive officer;

(ii) Appointment of an officer in charge of the compliance program by the board of directors ("*BOD*");

(iii) Development of a compliance manual and distribution to officers/employees;

(iv) Implementation of compliance education/training for employees (at least two hours per every 6 months);

(v) Establishment of an internal monitoring system and report to the BOD (at least once every 6 months);

(vi) Establishment of a company policy providing disciplinary measures for officers/employees who violate the FTL and competition related laws; and

(vii) Systematic management of documents related to compliance training and its implementation.

232. In addition to satisfying the above requirements, a company should apply for qualification of its compliance program to KOFAIR after operating its compliance program for one year. Upon a company's application, KOFAIR will test such company's compliance program and score it by one of eight levels from "AAA" to "D". The test normally includes inspection of documents, interviews with officers and employees and a site visit.

Turkey

233. Please see the link below for the Turkish Competition Authority's "Competition Law Compliance Program" which was announced on the Turkish Competition Authority's website on May 10, 2011: http://www.rekabet.gov.tr/dosyalar/images/file/UluslararsiIliskiler/Competition%20Compliance%20Program.pdf.

234. A brief summary of the Competition Compliance Program is as follows:

Given the difficulty of creating a standard compliance program for each undertaking, compliance programs are opted to be formed with respect to the structure and conditions of the sectors in which undertakings operate. However, the Turkish Competition Authority finds beneficial to adopt compliance programs that covers the four subjects below.

A) Preparation of internal guidelines

235. The Turkish Competition authority is of the opinion that compliance programs could be executed more effectively with written guidance. The guidelines should be written in plain language so that each employee may understand it. The guidelines should indicate the importance of compliance to the competition law for the undertaking and the high amount of fines and administrative measures that the Competition Board may impose on the undertakings that violate competition law. Additionally information on the main principles of competition law, the powers of the Turkish Competition Authority and Competition Board and information on the secondary legislation regarding the field of activity of the undertaking should be provided. The guidelines should also mention how and in what ways the internal auditing would be provided. Sanctions and disciplinary actions facing the employees that have caused competition law violations must be clarified along with a simple and clear "do and do not" list.

B) Regular training of the employees

236. Training should be for all employees. If this is seen to be unnecessary, training programs should be provided for directors and employees who are responsible with the strategic and commercial decisions. Trainings could be given either by in-house employees or by an external professional or institution.

C) The compliance programs should regularly be reviewed and evaluated

237. The examination and inspection of the employees without prior notice with respect to the compliance program are seen to be useful. The employees should know where to turn for questions or problems. Moreover, if the company has enough scale, it would be useful to have an in-house department or at least a consultant for this matter. The confidentiality of the employee who informs the relevant units about a competition law violation must be protected.

D) Discipline and incentive mechanisms.

238. Activities and employees that are important from a competition law point of view should be monitored and reported. Directors and employees should be informed about the possible sanctions the company could face along side with the possibility of personal liability. Additionally, employees who contribute to the level of compliance should be appreciated and rewarded.

239. The associations of undertakings should take necessary measures to prevent the activities that take place within their body resulting in competition law violations and ensure that its members are well-informed about competition law and policy. The associations of undertakings may also publish guidelines, manuals or policy documents to that effect.

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240. In cases where the management of an undertaking detects a competition violation, the violation should be immediately terminated and if necessary considering the leniency program the Competition Authority should be informed of the violation.

241. Large scaled holding companies should be especially careful with regards to the operation of compliance programs. Some sectors are more prone to competition law violations due to different factors such as; characteristics of the products, structure of the market, market entry conditions, existence of mechanisms facilitating communication between the competitors.

242. The difficulty of designating a comprehensive compliance programs for small and medium sized enterprises has been acknowledged by the Turkish Competition Authority. Therefore, it is advised that small and medium sized enterprises should regularly review and evaluate their decisions and practices in light of the information provided in the Turkish Competition Authority's website.

243. Furthermore, a control list that includes significant basic issues and may be useful for undertakings to review and assess their own positions is published as an annex of the compliance program. The list includes various questions under the below subject headings:

a) Information concerning the Competition Legislation and the Turkish Competition Authority.

b) Relationships with the competitors.

c) Relationships with customers and distributors.

d) Undertakings which has dominant position/ market power.

e) Association of undertakings.

f) Undertakings participating to public tenders.

244. Competition law compliance programs were first mentioned in the "2011 Competition Letter" written by the President of the Turkish Competition Authority. The Competition Letters published annually serve as an informal means to inform the public of various competition policies and principles and of the Turkish Competition Authority's focus areas for the coming year. In the 2011 Competition Letter (published on March 21, 2011) a significant emphasis was provided for the importance of competition compliance programs for the undertakings. It was mentioned that the Turkish Competition Authority would focus on this issue in the coming year. Later that year, the "Competition Law Compliance Program" was announced on May 10, 2011.

245. More recently, President of the Turkish Competition Authority in his annual message (i.e. "President's 2012 Message") made emphasis on the adoption of various competition compliance programs, pointing out the announcement of the Competition Law Compliance Program earlier in 2011.

246. The Turkish Competition Authority does not have such practice.

United Kingdom

247. In June 2011 the OFT published new guidance for businesses on competition law compliance, including specific advice for directors and general guidance for businesses. The OFT has recommended a risk-based four-step approach to achieving a competition law compliance culture. The guidance also makes it clear that the OFT will not, save in exceptional situations, regard a competition law compliance programme as a factor warranting an increase in the amount of the penalty[90].

248. The OFT's compliance guidance can be found on the compliance homepage on its website. This offers an extensive range of materials to guide businesses with effective competition compliance[91]. These materials include:

- → a film;
- → short form guidance;
- → a four-step compliance wheel; and
- → full detailed OFT written guidance manuals.

249. The OFT has also issued detailed guidance specifically addressed to directors, intended to help company directors understand their responsibilities under competition law. The OFT stated that directors play a key role in establishing and maintaining an effective competition law compliance culture within their company. Without the full commitment of individual directors to compliance with competition law, any compliance activities undertaken by the company are unlikely to be effective. The guidance explains the key competition law risks that directors should be aware of and the ways in which directors can minimise the risks of their company infringing competition law[92].

250. The OFT commissioned Synovate to undertake independent quantitative research to update the OFT's understanding of businesses and their experience of potential breaches of competition law. The OFT has published Synovate's Competition Law Compliance survey on its website[93].

251. In June 2011, to introduce the OFT's new compliance materials on its homepage, the OFT chairman Philip Collins gave a speech at King's College, London[94]. In that speech Mr Collins stressed that "it is essential that the compliance efforts are designed and suited to the particular business and is not just seen as a 'box ticking' or formulaic process".

90 See OFT1341: Guidance, June 2011: "*How your business can achieve compliance with competition law*", at http://oft.gov.uk/shared_oft/ca-and-cartels/competition-awareness-compliance/oft1341.pdf.

91 See http://oft.gov.uk/OFTwork/competition-act-and-cartels/competition-law-compliance.

92 OFT Guidance OFT1340, June 2011: *Company directors and competition law*. See http://oft.gov.uk/shared_oft/ca-and-cartels/competition-awareness-compliance/oft1340.pdf.

93 See OFT1270: *Competition Law Compliance Survey, Prepared for the Office of Fair Trading by Synovate (UK) Ltd*, June 2011, at http://oft.gov.uk/shared_oft/ca-and-cartels/competition-awareness-compliance/oft1270.pdf.

94 Speech By Philip Collins, Chairman, Office of Fair Trading: *Competition Law: Sanctions, Redress and Compliance*, King's College London, 27 June 2011. See http://oft.gov.uk/shared_oft/speeches/2011/1211.pdf.

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Mr Collins had previously addressed the Trade Association Forum annual conference in 2010, encouraging compliance amongst members[95].

252. In December 2011, OFT Chief Executive John Fingleton gave a speech to Charles River Associates' conference on Economic Developments in European Competition Policy, looking at the economics of compliance with competition law in the light of recent research by the OFT in this area[96].

253. The OFT published extensive and "business friendly" compliance material as recently as June 2011, and these are readily available on its website. It is unlikely that the OFT will expend further resources reviewing draft compliance programmes being proposed by a company to mitigate its risks of competition infringement. There are no provisions in the guidelines which suggest that the OFT will do so.

United States

254. The United States Sentencing Commission issued the Organizational Sentencing Guidelines in 1991, with subsequent updates[97]. The Guidelines propose a basic framework for an "effective" compliance program that will prevent or detect violations of law. To help organizations understand what the Sentencing Commission considers an effective program, the Guidelines provide that:

To have an effective compliance and ethics program, an organization shall:

(1) exercise due diligence to prevent and detect criminal conduct; and

(2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law[98].

255. The Guidelines outline the key elements of an effective compliance program:

→ The organization will have established standards and procedures[99] to prevent and detect criminal conduct[100].

→ The organization's governing authority (i.e., board) shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program[101].

→ High-level personnel of the organization[102] shall ensure that the organization has an effective compliance and ethics program, and specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program[103]. High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law[104].

→ Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority (e.g., Audit Committee), on the effectiveness of the compliance and ethics program[105]. If the specific individual(s) assigned overall responsibility for the compliance and ethics program does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program[106].

→ To carry out operational responsibility for compliance, such individual(s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority[107].

→ The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization[108] any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program[109].

95 Philip Collins, Chairman, Office of Fair Trading, 4 March 2010: *Compliance: a key role for Trade Associations in helping business understand and meet their legal obligations*. A speech given to the Trade Association Forum annual conference. See http://oft.gov.uk/news-and-updates/speeches/2010/0210.

96 John Fingleton, *The Economics of Compliance, 7 December 2011*. See http://oft.gov.uk/news-and-updates/speeches/2011/1711.

97 http://www.ussc.gov/Guidelines/Organizational_Guidelines/index.cfm.

98 United States Sentencing Commission, Sentencing Guidelines Chapter 8, [USSG] §8B2.1.

99 "Standards and procedures" means standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct. USSG § 8B2.1 Application Note 1.

100 USSG § 8B2.1(b)(1).

101 USSG § 8B2.1(b)(2)(A).

102 "High-level personnel of the organization" means individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest. USSG § 8A1.2 Application Note 3(B).

103 USSG § 8B2.1(b)(2)(B).

104 USSG § 8B2.1 Application Note 3.

105 USSG § 8B2.1(b)(2)(C).

106 USSG § 8B2.1 Application Note 3.

107 USSG § 8B2.1(b)(2)(C).

108 "Substantial authority personnel" means individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization. The term includes high-level personnel of the organization, individuals who exercise substantial supervisory authority (e.g., a plant manager, a sales manager), and any other individuals who, although not a part of an organization's management, nevertheless exercise substantial discretion when acting within the scope of their authority (e.g., an individual with authority in an organization to negotiate or set price levels or an individual authorized to negotiate or approve significant contracts). Whether an individual falls within this category must be determined on a case-by-case basis. USSG § 8A1.2 Application Note 3(C).

109 USSG § 8B2.1(b)(3).

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→ The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents, by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities[110].

→ The organization shall take reasonable steps to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct[111].

→ The organization shall take reasonable steps to evaluate periodically the effectiveness of the organization's compliance and ethics program[112].

→ The organization shall take reasonable steps to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation[113].

→ The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through appropriate incentives to perform in accordance with the compliance and ethics program and appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct[114].

→ After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program[115].

→ The organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each element of the compliance program to reduce the risk of criminal conduct identified through this process[116].

→ In order to get credit for violations where a high-level person was involved, the compliance program needs to be organized so that the individual with operational responsibility for the program reports directly to board, promptly if a problem, and annually on the program effectiveness. The compliance program must have detected the offense first and promptly reported it to authorities, and no compliance person was part of the offense[117].

256. Unfortunately, the Antitrust Division of the Department of Justice does not believe that these provisions should apply to antitrust program. The U.S. Attorney's Manual provides that:

it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, e.g., voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business. With this in mind, the Antitrust Division has established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program, and that amnesty is available only to the first corporation to make full disclosure to the government.

257. The claim that antitrust violations go to the "heart" of a business is not otherwise explained, particularly in comparison to other violations (e.g., securities fraud, bribery) that may well go to the "heart" of a corporation's activities, but since they are enforced by other agencies, the treatment of compliance programs is very different.

258. The Justice Department position is that a compliance program that fails to stop an antitrust violation is a failed program, and therefore is not deserving of credit. This is directly contrary to the position of the Sentencing Commission which accepts the fact that people are fallible, and that individual employees may ignore corporate policy and violate laws:

259. Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct[118].

260. Unfortunately, in addition to not giving credit for compliance efforts, the Antitrust Division has not released any guidance on antitrust compliance programs for many years. State and federal enforcement agencies do not review compliance programs or otherwise provide guidance.

261. In contrast, the FTC will generally take compliance efforts into consideration when reviewing the actions of a company that has violated the law, although there are no published guidelines. In some cases, the FTC will settle a case by including specific compliance requirements in a decree, which it will supervise for several years[119].

110 USSG § 8B2.1(b)(4)(A)-(B).

111 USSG § 8B2.1(b)(5)(A).

112 USSG § 8B2.1(b)(5)(B).

113 USSG § 8B2.1(b)(5)(C).

114 USSG § 8B2.1(b)(6)(A)-(B).

115 USSG § 8B2.1(b)(7).

116 USSG § 8B2.1(c).

117 USSG § 8C2.5(f)(3)(C).

118 USSG §8B2.1 (2011).

119 See, e.g., *In re* Transitions Optical, Inc., File No. 091-0062 (April 27, 2010).

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III. Voluntary compliance programs

1. In your jurisdiction, are there benefits in entering into compliance programs before from any enforcement action by competition authorities/agencies or courts (aside reducing exposure to the risk of breaching the rules)?

Please notably explain:

→ *whether a fine reduction is available for companies with voluntary ex-ante compliance programs at the time an infringement is committed? Please detail what would be considered as a genuine compliance program (compliance officer, level of commitment from management, audits, hotlines, sanctions, publicity, document retention policy etc.) the conditions to receive such reductions and the range of such reductions.*

→ *whether a voluntary ex-ante compliance program initiated by a group is likely to change anything in terms of parental liability if an infringement is committed by a subsidiary (i.e. in Europe, both the company participating to the infringement and the head of its group may be considered as jointly and severally liable with a fine based on the total group turnover)?*

→ *whether a voluntary ex-ante compliance program is likely to limit criminal liability for the companies/individuals concerned if an infringement is committed afterwards?*

→ *whether a voluntary ex-ante compliance program is likely to have an impact on damages actions?*

Australia

262. Where a corporation contravenes the CCA and legal proceedings are instituted by the ACCC, the Federal Court will consider a number of factors in determining an appropriate pecuniary penalty. One of these factors is whether a culture of compliance exists within the corporation. If the corporation is able to demonstrate that it does, this is treated as a mitigating factor in the calculation of the penalty.

263. There are a number of decisions where the Federal Court has considered whether or not a company possesses such a compliance culture and, if so, to what extent this should be taken into account[120].

264. The Federal Court will consider whether:

→ the corporation has a substantial compliance program in place, which has been actively implemented; and

→ the implementation of the compliance program was successful.

265. A substantial compliance program, which has been actively and successfully implemented, is likely to have a greater mitigating effect on the penalty than a compliance program which is token or ineffective.

266. In Australia, there are currently no specific criteria mandating what elements of compliance need to be in place to have a mitigating effect, nor is there any fixed "discount" or specific methodology used to calculate the "discount" that applies.

267. While it is accepted that the existence of a substantial culture of compliance can be a mitigating factor on penalties for contravening the CCA, there is currently no regulation, case law or precedent in Australia concerning the impact of a compliance culture or compliance programs to potentially limit criminal liability or affect third party damages actions.

Brazil

268. Although voluntary ex-ante compliance programs were never addressed by CADE, it is reasonable to infer that it would be taken into account by the authority. In an administrative proceeding regarding a cartel by medical laboratories judged in 2005[121], in which CADE imposed fines varying from 1% to 2% of the companies' gross revenue, the Commissioners recommended the defendants to formulate an antitrust compliance program in order to avoid further infractions to the economic order. Considering this recommendation, it is possible to infer that, if the defendants had a strong compliance program, CADE would at least be more susceptible to execute a favorable Settlement with the companies[122].

269. SDE Ordinance, on the other hand, had a specific provision setting forth a recommendation of penalty reduction for companies holding a Certificate[123], without specification of the range of such recommended reduction. This provision, however, was later revoked by Ordinance No. 48 of March 4, 2009. Therefore, currently there is no rule granting fine reduction for companies with voluntary ex-ante compliance programs.

270. The mere existence of a compliance program will not be considered as an attenuating circumstance by CADE, but it might be helpful to provide evidence to the Brazilian antitrust authorities of the commitment of the undertaking to seek serious compliance.

271. Notwithstanding the lack of rules that grants fine reductions or benefits to companies with voluntary ex-ante compliance programs, it is still important to implement them.

120 Including, for example, *TPC v CSR* [1991] ATPR 52,135 (41-076); *ACCC v George Weston Foods Ltd* [1999] FCA 858; *ACCC v Australian Safeway Stores Pty Ltd* (1997) 75 FCR 238; *ACCC v Rural Press Ltd* [2001] FCA 1065.

121 Administrative Proceeding No. 08012.009088/1999-48.

122 See request No. 08700.004221/2007-56, in which CADE considered the strong worldwide compliance program of a global group of the cement industry in order to execute a Settlement without the obligation to plea guilt.

123 Article 9 of SDE Ordinance No. 14/2004.

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In addition to enhance the good corporate governance and reputation, an effective antitrust compliance program may be a helpful argument in negotiations of settlement with CADE and can also prevent the anticompetitive practice to be adopted by an unwarned person. The rules set forth by SDE Ordinance and CADE's case law can serve as guidance for an effective and enforceable antitrust compliance program.

272. For example, a strong antitrust compliance program must contain: (i) indication of the practices that are considered anticompetitive by the Antitrust Law and CADE case law (with special emphasis on the practices that the employees, managers, officers and directors of the company are more susceptible to engage); (ii) appointment of an individual (if possible, a member of the senior management dedicated to antitrust compliance) to be in charge of the enforcement and supervision of the antitrust compliance program; (iii) mechanisms to verify the enforcement of the compliance program (e.g., external independent auditing, monitoring, periodic reports); (iv) punishment provisions for individuals engaged in anticompetitive practices; (v) mechanisms to ensure that the employees of the company that participate in associations do not engage in anticompetitive agreement with its members (e.g., prepare summary of the matters discussed in the meetings); (vi) compliance training for employees, managers, officers and directors; and (vii) a hotline to report anticompetitive practices. In addition, it is important to seek the effectiveness of the program, with the creation of proper incentives to comply (e.g., periodical training sessions, goals for the employees, compliance standards).

273. As per article 33 of the New Antitrust Law (equivalent to article 17 of the Antitrust Law), the companies of the same economic group are considered jointly and severally liable in case of condemnation by CADE and there is no provision setting forth any benefits in case of voluntary ex-ante compliance program.

274. Therefore, a voluntary ex-ante compliance program would not change anything in terms of parental liability. There is no provision in the New Antitrust Law regarding such benefit, nor a favorable case law in this sense. The base for the calculus of the penalty will still be the economic group turnover in the affected sector.

275. There are no provisions, neither in the Antitrust Law, nor the New Antitrust Law or related legislation, regarding the possibility of limitation to criminal prosecution for individuals responsible for involving companies with voluntary ex-ante compliance programs in anticompetitive practices.

276. There are also no provisions, neither in the Antitrust Law, nor the New Antitrust Law or related legislation, regarding the possibility of limitation to damages for companies with voluntary ex-ante compliance programs involved in anticompetitive practices.

Canada

277. The existence of a compliance program does not immunize businesses or individuals from enforcement action by the Commissioner or from prosecution by the DPP. In the Bulletin, the Bureau also notes that the mere pre-existence of a compliance program will not be considered grounds to recommend favourable treatment in sentencing to the DPP for either corporations or individuals with respect to criminal offences under the Act.

278. However, although the Bureau is not clear with respect to how it will evaluate the impact of the implementation of a compliance program when it comes to recommendations for sentencing or remedies, the Bureau notes that establishing a credible and effective program, or taking verifiable steps to strengthen an existing compliance program in response to a violation of the Act, can have a positive impact on the Commissioner's sentencing recommendations in criminal matters, or on the remedy sought by the Commissioner in civil reviewable matters.

279. In addition, section 718.21 of the Canadian *Criminal Code* provides that when sentencing an organization, the court shall take into consideration any measures that the organization has taken to reduce the likelihood of committing a subsequent offence. For example, such measures could include the implementation of a compliance program.

280. Furthermore, as indicated in the Bulletin, in certain circumstances, the Commissioner may be inclined to consider an alternative form of resolution to litigation where the business can demonstrate that:

- → it terminated the conduct in breach of the Acts as soon as it was detected;
- → it attempted to remedy the adverse effects of the conduct;
- → the conduct was contrary to corporate policy in existence at the time of the contravention; and
- → the contravention occurred at a lower level in the business and was not carried out or endorsed by senior management.

281. The Bureau considers that a proper compliance program should include five essential elements which are discussed in the Bulletin:

1. Senior Management Involvement and Support

282. Senior management should foster a culture of compliance within the business organization by playing an active and visible role in promoting its program.

2. Corporate Compliance Policies and Procedures

283. A corporate compliance program should include the development and documentation of compliance policies and procedures tailored to a business' operations, and updated when required to reflect material changes to the business, the law, the Bureau's enforcement policies, or to the industry

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(for instance, deregulation). Reasonable measures should also be taken to promptly notify employees of such changes, and relevant documentation should be available to all employees.

3. Training and Education

284. A corporate compliance program should include an ongoing training component focusing on compliance issues for staff at all levels who are in a position to potentially engage in, or be exposed to, conduct in breach of the Act.

4. Monitoring, Auditing and Reporting Mechanisms

285. The Bureau considers that effective monitoring, auditing and reporting mechanisms help prevent and detect misconduct, educate staff, provide both employees and managers with the knowledge that they are subject to oversight and determine the program's overall efficacy.

5. Consistent Disciplinary Procedures and Incentives

286. The Bureau notes that businesses should develop a disciplinary procedure addressing those who initiate or participate in conduct in breach of the Act, or those who do not abide by a business' program. This procedure should clearly state potential disciplinary actions.

6. The concept of parental liability is not applied in Canadian competition law.

287. As mentioned above, the existence of a compliance program does not immunize businesses or individuals from enforcement action by the Commissioner or from prosecution by the DPP. In the Bulletin, the Bureau also notes that the mere pre-existence of a compliance program will not be considered grounds to recommend favourable treatment in sentencing to the DPP for either corporations or individuals with respect to criminal offences under the Act.

288. However, although the Bureau is not clear with respect to how it will evaluate the impact of the implementation of a compliance program when it comes to recommendations for sentencing or remedies, the Bureau notes that establishing a credible and effective program, or taking verifiable steps to strengthen an existing compliance program in response to a violation of the Act, can have a positive impact on the Commissioner's sentencing recommendations.

289. Further, in the Bulletin, the Bureau notes that if a program is a sham and used only to conceal or deflect liability, it may be considered an aggravating factor for sentencing purposes or administrative monetary penalties.

290. This issue has not yet been considered in Canadian private actions.

Czech Republic

291. Although the Office stated that the implementation of a compliance programme could be considered as a mitigating circumstance when imposing a fine, this has never been tested in practice. The implementation of a compliance programme is not likely to be seen as limiting liability for companies or individuals under the competition law or criminal perspective or having impact on damage actions. In its decisional practice the Office has never considered the existence of the compliance guidelines. The argument of fine reduction due to an implemented compliance programme also has not been raised before the Office.

292. In our opinion, however, it is only a matter of time before the Office commences pursuing the compliance programme within its competition advocacy framework.

Egypt

293. The law does not provide for a fine reduction for companies with voluntary ex-ante compliance programs. However, the judge, upon his sole discretion, may take this fact into consideration when deciding the fine.

294. A voluntary ex-ante compliance program initiated by group would not change anything in terms parental liability. According to Egyptian Competition Law, they may be considered as jointly and severally liable if they fall under the definition of "Related Parties" as stipulated in the Executive Regulations to the Law.

295. Furthermore, a voluntary ex-ante compliance program does not limit criminal liability for the companies/individuals concerned if an infringement is committed afterwards.

European Union

296. As stated above, the European Commission supports the adoption of compliance programs but considers that they bring their own reward in limiting the risk of infringement.

298. The European Commission indeed states in its brochure that "*the mere existence of a compliance programme will not be considered as an attenuating circumstance. Nor will the setting-up of a compliance programme be considered as a valid argument justifying a reduction of the fine in the wake of investigation of an infringement*"[124].

298. It may be noted that the European Commission has once granted a reduction in fine to a company committing to adopt a compliance program after infringing the provisions on abuses of dominance[125]. However, a few months later, the same company was involved in a cartel case. The European Commission has never since applied any mitigating factor to companies with compliance programs at the time the infringement was committed or adopting such compliance programs just after the investigations took place. The Court of Justice supports that policy[126].

124 "Compliance Matters" Brochure, page 20.

125 Case No IV / 30.178 Napier Brown - British Sugar – 18 July 1988 p.83

126 see, for example, joined Cases T-101/05 and T-111/05, BASF and UCB, paragraph 52, and Case T-138/07, Schindler Holding, paragraph 28.

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299. There would however be scope in the EU provisions for applying a mitigating factor in cases where a company has taken all necessary steps to avoid infringements but an infringement is nonetheless committed by reason of negligence/willful conduct of employees. In such cases, it may be questioned whether the company – the sole addressee of EU competition rules, see 1. above – has really been involved in the infringement "intentionally or negligently" as required by Regulation N° 1/2003. More largely, there is no need to set high fines towards the company concerned in order to ensure deterrence, and the contribution to general interest brought by a sincere compliance program is not less important that the contribution to the general interest which are recognized in the leniency program and in the settlement procedure through significant reductions in fines.

300. In addition, it is important to note that the implementation by a parent company of a group-wide compliance programme is not in any way seen positively where enforcement actions are brought against subsidiaries. To the contrary, this may be considered as a sign that the parent company exercises decisive influence over its subsidiaries, therefore contributing to establish that the parent company shall be found jointly and severally liable for its subsidiary's infringement[127].

301. The Commission has not either given any support to the view that national courts should view positively the adoption of compliance programs in the frame of criminal or damages actions, being noted that these actions are in any event based on national law (see 1. above).

France

302. As stated above, the French Competition Authority supports the adoption of compliance programmes by companies but, in its Framework-Document, the Authority states that it is not appropriate to take compliance programmes into account when determining a company's fine either an aggravating or a mitigating circumstance.

303. Indeed, the Authority considers that the fact that the company has set up a compliance program has no bearing on the seriousness of the facts or on the importance of the economic harm they may have caused to the economy. Furthermore, although it is true that the existence of a compliance programme may be an element that differentiates the relevant company or organisation from other participants to the infringement, the Authority considers that this fact should not be taken into consideration in itself when making an individual decision on the amount of the financial penalty to be imposed, insofar as it did not prevent the occurrence of the infringement.

304. In case a company discovers a misconduct thanks to its compliance program, the Authority considers that it is the company's responsibility to cease the misconduct immediately and report this misconduct as soon as possible to the Authority under the leniency procedure. It is only when the leniency procedure is not available (non cartel cases including horizontal or vertical anticompetitive agreements, abuses of dominance) that the Authority would be prepared to consider a mitigating factor[128]. There is no precedent so far and the Framework-Document does not disclose the range of the reduction the Authority would consider.

305. Under EU case law[129], having a parent-company and its subsidiary share a common compliance programme may be regarded as an indication of the subsidiary's lack of commercial autonomy and may therefore contribute to having the parent-company found liable for its subsidiary's infringement. We are not aware of any similar French precedent.

306. We are not either aware of precedents referring to the adoption of compliance programmes as likely to have a positive impact on criminal or damages actions.

India

307. The provisions of the Act dealing with the imposition of penalties for anti-competitive activities are silent on whether the existence of compliance programme would serve as a mitigating factor and result in the reduction, if any, of the quantum of the penalty imposed on an enterprise.

308. However, the language of the Guidelines suggests that the existence of a competition compliance programme may influence the quantum of the penalty in the case of enforcement action. No range for such reduction or conditions on which such reduction of penalty may be granted has been indicated in the Guidelines.

309. Further, the law is silent on what would amount to a "genuine" compliance programme. It must be noted though that the Guidelines provide an indicative list of the essential features that are required in a competition compliance programme. Please refer to our response to Question 1 above.

310. The Act provides that in the case of the contravention of the provisions of the Act or rules, regulations or orders made or directions issued thereunder by companies, every officer in charge shall, along with the company itself, be deemed to be guilty of the contravention and subject to liability under the Act.

311. However, this presumption of liability is rebuttable if the person can establish that the contravention was committed without his knowledge or that he had exercised due diligence to prevent the commission of such contravention.

312. Keeping this in mind, a genuine competition compliance programme initiated or adopted by a group may assist the parent enterprise in mitigating or escaping its liability by establishing that due diligence had been exercised by it to

127 For a recent example, see the judgment of the EU General Court of 2 February 2012 in the T-76/08 case "EI du Pont de Nemours et Cie v. Commission".

128 Framework-Document para. 27 and 28.

129 For a recent example, see the judgment of the EU General Court of 2 February 2012 in the T-76/08 case "EI du Pont de Nemours et Cie v. Commission".

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prevent the contravention of Indian competition law by its subsidiaries. However, there has been no precedent in this regard, and there is no express provision under the Act or the regulations framed thereunder to this effect. The existence of a group level ex ante competition compliance programme could potentially have a bearing on the liability of a parent company under Indian competition law, although the same remains to be tested and established in practice.

313. As a violation of the substantive provisions of the Act does not lead to attachment of criminal liability, the compliance programme would have no bearing on criminal liability. It is unlikely that the compliance programme can influence the imposition of criminal sanctions for failure to obey orders of the CCI.

314. However, with respect to criminal liability under the IPC, the existence of a genuine or bona fide competition compliance program could influence the imposition of criminal sanctions on the company and individual officers in charge of the enterprise, by serving as a mitigating factor.

315. It must be re-iterated that competition law in India, being relatively new, has not developed sufficiently in the area of compliance programmes and thus no clear jurisprudence has emerged reflecting the extent of influence the adoption of competition compliance programmes may have on private and public enforcement action.

316. Damages could be claimed before the CompAT, or potentially under tort law. The existence of a bona fide and genuine competition compliance programme could possibly indicate that due diligence or reasonable care had been exercised, and might reduce the quantum of the damages awarded. There is however no established precedent for private enforcement or damages claims for anti-competitive actions.

Israel

317. An effective voluntary compliance program may have a direct and significant bearing on the possible criminal liability of senior management, in cases where the indictment rests on indirect liability under section 48 of the Antitrust Law.

318. As explained in section 1 above, the Antitrust Law imposes direct criminal liability on individuals who participated in the antitrust offence. In addition, section 48 of the Antitrust Law states that in the event that an offense was committed by the company (namely, an offense committed by any of the company's employees) anyone who was an active director or senior executive employee at the time the offence was committed will also be prosecuted. In effect, the IAA's practice is that nearly every time a corporation commits an antitrust offense, the corporation's general manager (as of the date of committing the offense) and other senior management officers are also charged, regardless of their personal involvement in the offence committed.

319. According to section 48 of the Antitrust Law, officers can defend themselves from indirect liability if they can prove – and the onus of proof rests with them – that they were unaware of the circumstances giving rise to the offense and that they "adopted all reasonable measures to guarantee compliance" with the Antitrust Law. This defense was interpreted very narrowly by the courts, but the IAA clarified that an effective antitrust compliance program would enable senior management to establish such defense. Thus, if a corporation has established an effective compliance program, the IAA will likely refrain from indicting its senior management for their indirect liability. It should be stressed that this policy applies only to ex-ante compliance programs and only to officers that are not directly implicated (took no part in the offence and were unaware of the circumstances surrounding it).

320. The IAA's position is that a genuine compliance program is one that meets the multiple requirements set in the MCP (notable requirements were detailed in section 2 above).

In general, a parent company is not criminally liable for offences carried out by its subsidiary. However, officers of the parent company often serve as directors or officers in the subsidiary, and thus may benefit from the implementation of a compliance program by the subsidiary.

321. Apart from its important role in defending against indirect personal liability, a compliance program may enable the corporation to be favorably treated in terms of its ability to seek the IAA's guidance in antitrust issues.

322. The IAA provides a special pre-ruling track for corporations that adopted a voluntary compliance program. The IAA's guidelines regarding "Answer to Business Review Inquiry from the Antitrust Director-General" (1999 IAA Website 3004265[E]).).) state that "*An answer to a business review inquiry is given as a response to an appeal from a corporation which is implementing an internal compliance program. The business review inquiry procedure refers to a specific and express set of facts that raises an antitrust question, which is submitted to the Antitrust Director-General by the corporation that is carrying out an internal compliance program*". English version of the guidelines is available at http://eng-archive.antitrust.gov.il/ANTItem.aspx?ID=31&FromSubject=100232&FromYear=2012&FromPage=0

Japan

325. Such fine reduction is not set forth under the Anti-Monopoly Act. However, there is a possibility that smaller amount of fine as a criminal penalty is ordered by court in extenuation of implementing sufficient compliance programs though no precedent is found, but it depends on the circumstance of infringement and the content of compliance program, etc. Smaller amount of fine may be ordered, for example, in the event that a few employees violate the Anti-Monopoly Act regardless of sufficient training to employees.

326. On the other hand, the surcharge imposed by payment order of FTC is not reduced even if the company conducts a voluntary compliance program because the rate of surcharge is definitely set forth under the Anti-Monopoly Act and FTC has no discretion to reduce the surcharge.

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327. Originally, the parent company does not have a liability with regard to the infringement of its subsidiary, so that the adoption of a compliance program has no impact in that respect.

328. As in above, there is a possibility that criminal liability is limited by court if implementation of compliance programs is considered as a mitigating factor in criminal court proceedings, but it depends on the circumstance of infringement and the content of compliance program, etc.

329. A compliance program would have little impact on damage actions because the damage of the counterparty would not decrease even if the violating company has implemented such compliance programs.

Netherlands

330. In exceptional circumstances a voluntary ex-ante compliance programme may result in a reduction in fine. According to the NMa, the compliance programme should in such event have a fully implemented and sufficiently effective internal control system to encourage compliance. In addition, no high-placed representatives of the undertaking should have been involved in the infringement. However, there has been no precedent to date.

Pakistan

331. According to the Guidelines on Imposition of Financial Penalties (Fining Guidelines) released by the Commission, having a voluntary ex-ante compliance program at the time an infringement is considered as one of the mitigating factors during the assessment and imposing of an appropriate penalty on the concerned undertaking. Section 8.1 of the guidelines lists one of the mitigating factors as being:

"adequate steps taken with a view to ensuring compliance with the prohibitions of Chapter II of the Ordinance, for example, existence of any compliance programme; and…"

332. On what would be considered as a genuine compliance program and what mitigating value would be accorded to the existence of any such program, 8.2 of the guidelines state:

"In considering how much mitigating value may be accorded to the existence of any compliance scheme of an undertaking, the Commission may consider:

- whether there are appropriate compliance scheme and procedures in place;
- whether such scheme has been actively implemented;
- whether it has the support of, and is observed by, senior management; and
- whether such scheme is evaluated and reviewed at regular intervals?"

323. The imposition of a penalty is however at the discretion of the Commission and the assessment of an appropriate penalty to be imposed for all types of infringements shall depend on the facts of each case.

324. The only information available related to the relationship of parent and subsidiary companies in the case of an infringement being committed by a subsidiary can be found in the fining guidelines. section 9.4 states:

"The anti-competitive conduct of an undertaking can be attributed to its parent company where the subsidiary does not independently determine its market behavior but, mainly because of economic and legal ties has essentially followed its instructions, in such instances commission can choose whether to attribute the infringement committed by the subsidiary to it or to the parent company".

325. Having a voluntary ex-ante compliance program is one of the mitigating factors during the assessment of penalties by the Commission in the event of an infringement. Penalties include criminal liability as well, so the same principles would apply on it.

326. Section 8 of The Competition (Leniency) Regulations, 2007 states the following: "*Effect of leniency. – Immunity granted by the Commission cannot exclude claims by third parties who may have suffered loss as a result of the activities in respect of which immunity is granted. Third parties, therefore, shall have the right to pursue the private claims for damages before the Court of competent jurisdiction*".

Singapore

327. The CCS has stated in its guidelines that it would consider a compliance programme as a mitigating factor. However, this would depend on:

(a) Whether there are appropriate compliance policies and procedures in place;

(b) Whether the programme has been actively implemented;

(c) Whether it has the support of, and is observed by, senior management;

(d) Whether there is active and ongoing training for employees at all levels who may be involved in activities that are touched by competition law; and

(e) Whether the programme is evaluated and reviewed at regular intervals.

328. The CCS has issued no guidelines as to what would be considered a genuine compliance program. However, in our experience, the following would be required in a compliance program:

(a) An introduction of the law;

(b) Examples of breaches;

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(c) An introduction of the penalties;

(d) A system of reporting;

(e) Audits, hotlines;

(f) Internal sanctions for breaches;

(g) Document publicity;

(h) Document retention policy;

(i) Regular training and updating programmes; and

(j) Commitment from management.

329. The CCS would not automatically deem a parent and subsidiary a single economic entity ("SEE") for the purposes of the Act, and hence, liability will not typically attach to both. Whether a parent and subsidiary is a SEE depends on whether the subsidiary is autonomous and economically independent.

330. If the parties are considered a Single Economic entity, then there is a possibility of parental liability where the subsidiary has been in violation. In such an instance, the presence of a group compliance program may mitigate against parental liability. However, this is dependent on the effectiveness of the compliance programme.

331. There is no criminal liability in Singapore.

332. A voluntary ex-ante compliance program is a mitigating factor only when it relates to financial penalties issued by the CCS. Nevertheless, it can potentially have an impact on private actions for damages, although the general principle of damages is to compensate for loss. This stems from the party causing the loss having endeavoured to take steps to mitigate any violations.

South Korea

333. The primary benefit of implementing a compliance program is that in the event that is found by the KFTC to have violated the FTL, it can qualify for a reduction of penalties if the test result equivalent to or above "A" is achieved. For your information, according to KOFAIR, 44 companies applied for qualification in 2010, and 29 companies received levels equivalent to "A" or above (22 companies received "A", and 7 companies received "AA").

334. According to the Notification, the benefits expected by establishing a compliance program and obtaining qualification thereof can be summarized as follows:

→ Upon a violation of the FTL, KFTC may reduce the administrative fine to be imposed on the company by up to 20% once (certain exceptions exist, such as for a cartel or high officer's involvement in the violations).

→ Upon a violation of the FTL, the KFTC may reduce the level of public disclosure order to be imposed on the company by one time (the same exceptions as above (i) exist).

→ KFTC would not conduct an *ex officio* investigation on the company for up to two years (certain exceptions exist, such as when the company is penalized for obstruction of the KFTC's investigation within two years or when there exist clear suspicion of violation).

335. Please note in this regard that the potential reductions in any monetary fines that may be payable apply to violations of the FTL in the future and do not extend to past violations. Accordingly, implementation of the compliance program would not immunize a corporation against a potential finding of violation for past practices.

336. As a general matter, a parent company will not be found liable for the acts committed by its Korean subsidiary, unless there is evidence implicating the parent company. Accordingly, a voluntary ex-ante compliance program initiated by a group will not change anything in terms of parental liability if an infringement is committed by a subsidiary.

337. For criminal liability and civil damage claims, a compliance program would not, from a strict legal perspective, change the amount of exposure. However, if a company has duly implemented a compliance program, this may be considered by the reviewing court as an extenuating factor in determining the liability.

Turkey

338. Since the competition law compliance program is a newly introduced notion to the Turkish competition law, case law on the subject is very limited. There is no recognition of a fine reduction to companies with voluntary ex-ante compliance programs. The existence of a compliance program is mentioned in only a few Competition Board decisions.

339. One of these decisions is the Unilever decision[130]. During the onsite investigations conducted by the case handlers on the premises of Unilever Turkey, various educational documents covering general competition law matters and previous decision of the Competition Board regarding Unilever Turkey was found. Moreover a competition law compliance guideline with a foreword written by the chairman and the chief legal counsel was also encountered during the onsite investigations. While the wording of the decision does not explicitly state that the existence of these efforts was taken into consideration in the final decision itself (the Competition Board decided that there was no need to open an investigation), these documents were considered as an indication that Unilever is trying to comply with competition rules.

340. Since the competition law compliance program is a newly introduced notion to the Turkish competition law, case law on the subject is very limited. Having said that, showing due diligence on the adoption of competition law policies would be in favour of the infringing party.

130 The decision of the Competition Board dated 17.3.2011 and numbered 11-16/287-92.

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341. As explained above, the sanctions that could be imposed under the Competition Law are administrative in nature (i.e. no criminal sanctions). That said, there have been cases where the matter had to be referred to a public prosecutor after the competition law investigation is complete. On that note, bid-rigging activity and illegal price manipulation (i.e. manipulation through disinformation or other fraudulent means) may be criminally prosecutable under the Turkish Criminal Code. Such prosecutions do not have any relationship with competition law and would be solely based on the Turkish Criminal Code. Therefore, it is theoretically possible for a defendant to raise the existence of an ex-ante compliance program during criminal prosecutions. However, the effectiveness of such claims would be arguable since the final judgement of whether the existence of an ex-ante compliance program could be considered as a mitigating factor would rest on the criminal judge.

342. While the lack of precedents limit a clear cut answer, it is theoretically possible for either party to raise the existence of an ex-ante compliance program in damages actions. Theoretically speaking, raising the existence of a compliance program could work for (e.g. damaging party took all the necessary intercompany measures to avoid breaching competition law) or against (e.g. possible evidence for bad faith) the defendant depending on the properties of the case.

United Kingdom

1. Reduction in Fines for Voluntary Compliance Programmes

343. In section 7 of its detailed guidance, the OFT states that its starting point in relation to setting penalties for businesses that have undertaken compliance activities is "neutral".

344. There are no automatic discounts or increases in the level of financial penalty where an infringing party has been operating a competition compliance programme. However, the amount of a financial penalty imposed for a competition law infringement may be reduced at the discretion of the OFT, where the infringing party can demonstrate that "adequate steps" had been taken with a view to ensuring compliance with the prohibitions on anti-competitive behaviour in the Competition Act 1998 and article 101 and 102 TFEU[131].

345. Each case will be assessed on its own merits. An infringing party, depending on the size of the business and level of exposure to competition law risk, would be expected to adduce evidence of adequate steps having been taken in relation to:

- → achieving a clear and unambiguous commitment to competition law throughout the organisation;
- → risk identification;
- → risk assessment;
- → risk mitigation, and
- → review.

131 This point was already made in the OFT's 2004 guidance on the appropriate amount of a penalty (OFT 423), at paragraph 2.16.

346. The OFT states that, at its complete discretion, and if it considers that a reduction in financial penalty is justified in the first instance, then it may reduce that level of fine by up to 10 per cent.

347. The OFT makes it clear that if a discount is appropriate then it can take into account compliance efforts undertaken either prior to the infringement or "implemented quickly following the business first becoming aware of the potential competition infringement".

2. Parental Liability – Voluntary Compliance Programmes

348. The OFT[132] and the CAT[133] have emulated the jurisprudence of the European courts, established in the Akzo case. Where a parent company exercises "decisive influence" over the commercial policy of its subsidiary, the presumption is that this subsidiary will form part of the same "undertaking" as the parent company[134]. As part of that same undertaking, the parent company will be jointly and severally responsible for any infringement of competition law.

349. The parent company can attempt to rebut this presumption, in order to escape the liability of its subsidiary which has been found to have infringed competition law. The parent company can do so by showing that the subsidiary and parent company's commercial policy are in fact separate. In Akzo, the Court of Justice stated that the parameters relevant for establishing a subsidiary's independence are not limited to "commercial policy" in the strict sense (e.g., the subsidiary's conduct with respect to pricing, production, distribution, sales objectives, gross margins, sales costs, cash flow, stocks and marketing) but also extend to all relevant factors "relating to economic, organisational and legal links which tie the subsidiary to the parent company, which may vary from case to case and cannot therefore be set out in an exhaustive list".

350. It is possible therefore that competition compliance programmes, specifically designed for a particular subsidiary, may fall within this broad definition of "commercial policy", but it is likely that a whole range of other commercial activities may act to determine "decisive influence". No competition cases to date have been brought by an infringing party in the UK courts where evidence of a competition compliance programme, specific to the subsidiary, would exonerate liability of a parent company.

3. Criminal Liability – Voluntary Compliance Programmes

351. The cartel offence in section 188 of the Enterprise Act 2002 states that an individual is guilty of an offence if he "dishonestly" agrees with one or more persons anti-competitive arrangements. The test for "dishonesty" is well understood in English criminal law and is set out in the case of R v Ghosh.[135] This has created a two-part test:

132 Case CE/4327-04 "*Bid-rigging in the construction industry in England*" (21 september 2009), No. CA98/02/2009.

133 Durkan Holdings Limited, Durkan Limited and Concentra Limited (formerly known as Durkan Pudelek Limited) v Office of Fair Trading [2011] CAT 6.

134 Case C-97/08 *Akzo Nobel and others v. Commission* (10 September 2009).

135 [1982] QB 1053, 75 Cr. AppR. 154 CA, 2 All ER 689, CA.

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1. Was the act one that an ordinary decent person would consider to be dishonest (the "objective test")? If so:

2. Must the accused have realised that what he was doing was, by those standards, dishonest (the "subjective test")?

352. The fact that a company has voluntarily introduced an ex-ante compliance programme would logically indicate that its staff and directors objectively and subjectively know and believe that anti-competitive behaviour is dishonest. Extending this logic further, it would therefore be unlikely to limit criminal liability for the individuals concerned if an infringement is committed afterwards. On the contrary, evidence that the relevant individuals had completed the relevant compliance programme and still went ahead with the anti-competitive behaviour would be important aggravating evidence for any jury to consider.

353. The extent to which any criminal liability may apply will depend very much on the facts of each case but directors should remain very much conscious of this risk.

4. Damages Actions – Voluntary Compliance Programmes

354. Follow-on damages actions are generally brought by third parties after the OFT has issued an infringement decision on which that third party can rely for evidence of an infringement. The existence of a compliance programme will not therefore be usually relevant in that specific regard. However, the discovery exercise required during litigation before the English courts will likely uncover the fact that there was a compliance programme, the content of it, and any potential competition law infringements uncovered as a result of that compliance programme. Any infringement which has been uncovered as a result of the compliance programme would likely be very useful to the third party's damages action, as it would constitute direct evidence of wrong doing. The best way to protect such material from being subsequently disclosed is to engage in-house and outside legal counsel so that legal privilege would apply to the greatest extent possible[136]. This could mean having in-house and outside legal counsel involved in the compliance programme, seeking any advice on any material uncovered by that programme, making any leniency application and carrying out any discovery exercise.

United States

355. As noted above, under the United States Sentencing Guidelines, fine reductions are available for "effective" compliance programs, except in the area of antitrust. The Sentencing Guidelines provide nonbinding recommendations[137] to courts as to the proper amount of fine based on the nature of the violation, and certain factors that may increase the fine (e.g., repeated violations), or factors that may mitigate a fine (e.g., a compliance program). In the presence of a compliance program, a $1 million fine might be reduced to $50,000. Although there are no statistics available, anecdotal evidence indicates that many to prosecutors frequently decide not to prosecute a corporation when it is clear that a violation was caused by a "rogue employee" and the corporation, as evidenced by its compliance program, had no intent to violate the law.

356. In a private treble damage action, a compliance program will not have any effect, since the private plaintiff does not care. If the private plaintiff was injured, it wants to recover damages.

2. In your jurisdiction, are there risks entering into voluntary compliance programs if they do not prove to be 100% effective?

Please notably explain:

→ *whether a voluntary compliance program would be considered by the authorities/agencies or courts in your jurisdiction as a flawed/sham compliance program in case an infringement occurs or do they recognize that a compliance program may be sincere and effective even if not 100 % successful?*

→ *Whether the commitment of an infringement after the adoption of a voluntary compliance program has been/could be considered as an aggravating circumstance to increase fines or other penalties?*

→ *Whether failed compliance programs are likely to facilitate criminal prosecution against the company and/or executives concerned (revealing willful conduct) i.e. as proof that a violation was knowing and willful?*

→ *Whether the adoption of a voluntary compliance program at the very least creates an obligation to go for leniency when an infringement is discovered?*

Australia

357. Where a compliance program is inadequate or ineffective, this is not treated as an aggravating factor by the Federal Court in determining the level of penalty, i.e., the ineffectiveness of the compliance regime will not, *per se*, increase the fine[138].

358. However, an ineffective compliance program may neutralise the weight given to the compliance program and diminish or negate its significance as a mitigating factor when it is considered by the Federal Court[139]. Little or no credit will be given by the Court where the steps taken by a company are inadequate or superficial[140].

136 The OFT recognises legal privilege for in-house counsel in competition cases as a matter of English law but the European Court has confirmed that it takes the opposite view: Case C-550/07 P *Akzo Nobel v Commission*, 14 September 2010. Under European competition law, only outside counsel benefit from legal privilege.

137 http://www.ussc.gov/Legal/Primers/Primer_Organizational_Fines.pdf.

138 ACCC v George Weston Foods Ltd [2000] FCA 690.

139 *Ibid.*

140 ACCC v Visy Industries Holdings Pty Limited (No. 3) [2007] FCA 1617.

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359. For example, the Federal Court is unlikely to regard with favour compliance initiatives where:

- → the compliance program is comprised of booklets or brochures, but these are not widely distributed or are out-of-date;
- → measures taken by a corporation are too general;
- → there has been no recent or regular training of relevant personnel; or
- → there is evidence that compliance guidelines were in place, but were ignored by senior management.

360. In cases such as these, the ACCC usually requires the contravening corporation to remedy any shortcomings in its compliance procedures.

361. In addition, where a corporation has implemented a carefully designed and properly implemented compliance program, but unlawful behaviour has nevertheless occurred within the corporation, especially if it has occurred multiple times, then the program is more likely to be regarded as deficient, and the risk is that the contravention is more likely to be regarded as deliberate.

Brazil

362. There is no case law in Brazil, regarding increase of fines and penalties in case of flawed/sham compliance program, to enable the assessment of risks for companies with a voluntary ex-ante compliance program that are condemned by CADE. However, both the article 27 of the Antitrust Law and article 45 of the New Antitrust Law determines that the good-faith of the defendant will be considered in the calculus of the fine to be imposed over the defendant. Therefore, if CADE concludes that the company acted with bad faith or willful misconduct, the fine may be increased.

363. It seems clear that the Brazilian antitrust authorities shall not consider the existence of a program as an aggravating circumstance.

364. However, an ineffective and unenforced voluntary ex-ante compliance program may be interpreted by CADE as an instrument to give the false idea that the company complies with the legislation. Since there is no case law in this regard, it is not possible to assert if such ineffective compliance program would lead to a willful misconduct or bad faith interpretation.

365. The willful misconduct or bad faith of the defendants are interpreted by CADE as a behavior of the companies to hide the unlawful practice or mislead the antitrust authorities. For example, in an administrative proceeding regarding cartel formation, judged on August 31, 2011, CADE applied an increase over the fine imposed to the companies. The members of the cartel created a mechanism to mislead the antitrust authorities by lowering the prices periodically to simulate competition.

366. Notwithstanding, the article 7 of SDE Ordinance provides that the SDE can revoke the Certificate if the company is condemned by CADE due to anticompetitive practices. Furthermore, the non-enforcement of a compliance program established by a Settlement or Performance Commitment will be considered a breach to the agreement between the company and CADE.

367. As for criminal prosecution, there is no legislation or case law regarding ineffective voluntary ex-ante compliance programs.

368. The implementation of compliance programs does not make it obligatory to apply for leniency. However, the application for leniency by a company with a voluntary ex-ante compliance program may be seen the Brazilian antitrust authorities as a tentative to remedy the unlawful practice in which the company engaged.

Canada

369. In the Bulletin, the Bureau notes that if a program is a sham and used only to conceal or deflect liability, it may be considered an aggravating factor for sentencing purposes or administrative monetary penalties.

370. However, the Bureau considers that, in some cases, a compliance program that has not been completely successful can still be genuine and, in a situation where a violation of the Act would have occurred, could make recommendations to strengthen an existing compliance program.

371. In the Bulletin, the Bureau points out that where senior managers of a company either participated in or condoned conduct that breaches the Acts, the Bureau will conclude that senior management's commitment to compliance was not serious and the program was neither credible nor effective. The Bureau also notes that knowingly contravening the law despite the existence of a program may be considered an aggravating factor for individuals involved in the offence when the Commissioner assesses whether to recommend that charges be laid against them. In such cases, the Bulletin states that the Commissioner would also recommend that charges be laid against the company.

372. There is no obligation for a business to seek leniency under any circumstances.

Czech Republic

373. As explained, in its guidelines the Office described the main features of the compliance programme in order to be considered effective. Since to date the Office has not reviewed or considered any compliance programme as mitigating circumstance, thus there should not be any risks for entering into a compliance programme not successfully implemented.

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Egypt

374. A voluntary compliance program will be taken into consideration by the ECA and the court in light of the acts of the person in breach. However, as stated earlier, the anti competitive practices under Egyptian law are criminal in nature so if committed and proved they are considered crimes.

375. There is no stipulation in the Law concerning considerations of infringement after the adoption of a compliance program being an aggravating circumstance.

376. Failed compliance programs may facilitate criminal prosecution as they are considered as indication or partial evidence of criminal intention.

377. Adoption of a voluntary program does not create obligation to go for leniency when an infringement is discovered.

European Union

378. In a 1998 decision[141], the Commission held that committing a infringement while having a compliance programme could be considered an aggravating circumstance for the calculation of the fine. The circumstances of that case were however particular, as the company concerned had obtained a reduction in fine a few months before on the basis of a commitment to adopt a compliance program.

379. In its information brochure, the European Commission acknowledges that a compliance programme may be considered as effective even if it may not prevent any infringement from occurring[142]. The Commission even expressly states that having adopted a compliance programme that failed to prevent an infringement from occurring would not be considered an aggravating circumstance[143]. It is however the responsibility of the company to put an immediate end to the infringement when discovered. The Commission also advises to go for leniency in such circumstances but does not consider it is an obligation[144].

380. It is also to be noted that the existence of a compliance program may facilitate the evidence that the company entered into a prohibited behavior intently (see [145] above) therefore justifying the imposition of fines.

381. The Commission has not given any indication that an infringement committed while a compliance program is in place should be considered by national criminal courts as a revealing willful conduct, although this is not in our view to be excluded.

France

382. A compliance programme that is not 100% successful would not be considered as a sham compliance program.

384. Indeed, in its Framework-Document, the Authority acknowledges that a programme meeting all the conditions to be considered as effective may not prevent any infringement from occurring[146].

385. The Framework-Document also clearly states that a compliance programme that failed to prevent an infringement will not be considered as an aggravating circumstance[147], even if it turns out that corporate officials or managers took part in the infringement despite their commitment to comply with competition law and support the company's programme.

386. However, the Authority considers that the effectiveness of a compliance programme is partly revealed ex post, by the decisions made by the company when discovering such an infringement. The Authority clearly considers that companies have a duty to stop the infringement and apply for leniency.

387. We are not aware of criminal precedents referring to compliance programs in force at the time the infringement was committed but it is not excluded that this could contribute to evidence that employees knowingly participated to the infringement. In its Framework-Document, the Authority itself states that it will definitely consider referring the case to criminal courts where directors who have endorsed compliance program and later on participated to an infringement[148].

India

388. The Act is silent in this regard. The Guidelines, while discussing the need for the review of competition compliance programmes, refers to the evaluation of the programme against the results achieved to determine its efficacy. The Guidelines do appear to implicitly acknowledge

141 Decision of the European Commission of 14 October 1998 in Case IV/F-3/33.708 "British Sugar plc"; paragraphs 208 and 210: "British Sugar acted in a manner contrary to the clear wording contained in its compliance programme, which it announced to the Commission Moreover, British Sugar promised in its compliance programme to take every step to ensure compliance with the Community competition rules, even to go beyond its strict legal obligations and avoid any doubtful behaviour, and to pass this message on to every level of the company's hierarchy. The infringement found in this Decision shows that this promise has not been fulfilled. (…)In conclusion, the aggravating factors mentioned justify an increase of 75 %, namely ECU 18,9 million in the basic amount for British Sugar".

142 "Compliance Matters" Brochure, page 18: "An effective compliance strategy will be expected to simply prevent any infringement from happening. Yet it may prove insufficient to ensure compliance, and there may nevertheless be instances of wrongdoing".

143 "Compliance Matters" Brochure, page 21: "It goes without saying that the existence of a compliance programme will not be considered an aggravating circumstance if an infringement is found by the enforcement authorities".

144 "Compliance Matters"Brochure, pages 18 and 19.

145 See decision of the European Commission of 14 October 1998 cited above at para.192.

146 The President of the Autorité de la concurrence, Bruno Lasserre also stated at its conference of 21 June 2011 at the MEDEF that:"To be effective, a compliance programme must be consistent with the undertaking's culture and defined by the company itself. Under no circumstance will an undertaking be criticized for having implemented a compliance programme that failed. The chosen approach focuses on incentives"(free translation).

147 Framework-Document of 10 February 2012, para. 26.

148 Framework-Document of 10 February 2012, para. 26.

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that even a genuine and *bona fide* competition compliance programme might not be a 100% effective.

389. Whether the adoption of a compliance programme could prove to be an aggravating circumstance with respect to the imposition of penalties for the contravention of the Act would depend on the facts and circumstances of each case. If it is demonstrated that a compliance programme was not intended to be genuine or effective, it could potentially go against the party and serve to enhance the quantum of the penalty imposed or adversely affect criminal proceedings against a company or its executives under the IPC.

390. There is no obligation under the Act or the rules, regulations or notifications framed thereunder that creates an obligation to file for leniency if an enterprise were to adopt a voluntary competition compliance programme.

Israel

391. Generally, a sincere and effective compliance program, even if not 100% successful, may be sufficient to invoke the defense under section 48 of the Antitrust Law and prevent indictment of senior management.

392. In addition, the fact that a compliance program was in place, even if not successful, may play a role in the IAA's decision to settle an infringement of the Antitrust Law, without criminal proceedings. See for instance Approval of a Consent Decree between the General Director and the Israeli Association of concrete manufacturers, 2007 IAA Website 5000478 (compliance program as one of the reasons for waving the criminal path).

393. However, a sham compliance program may serve as an aggravating circumstance in a criminal proceeding against senior management, because it may indicate that the corporation willfully and deliberately breached the law.

394. There is no requirement to go for leniency when an infringement is discovered after the adoption of a voluntary compliance program exists under Israeli Law.

Japan

395. As an infringement occurs, it is more likely that such compliance program is considered to be flawed/sham rather than sincere and effective, depending on circumstances. The investigator of FTC has made a similar claim in a hearing proceeding in FTC.

396. The amount of surcharge imposed by the payment order of FTC does not change as above. Also, the adoption of the compliance program would not be a reason for FTC not to issue the cease-and-desist order if the infringement was committed.

397. On the other hand, although precedents are not found, there is possibility that larger amount of fine as criminal penalty is ordered, depending on circumstances. The court may deem the infringement to be malicious because the violator recognizes the illegality of the infringement if the compliance program is implemented. This would be especially true in the event that the directors violate the compliance program which they established.

398. The failed compliance program would be directly related to the possibility of the criminal prosecution. However, if the infringement is deemed to be malicious because of the failed compliance program as above, criminal prosecution is more likely to be conducted.

399. The adoption of a voluntary compliance program is not related to an obligation to go for leniency.

Netherlands

400. First of all, we note that (given the absence of any formal or informal rules on compliance programmes), there are no rules sanctioning voluntary non-100% effective compliance programmes. Neither are there any precedents in the Netherlands on which to rely for guidance in respect of this question. In theory however, it is conceivable that the NMa would consider the entering into a non-effective compliance programme an aggravating factor in determining a fine, e.g. if it was purposely set-up as a "sham". Other than that, the risks of entering into a non-100% effective programme seem very limited.

Pakistan

401. The Act is fairly recent and there is not enough case material on the subject to answer this question.

402. While the presence of an ex-ante voluntary program is one of the mitigating factors when assessing fines and other penalties in cases of infringements, the list of aggravating factors in the fining guidelines does not include the adoption of a voluntary compliance program as being an aggravating circumstance to increase fines or other penalties. The guidelines however state that there is no binding or exhaustive list of criteria that must be taken into account in every case when assessing the gravity of an infringement and that it has to be determined by reference to numerous factors such as circumstances of case, its context and the dissuasive effect of the fine.

403. As discussed earlier above, the adoption of a voluntary compliance program by an undertaking is one of the mitigating factors according to the fining guidelines released by the Commission when assessing penalties in cases of infringements. However the discretion to assess and impose penalties on undertakings lies solely with the Commission and courts of law and there is no obligation to go for leniency in the case of adoption of a voluntary program when an infringement is discovered.

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Singapore

404. There are many factors into considering whether a voluntary compliance programme is a sham or whether it is sincere and effective. This would largely depend on whether:

(a) Whether there are appropriate compliance policies and procedures in place;

(b) Whether the programme has been actively implemented;

(c) Whether it has the support of, and is observed by, senior management;

(d) Whether there is active and ongoing training for employees at all levels who may be involved in activities that are touched by competition law; and

(e) Whether the programme is evaluated and reviewed at regular intervals.

405. If there is a genuine intention to have and to implement a compliance programme, then it will not be considered flawed or a sham.

406. The commitment of an infringement after the adoption of a voluntary compliance program is unlikely to be considered by the CCS to be an aggravating circumstance.

407. The following factors are considered aggravating circumstances when considering the level of penalties:

(a) Role of undertaking as a leader in, or an instigator of, the infringement;

(b) Involvement of directors or senior management;

(c) Retaliatory or other coercive measures taken against other undertakings aimed at ensuring the continuation of the infringement;

(d) Continuance of the infringement after the start of investigation;

(e) Repeated infringements by the same undertaking or other undertakings in the same group;

(f) Infringements which are committed intentionally rather than negligently; and

(g) Retaliatory measures taken or commercial reprisal sought by the undertaking against a leniency applicant.

408. There are no criminal penalties for cartel behavior or abuses of dominance. In any event, an officer found for example misleading or failing to produce documents or information may be subject to criminal prosecution. A failed compliance program does not assist one way or the other on this front.

409. The adoption of a voluntary compliance program does not *per se* create an obligation to go for leniency when an infringement is discovered. Applying for leniency would be a commercial decision taken by the affected undertaking.

South Korea

410. In Korea, there is no appreciable risk associated with entering into a compliance program even if it is not 100% effective. A failed compliance program plan would not likely be considered as an aggravating circumstance to increase fines or other penalties or facilitate criminal prosecution against a company or executives. Finally, adoption of a voluntary compliance program does not create an obligation to apply for leniency when an infringement is discovered.

Turkey

411. The Competition Authority is more inclined to consider the existence of a compliance program to be a sincere effort by the undertakings even if the compliance program is not entirely successful.

412. There are no precedents that would suggest that a commitment of an infringement after the adoption of a voluntary compliance program could be considered as an aggravating circumstances under Turkish Law.

413. We are not aware of any precedents that would suggest failed compliance programs may facilitate criminal prosecution.

414. There is no requirement to go for leniency when an infringement is discovered after the adoption of a voluntary compliance program. However, we have performed compliance programs for clients for the purpose of obtaining information and data to be used in a prospective leniency application.

United Kingdom

→ Aggravating Circumstances / Sham Arrangements

415. The OFT has stated in section 7 of its detailed guidance that it will not, subject to some exceptions, ordinarily regard the existence of a competition law compliance programme as a factor to warrant an increase in the amount of the fine to be imposed against that undertaking for a competition law infringement. The exceptions include situations where the purported compliance programme had been used to facilitate the infringement, to mislead the OFT as to the existence or nature of the infringement, or had been used in an attempt to conceal the infringement.

→ Criminal Prosecutions

416. Please see the responses to question 3.1. above in relation to criminal prosecutions.

→ Leniency Obligation

417. The adoption of a voluntary compliance programme by a company will not create an obligation on the company to apply for leniency when an infringement is discovered.

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418. A compliance programme simply acts as a mechanism to try and prevent anti-competitive behaviour and to identify when that might be occurring. However, even where anti-competitive behaviour is identified as a result of a compliance programme, under the UK leniency regime, a company is not under an obligation to apply for leniency[149]. Leniency programmes are designed to encourage infringing parties to benefit from immunity if they do come forward voluntarily with evidence of cartel activity (see question 4.1 for a fuller discussion).

United States

419. The Sentencing Commission recognizes that a good faith compliance program may not be 100% effective. If the compliance program satisfies the Sentencing Guidelines, then credit would still be available.

420. However, the Antitrust Division does not currently credit compliance programs, and views any program that is not perfect as a "failed" program[150]. For antitrust enforcement, it has an amnesty/leniency program that will provide complete amnesty from criminal liability for the first party that confesses to participation in a cartel[151]. The only qualification to the receipt of amnesty is to be the first party to come to the Department of Justice with information that it did not have. The party is not required to have had a compliance program, and is not required to have one thereafter.

421. The Department justifies the amnesty program as being the most effective tool to uncover international cartels. The lack of any compliance factor is not explained anywhere.

IV. Compliance programs in leniency/settlement proceedings

1. In your jurisdiction, can the competition authority authority/court impose the adoption of a compliance program when an infringement is uncovered? Have there been precedents?

Australia

422. There are several means by which a corporation can be required to adopt or improve its compliance program.

423. Pursuant to section 87B of the CCA, in cases where a contravention has occurred, the ACCC may be prepared to accept court-enforceable administrative undertakings ("*87B undertakings*"). In an 87B undertaking, corporations or individuals generally agree to remedy the anticompetitive behaviour, accept responsibility for their actions and to establish, or review and improve, their compliance programs and compliance culture.

424. Towards this, the ACCC has developed four specific compliance program templates, which give an indication to corporations as to the type and level of commitment expected to be given, depending on the size of the corporation, the level of competition risk and the nature of the contravention that the 87B undertaking is intended to remedy[152].

425. These templates include commitments which range from training employees, up to and including extensive commitments to appoint a compliance officer, instigate complaints-handling procedures, engagement of an independent third party to complete an annual review of compliance procedures and the submission of compliance documentation to the ACCC for review. Corporations usually commit to implementing the amended program within a specified timeframe[153].

426. While internal reporting requirements may be included in 87B undertakings, in Australia companies are not currently required to include commitments to self-report contraventions or apply to the ACCC for leniency as part of their compliance program.

427. The ACCC maintains a public register listing the 87B undertakings it accepts annually[154].

428. Where the ACCC has instituted legal proceedings against a company, 87B undertakings may also be given to the ACCC in conjunction with the settlement of legal proceedings before the Federal Court, described in further detail below.

429. In addition to 87B undertakings accepted by the ACCC, under section 86C of the CCA, the Federal Court also has the power to order a corporation to implement a competition compliance program. Where this is the case, each order must fit the circumstances of the case and must be tailored to the particular contravention. The Court will be reluctant to order a party to implement a compliance program where there is no clear benefit to the party's future behaviour[155], or in circumstances where there has been a deliberate breach by personnel when the Court is satisfied that a well-designed compliance program is already in place[156].

149 Thus in its guidance for directors, the OFT provides practical worked examples, advising that "*The companies should consider making a leniency application to the OFT or the European Commission (or both)*". Note that this is expressed as advice and not as a mandatory obligation. See OFT Guidance OFT1340, *Company directors and competition law*, June 2011, page 28 onwards.

150 Comments of Scott D. Hammond, Deputy Assistant Attorney General, at American Bar Association Section of Antitrust Law Spring Meeting, "Agency Update with the Antitrust Division DAAGs" (Washington, D.C., Mar. 30, 2011).

151 http://www.justice.gov/atr/public/criminal/leniency.html.

152 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/716224.

153 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/716224.

154 See ACCC website: http://www.accc.gov.au/content/index.phtml/itemId/815599.

155 *ACCC v 4WD Systems Pty Ltd* [2003] FCA 850.

156 *ACCC v George Weston Foods Ltd* [2004] FCA 1093.

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Brazil

430. CADE can impose the obligation to implement a compliance program in the negotiation of a Settlement, although this negotiation can occur before any evidence regarding the anticompetitive practice is gathered. However, in case of condemnation, there is no specific provision in the Antitrust Law or New Antitrust Law regarding an obligatory implementation of a compliance program. Notwithstanding, the article 38, item VII, of the New Antitrust Law, provides that CADE may impose "any act or measure necessary for the elimination of the harmful effects to the economic order". Using an extensive interpretation, this disposition could be construed as possibility for CADE to impose the implementation of a compliance program.

Canada

431. Yes. In a number of cases, the Bureau entered into a consent agreement with businesses which agreed to implement a corporate compliance program following the investigation of a violation of the Act. These consent agreements can be embodied in a court decision, if they relate to criminal matters, or negotiated by the parties and registered with the Tribunal, for non-criminal matters.

Czech Republic

432. In general, the Office may impose various obligations which may, in theory, consist also in the adoption of a compliance programme. However, this kind of obligation has never been imposed.

Egypt

433. Yes, the ECA has the power according to the law (article 20) to take any measure to remedy the situation and stop the violation.

However, we are note aware of any precedents.

European Union

434. Under article 7(1) of Regulation N° 1/2003, the Commission may impose "any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end". In addition, article 9 provides that the Commission may, where appropriate, close proceedings on the basis of commitments proposed by companies to meet its concerns in one given enforcement case. These provisions are not used so far as a basis to impose or make compliance programs binding on companies.

France

435. The French Competition Authority can impose "specific conditions" on companies found guilty of an infringement but the Authority is not imposing compliance programmes on that basis.

436. The French Competition Authority may also close proceedings on the basis of the commitments proposed by the companies concerned to address its concerns on practices likely to fall into the scope of the prohibition[157]. Such commitments have included compliance programmes in a number of cases[158].

India

437. While there is no express provision of law under which the CCI may impose the adoption of a compliance programme, the Act does vest the CCI with broad powers to "pass such order or issue such directions as the CCI may deem fit". It would therefore appear that, when an infringement is uncovered, the CCI is well within its powers to require an enterprise to adopt a compliance programme.

Israel

438. In several cases, the IAA conditioned the approval of a restrictive arrangement or a contemplated merger, by an undertaking's adoption of a compliance program in line with the MCP. This requirement was made, among others, where the IAA came to realize, during the course of its investigation, that the applicant was part to an illegal activity or where the IAA sought to diminish potential anticompetitive prospects of the joint venture for which the application was made.

439. See, for instance, CR 48/04 (AT 513/04) "ACUM" – the Composers, Authors and Publishers Society of Israel, Ltd v. the General Director, 2004 IAA Website 5000043 (approval of a collecting society approved under a condition that a compliance program in the format of the MCP will be adopted); Conditional approval of a merger between Arad Ltd and Aram *Ltd.*, 2001 IAA Website 3011974 (merger approved under the condition that the merged entity will implement a compliance program in the MCP format; Decision under Section 14 of the Law, to exempt an arrangement between the Israeli Federation of Hotels and its members, 2002, IAA Website 3015709 (approval of a joint purchasing activity subject to adopting a compliance program in the MCP format). We note, though, that such a requirement is less common in approvals granted in recent years.

Japan

440. In many cases, the adoption of a compliance program is imposed by a cease-and-desist order issued by FTC. In the cease-and-desist order, FTC's approval before the adoption of a compliance program and the report to FTC after its adoption are obligated.

Netherlands

441. The NMa has been known to close in-depth investigations in exchange for the setting up of a (industry-wide) compliance programme (for instance in the cases regarding pharmacy,

157 Article L 464-2 of the code de Commerce.

158 See, e.g., Autorité de concurrence - Décision n° 10-D-29 of the 27 september 2010.

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real-estate agents, publishers and shrimps). In addition, the drawing up of a compliance programme is often part of commitments offered in commitments proceedings.

Pakistan

442. There have been no precedents where the competition authority or courts have imposed the adoption of a compliance program on an undertaking in the case of an infringement being uncovered. Pursuant to section 31 of the Act, the Commission enjoys the power to require an undertaking to take such actions as may be necessary to restore competition and not to repeat the prohibitions specified in Chapter II of the Act or to engage in any other practice with similar effect. As such it may require an undertaking to adopt a compliance program.

Singapore

443. There have not been decisions where the CCS imposed the adoption of a compliance programme when an infringement has been uncovered.

444. However, Section 69(1) of the Act allows the CCS to issue any directions it considers appropriate to bring the infringement to an end, or to remedy, mitigate or eliminate any adverse effects. This could include imposing the adoption of a compliance programme.

South Korea

445. While the KFTC can certainly recommend that a company adopt a voluntary compliance program, it cannot under the law force a company to adopt one. There has been no precedent to our knowledge of the KFTC ever imposing a compliance program on a company.

A. Leniency

446. While Korea does have a leniency program, adopting a compliance program is not a condition to obtaining immunity or a reduction in fines.

B. Settlement

447. On November 22, 2011, the Korean National Assembly passed an amendment to the FTL introducing a "Consent Decision" system to the FTL.

448. The Consent Decision system applies in order to reach a settlement with KFTC in investigation cases involving alleged violations that are not severe, except for a cartel. The respondent in an investigation by the KFTC may propose appropriate remedial measures for recovery of consumer harm and the competitive order and the KFTC may bring a rapid conclusion to the case without making a finding of illegality, after consultations with the Prosecutor General and providing interested parties and government agencies with the opportunity to submit their opinions.

449. The main characteristics of the Consent Decision system introduced by the amendment are as follows:

→ an enterpriser or enterprisers' organization being investigated by the KFTC may submit a written application for a Consent Decision. However, the application may be withdrawn before the Consent Decision is actually issued.

→ The written application shall include (i) remedial measures necessary to recover the competitive order or improve the transactional order, and (ii) remedial measures necessary to recover or prevent harm to consumers or other enterprisers.

→ A Consent Decision does not signify that the conduct in question has been recognized as a violation of the FTL, and no one may assert that certain conduct is in violation of the FTL by reason of a Consent Decision.

→ The KFTC must provide interested parties the opportunity to submit their opinions at least 30 days prior to the date of issuance of the Consent Decision, by either individual or public notice to such parties. The KFTC must also give notice to interested government agencies and consider their opinions, and must consult with the Prosecutor General prior to issuing the Consent Decision.

→ The KFTC may impose an enforcement fine of KRW 2 million per day on persons who do not comply with a Consent Decision within a reasonable amount of time and without reasonable justification for such non-compliance, until the Consent Decision is complied with or cancelled.

→ In case of non-compliance of the Consent Decision, the KFTC may cancel the Consent Decision and resume the original investigation.

450. However, the following cases cannot be subject to a Consent Decision:

→ conduct in violation of article 19(1) of the FTL (Prohibition of Unfair Collusive Conduct);

→ conduct that meets the criteria requiring the KFTC to file a criminal complaint to the Prosecutor General as it is objectively in clear and material violation of the FTL and causes severe harm to the competitive order.

Turkey

451. There have been no precedents where the Competition Board imposed the adoption of a compliance program. There are no normative roadblocks preventing the Competition Board to make such decisions. Theoretically, the Competition Board may impose different behavioural sanctions on the infringing undertakings (one of such behavioural sanctions could be the implementation of a compliance program). Considering the fact that compliance programs drew attention only recently, it is possible to see Competition Board decisions that would impose such sanctions in the future.

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United Kingdom

452. The OFT's competition compliance guidance published for business is a suggested process and it is not mandatory for companies to follow this guidance. There is no specific statutory provision which directly states that either the OFT or the Courts have the power to impose a requirement that an infringing party must adopt a competition compliance program, as part of a range of "sanctions" that the competition authorities may impose.

United States

453. The Federal Trade Commission frequently includes compliance requirements in decrees used to resolve its actions. The Justice Department will often include compliance requirements when settling actions other than antitrust[159].

2. If a leniency program exists in your jurisdiction, please explain whether adopting a compliance program is a condition to obtain immunity/fine reductions?

In the affirmative, please notably explain:

- → *the main features of the leniency program;*
- → *the conditions applicable to such a compliance program (compliance officer, level of commitment from management, audits, hotlines, sanctions, publicity, document retention policy etc.);*
- → *whether the competition authority/agency or court will review the implementation of the program;*
- → *the consequences in case infringements are uncovered after the implementation of such programs.*

Australia

454. The ACCC operates a cartel immunity policy and cooperation policy for enforcements matters, which are intended to encourage self-reporting of cartel involvement[160].

455. The cartel immunity policy does not include a requirement that a successful applicant must have a compliance program in place, nor is it conditional upon the adoption of one by an applicant.

456. In cases where infringements are discovered subsequent to the implementation of a competition compliance program, this will not render the corporation ineligible for immunity. The prior existence, or otherwise, of a compliance program is not a factor that is taken into account when a corporation approaches the ACCC seeking leniency.

457. As mentioned above, obligations to self-report or apply for leniency are not currently a feature of compliance programs in Australia.

Brazil

458. The adoption of a compliance program is not a condition to obtain immunity/fine reduction under a leniency agreement.

459. In order to benefit from the Brazilian leniency program, the applicant must be the first to propose leniency to the SDE and the authority will accept only if it does not have enough information to carry out a potentially successful cartel investigation and prosecution. SDE shall grant a marker – valid for 30 days – in order to protect the applicant's position as the first cartel member to cooperate. The applicant shall comply with the following requirements: (a) to confess the participation in the cartel; (b) to cease and desist from the unlawful practice; (c) to declare that it was not the leader of the cartel; and (d) to agree to cooperate with the investigation. Its cooperation with the authorities shall result in the identification of the other cartel members and the gathering of documents and additional evidences. The effective cooperation after the execution of the leniency agreement will guarantee full administrative and criminal immunity to the applicant.

460. The benefit granted to qualified company shall also benefit its directors, officers and employees involved in the cartel, since they cooperate with the authorities and agree to execute the leniency agreement as well.

Canada

461. The Bureau's immunity and leniency bulletins do not address this issue.

Czech Republic

462. The implementation of the compliance guidelines is not a precondition to obtain immunity under the leniency programme.

Egypt

463. Adopting a compliance program is not a condition to obtain immunity or fine reduction.

European Union

464. Adopting a compliance programme is not a condition to obtain immunity or fine reductions under the EU leniency procedure[161].

159 Recently, in United States v. Bridgestone Corp., No. 4;11-cr-00651 (S.D. Tex. Oct. 5, 2011), a case involving both antitrust and improper payments, the agreement settling the matter contained a compliance program for improper payments, but no mention of compliance regarding antitrust.

160 See ACCC websites: http://www.accc.gov.au/content/index.phtml/itemId/879795 and http://www.accc.gov.au/content/index.phtml/itemId/459482.

161 Commission Notice on Immunity from fines and reduction in fines in cartel cases (2006).

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France

465. Adopting a compliance programme is not a condition to obtain immunity or fine reductions under the French leniency procedure[162].

India

466. The adoption of a compliance programme is not a pre-requisite for eligibility for the grant of a reduction in fines under the Lesser Penalty Regulations.

467. The Act and the rules and regulations thereunder do not presently provide for any settlement proceedings.

Israel

468. In 2005, the IAA adopted a Leniency Program, which accords a corporation, a director or an employee of a corporation an immunity from criminal prosecution in cartel cases provided, among other conditions, that the applicant was the first to move foreword, that it was not the leader of the alleged cartel, that it provided the IAA with complete information before the investigation was made public and fully cooperated with the investigation, and that it had ceased its involvement in the cartel (under the IAA's guidance). See An Immunity Program for Antitrust Offences, 2005 IAA Website 5000097.

469. The Immunity Program does not require the adoption of a compliance program as a pre-condition for the immunity. Moreover, the adoption of a compliance program when an investigation is active or expected, may raise potential obstruction of justice issues and requires prior consultation with a local antitrust expert.

Japan

470. A leniency program exists in Japan, but adopting compliance program is not required for reduction and exemption in leniency program.

471. If the violator who conducted a cartel applies for the leniency program, the surcharge imposed by FTC is reduced or exempted.

472. Only five violators can apply for it in one cartel case (the number of the violators who apply for it after the investigation of FTC is up to three). In the event that a violator applies for it primarily before the investigation of FTC, its surcharge is exempted. The surcharge of the second applicant before the investigation of FTC is reduced by 50%. The surcharge of rest applicant is reduced by 30%.

473. However, it is required to cease violation by the date of the investigation of FTC for application of the leniency program

474. They do not review the implementation of the compliance program because it is not required in the leniency program.

475. However, if the infringements of the applicant for the leniency program are uncovered after the investigation of FTC, such applicant is disqualified at the leniency program.

Netherlands

476. The adoption of a compliance programme is not a condition laid down in the NMa's leniency guidelines. The guidelines do, however, state that a leniency applicant should immediately terminate its involvement in the cartel, unless otherwise agreed with the NMa's Leniency Office.

Pakistan

477. As discussed earlier above, the adoption of a voluntary compliance program by an undertaking is one of the mitigating factors according to the fining guidelines released by the Commission when assessing penalties in cases of infringements.

478. There is a leniency program that exists in the jurisdiction of Pakistan called "The Competition (Leniency) Regulations, 2007" ("Leniency Regulations"). However there is no mentioning of the adoption of a compliance program being a condition to obtain immunity/fine reductions. Nevertheless, the main features of the leniency program are as follows:

479. Total immunity from financial penalties possible if:

- → The Undertaking is the first to provide the Commission with evidence of any activity leading to violations of the competition laws, provided that the Commission does not already have sufficient information to establish the existence of the alleged activity.
- → The undertaking provides the commission with all information, documents and evidence available to it regarding the prohibited activity.
- → Maintains complete cooperation throughout the proceedings
- → Refrains from further participation in the alleged activity from the time of its disclosure to the commission
- → Must not have taken steps to incite another undertaking to take part in any of the activities in question.

480. Regulation 4 of the Leniency Regulations, deals with the reduction of penalty and provides:

481. "4. Grant of reduction in the amount of penalty.–

(1) An undertaking may benefit from a reduction in the financial penalty of up to 100% if:

162 Communiqué de procédure du 2 mars 2009 relatif au programme de clémence français, available at: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=260&id_article=1296.

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→ the undertaking seeking reduction is the first to provide the Commission with independent, additional or corroborating or contemporaneous evidence of any of the activities prohibited under Chapter II of the Ordinance; and

→ this information is given to the Commission:

→ prior to issuance of a show cause notice under section 30 of the Ordinance; or

→ after initiation of proceedings under Section 30 of the Ordinance but before the Commission has passed any Order under Section 31 of the Ordinance confirming infringement and violation under Chapter-II;

(2) An undertaking may benefit from a reduction in the financial penalty up to 85% if:

→ the applicant undertaking gives information to the Commission prior to the conclusion of the proceedings before the Appellate Bench of the Commission or prior to participation in proceedings before the Supreme Court where the original order is passed by two or more Members/ or prior to recovery of the penalty imposed upon passing of the original order by single Member (where no appeal is preferred) under the Ordinance; and

→ the applicant undertaking submits additional evidence previously unknown to the Commission which represents significant added value with respect to the evidence already in Commission's possession thus further substantiating the infringement under the Ordinance.

(3) Any application for leniency under these Regulations shall be entertained subject to the conditions imposed by the Commission including that the applicant shall: (a) admit infringement of the offence unconditionally, b) abandon its participation in any prohibited activity forthwith and c) makes full and true disclosure.

(4) Any reduction in the level of the financial penalty under these circumstances is discretionary. In exercising this discretion, the Commission will take into account:

→ the stage at which the undertaking comes forward;

→ the evidence already in the Commission's possession; and/or relied upon by the Commission; and

→ the quality and nature of the information provided by the undertaking.

482. Provided further that the undertaking cooperates genuinely, fully and on a continuous basis from time it submits its application throughout the Commission's administrative procedure".

Singapore

483. Adopting a compliance program is not a condition to obtain immunity or reductions in fines within the CCS's leniency programme.

484. The CCS will grant an undertaking the benefit of total immunity from financial penalties if all of the following conditions are satisfied:

(a) The undertaking is the first to provide the CCS with evidence of the cartel activity before an investigation has commenced, provided that the CCS does not already have sufficient information to establish the existence of the alleged cartel activity; and

(b) The undertaking:

→ Provides the CCS with all the information, documents and evidence available to it regarding the cartel activity;

→ Maintains continuous and complete co-operation throughout the investigation and until the conclusion of any action by the CCS arising as a result of the investigation;

→ Refrains from further participation in the cartel activity from the time of disclosure of the cartel activity to the CCS (except as may be directed by the CCS);

→ Must not have been the one to initiate the cartel; and

→ Must not have taken any steps to coerce another undertaking to take part in the cartel activity.

485. The CCS will also take into account:

(a) The stage at which the undertaking comes forward;

(b) The evidence already in the CCS' possession; and

(c) The quality of the information provided by the undertaking.

486. The CCS has also introduced a leniency plus programme. Here, an undertaking co-operating with an investigation by the CCS in relation to cartel activity in one market may also be involved in a completely separate cartel activity in another market, which also infringes the Section 34 prohibition.

487. To qualify for leniency plus, the CCS would have to be satisfied that:

(a) The evidence provided by the undertaking relates to a completely separate cartel activity. The fact that the activity is in a separate market is a good indicator, but not always decisive; and

(b) The undertaking would qualify for total immunity from financial penalties in relation to its activities in the second market.

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488. If the CCS is satisfied with the above, then the undertaking would receive a further reduction in the financial penalties imposed on it in relation to the first market, which is additional to the reduction which it would have received for its co-operation in the first market alone.

489. Such information must be sufficient to allow the CCS to exercise its formal powers of investigation or genuinely advances the investigation.

490. The CCS will grant an undertaking which provides evidence of cartel activity but is not the first to come forward a reduction of up to 50 percent in the level of financial penalties. Aside the fact that the undertaking has to come forward before the CCS issues a written notice of its intention to make a decision, the undertaking has to satisfy the criteria above.

491. The CCS will not review the implementation of the programme.

492. As mentioned above, in question 3.3, the commitment of an infringement after the adoption of a voluntary compliance program is not considered by the CCS to be an aggravating or mitigating circumstance.

South Korea

493. Adopting a compliance program is not a condition to entering into a Consent Decision.

Turkey

494. The implementation of the compliance program is not a condition to obtain immunity or fine reduction under Turkish Law.

United Kingdom

495. There is no requirement for the company to adopt a compliance programme in order to benefit from the leniency programme.

496. The OFT operates a leniency programme whereby a company may obtain total immunity from a fine if it is the first company to inform the OFT of a cartel's existence (type A immunity), and to provide it with significant evidence of the cartel's operation.

497. In order to benefit from the OFT's type A immunity under its leniency programme, the conditions which a company must satisfy are:

- provide the OFT with all information available to it regarding the cartel activity;
- maintain continuous and complete co-operation with the OFT throughout the investigation;
- refrain from further participation in the cartel (unless otherwise directed by the OFT); and
- not have taken steps to coerce another undertaking to take part in the cartel.

498. A company may also receive a reduction in fine (but not immunity) if it is not the first company to come forward, but as the "second mover" it is still able to provide the OFT with substantial and new evidence in relation to the cartel.

499. Where a company has applied for leniency, the OFT's focus will be on the leniency applicant complying with the requirements of the four conditions above, rather than the implementation of a compliance programme.

500. As regards uncovering further infringements, compliance programmes are not a condition of leniency applications in the UK, and any consequences would not, strictly speaking, arise after the implementation of a compliance programme. Instead, the consequences would potentially flow from breaching the OFT's requirement to refrain from further participation in the cartel (condition three in the four bullet-points above).

United States

501. As noted above, the leniency program of the Department of Justice does not contain a compliance requirement. The leniency program of the Sentencing Commission does contain a compliance requirement, but is not currently applied to antitrust. Compliance requirements are frequently found in consent decrees with the Federal Trade Commission.

3. If settlement proceedings are available in your jurisdiction, please explain whether adopting a compliance program is a condition?

In the affirmative, please notably explain:

- *the main features of the settlement procedure;*
- *the conditions applicable to such a compliance program (compliance officer, level of commitment from management, audits, hotlines, sanctions, publicity etc.);*
- *whether the competition authority/agency or court will review the implementation of the program;*
- *the consequences in case infringements are uncovered after the implementation of such programs.*

Australia

502. A negotiated settlement between the ACCC and a contravening party is generally not conditional upon implementation of a compliance program by the contravening

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corporation. Rather, settlement tends to be dependent on the level of cooperation offered by the contravening party and the parties' ability to reach a statement of agreed facts and a proposal as to the penalty to jointly submit to the Federal Court.

503. However, the ACCC will often request the contravening corporation to provide a court-enforceable 87B undertaking setting out the improvements it will make to its existing compliance program. Where this is the case, the parties usually ask the Court to take note of the compliance undertaking in its decision, although this does not amount to an order by the Federal Court.

Brazil

504. The implementation of a compliance program is not a condition to request a Settlement with CADE. However, CADE may require the company to adopt a compliance program in order to negotiate a Settlement, as per the article 129-A, item III, of CADE's Internal Rules, and Brazilian case law. It is important to emphasize that, due to the enactment of the New Antitrust Law, the current CADE's Internal Rules shall be replaced by a new version.

505. The Settlement under the New Antitrust Law is not significantly differ from the Antitrust Law provisions. The Settlement must contain: (i) specification of the obligations of the defendants in order to cease the anticompetitive practice; (ii) determination of the penalty in case of non-compliance with the obligations set forth in the Settlement; and (iii) the value of the pecuniary contribution to the Collective Rights Defense Fund, if applicable (provided that, in case of cartel formation, this pecuniary contribution is obligatory). The Settlement can only be proposed once by the undertakings. If there was leniency in the case, CADE's Internal Rules impose the obligation to plea guilty in order to reach a Settlement. If there was no leniency, CADE will decide the convenience of the guilty plea requirement for a Settlement.

506. There is no pre-established conditions to such compliance program. However, in a previous occasion[163], CADE requested: (i) appointment of an officer to be in charge of the enforcement and supervision of the antitrust compliance program; (iii) periodic reports regarding the enforcement of the compliance program; (iv) compliance training for employees, managers, officers and directors; (v) a hotline to report anticompetitive practices; and (vi) identification of the prohibited practices and the people or department that are more susceptible to commit them.

507. CADE's Attorney Office periodically verifies if the undertakings are complying with the conditions of the Settlement. If it finds that the company is breaching the Settlement, CADE will revoke it and restart the administrative proceeding. Therefore, CADE may periodically verify if the company is duly enforcing its compliance program and, if it considers that the program is ineffective, it may declare the breach of the Settlement. It is important to emphasize that the Settlement obligatorily sets forth a fine for non-compliance of its conditions. Therefore, besides the restart of the proceeding, the company will also bear an administrative fine.

508. In case the company does not cease the anticompetitive practice that was subject to the Settlement, CADE will revoke the Settlement, restart the administrative proceeding and impose a fine for the non-compliance of the Settlement. In this case, the breach of the Settlement will have more relevance to CADE's judgment than the breaching event (ineffectiveness of the compliance program, which was a condition set forth in the Settlement).

509. If the company engages in another anticompetitive practice, in addition to the practice that was subject to Settlement, it shall face difficulties in trying to qualify for another Settlement.

Canada

510. In Canada, there is no formal settlement proceedings; in criminal matters, it is however possible to enter into a plea agreement with the DPP. Such agreement must be sanctioned by the court and may include, for example, a recommendation for the issuance of a prohibition order and, sometimes, an undertaking by the parties in relation to the implementation of a compliance program.

Czech Republic

511. The adoption of a compliance programme is not a condition for entering into settlement procedure.

Egypt

512. There exist settlement proceedings in the Law. However, there is no stipulation in the Law that adopting a compliance program is a condition to settle with the person in breach.

513. In order to settle, the person in breach has to pay a fine ranging between double the minimum and maximum limits of the fine provided for in the Law. The Competent Minister is to decide the amount of settlement (this power has been delegated in November 2011 to the chairperson of ECA).

European Union

514. Adopting a compliance programme is neither a condition to enter a settlement nor to obtain a fine reduction under this procedure[164].

163 Settlement in administrative proceeding No. 08012.005328/2009-31.

164 Regulation N°622/2008 and Commission Notice on the conduct of settlement procedures (2008).

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France

515. Adopting a compliance programme is not a condition to enter into a settlement with the Authority under the procedure of "non contestation des griefs" but such a commitment is likely to maximize the reduction in fine which may be obtained on that basis.

516. The "non-contestation des griefs" procedure is laid down in article L464-2 III of the code de commerce and the French Authority has recently provided detailed guidance in that respect[165].

517. Under this procedure, companies receiving a statement of objections may decide not to discuss or challenge these objections, in which case the maximum fine incurred is reduced from 10 to 5% and the Authority can give a reduction of fine up to 10%. If, in addition, the company commits to adopt a compliance programme, an additional reduction of up to 10% can be applied. Other kind of remedies may also be proposed for a reduction up to 5%. As a result, the maximum fine reduction which is available is of 25%.

518. In case such a commitment is given to the Authority and the company is later found to have participated to a new infringement, the Authority could impose a fine for violation of the commitment[166].

India

519. The Act and the rules and regulations thereunder do not presently provide for any settlement proceedings.

Israel

520. The adoption of a compliance program is not a formal precondition to a settlement with the IAA, but such a requirement was part of past settlements. It is less common in settlements made in recent years.

Japan

521. Settlement proceedings are not established in the administrative procedures and the criminal procedures. In the civil procedures, settlement proceedings are often implemented but adopting a compliance program is not a condition.

522. The settlement in the civil procedures is conducted in the extrajudicial consultation or in the judicial consultation with judges.

Netherlands

523. It is possible to negotiate a settlement with the NMa. This may result in the NMa closing its investigation in exchange for appropriate measures, either informally by way of a "non-sanction" decision or formally through the commitments procedure. The drawing up of a compliance programme is often part of commitments offered in commitment proceedings. If the undertaking fails to comply with the commitment, the NMa can – without further investigation – impose a fine amounting to the higher of 10 per cent of turnover or EUR 450,000. It can also decide to reopen its investigations.

Pakistan

524. The settlement proceedings are not available in our jurisdiction

Singapore

525. Settlement proceedings are not available in a formal sense in Singapore. Only an application for leniency is available in Singapore.

South Korea

526. Adopting a compliance program is not a condition to entering into a Consent Decision.

Turkey

527. Adopting a compliance program is not a condition to obtain immunity/fine reductions in leniency applications in Turkey.

United Kingdom

528. There is no condition requiring that a party must already have in place a competition compliance programme, before entering into settlement discussions with the OFT, in relation to any potential competition infringement under consideration.

529. No detailed rules exist on settlement discussions with the OFT. The OFT enters into early resolution or settlement discussions at its discretion and on a case-by-case basis, and would most likely do so where the OFT considers that the evidential standard for an infringement has been met. Settlement negotiations are generally without prejudice and by their nature are non-prescriptive in process.

530. In March 2011, the OFT provided general principles in its revised guidance on investigation procedures[167]. This guidance states that entering into an early resolution or

165 Communiqué de procédure relatif à la non-contestation des griefs, of 10 February 2012, available at: http://www.autoritedelaconcurrence.fr/doc/communique_ncg_10fevrier2012.pdf.

166 Article L 464-3 of the Code de Commerce and Framework-Document of 10 February 2012, para. 26.

167 See OFT Guidance 1263: "A guide to the OFT's investigation procedures in competition cases", (march 2011).

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settlement process may apply where the company under investigation admits to infringing competition law and subsequently cooperates with the OFT's investigation. In return the OFT will reduce the penalty it imposes on the infringing company.

531. The OFT guidance does not state whether an undertaking to implement or update an existing compliance programme will be taken into account by the OFT during the course of any settlement discussions, nor whether the OFT will monitor or review the implementation of a compliance programme. To the extent that a compliance programme were to be considered at all, it is likely to be treated as ancillary to other conduct remedying the infringement.

United States

532. As noted above, compliance programs are a frequent component of settlement agreements of the FTC and other government agencies, but not the Antitrust Division of the Department of Justice.

533. The provisions of the compliance programs vary widely depending on the agency and laws involved. In general, they do track the requirements of the Sentencing Guidelines. In some cases, the agency may appoint a monitor to oversee the implementation of the compliance program[168].

4. Please detail any other procedural framework in which compliance programs may be submitted to the competition authority/agency or court (such as closure of proceedings when a company proposes remedies in non cartel cases)

Australia

534. These processes are described in detail above.

Brazil

535. The undertakings can submit a compliance program to CADE in case of a Settlement proposal, as mentioned above.

Canada

536. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

Czech Republic

537. There is no specific procedure for submitting the compliance guidelines to the Office; however, the companies may submit their compliance programme to the Office within the competition advocacy.

Egypt

538. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

European Union

539. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

France

540. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

India

541. The Act does not contain specific framework for submission of compliance programmes to the CCI. However, there is nothing in the Act that precludes a party from including a compliance programme in submissions filed before the CCI, whether it be proceedings in an abuse of dominance case or while filing for pre-approval in a merger. The parties may voluntarily agree to adopt a draft compliance programme as a measure to mitigate any competition concerns.

542. However, there is no instance of this being done in practice thus far and this has not been borne out in orders or practice.

Israel

543. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

Japan

544. There is no other procedure in which compliance programs are submitted to FTC or court.

Netherlands

545. Please see the answer above.

168 See, e.g., In re Coca-Cola Co., FTC File No. 101-0107 (sept. 27, 2010).

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Pakistan

546. No such information is available

Singapore

547. The above is not applicable.

South Korea

548. The procedure is described above.

Turkey

549. There is no settlement procedure in Turkey.

United Kingdom

550. There are three other forms of procedural frameworks relevant to this question: merger remedies, market investigations and abuse of dominance cases.

Compliance with Merger Remedies

551. Compliance monitoring outside of cartel cases may take place in the context of merger remedies, which may be agreed by the parties with the OFT or the Competition Commission ("the CC"). Such merger remedies can take the form of either divestitures of parts of the business or behavioural remedies and are designed to remedy, mitigate or prevent a substantial lessening of competition ("SLC") and adverse effects resulting from a merger.

552. The CC provides guidance in its Merger Remedies guidelines[169]. The CC guidelines explain that monitoring of merger remedies is designed to facilitate the proper compliance and on-going implementation of the remedies suggested by the CC, which may be required before a merger clearance is approved. Although there are no rules as to the types of conditions that are applicable to either divestments or to other remedies, generally structural remedies will provide that a disposal takes place within a specified and reasonable timeframe. The CC is not prescriptive about divestments but normally these divestments take place within six months. It is also normal for the OFT or the CC to approve the purchaser.

553. The CC's guidelines explain that the Enterprise Act requires that the CC, when considering these remedial actions, shall "in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it". To fulfil this requirement, the CC will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will then select the least costly and intrusive remedy that it considers to be effective.

554. Where divestiture undertakings are in place, the CC will normally require the appointment of an independent monitoring trustee to oversee the parties' compliance with the undertakings[170]. The trustee will report to the CC at regular intervals. The trustee's overall duty is to act in the best interests of securing an appropriate divestiture. The trustee will monitor the ongoing management of the divestiture package and the conduct of the process. The CC will have the right to propose and direct measures necessary to ensure compliance with the undertakings.

Compliance with Undertakings and Orders in Market Investigations

555. Where the OFT has referred a market to the CC, the CC will then investigate that market for up to two years. The CC's final report may identify an adverse effect on competition which it is then obliged to remedy, mitigate or prevent. The CC can do so via enforcement orders or undertakings. Under section 162 of the Enterprise Act 2002, the OFT is obliged to monitor compliance with these undertakings and orders and to determine whether they are no longer appropriate and need to be varied or revoked. The OFT is also obliged to monitor the effectiveness of these undertakings and orders and report back to the CC or the Secretary of State. Under section 167 of the Enterprise Act 2002, the OFT has the power to enforce undertakings or orders via civil proceedings where they are breached. Any person affected by a breach may also bring an action for damages.

Compliance with Commitments in Dominance Cases

556. In certain circumstances, the OFT may be prepared to accept structural or behavioural commitments to resolve a case involving allegations of an abuse of a dominant position. However, the OFT has clearly stated that it will not accept binding commitments in cases involving a "serious abuse" of a dominant position. The OFT will use its discretion on a case by case basis to determine the seriousness of an abuse but in general it will treat predatory pricing as a "serious abuse". In addition, the OFT will not accept binding commitments in circumstances:

- → where compliance with and the effectiveness of any binding commitments would be difficult to discern, and/or
- → where the OFT considers that not to complete its investigation and make a decision would undermine deterrence[171].

557. Once the OFT has accepted any binding commitments, the OFT can respond to any breach of them by requiring compliance via a court order. Any failure to comply with the court order will be treated as contempt of court, penalised by imprisonment or fines[172].

169 "Merger Remedies: Competition Commission Guidelines"(november 2008).

170 *Op. cit.*, footnote 28; para 3.23.

171 OFT 407, December 2004: Enforcement: Incorporating the Office of Fair Trading's guidance as to the circumstances in which it may be appropriate to accept commitments. See paragraphs 4.4. and 4.5. on page 12. See also OFT Guidance 1263: "A guide to the OFT's investigation procedures in competition cases", (march 2011): paragraph 10.17, page 54.

172 OFT 407, december 2004: see paragraph 4.28, page 17 and paragraph 2.9, pages 5/6.

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United States

558. There is no other procedural framework in which compliance programmes are explicitly mentioned as possible or necessary steps to be taken.

V. Lack of any compliance program

In your jurisdiction, are there risks not entering into compliance programs for companies/trade associations which have already been involved in enforcement actions aside from the risks of violations?

Australia

559. It is rare that, following enforcement action, a corporation would not implement a compliance program. Typically, the ACCC would require implementation of such measures, either through an 87B undertaking or by seeking the appropriate orders from the Federal Court.

560. However, if a corporation was to fail to comply with the terms of its 87B undertaking, then the ACCC may apply to the Federal Court for orders requiring the corporation to comply. In doing so, the ACCC is not required to prove that the failure was deliberate, although this may be a relevant consideration for the Federal Court in deciding what orders to make.

561. In the absence of a compliance program following a further infringement, it is unlikely that the contravening corporation will be considered to have a culture of compliance, a fact which would be taken into account by the Court, as would the fact that there has been a subsequent "repeat" infringement by the company, when determining the penalty to be imposed.

Brazil

562. No, there is no explicit risk based on the Antitrust Law or CADE case law. However, enter into compliance programs is a positive decision for companies/trade associations which have already been involved in enforcement actions in order to prove they seriously seek to comply the antitrust provisions and avoid new violations.

Canada

563. In Canada, in a situation where a company or a trade association has been involved in enforcement actions by the Bureau, the prohibition order against that party, or the consent agreement entered into between the Commissioner and the party, will generally require that the other party implement a compliance program. In such case, if the company or trade association does not implement the required compliance program, it will be in breach of the order and would likely be subject to further enforcement action by the Bureau.

Czech Republic

564. There is no risk connected with non-entry into the compliance programme for undertakings which have already been sanctioned.

Egypt

565. Egyptian Competition Law does not provide for any penalty for not entering into a compliance program.

European Union

566. No provision explicitly refers to the risks of not having a compliance program for companies which have already been involved in enforcement actions. However, as mentioned above, the European Commission enjoys a broad margin of discretion in determining the aggravating factor to be applied in cases of repeated offences as well as in order to ensure a sufficient deterrent effect to fines. A company involved in prior enforcement actions which has not taken any step to ensure compliance with competition rules could therefore face higher fines.

France

567. No provision explicitly refers to the risks of not having a compliance program for companies which have already been involved in enforcement actions. However, the French Authority enjoys a broad margin of discretion in determining the aggravating factor to be applied in cases of repeated offences and might notably consider that the very existence of a repeated infringement attests that the previous finding of infringement and the financial penalty that may have been attached to it have not proved sufficient to drive the undertaking towards compliance with competition rules[173]. A company involved in prior enforcement actions which has not taken any steps to ensure compliance with competition rules could therefore face higher fines.

India

568. Given the limited precedence and development of jurisprudence, it is not possible to comment on or evaluate the risk of not entering into compliance programmes at present. It is however recommended that a sound competition compliance programme be adopted by any enterprise that has been involved in enforcement actions.

Israel

569. This matter was never directly discussed in Israeli case law. In general, past convictions are an aggravating circumstance. This aggravating circumstance may be mitigated by the adoption of a compliance program by the alleged repeated offender.

173 See the Communiqué de procédure relatif à la méthode de détermination des sanctions pécuniaires of 16 May 2011 available at: http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=260&id_article=1601.

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Japan

570. In the event that the company received the cease-and-desist order which requests to establish compliance program, it deem violation of such an order unless establishing requested compliance program. In such a case, the company is likely to be punished by fine of not more than JPY three hundred million and the offender of the company is likely to be punished by imprisonment with work for not more than two years or by a fine of not more than three million yen.

Netherlands

571. First of all, we note that (given the absence of any formal or informal rules on compliance programmes), there are no rules sanctioning the failure to adopt a compliance programme subsequent to having been subjected to enforcement actions. Neither are there any precedents in the Netherlands on which to rely for guidance in respect of this question. Obviously, there are risks if the adoption of a compliance programme was part of previous commitments agreed with the NMa, or of a settlement. In theory – depending on the circumstances of the case – it is also conceivable that the NMa would consider the failure to enter into a compliance programme an aggravating factor in determining a fine for a "repeat offender".

Pakistan

572. The adoption of a compliance program by an undertaking remains a voluntary exercise. However there are additional penalties for undertakings who are involved in continuous violations of the competition laws.

Singapore

573. There are no direct risks of not entering into compliance programmes for companies/trade associations which have already been involved in enforcement actions.

574. However, the practical effect of a lack of compliance programmes is the risk of repeated infringements. Repeated infringements by the same undertaking would be an aggravating factor in assessing the amount of financial penalty imposed.

South Korea

575. In Korea, there is no appreciable risk in not entering into a compliance program for companies/trade associations which have already been involved in enforcement actions.

Turkey

576. The case law does not suggest the existence of standalone risks associated with not adopting a compliance program.

United Kingdom

577. The OFT has not established any specific rules in relation to companies / trade associations that have repeatedly infringed competition law and have failed to implement a compliance programme, although there is a risk that it would comment adversely in any decision finding an infringement. The key risk that a company / trade association would face from not implementing a compliance programme is that the entity may inadvertently commit further competition law infringements. Committing more than one competition law infringement has a substantial impact on the penalty imposed by the OFT for the infringement.

578. The OFT has a wide discretion to increase a company's penalty for infringements by up to 100% if the company has previously breached competition law[174]. It is likely that the OFT would increase a recidivist company's penalty by a high percentage if it had not attempted to prevent a further breach, i.e. by failing to implement a compliance programme. The company would also lose the opportunity to gain a 10% reduction in its fine for taking adequate steps to comply with competition law.

579. The increase in the likelihood of breaching competition law and the potentially substantial increase in the level of fine for doing so are therefore the key risks of not implementing a compliance programme following an initial breach of competition law. In addition, by not reforming its corporate culture to avoid future such infringements, the company would have unnecessarily deprived itself of the opportunity to be the first cartelist to seek leniency from the OFT and thereby forfeit full immunity.

580. Further, a failure by the directors to introduce a proper compliance programme even after the company has been subject to enforcement actions might be regarded as a breach of their fiduciary duties to the company and / or negligence by its shareholders. Those shareholders might seek legal advice as to whether they could bring an action against those directors, which could prove to be costly for all those involved.

United States

581. Prosecutors in areas other than antitrust have used the lack of a compliance program, or the reduction of assets devoted to compliance, as evidence of intent to violate the law[175].

174 OFT Draft Guidance as to the appropriate amount of a penalty, October 2011. See paragraph 1.17, page 7, paragraph 5.40, page 41, and paragraph 5.46, page 43, at http://oft.gov.uk/shared_oft/consultations/oft423con.pdf.

175 See, e.g., United States v. Merck-Medco Managed Care, Case No. 00-CV-737, complaint (E.D. Pa. Sept. 29, 2003).

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VI. Compliance programs in other fields

In your jurisdiction, are you aware of more proactive policies towards compliance programs (i.e. anti-bribery, environment etc.).

Australia

582. In Australia, the standards-setting organisation, Standards Australia, has published Australian Standard, *AS 3806-1998 Compliance Programs*, which sets out the principles for the development, implementation and maintenance of effective compliance programs in both public and private organisations, across all sectors of the economy. The principles contained within *AS 3806-1998* are designed to enable organisations to identify and remedy any deficiencies in their compliance with laws, regulations and codes and develop processes for continual improvement in this area[176]. However, there is no legal obligation to comply with the Standard.

583. The Australasian Compliance Institute is also active in the promulgation of compliance. It is the principle association for compliance professionals in Australia and is involved in the ongoing training and accreditation of professionals working across a wide range of compliance fields in Australia. It is also active in making submissions to Australian regulators regarding changes to regulations or laws which affect corporate compliance in Australia.

Brazil

584. Brazil has proactive policies towards compliance programs regarding environmental and corporate law. Although the Brazilian governmental authorities do not issue guidelines, the companies have developed compliance programs in order to enhance their reputation and market value.

Canada

585. No mechanism such as fine reduction has been implemented so far in case of application of compliance program.

Czech Republic

586. Even if the compliance programme is not mandatory, many companies, especially those listed in various stock exchanges, implement not only the competition compliance programme but also compliance programmes focused on anti-bribery, data protection or the environment.

176 See Standards Australia website: http://infostore.saiglobal.com/Store2/Details.aspx?productID=304428.

Egypt

587. Consumer protection, there was a campaign led by the Consumer Protection Authority for compliance with the provisions of the Consumer Protection Law in 2009/2010.

588. Anti bribery, there is an anti bribery committee that was established in 2010 following Egypt's ratification of the UN Convention on Combating Corruption.

589. Income Tax compliance program, which was adopted after the promulgation of the income tax law No. 91 of 2005.

European Union

590. Compliance programmes exist in other fields than competition law. However, we are not aware of similar incentive mechanism providing as fine reduction so far in case of adoption and implementation of a compliance program.

France

591. Compliance programmes exist in other fields than competition law. However, we are not aware of similar incentive mechanism providing as fine reduction so far in case of adoption and implementation of a compliance program.

India

592. Companies in India do frame and implement compliance programmes to ensure compliance with anti-bribery laws, labour laws and tax laws. Companies also adopt programmes to ensure general corporate governance as well as adherence of the listing agreement, where applicable.

593. At the moment, the importance and awareness of compliance is increasing amongst Indian companies, but have not fully developed.

Israel

594. Israeli corporations adopt compliance programs in many areas including sexual harassment, environment regulation, anti-bribery and safety.

595. A relatively new area of compliance, which develops rapidly, is compliance with Securities Law regulations. This is of special interest, because of the clear similarities to antitrust compliance program.

596. Israeli Securities Law, 1968 (the "Securities Law") was amended recently, and the Israeli Securities Authority (the "ISA") was accorded with powers to impose significant administrative sanctions (mostly monetary payments) on individuals, unless they can prove they had taken all reasonable measures to prevent Securities Law violations. This defense is very similar to the one afforded to senior management under the Antitrust Law.

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597. Like the IAA – the ISA published a Model Compliance Program, announced that adoption of this program would be a relevant factor in its decision whether to choose criminal or administrative measures, and explained that it may serve as a safe harbor for senior management against possible criminal and administrative sanctions for their indirect liability under the Securities Law.

Japan

598. Some companies in Japan adopt other compliance programs related to an anti-bribery, environment, management of information (including personal information), industry laws applicable to the companies, etc.

Netherlands

599. No mechanism such as fine reduction has been implemented so far in case of application of compliance program.

Pakistan

600. There are no as such proactive policies towards compliance programs in Pakistan. Various companies in the country do follow certain compliance codes in the working of their businesses but the adoption and implementation of any compliance program is voluntary. Major institutions of the economy like the State Bank of Pakistan, Securities and Exchange Commission of Pakistan, Pakistan Environmental Protection Company etc, stress for compliance to the relevant laws and rules and regulations to the companies in the market but there are no as such proactive policies seen towards drafting of specific compliance programs for companies.

Singapore

601. In Singapore, proactive policies towards compliance programmes present in certain industries and sectors.

602. With respect to anti-bribery, while compliance programme are not per se advocated by the Corrupt Practices Investigation Bureau ("CPIB"), strict laws against public officers who take bribes would encourage public bodies to pro-actively initiate compliance programs. Hence, it is common to find these as part of employment or ethics handbooks.

603. For example, section 8 of the Prevention Of Corruption Act (Cap. 241) ("PCA") states that any gratification given or received by a public officer is presumed to be a bribe and is therefore punishable. Punishments are also harsh, with Section 13 providing that offenders may have to pay a penalty equal to the amount of bribe received apart from punishment in the form of fines and/or imprisonment term.

604. The CPIB has also recommended preventive measures as well as a list of dos and don'ts relating to anti-bribery. This would guide public bodies in shaping their compliance programmes to ensure that activities which breach the PCA do not occur. These measures and the list of dos and don'ts can be seen from the following link on CPIB's website: http://app.cpib.gov.sg/cpib_new/user/default.aspx?pgID=167.

605. There have also been proactive policies toward compliance programmes with respect to matters pertaining to the environment, such as clean air, clean water and hazardous materials. For example, Section 20 of the Environmental Protection And Management (Hazardous Substances) Regulations states that every person authorised to store hazardous substances shall ensure that his agents and employees have received adequate instruction and training to enable them to understand the nature of the dangers of all the hazardous substances being stored, as well as an emergency action plan to be implemented in the event of any accident or emergency. A compliance program would thus be appropriate to educate one's employees regarding the dos and don'ts of storing hazardous materials.

606. Singapore has also taken steps to encourage compliance in its anti-money laundering and combating the financing of terrorism regimes ("AML/CFT"). Singapore's main legislations are the Corruption, Drug Trafficking And Other Serious Crimes (Confiscation Of Benefits) Act Cap. 65A ("CDSA") and the Terrorism (Suppression of Financing) Act Cap. 325 ("TSFA"). Soft laws (for banks and financial institutions) consist of notices and regulations issued by the Monetary Authority of Singapore ("MAS"), such as the Monetary Authority of Singapore (Anti-Terrorism measures) Regulations 2002 as well as the Notice to Banks on Prevention of Money Laundering and Countering the Financing of Terrorism [MAS Notice 626] ("MAS Notice"). Soft laws also exist for some professions, such as lawyers.

607. As Singapore adopts a risk-based approach to customer due diligence ("CDD"), it means that banks must implement a prescribed minimum level of checks to be carried out according to the money laundering risk posed by the customer in question. Similar requirement exists for other financial institutions as well as certain professions, such as law firms.

608. There is also an internal export control compliance programme present for the Strategic Trade Scheme ("STS") within the Singapore Customs. Such a compliance programme is necessary to obtain permits for traders who export or import strategic goods or weapons and their related technology. The assessment criteria for the compliance programme is seen in the STS handbook present in the Singapore Customs website.

609. A final example can be in the national good laboratory practice compliance programme, which reviews a research laboratory's process and conditions in which its non-clinical studies are planned, performed, monitored, recorded, reported and archived. The system can be applied to the risk assessment of chemicals for registration of products. The basic document dealing with the GLP is the Organisation for Economic Co-operation and Development ("OECD") Principles of Good Laboratory Practice, which is produced by the OECD GLP Working Group.

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Turkey

611. The Regulation on Compliance Programs for Anti-money Laundering and Combating the Financing of Terrorism[177]:

611. The objective of this regulation, for the implementation of Law No. 5549 on Prevention of Laundering Proceeds of Crime dated October 11, 2006, is to regulate principles and procedures regarding establishment of compliance programs and assignment of compliance officers by obliged parties for the purpose of anti-money laundering and combating the financing of terrorism. The compliance program to be established, on a risk based approach for the purpose of ensuring the required compliance with the law and regulations and communiqués issued in accordance with the law, shall cover the following measures in order to prevent laundering proceeds of crime and financing of terrorism:

a) Developing institutional policy and procedures,

b) Carrying out risk management activities,

c) Carrying out monitoring and controlling activities,

d) Assigning compliance officer and establishing the compliance unit,

e) Carrying out training activities,

f) Carrying out internal control activities.

United Kingdom

612. In the area of financial and corporate crime, the UK has a number of regimes which should lead to a more pro-active approach towards wider compliance programmes.

613. Under the UK Bribery Act 2010 (which came into force on 1 July 2011), the only defence available to a commercial organisation charged with the corporate offence of failing to prevent bribery (which is punishable by an unlimited fine), is demonstrating that it had adequate procedures in place to prevent bribery. This coupled with the fact the absence of anti-bribery procedures may increase the risk that personnel may have (inadvertently) committed other bribery offences (which could lead to a prison sentence of up to 10 years and/or an unlimited fine for the individual) has led to greater awareness and increased pro-activity in anti-bribery compliance programmes (although a significant number of companies have yet to adequately address this area).

614. Those businesses which are within the scope of the Money Laundering Regulations 2007, are required to establish and maintain appropriate and risk-sensitive policies and procedures relating to matters such as customer due diligence. This requires such businesses to have pro-active policies and compliance programmes in this area. In addition, firms supervised by the UK Financial Services Authority are subject to an overarching requirement to have effective systems and controls to counter the risk that the firm might be used for the purposes of financial crime.

615. It should be possible to integrate such policies as part of a business's overall compliance programme. In this regard, we note that paragraph 1.7 of the OFT's detailed guidance (OFT1341) states that "competition law compliance can sit comfortably and be addressed in an integrated fashion with other items on a business's governance agenda, such as anti-bribery and corruption, internal anti-fraud controls, health and safety and environmental concerns".

United States

616. In areas such as improper payments (Foreign Corrupt Practices Act), securities law violations, environmental compliance, worker safety, and employment discrimination, enforcement agencies routinely include compliance programs as part of settlement agreements.

Others

617. On 18 February 2010, the OECD Council has adopted a Good Practice Guidance on Internal Controls, Ethics and Compliance[178], as an integral part of its Recommendation for Further Combating Bribery of Foreign Public Officials in International Business Transactions. The Guidance is intended to serve as non-legally binding guidance to companies in establishing effective internal compliance programmes for preventing and detecting foreign bribery. It does not suggest reductions in penalties when such programmes are applied but it is likely that that enforcement agencies and courts will take into account such initiatives – or their absence – in enforcement actions.

177 Published in the Official Gazette No. 26999 of September 16, 2008.

178 www.oecd.org/dataoecd/5/51/44884389.pdf.

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Tab.: Guidance and incentives propose in the jurisdictions covered by the survey

	Guidance available on the design and implementation of compliance programs	Reductions in fine for companies that have taken appropriate steps to ensure compliance	Incentive to adopt or upgrade the program in the frame of leniency or settlement procedures
Australia	Yes	The existence of a competition culture is taken into account in determining the amount of penalties	In settlement discussion, the ACCC frequently requires an undertaking to adopt or improve a compliance program
Brazil			A compliance program can be imposed in settlement proceedings
Canada	Yes	A compliance program can have a positive impact on the Commissioner's sentencing recommendations	Plea agreements may include a compliance program
Czech Republic	Yes	Mitigation factor available (no precedent)	
Egypt	Yes	Courts could take it into consideration when deciding the fine	
European Union	Yes		
France	Yes		Reduction up to 10 % in settlement proceedings available to companies offering a commitment to implement a compliance program
India	Yes	A compliance program may influence the quantum of the penalty (no precedent)	
Israel	Yes	Effective compliance programs allow senior management to defend themselves against indictment	A compliance program can be imposed in settlement discussions although it has been less frequent recently
Japan		Criminal fines may be slightly reduced	
Netherlands		Reduction possible in exceptional circumstances (no precedent)	A compliance program can be imposed in settlement proceedings
Pakistan	Yes	Reduction possible	
Singapore	Yes	Mitigation factor available	
South Korea	Yes	Reduction up to 20 % for companies with A level compliance programs	
Turkey	Yes	No formal recognition of a fine reduction but likely to be taken into account	
United Kingdom	Yes	Reduction possible up to 10%	
United States	Yes (but not for antitrust)	No for matters handled by Department of Justice Antitrust Division; Yes for matters handled by Federal Trade Commission	No for matters handled by Department of Justice Antitrust Division; Yes for matters handled by Federal Trade Commission

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Enforcers' Consideration of Compliance Programs in Europe: Are 2011 Initiatives Raising Their Profile or Reducing It to the Lowest Common Denominator?

Nathalie Jalabert-Doury &
Gillian Sproul

Mayer Brown

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Enforcers' Consideration of Compliance Programs in Europe: Are 2011 Initiatives Raising Their Profile or Reducing It to the Lowest Common Denominator?

Nathalie Jalabert-Doury &
Gillian Sproul[1]

I. INTRODUCTION

In Europe, compliance programs have been implemented by companies for many years. However, few competition authorities had clarified how they viewed these compliance initiatives, nor the impact of having (or not having) compliance programs on enforcement decisions. It took a long time for the European Commission to address the issue in any of its reports or notices.

Then, in 2011, three competition authorities produced new guidance documents, outlining their support for compliance programs: the U.K. Office of Fair Trading ("OFT), the French Competition Authority ("FCA"), and the European Commission itself.

Are these documents good news for businesses? The documents do show that competition authorities will now at least recognize compliance programs in Europe. However, behind the supportive tone, and the provision of more detailed guidance, the new guidelines in the United Kingdom and France only go as far as maintaining existing compliance reductions with reinforced conditions. Furthermore, the main emphasis of the European Commission's guidance appears to be on its commitment not to consider compliance programs as an aggravating circumstance.

II. THE U.K. OFFICE OF FAIR TRADING: A CONTINUED COMMITMENT TO PROVIDE GUIDANCE AND INCENTIVES

Historically, when assessing whether to reduce fines imposed on companies that have infringed competition rules, the OFT has considered whether adequate steps have been taken with a view to ensuring their compliance with competition rules (allowing a discount in penalties of between 5 percent and 10 percent). In 2004, the OFT published its first guidance on how businesses can achieve compliance with competition law and undertook research into the drivers of compliance and non-compliance.[2]

In June 2011, the OFT developed new guidance documents, outlining how companies could achieve compliance. It also published new guidance targeted specifically at directors to help them understand their "key roles" in establishing and maintaining a compliance culture within their company.[3]

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[1] Nathalie Jalabert-Doury is Partner, Mayer Brown, in the Paris office; Gillian Sproulis is Partner, Mayer Brown, in the London office.

[2] www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft423.pdf.

[3] OFT, *How your business can achieve compliance*, and *Company directors and competition law*, June 2011.

These two 2011 OFT guidance documents, together with other materials, are available on the OFT's compliance web page.[4] The documents provide detailed recommendations and practical examples to assist companies and their directors on how to set up effective compliance programs. In particular, the OFT details the various components that an effective compliance program should contain and the steps that should be taken to develop and maintain an effective compliance program—risk identification, risk assessment, risk mitigation, and regular review—and the processes within which that program should operate. It has also included tools for helping companies achieve effective compliance.

The OFT has confirmed that reductions in penalties of up to 10 percent may be considered by the OFT where a company has implemented a compliance process that follows the guidance, either before the infringement has occurred or quickly after an infringement has been identified.

The OFT's decision to take into account, as a mitigating factor, steps taken by a company to reduce the risk of future competition infringement was approved by the U.K.'s Competition Appeals Tribunal ("CAT") in 2011. The CAT went so far as to stress that "the decision-maker should in our view take such a [compliance] programme into account in assessing any deterrent element in the penalty."[5]

Naturally, the commitment to compliance has to be genuine. A compelling incentive to comply exists in the OFT's policy on Company Director Disqualification Orders ('CDO'), which were introduced in 2003. In new guidance that signals a stricter approach to disqualifying directors whose companies have infringed competition law, the OFT categorically states that it expects all directors to be "committed" to competition law compliance, and that compliance will be a consideration when the OFT is deciding whether to pursue director disqualification. Where an infringement has been committed, but directors can demonstrate that they have been genuinely committed to competition law compliance and have taken reasonable steps to ensure that the company has an effective compliance culture, it is unlikely that the OFT will apply for such an order. However, where a director can be shown to have participated in the infringement, the OFT is likely to make an application for a CDO notwithstanding the adoption of a compliance program. The director guidance referred to above[6] is designed to assist directors in developing a sufficient awareness of competition law to enable them to avoid these risks.

The OFT's policy on competition compliance programs deliberately places a high burden on company directors—including those who are not executive directors—to ensure that, as the leaders of their companies, they have at least made every effort to implement an effective competition compliance program. Understandably, the proactive policy of the OFT is designed to filter out sham compliance programs and to credit genuine ones. Taking that logic one step further, it would be relevant to take into consideration genuine attempts by parent companies to ensure compliance on the part of their subsidiaries when assessing parental liability. The role of parent companies is to deliver a very clear message to their group companies regarding effective competition compliance programs. However, those subsidiaries are best placed to ensure day-to-day monitoring within their organizations, and it can be argued that parent companies should not be answerable for the anticompetitive behavior of their subsidiaries in these circumstances.

[4] www.oft.gov.uk//OFTwork/competition-act-and-cartels/competition-law-compliance/

[5] CAT, 11 March 2011, Case numbers 1114/1/1/09 e.a., ¶ 217.

[6] OFT, *supra* note 3.

III. THE FRENCH COMPETITION AUTHORITY: THE ONE-TIME INCENTIVE IS MAINTAINED BUT WITH INCREASED CONDITIONS

Under article L463-2 III of the French Commerce Code, where a company agrees not to challenge the objections made by the Authority, the maximum fine incurred is 5 percent instead of 10 percent of its worldwide turnover. If, in addition, this company undertakes to amend its behavior in the future, the fine is directly reduced. Such undertakings notably consist in the adoption of compliance programs.

On that basis, the FCA has developed a proactive compliance policy, granting significant reductions in the penalties imposed on companies undertaking to implement such compliance programs. Over the years, the range of penalty reductions has, however, progressively declined and, in recent cases, the maximum reduction was 25 percent for companies: a) not challenging the objections, b) undertaking to set up strong compliance programs, and c) providing a number of additional behavioral commitments (such as limitations on bidding consortia or trade union meetings). In the meantime, the standards that compliance programs have to meet to benefit from the maximum penalty reduction have progressively increased.

In 2008, the FCA commissioned and published a study on compliance programs[7] offering guidance on optimal compliance programs, identifying a number of blocking factors in France, and recommending a number of measures, including the adoption of guidelines and incentives in the form of fine reductions.

Based on this experience, the FCA published two drafts for comment in October 2011: procedural guidelines on the settlement procedure and a framework document on compliance programs.[8] The consultation period is now over and the FCA is expected to adopt and publish final versions in February 2012.[9]

These drafts reinforce the conditions according to which a compliance program will be considered by the FCA to be effective, and propose to limit at 10 percent the maximum reduction available (not challenging the objections counts for a maximum 10 percent reduction; other remedies count for a maximum of 5 percent). If the total reduction available remains in the same range as recent cases (25 percent), the amount dedicated to the compliance program is low compared to the level of commitment now expected by the Authority, i.e. a firm, clear, and public commitment by the entire board and management to comply with competition law; a commitment to put one or more individuals in charge of implementing and overseeing the compliance program, with the necessary authority and means to fulfil this role; a commitment to set up effective training tools; implementation of effective control mechanisms (including alert hotlines and audits); and a commitment to set up effective follow-up mechanisms (including sanctions).

We do not believe the FCA would consider that implementing a compliance program within a group would be considered as evidence of decisive influence of the holding company on its subsidiaries, and there is no such precedent. This is, however, not stated in the drafts.

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[7] http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=285 .

[8] http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=415&id_article=1711 .

[9] The FCA published the guidelines on Feb. 10, 2012, and can be viewed at http://www.autoritedelaconcurrence.fr/doc/framework_document_compliance_10february2012.pdf.

In addition, these drafts show the same level of concern as the OFT's—to have adequate safeguards against sham compliance programs. The FCA warns company directors and executives that their participation in an infringement after the adoption of such a compliance program is likely to result in personal criminal prosecution.[10] In addition, where a compliance program is in place and an infringement is discovered, the FCA considers that it is the responsibility of the company concerned to submit a leniency application as quickly as possible.

The FCA also stresses in these drafts that no other reduction is available on compliance program grounds and, notably, that having a compliance program in place or adopting one after the infringement has been committed will not be considered as a mitigating circumstance.

IV. THE EUROPEAN COMMISSION: COMPLIANCE MATTERS… BUT DOES NOT REALLY COUNT

On November 24, 2011, the European Commission issued a brochure entitled *Compliance matters,* and created a webpage dedicated to compliance materials.[11]

This was unexpected, as Commissioner Joaquín Almunia had stressed in numerous speeches that the main tools for promoting compliance were the deterrent effects of EU penalties and the EU leniency policy. Against that backdrop, the EU Commissioner regularly explains that there should be no reduction in penalties or other preferential treatment for companies adopting compliance programs.[12]

The brochure provides broad and rather general recommendations for developing compliance programs and includes two pages on how the Commission welcomes compliance efforts by companies. Two positive statements may be noted. First, the brochure acknowledges that a compliance program can be effective even if it is not sufficient to prevent all infringements from happening. Second, the brochure states that the existence of a compliance program "will not be considered as an aggravating circumstance" if an infringement is found by the enforcement authorities. This statement contrasts with the *British Sugar* case, in which the Commission increased the fine for a failed compliance program (knowing that the adoption of that compliance program had been considered as a mitigating circumstance in a previous case).[13]

Aside from these two positive statements, the policy is unchanged: The existence of a compliance program at the time of the infringement or the setting-up of a compliance program in the wake of an investigation will not be considered as an attenuating circumstance. The brochure also does not say anything about parental liability issues, nor whether the EU Commission will continue to consider that the adoption of a compliance program at the group level provides evidence of the decisive influence of the group on its subsidiaries, and therefore can

[10] Under article L 420-6 of the French Commerce Code, it is also a criminal offense for an individual to take a personal, fraudulent, and decisive part in a serious violation of the prohibition against cartels and abuses of dominance.

[11] http://ec.europa.eu/competition/antitrust/compliance/index_en.html.

[12] *See*, for example, Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, Compliance and Competition policy, Speech/10/586, given at the Businesseurope & US Chamber of Commerce Competition Conference Brussels, (October 25, 2010).

[13] Decision IV/30.178 dated July 18, 1998 Napier Brown/British Sugar and decision IV/F-3/33.708 dated October 14, 1998, British Sugar.

contribute to a decision holding the group jointly and severally liable for any infringement committed by the latter.[14]

Interestingly, in its report on the Annual Report on EU Competition Policy,[15] the European Parliament suggested that the Commission reviews its fining guidelines and considers principles such as: "taking into account that the implementation of robust compliance programs should not have negative implications for the infringer beyond what is a proportionate remedy to the infringement;" introducing a distinction in the levels of penalty imposed on undertakings that have acted intentionally or negligently; and specifying conditions under which companies who exercise decisive influence over a subsidiary, but are not directly involved in an infringement, should be made jointly and severally liable.

V. CONCLUSION

Last year, 2011, has certainly seen more consistency in the approaches of these three authorities,[16] but by approximating positions at an intermediate level, rather than by raising their profile. From a situation where two National Competition Authorities were promoting compliance on totally different grounds, the approaches are becoming more consistent, with reinforced conditions and safeguards, while the European Commission itself has taken a small step towards better supporting compliance initiatives.

However, most competition authorities—and clearly the European Commission—have the tools to increase the profile of compliance programs when determining fines and deciding parental liability issues.

The business community is at the forefront of this issue, and the encouragement of the European Parliament to go further will certainly help. Also helpful are other initiatives such as those by National Competition Authorities or Courts, not to mention positive examples abroad. It is somehow striking that jurisdictions abroad, and notably a number of "younger" competition authorities,[17] are more advanced in that respect than most European Competition Authorities.

[14] For a recent example, *see* General Court, July 13, 2011, Schindler Holding, case T-138/07.

[15] Report on the Annual Report on EU Competition Policy, 29.11.2011 (A7-0424/2011), Rapporteur: Andreas Schwab.

[16] The present article only details European Competition Authorities with guidelines on compliance, but a number of other European Competition Authorities support compliance efforts by companies.

[17] *See* the jurisdictions listed in ICC, *Promoting antitrust compliance: the various approaches of national competition authorities*, http://ec.europa.eu/competition/antitrust/compliance/compliance_programmes_en.html and on the ICN website, *available at* http://www.internationalcompetitionnetwork.org/working-groups/current/cartel/awareness/business.aspx .

Lessons Learned
From Compliance to Global Cartels
Translating Theory Into Practice
June 13, 2013



Karine Faden
Managing Counsel
Regulatory, Antitrust & Competition

Today's Topics

- Translating theory into practice
- Maximizing impact with limited resources
- Making it real
- Fostering a dynamic compliance culture

Translating Theory Into Practice

THEORY

- Antitrust law isn't easy
- Antitrust training isn't fun
- Lawyers are serious, scary, and to be avoided
- More is better
- Online is the solution
- Compliance is a box

PRACTICE

- The rules are (mostly) clear
- Salient training is engaging
- Work seriously with your lawyers, avoid the scariness
- Less is often more
- Online is a tool
- Compliance is dynamic

Maximizing Impact with Limited Resources

- No one size fits all
- Live training is key
- Planning is cost-effective
  - Annual sales meetings
  - Large conference rooms!
- Deputized counsel
- Local counsel
  - Japan
  - Brazil
  - Europe
- Develops global outreach culture



Maximizing Impact with Limited Resources

- Why should you care?
  - Increasing cost-sensitivity: if we're outsourcing compliance materials, it's probably because we don't have time to prepare them, so we need them to work



  - Increasing enforcement: as consequences of violations grow, the importance of meaningful, clear advice does, too





  - Increasingly global: companies focus increasingly on international competition laws and integrate jurisdictional specific training into our compliance programs

CADE Conselho Administrativo de Defesa Econômica

JFTC

Competition Bureau Canada

Bureau de la concurrence Canada

Making It Real

- In English (or Japanese), but not legalese
  - Keep references to laws as bare bones as possible, if you want your audience to stay awake
  - Make sure you're awake yourself: if you don't seem energized and focused, you might as well not have called the team in
- Customize as much as possible for the business unit
  - Use real life examples from actual counseling
  - Ask for actual emails and modify as appropriate
- Customize from the headlines
  - If there are industry examples that make this real, use them
- Keep it interactive, and your next session will be even better
- Dynamic incentivizes reporting, facilitates monitoring

Fostering a Dynamic Compliance Culture

- Have a clear compliance focus, from the top
- When in doubt, check it out (with Legal)
- Be available, patient, and listen (to your clients)
  - And they will come to you
- Provide clear advice: the shorter the better (really)
- Be the business partner, not the business auditor
  - That doesn't mean you don't audit, but it helps when you need to
- Be crossing guards, not police: try to find a safe way across
- Don't be the Department of No
  - And when you have to say no, clients will listen

UNITED

Questions?

Thank you for your attention!



UPDATE ON ANTITRUST ENFORCEMENT IN INDIA

Update on Antitrust Enforcement in India

Fourth Annual

Chicago Forum on International Antitrust Issues

June 13–14, 2013

DRAFT

Nicholas J. Franczyk
Counsel for International Technical Assistance
Office of International Affairs
Federal Trade Commission
Washington, D.C.

The views expressed are those of the speaker and not necessarily those of the Federal Trade Commission or any individual commissioner.

Brief History of Competition Law in India

- **Indian independence in 1947**
  - "Command and control" law, rules and regulations
  - Increased governmental control of industrial sector through industrial licensing policy

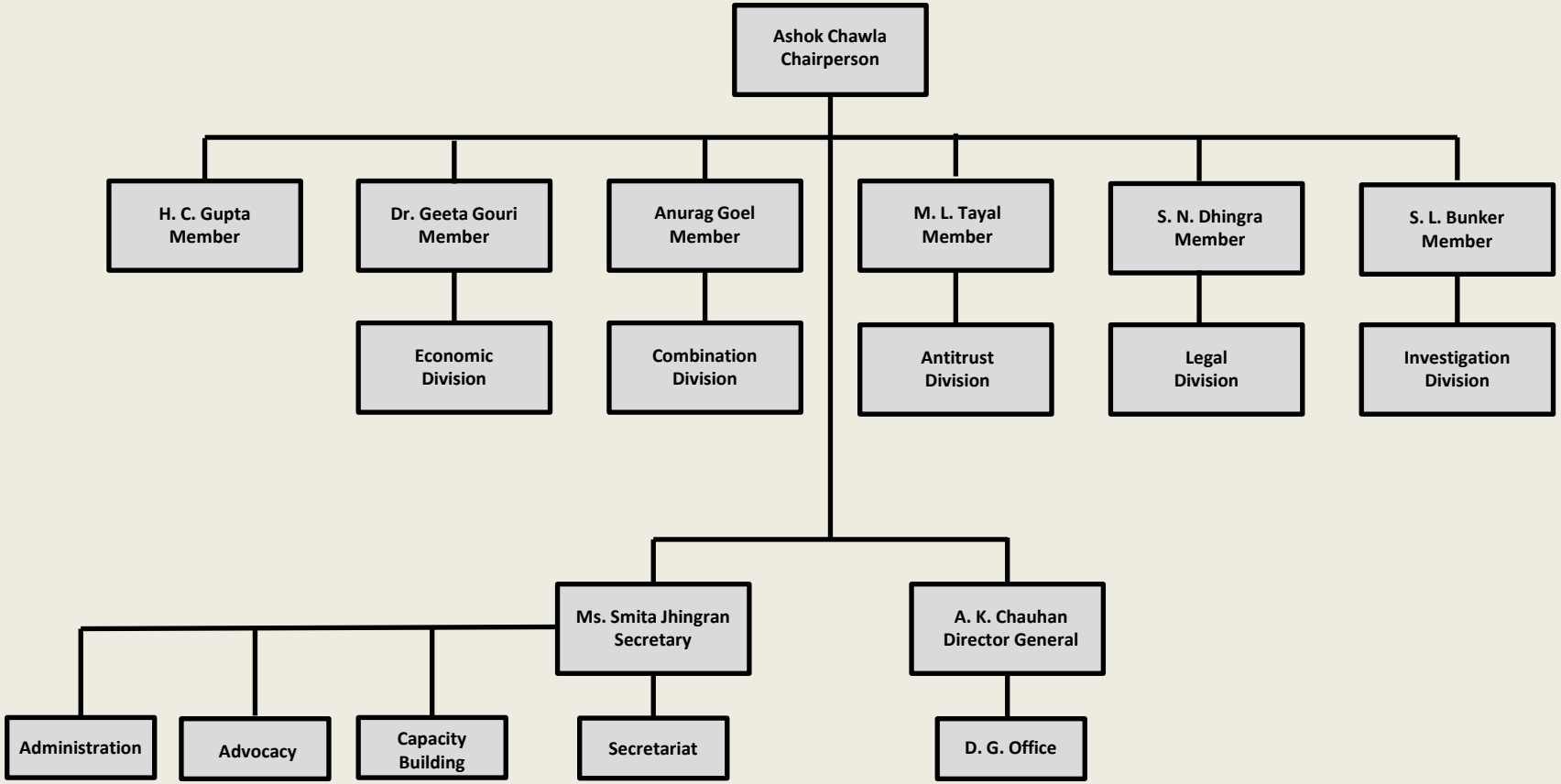
- **Monopolies and Restrictive Trade Practices Act (1969)**
  - 1984 amendment added consumer protection provision
  - 1991 amendment removed provisions re concentration of economic power and various restrictions on dominant firms

- **Economic Reforms of the 1990s**
  - Liberalization, privatization, and globalization
  - MRTP Act becomes obsolete; recognized need for economics-based competition law

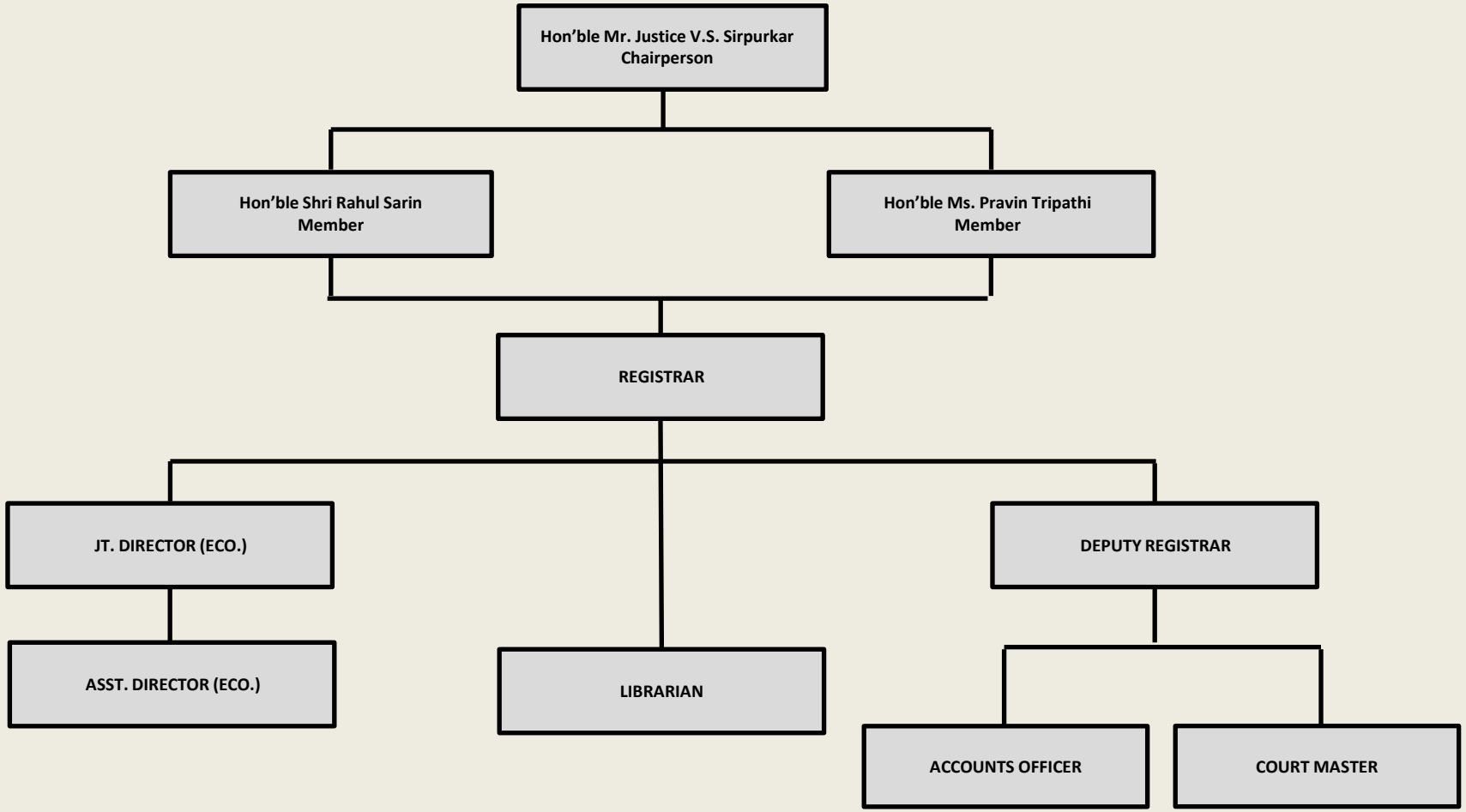
- **Competition Act, 2002**
  - Signed into law January 2003
  - Immediate legal challenges; Act's substantive provisions do not go into effect

- **Competition (Amendment) Act, 2007**
  - Largely modeled on EU law
  - Anticompetitive agreements (effective May 20, 2009)
  - Abuse of dominant position (effective May 20, 2009)
  - Combinations/Mergers (effective June 1, 2011)

Competition Commission of India



Competition Appellate Tribunal



Inquiry Process – Non-merger Investigations

- Initiation of inquiry
  - On receipt of any information
  - On a reference from the Central or State Government, or a statutory authority
  - On its own motion

- Decision of the Commission
  - No prima facie case: CCI must issue order closing matter; order subject to appeal
  - Prima facie case
    - CCI issues order for Director General to investigate and submit a report
      - DG must complete investigation in 45 days (*see Competition Commission of India v. Steel Authority of India Ltd.*, 10 SCC 744 (2010)
      - DG Report disclosed to the parties
  - Consideration of objections and suggestions
  - "Hearing" before Commission
  - Final order (no violation or violation, including any penalty)
  - Appeal to Competition Appellate Tribunal (within 60 days)

Inquiry Process – Merger Investigations

- Mandatory notification (filed jointly in a single document)
  - Form I ($20,000)
  - Form II ($80,000)
    - Horizontal overlap with combined market share > 15% or
    - Vertically-linked transaction with individual or combined market share > 25% or
    - At option of parties

- Trigger events
  - Approval of the proposed transaction by BOD; or
  - Execution of any agreement or other binding document "conveying an agreement or decision to acquire control, shares, voting rights or assets"

- Maximum 210-day review period (earlier of 210 days or approval by the Commission)

- Prima facie opinion within 30 days of valid filing
  - Does not include "clock stops" for additional information

- Investigation conducted within CCI (no referral to Director General)

- Final order
  - Approving, prohibiting, or approving subject to conditions
  - Deemed approved if no order within 210 days

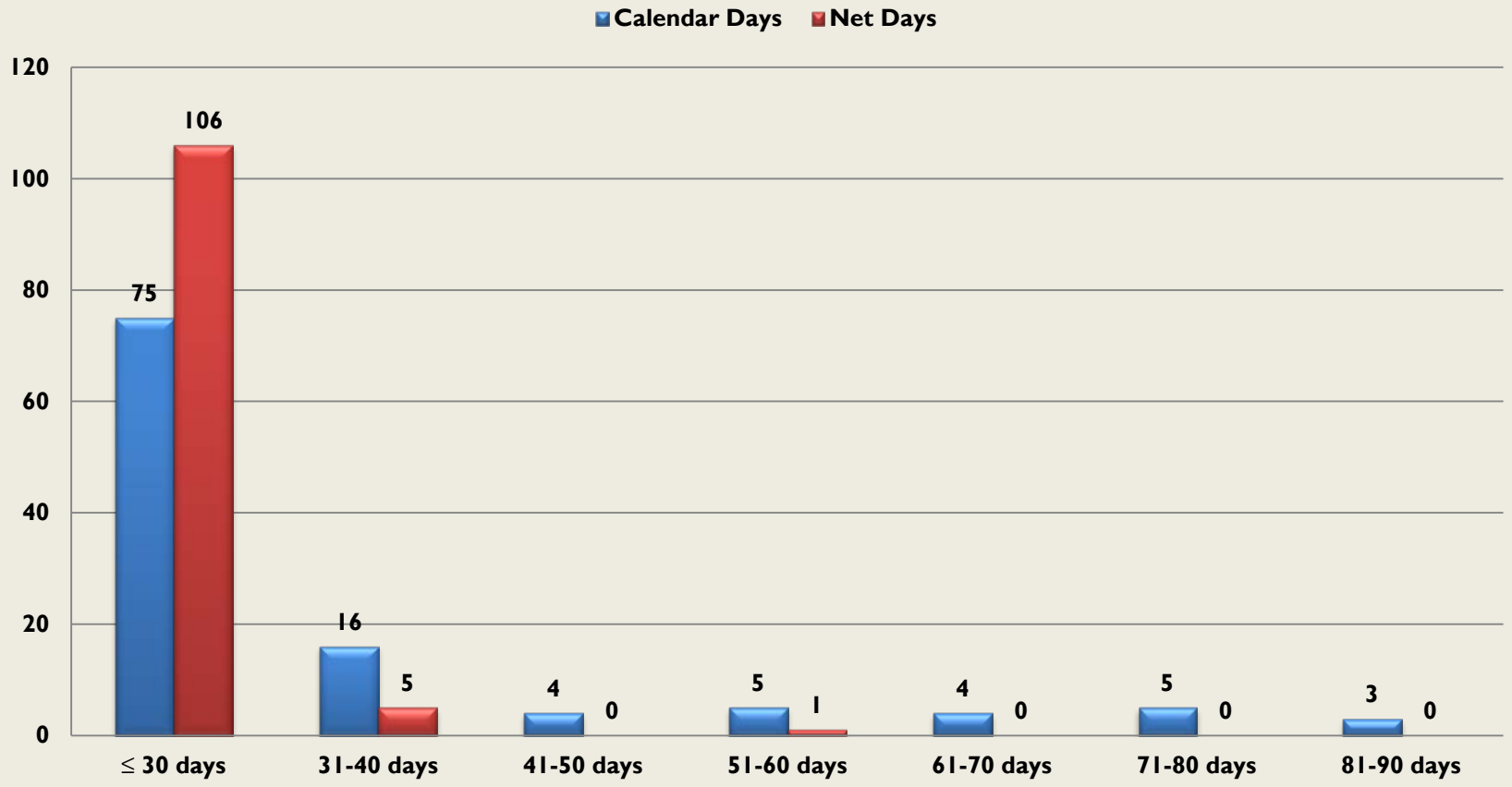
- Appeal to Competition Appellate Tribunal (within 60 days)

Remedial Powers

- **Anticompetitive Agreements and Abuse of Dominance**
  - TRO during pendency of investigation (issued by CCI)
  - Cease and desist
  - Monetary penalties
    - Up to 10% of the average turnover for the last three years
    - Cartels – greater of 10% of turnover or 3X the profit for each year of the violation
  - Modify the agreement
  - Division of a dominant firm
  - Competition Appellate Tribunal may award compensation for loss or damages

- **Mergers**
  - Approve
  - Prohibit
  - Approve subject to modifications

Competition Commission of India
Merger Reviews
June 2011 through May 2013*



* The Competition Act's provisions relating to mergers went into effect on June 1, 2011. The data exclude five transactions: four that did not require notification (Combination Registration Nos. 8, 55, 69 and 111) and one that was withdrawn (Combination Registration No. 52).

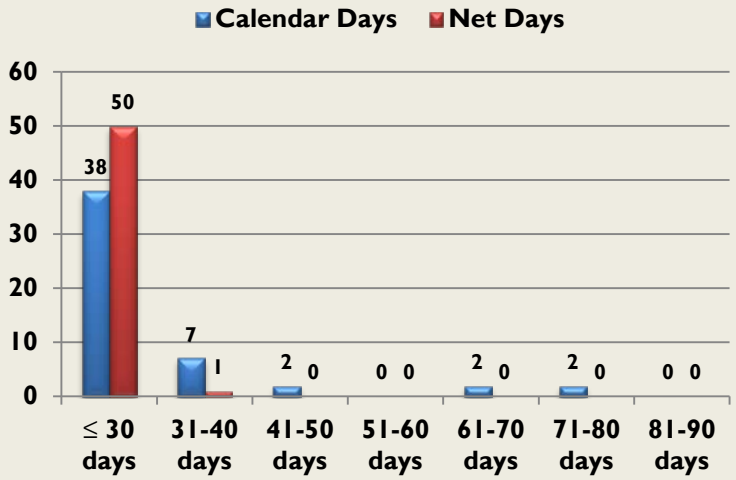
Competition Commission of India
Merger Reviews
June 2011 through May 2013

Transaction	Number	Total Days (Average)	Total Days (Range)	Net Days (Average)	Net Days (Range)
All transactions	112	29.4	7 to 90	18.2	7 to 55
Transactions w/o Additional Information	46	17.0	7 to 55	n.a.	n.a.
Transactions w/ Additional Information	66	38.0	14 to 90	19.0*	9 to 33

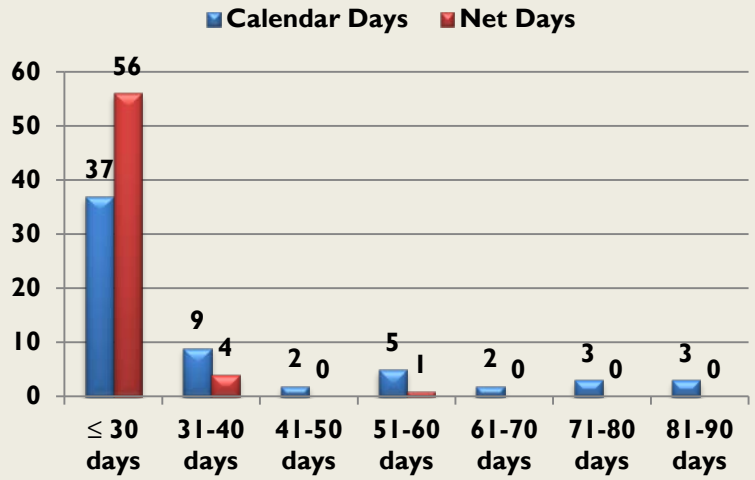
* CCI cleared transactions an average of 10.4 calendar days after the parties submitted responsive documents and information (range 0 to 35 days).

Competition Commission of India
Merger Reviews: Year 1 vs. Year 2

June 2011 through May 2012



June 2012 through May 2013



Competition Commission of India
Merger Reviews: Year 1 vs. Year 2

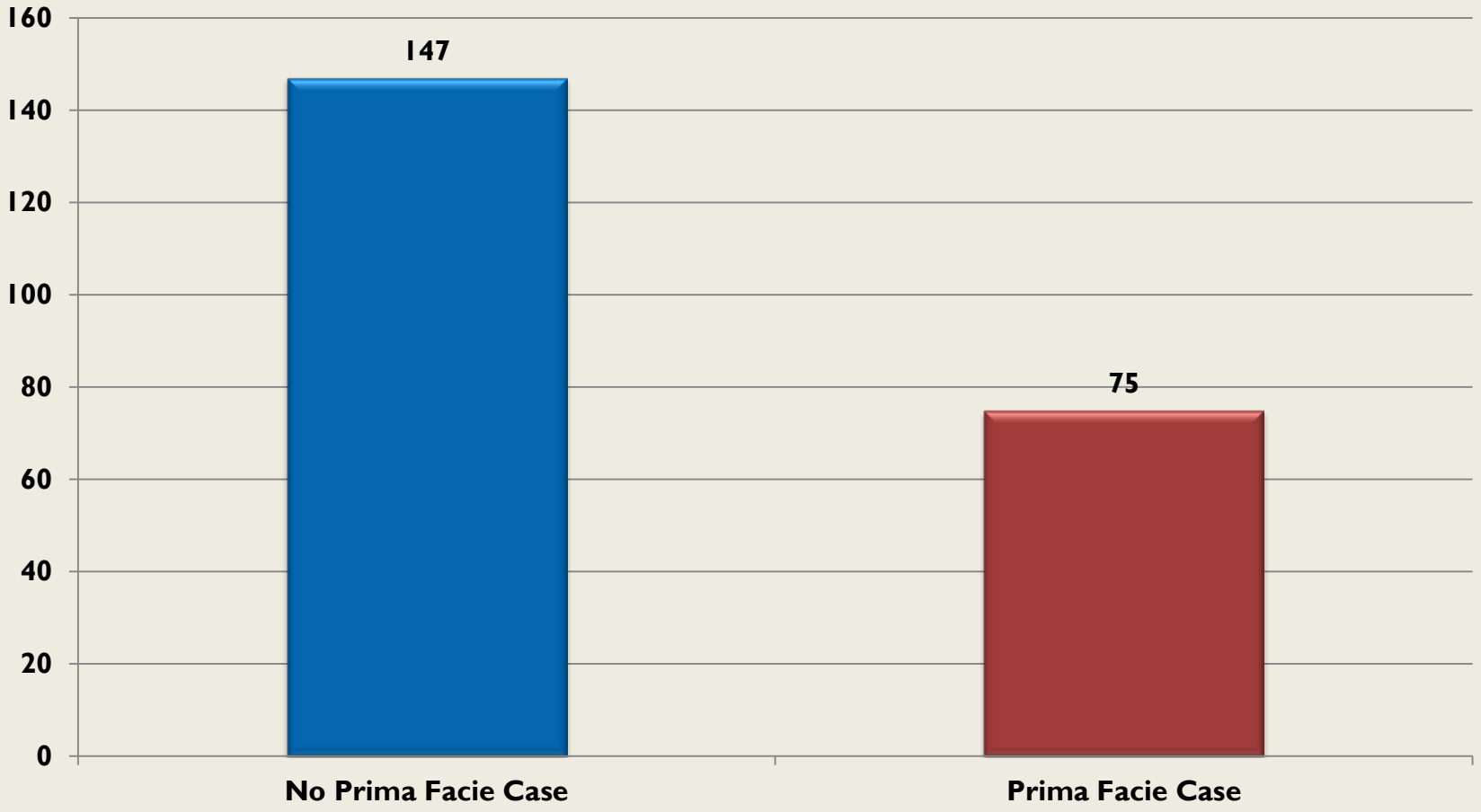
June 2011 through May 2012

Transaction	Number	Total Days (Average)	Total Days (Range)	Net Days (Average)	Net Days (Range)
All transactions	51	25.4	7 to 77	16.1	7 to 37
Transactions w/o Additional Information	23	14.4	7 to 37	n.a.	n.a.
Transactions w/ Additional Information	28	34.5	18 to 77	17.4	10 to 29

June 2012 through May 2013

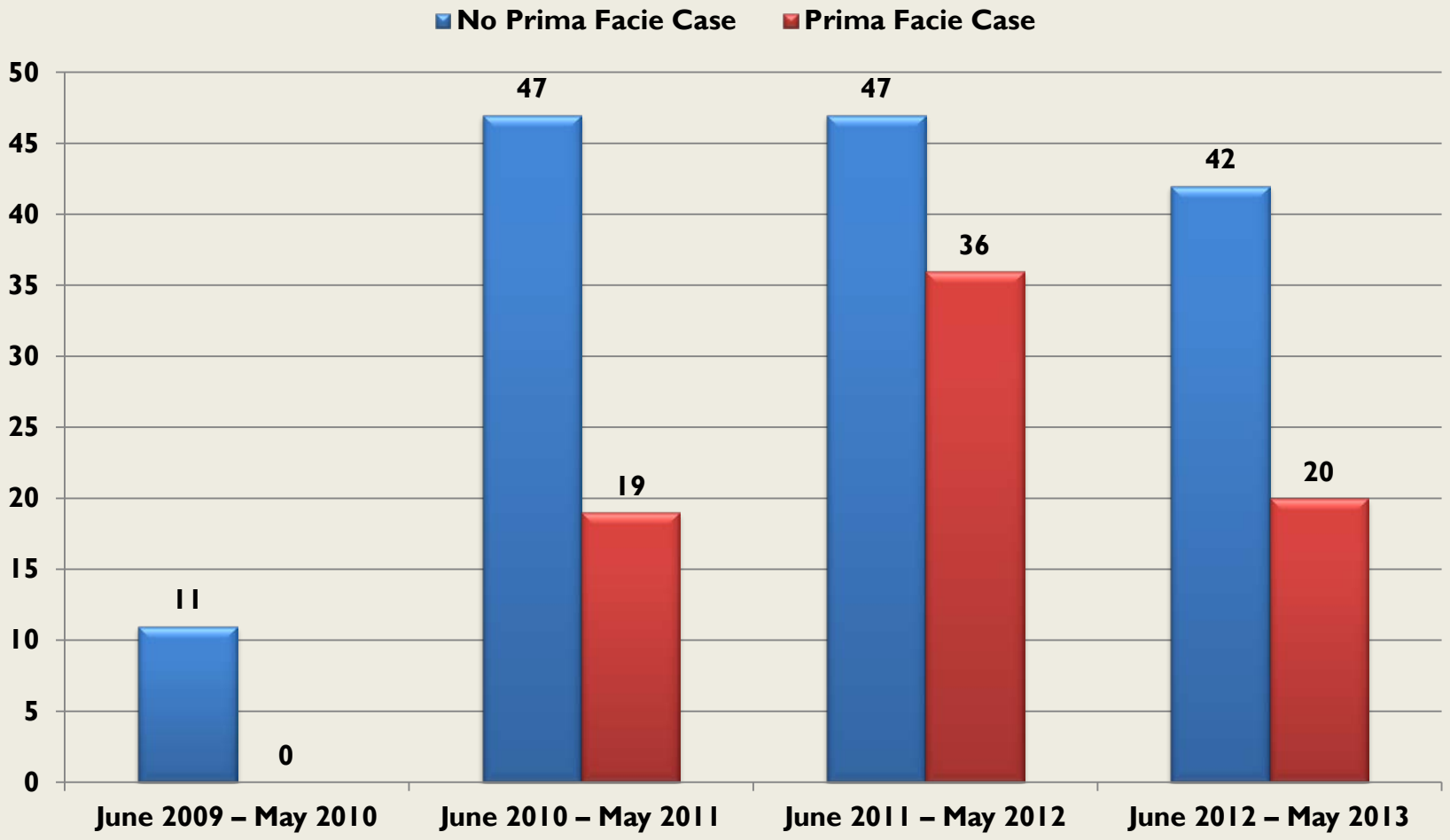
Transaction	Number	Total Days (Average)	Total Days (Range)	Net Days (Average)	Net Days (Range)
All transactions	61	32.7	8 to 90	20.0	8 to 55
Transactions w/o Additional Information	23	19.6	8 to 55	n.a.	n.a.
Transactions w/ Additional Information	38	40.6	14 to 90	20.3	9 to 33

Competition Commission of India
Non-merger Final Decisions
May 2009 through May 2013*

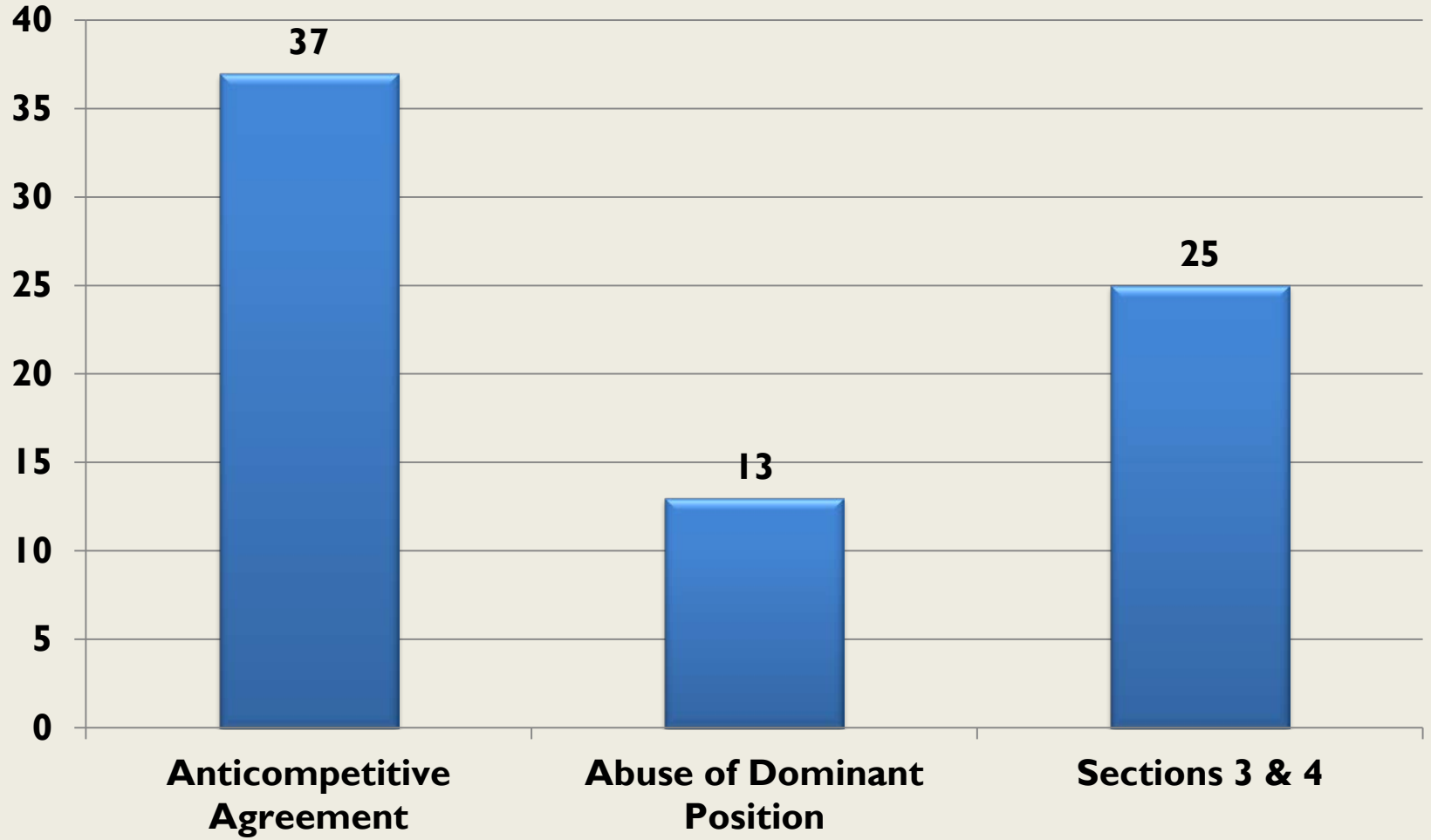


* The Competition Act's provisions relating to anticompetitive agreements and abuse of dominant position went into effect on May 20, 2009.

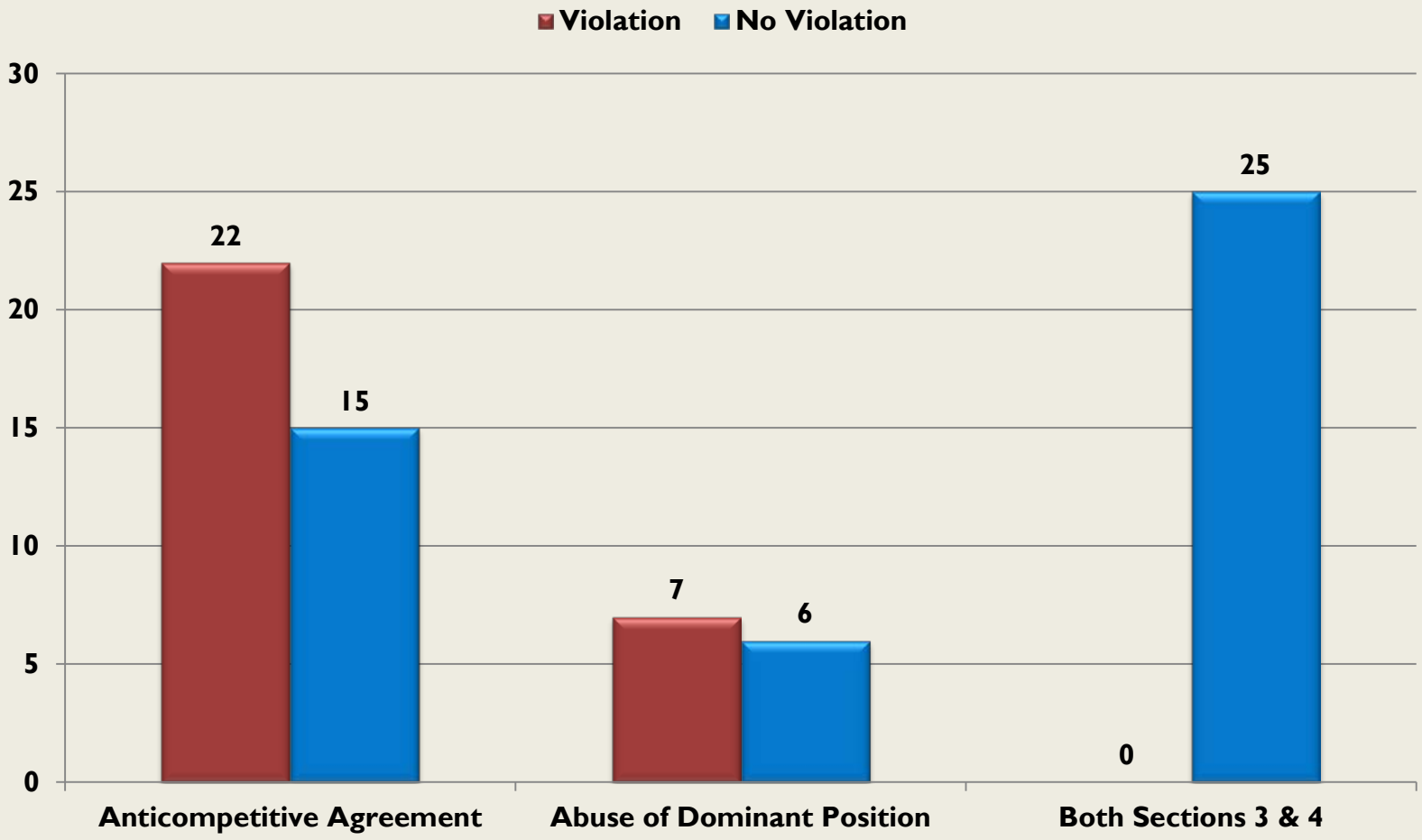
Competition Commission of India
Non-merger Final Decisions
Year-by-Year



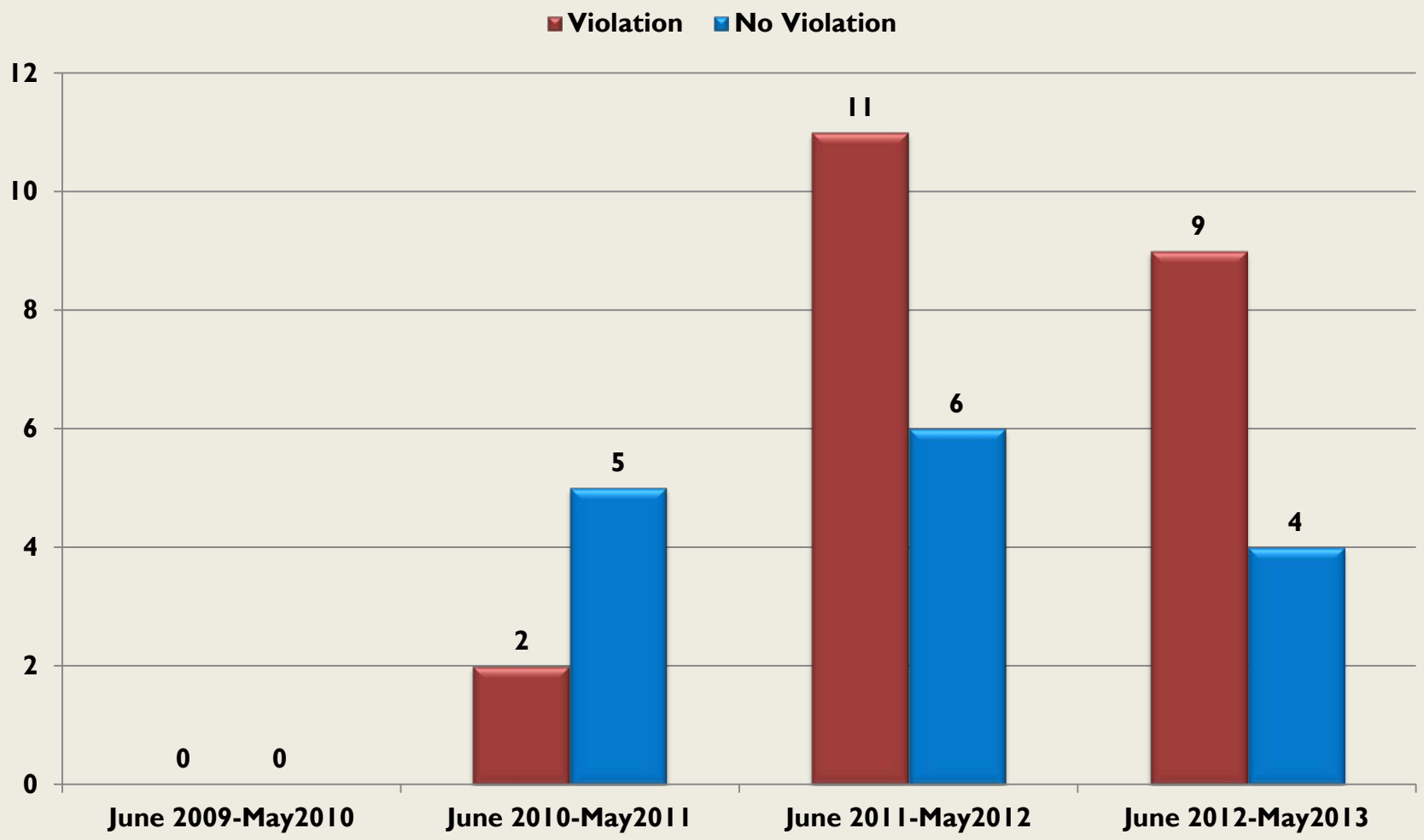
Competition Commission of India
Breakdown of Prima Facie Cases by Alleged Violation
May 2009 through May 2013



Competition Commission of India
Breakdown of Prima Facie Case Decisions
Violation or No Violation
May 2009 through May 2013



Competition Commission of India
Breakdown of Anticompetitive Agreement Decisions
Year-by-Year



Competition Commission of India
Anticompetitive Agreement Decisions
June 2012 through May 2013

Violation

- *South Eastern Railway v. Orissa Concrete and Allied Industries Ltd.* (Feb. 21, 2013)
- *Santuka Associates Pvt. Ltd. v. All India Organization of Chemists and Druggists* (Feb. 19, 2013)
- *Cinergy Independent Film Services Pvt. Ltd. v. Telangana Telugu Film Distributors Ass'n* (Jan. 10, 2013)
- *Ashtavinayak Cine Vision Ltd. v. PVR Picture Ltd.* (Jan. 10, 2013)
- *Vedant Bio Sciences v. Chemists & Druggists Ass'n of Baroda* (Sept. 5, 2012)
- *Sajjan Khaitan v. Eastern India Motion Picture Ass'n* (Aug. 9, 2012)
- *In re: Alleged Cartelization by Cement Manufacturers* (July 30, 2012)
- *Builders Association of India v. Cement Manufacturers' Ass'n* (June 20, 2012)
- *Varca Druggist & Chemist v. Chemists and Druggists Ass'n, Goa* (June 11, 2012)

No Violation

- *Shailesh Kumar v. Tata Chemicals Ltd.* (April 16, 2013)
- *All India Tyre Dealers' Federation v. Tyre Manufacturers Ass'n* (Oct. 30, 2012)
- *Gupta v. Omaxe Ltd.* (Oct. 18, 2012)
- *Prints India v. Springer India Pvt. Ltd.* (July 3, 2012)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Anticompetitive Agreement Decisions
June 2011 through May 2012

Violation

- *UTV Software Communications Ltd., Mumbai v. Motion Pictures Ass'n, Delhi* (May 8, 2012)
- *Gulshan Verma v. Union of India, through Secretary, Ministry of Health and Family Welfare* (April 25, 2012)
- *Manju Tharad v. Eastern India Motion Picture Ass'n Kolkata* (April 24, 2012)
- *In re: Aluminium Phosphide Tablets Manufacturers* (April 23, 2012)
- *Coal India Ltd. v. GOCL Hyderbad* (April 16, 2012)
- *A Foundation for Common Cause & People Awareness v. PES Installations* (April 16, 2012)
- *In re: LPG Cylinder Manufacturers* (February 24, 2012)
- *Sunshine Pictures v. Central Circuit Cine Ass'n (*Feb. 16, 2012)
- *Reliance Big Entertainment v. Karnataka Film Chamber* (Feb. 16, 2012)
- *FCM Travel Solutions (India) Ltd., New Delhi v. Travel Agents Federation of India* (Nov. 17, 2011)
- *Uniglobe Mod Travels v. Travel Agents Ass'n of India* (Oct. 4, 2011)

No Violation

- *In re: Rise in Onion Prices* (April 10, 2012)
- *In re: Glass Manufacturers of India* (Jan. 24, 2012)
- *In re: Airlines* (Jan. 11, 2012)
- *In re: Domestic Air Lines* (Jan. 11, 2012)
- *In re: Sugar Mills* (Nov. 30, 2011)
- *Travel Agents Ass'n of India v. Lufthansa German Airlines* (Oct. 31, 2011)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Anticompetitive Agreement Decisions
June 2010 through May 2011

Violation

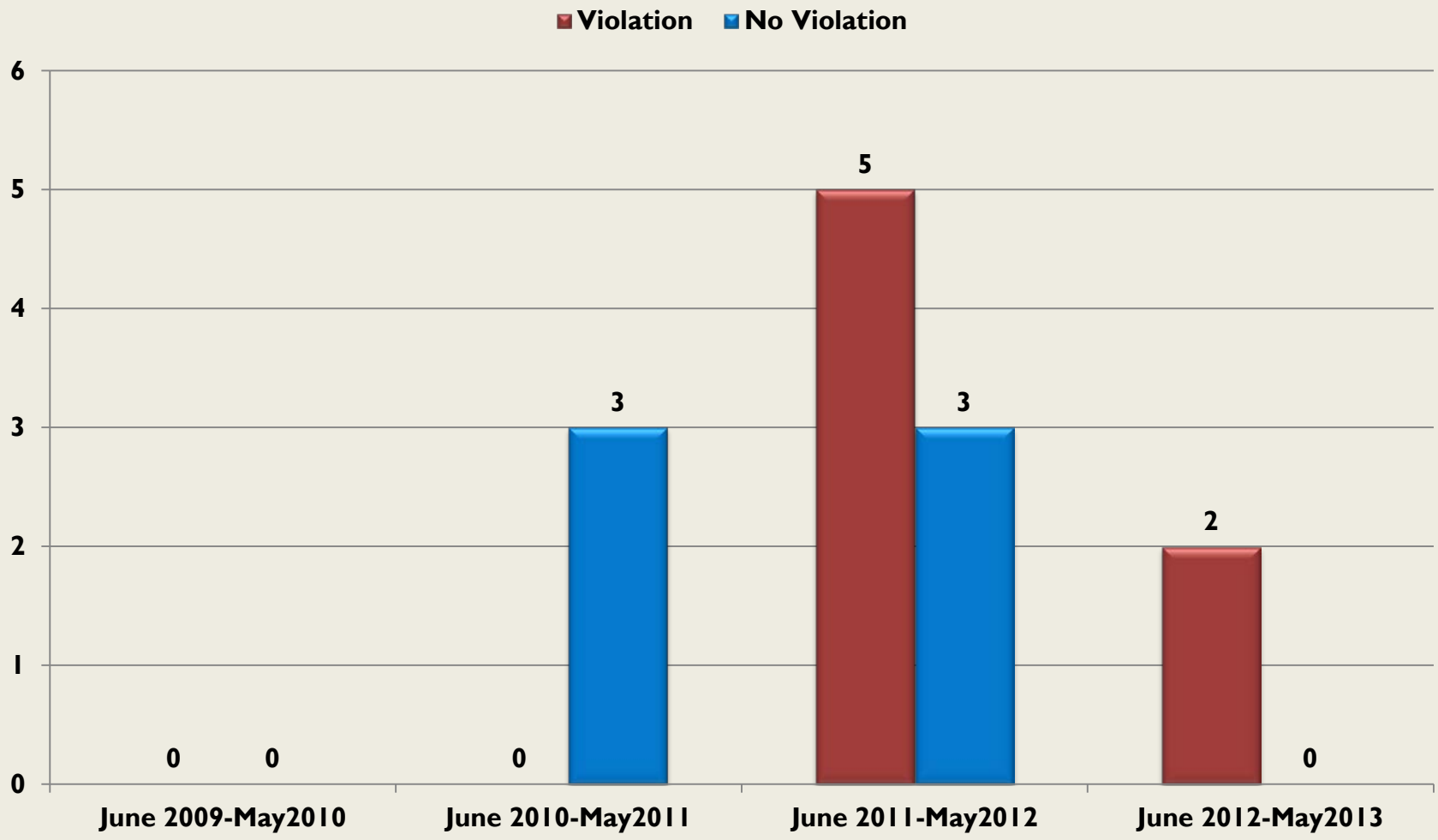
- *FICCI Multiplex Ass'n of India v. United Producers Distributors Forum* (May 25, 2011)
- *Vijay Gupta v. Paper Merchants Ass'n, Delhi* (March 24, 2011)

No Violation

- *DDRS (G)-II Railway Board, Ministry of Railways v. RMG Polyvinyl India Ltd., New Delhi* (April 6, 2011)
- *S.K. Sharma, Deputy, CMM-IV, North Western Railway, Hasanpura, Jaipur v. RMG Polyvinyl India Ltd., New Delhi* (April 6, 2011)
- *Rohit Medical Store v. Aashish Enterprises* (Dec. 16, 2010)
- *Federation of Indian Airlines* (Dec. 2, 2010)
- *Neeraj Malhotra v. Deustche Post Bank Home Finance* (Dec. 2, 2010)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Breakdown of Abuse of Dominant Position Decisions
Year-by-Year



Competition Commission of India
Abuse of Dominant Position Decisions
June 2012 through May 2013

Violation

- *Surinder Singh Barmi v. Board for Cricket Control in India* (Feb. 8, 2013)
- *Kansan News Pvt. Ltd. v. Fastway Transmission* (July 3, 2012)

No Violation

None

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Abuse of Dominant Position Decisions
June 2011 through May 2012

Violation

- *Kapoor Glass v. Schott Glass India* (March 29, 2012)
- *Magnolia Flat Owners Ass'n v. DLF Universal* (Jan. 31, 2012)
- *DLF Park Place Residents v. DLF Ltd.* (Aug. 29, 2011)
- *Belaire Owner's Ass'n. v. DLF Ltd. and HUDA* (Aug. 12, 2011)
- *MCX Stock Exchange Ltd. v. National Stock Exchange* (June 23, 2011)

No Violation

- *Anita Gupta, Mumbai v. BEST Undertaking* (Jan. 11, 2012)
- *Pankaj Gas Cylinders Ltd. v. Indian Oil Corporation Ltd.* (June 22, 2011)
- *Pawan Kumar Agarwal v. Rashtriya Ispat Nigam Ltd.* (June 14, 2011)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Abuse of Dominant Position Decisions
June 2010 through May 2011

Violation

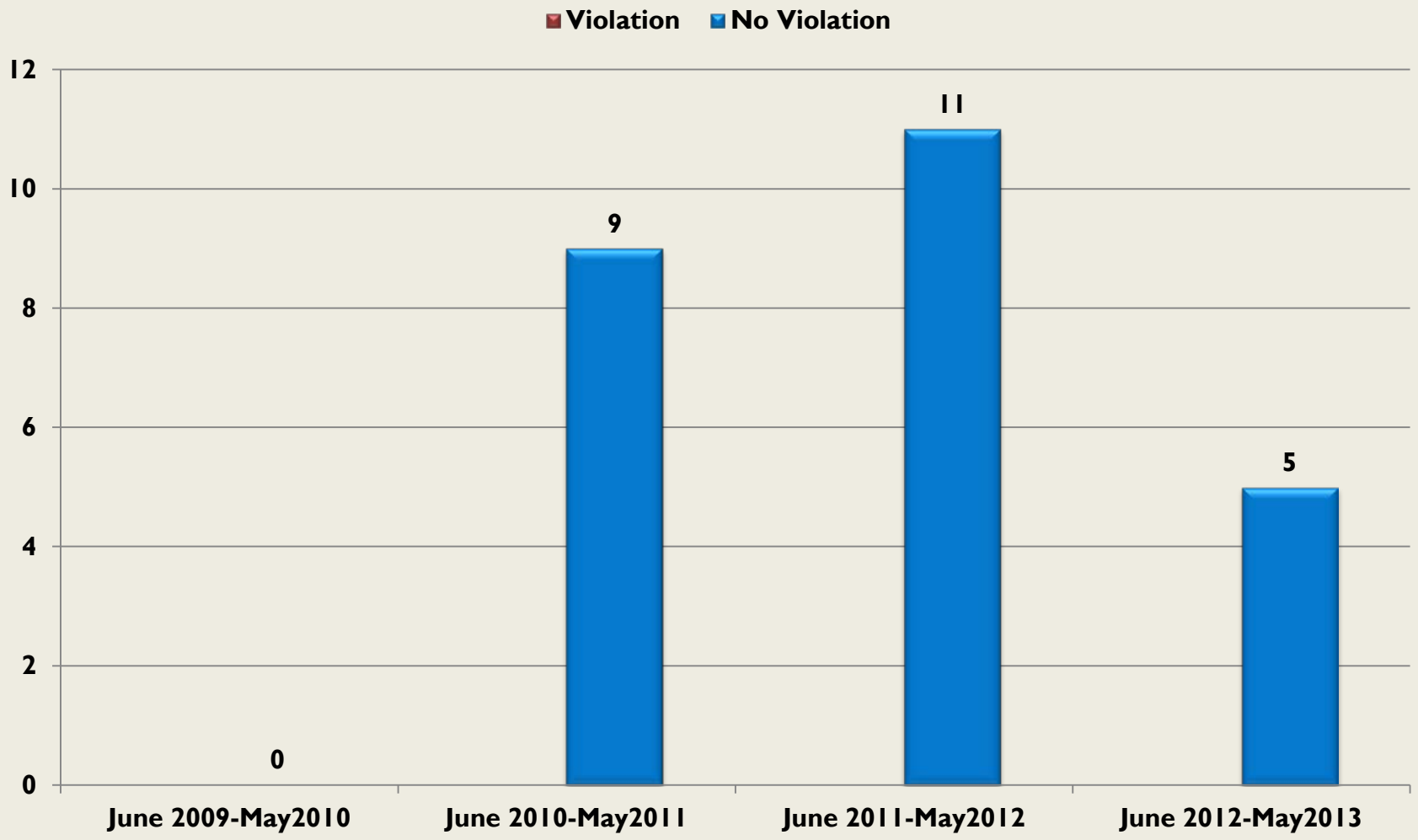
None

No Violation

- *Pravahan Mohanty v. HDFC Bank Ltd., Chennai* (May 23, 2011)
- *Neeraj Malhotra, Advocate v. North Delhi Power Ltd.* (May 11, 2011)
- *Dhruv Suri v. Mundra Port & Special Economic Zone Ltd.* (Dec. 29, 2010)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Breakdown of Sections 3 & 4 Decisions
Year-by-Year



Competition Commission of India
Breakdown of Sections 3 & 4 Decisions
June 2012 through May 2013

Violation

None

No Violation

- *Yogesh Ganeshlaji Somani v. Zee Turner Ltd.* (March 21, 2013)
- *Sonam Sharma v. Apple, Inc.* (March 19, 2013)
- *Film & Television Producers Guild of India v. Multiplex Association of India* (Jan. 3, 2013)
- *Arshiya Rail Infrastructure Ltd. v. Ministry of Railway* (Aug. 18, 2012)
- *Automobile Dealers Ass'n, Hathras, UP v. Global Automobiles and Pooja Expo India Pvt. Ltd.* (July 3, 2012)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Breakdown of Sections 3 & 4 Decisions
June 2011 through May 2012

Violation

None

No Violation

- *GKB Hi Tech Lenses v. Transitions Optical* (May 16, 2012)
- *Royal Energy Ltd. v. Indian Oil Corporation Ltd.* (May 9, 2012)
- *Manappuram Jewellers v. Kerala Gold & Silver Dealers Ass'n* (April 23, 2012)
- *B. Venkat Reddy v. Shri Ram Transport Finance Company* (April 10, 2012)
- *M.P. Mehrotra v. Kingfisher Airlines* (Jan. 9, 2012)
- *Jindal Steel & Power Ltd. v. Steel Authority of India* (Dec. 20, 2011)
- *Pandrol Rahee Technologies v. Delhi Metro Rail Corp.* (Oct. 10, 2011)
- *JAK Communications v. Sun Direct TV* (Aug. 30, 2011)
- *Durga City Cable Network v. In2 Cable* (Aug. 10, 2011)
- *Explosive Manufacturers Welfare Ass'n v. Coal India Ltd.* (July 26, 2011)
- *Govind Aggarwal v. ICICI Bank Ltd.* (June 7, 2011)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Commission of India
Breakdown of Sections 3 & 4 Decisions
June 2010 through May 2011

Violation

None

No Violation

- *Yogesh Suomoto MRTPC v. North Delhi Power Ltd.* (May 31, 2011)
- *Ramachandra Reddy v. HDFC Bank Ltd.* (May 31, 2010)
- *Consumers Guidance Society v. Hindustan Coca Cola Beverages Pvt. Ltd.* (May 23, 2011)
- *Cine Prekshakula Viniyoga Darula Sangh v. Hindustan Coca Cola Beverages Pvt. Ltd.* (May 23, 2011)
- *Metalrod Ltd. v. Religare Finvest Ltd.* (May 23, 2011)
- *Jupiter Gaming Solutions Pvt. Ltd. v. Government of Goa* (May 12, 2011)
- *Consumer Online Foundation v. Tata Sky Ltd.* (March 24, 2011)
- *Surinder Bhakoo v. HDFC Bank Ltd.* (March 22, 2011)
- *Yashoda Hospital and Research Centre Ltd. v. Indiabulls Financial Services Ltd.* (March 22, 2011)

Orders available at http://www.cci.gov.in/index.php?option=com_content&task=view&id=150

Competition Appellate Tribunal
Final Decisions

- *Savitri Leasing & Finance, Ltd. v. Punjab National Bank* (April 30, 2013) (upholding CCI decision of no prima facie case under Section 3 or 4)

- *Singhania and Partners LLP v. Microsoft Corporation of India Pvt. Ltd.* (Oct. 9, 2012) (upholding CCI decision of no abuse of dominant position)

Highlights of the Proposed Amendments to the Competition Act*

- **Substantive amendments**
  - Merger review period shortened from 210 days to 180 days
  - Introduction of collective dominance ("No enterprise of group, ***jointly or singly*** shall abuse its dominant position.")
  - Definition of "group" made consistent with earlier Government Notification (March 2, 2011) ("two or more enterprises which, directly or indirectly, are in a position to … exercise ***fifty percent*** or more of the voting rights in the other enterprise ….")
- **Procedural amendments**
  - CCH Chairperson may authorize dawn raids
  - Opportunity to be heard before imposition of monetary penalties

* The Competition (Amendment) Bill, 2012(Dec. 10, 2012).

Highlights of the Amendments to the Combination Regulations

- **February 23, 2012***
  - Exempt from filing intra-group mergers and amalgamations involving wholly-owned subsidiaries of holding companies within the same group
  - Exempt from filing acquisition of less than 25% (up from 15%) of the shares or voting rights of a company on cumulative basis
  - Form II (long form) notification required only in the following instances:
    - horizontal overlap with combined market share > 15%
    - vertically-linked transaction with individual or combined market share > 25%
    - at option of the parties
  - Exempt from filing acquisitions of shares or voting rights (a) pursuant to a bonus issue or stock splits or buy backs and (b) pursuant to subscription rights, not leading to acquisition of control
  - Filing fees increased
    - Form I (from INR 50,000 (USD 1,000) to INR 1,000,000 (USD 20,000)
    - Form II (from INR 1,000,000 (USD 20,000) to INR 4,000,000 (USD 80,000)

* The Competition Commission of India (procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2012

Highlights of the Amendments to the Combination Regulations

- **April 4, 2013***
  - Exempts the "gross acquisition" of shares or voting rights up to 5% in a financial year when the acquirer (or its group) already owns between at least 25%, but not 50% or more either prior to or after the acquisition (provided it does not result in sole or joint control by the acquirer or its group)
  - Broaden the scope of exemption given to the acquisition of current assets to include "trade receivables and other similar current assets"
  - Broadened the scope of exemption for intra-group mergers and amalgamations (from "wholly-owned" to "more than fifty per cent (50%) shares or voting rights" (provided it does not result in transfer from joint control to sole control)
  - Reduced the scope of the exemption for intra-group acquisitions in cases "where the acquired enterprise is jointly controlled by enterprises that are not part of the same group."

* The Competition Commission of India (procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2013

Federal Trade Commission Technical Assistance to CCI (Since August 2010)

August 2010	Investigative Techniques Seminar on Planning and Conducting an Abuse of Dominance Investigation
August 2010	Investigative Techniques Seminar on Investigating Horizontal Restraints
September 2010	Investigative Techniques Seminar on Planning and Conducting a Merger Investigation
April 2011	Identification and Proof of Agreements and Trade Association Conduct
April 2011	Economic Framework for Merger Review & Analysis
August 2011	Merger Review & Analysis (Part I)
September 2011	Merger Review & Analysis (Part II)
September 2011	Practical Skills for Investigating an Alleged Abuse of Dominant Position (Director General Staff)
July 2012	Economic and Financial Analysis for Merger Review
August 2012	Advanced Economic Issues (held in Washington, D.C.)
September 2012	Advanced Issues in the Analysis of Anticompetitive Agreements

Some Observations

- **CCI burdened by heavy case load**
  - Large backlog of pending MRTPA cases transferred to CCI
  - Many consumer protection and private dispute cases
  - Competition Act's order requirement in cases of no violation (order subject to appeal)

- **Professional staffing issues**
  - Investigative (DG) staff (about 11 of 32 positions filled)
    - Too small; no economists
  - CCI staff (about 40 of 90 positions filled)
    - Too few economists (no PhDs); no role in DG's investigations; role within CCI not clear

- **Anticompetitive agreements**
  - Some good decisions (e.g., *Uniglobe Mod Travels v. Travel Agents Ass'n of India* (Oct. 4, 2011) and *Vedant Bio Sciences v. Chemists & Druggists Ass'n of Baroda* (Sept. 5, 2012))
  - Some difficulty with inferring agreements (particularly DG staff)
    - Observable act versus challenged conduct
    - Concern with noncompetitive appearance of market
    - But see *All India Tyre Dealers' Federation v. Tyre Manufacturers Ass'n* (Oct. 30, 2012)

Some Observations

- **Abuse of dominant position**
  - Market definition: No demonstrated ability to conduct SSNIP test
    - Focus almost exclusively on functional interchangeability and seldom on price
    - Decisions often lack views of industry participants
    - Sometimes do not distinguish marginal consumers from infra-marginal consumers
  - Dominance: Found dominance at 30% market share with actual new entry (*MCX Stock Exchange Ltd. v. National Stock Exchange* (June 23, 2011) (dissent by Members Gouri and Goel))
  - Some "difficulty" with aftermarkets
  - Lack of effects-based analysis (no AAEC clause in Section 4)

- **Merger review: the sky has not fallen, at least not yet**
  - CCI has met its commitment to complete initial reviews in 30 days (95% within 30 days (net))
  - CCI has been responsive to stakeholder concerns
    - Issued amendments to existing merger regulations in February 2012 and April 2013
    - Some movement toward ICN Recommended Practices
  - But has requested additional information and documents in 60% of merger transactions
  - Will CCI be able to conduct a sound market definition analysis when the time comes?

Some Observations

- **No "national champion" or SME mindset in competition law or policy**
  - Foreign direct investment (as of September 14, 2012)
    - 100% for single-brand retail (must source 20% locally)
    - 51% for multi-brand retail (up to individual state)
  - No special treatment for small and medium size enterprises
  - MCA championing a Draft National Competition Policy

- **Monetary penalties:** Guidance needed on CCI's approach to calculation of penalties
  - Up to 10% of the average turnover for the last three years
  - Cartels – greater of 10% of turnover or 3X the profit for each year of the violation
  - Lack of clarity on how penalties are determined ("commensurate" to the violation)
    - All sales/profits or only those at issue
    - Percentage calculation
      - » *MCX Stock Exchange Ltd. v. National Stock Exchange* (June 23, 2011) (AOD case with a fine of 5% of average T/O or about $1.1 million)
      - » *Belaire Owner's Ass'n. v. DLF Limited and HUDA* (Aug. 12, 2011) (AOD case with a fine of 7% of average T/O or about $126 million)
      - » *Builders Association of India v. Cement Manufacturers' Assn.* (June 20, 2012) (Cartel case with a fine of 0.5X net profit or about $1.2 billion)

- **Private antitrust bar:** some good antitrust attorneys, some not so good antitrust attorneys



ANTITRUST PERSPECTIVE ON INNOVATION, NEW PRODUCT DEVELOPMENT, STANDARD SETTING AND LICENSING

AXINN | VELTROP | HARKRIDER | LLP

Antitrust, Innovation, and Standard-Setting

John D. Harkrider

STANDARDS 101

Industry standards are a crucial part of the global economy—and have been for decades

May be set collaboratively through formal standards bodies, called standard-setting organizations (“SSOs”) or standards-development organizations (“SDOs”), or by individual firms in the marketplace

Examples of “formal” standards and SSOs:

- 2G, 3G, 4G cellular technology (ETSI)
- 802.11 WiFi (IEEE)
- HTTP, SSL (IETF)

Examples of *de facto* standards and their creators:

- Alternating-current electricity (Tesla/Westinghouse)
- VHS (JVC)
- Blu-ray DVD (Sony)

THE BENEFITS AND RISKS OF STANDARDS

Standards enable products from a variety of manufacturers to interoperate

- E.g., Windows phones, Android devices, and iPhones are compatible thanks to cellular standards

Benefits: Network effects enhance value, producers can focus on developing better products

Risks: Enhanced value from standardization can confer power on companies with patents essential to standardized technology

Potential for patent holders to “hold up” implementers

Solution: reasonable or royalty-free licensing commitments

- Standardization, whether formal or *de facto*, often predicated on such commitments

F/RAND COMMITMENTS

Patent holders often commit to license their standard-essential IPR on fair, reasonable and nondiscriminatory terms as a condition of standardization

- Often required by SSOs
- Can be made voluntarily by firms seeking to establish *de facto* standards in marketplace

F/RAND commitments balance the interests of patentees (innovators) and licensees (implementers)

- Prevent *ex post* hold-up by patentees, thereby inducing licensees to adopt standards
- Encourage patentees to innovate and contribute technology, because patentees can obtain return on their innovative efforts

MEANING OF F/RAND

Emerging consensus around meaning of F/RAND:

- No injunctions against willing licensees
- Cash-only license option
- On a standard-by-standard basis, standalone license must be available for SEPs reading on particular standard
- Same-standard reciprocity

Emerging consensus around meaning of “willing” licensee:

- If negotiations not fruitful, licensee willing to pay neutrally-determined compensation (set by court or arbitration)

INJUNCTIONS AND SEPS

Where implementer refuses to negotiate or is unwilling to pay neutrally-set rates, availability of injunctions facilitates standard-setting

- No “hold up” power

The threat of an injunction can induce even an otherwise unwilling counterparty to negotiate

- Promotes resolution of the dispute
- Can induce pro-competitive cross licensing and “patent peace”
- Avoids appropriation of patentee’s legitimate IP rights

Without injunctions, risk of “hold up” simply replaced by risk of “hold out”

Injunctions far from automatic: courts must consider validity and infringement, *eBay* factors

THE "HOLD UP" PROBLEM: MORE HYPOTHETICAL THAN REAL?

Little evidence of "hold up"

- No injunctions issued in U.S. over smartphone SEPs
- Only SEP injunction Motorola secured in Europe was lifted as soon as Apple agreed to pay court-confirmed FRAND rate
  - In compliance with German *Orange Book* procedures
  - Six attempts before court found Apple to be making FRAND offer

"SSO and industry participant commentators overwhelmingly report that patent hold-up is not a problem." –**Roger Brooks**, 2011

"There is little evidence that 'patent hold-up' in the standards context is a real problem." -**Microsoft**, 2011

Is "hold out" the real problem?

- Apple has not paid *any* royalties for Motorola's U.S. SEPs despite 5+ years of attempted negotiations and litigation
- Over that time, reaped up to 80% of profits in smartphone industry

INJUNCTIONS AND THE RISK OF ASYMMETRICAL REMEDIES

FRAND commitments have been interpreted to be contracts, and implementers to be third-party beneficiaries

- Result: implementers can bring single breach of contract claim and set portfolio-wide rate

SEP-holders lack an equivalent remedy

- Without injunctive relief available, only option is seriatim damages litigation on patent-by-patent basis

Need for balanced approach to avoid this problem recognized by industry participants and antitrust agencies

VIEWS FROM THE INDUSTRY

"Any uniform declaration that [injunctions] would not be available if the patent holder has made a commitment to offer a RAND license for its essential patent claims in connection with a standard may reduce any incentives that implementers might have to engage in good faith negotiations with the patent holder."

-**Microsoft**, Comments to FTC Patent Standards Workshop (June 14, 2011)

"If the infringer is unwilling to accept terms that have actually been affirmed as RAND by a court, there is no reason for it to be able to continue infringing; no one can contend that a RAND commitment by a patent owner is consent to royalty-free licensing, or to a treadmill of sequential litigations to recapture unpaid royalties as damages."

-**Qualcomm**, Comments to FTC Patent Standards Workshop (June 13, 2011)

VIEWS FROM THE INDUSTRY (CONT.)

"A categorical rule preventing FRAND-encumbered SEP-holders from seeking injunctions on SEPs would unfairly penalize SEP holders for having given FRAND commitments—by artificially devaluing SEPs and overvaluing non-SEP implementation patents. As a result, patentees will have less of an incentive to participate in standard setting, be less inclined to contribute their technology to standards, and in general invest less in improving standards and innovation."

-**BlackBerry**, Apple v. Motorola *Amicus* Brief (May 7, 2013)

"Rather than a categorical prohibition on injunctive relief in the standard-essential patent context, the appropriateness of such relief should be considered on a case-by-case basis . . . The FTC has recently issued several public interest statements and consent orders, each of which counsel for this approach by noting that injunctive relief should be available in the standard-essential patent context under certain circumstances, such as where the infringing party is an unwilling licensee under the patent holder's patents."

-**Nokia**, Apple v. Motorola *Amicus* Brief (Apr. 4, 2013)

VIEWS FROM THE AGENCIES

"[I]f a putative licensee refuses to pay what has been determined to be a F/RAND royalty, or refuses to engage in a negotiation to determine F/RAND terms, an exclusion order could be appropriate . . . [T]he imposition of one-size-fits-all mandates for royalty-free or below-market licensing…would undermine the effectiveness of the standardization process and incentives for innovation."

-**DOJ/USPTO**, Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments (Jan. 8, 2013)

"We agree that injunctions may issue in certain situations even when a RAND-encumbered SEP is involved, such as when a licensee is unwilling to license on FRAND terms."

-**FTC**, *In re Motorola Mobility*, Statement of the Commission (Jan. 3, 2013)

IN RE MOTOROLA MOBILITY: A BALANCED APPROACH

Key aim of the *Motorola Mobility* Order is to ensure that willing licensees are not subject to SEP injunctions

Google/Motorola can't get an injunction on FRAND-encumbered SEPs against willing licensee and must:

- Offer to license at least 6 months prior to seeking injunctive relief
- Offer to arbitrate the reasonableness of any disputed license terms at least 60 days before seeking injunctive relief (and hold that offer open for at least 30 days after filing suit).

For existing actions, can't get injunction without following process in Order

Generally prohibits injunctive relief against a party that brings a timely action to have a court determine FRAND terms for relevant SEPs if the counterparty agrees to be bound by the result of that rate-setting

WHITHER STANDARD-SETTING?

System of bilateral negotiations over SEPs worked smoothly for decades

SEPs have been caught up in the "patent wars"

- Google acquired significant SEP portfolio through Motorola Mobility acquisition, wants patent peace
- In Microsoft's and Apple's strategic interests to devalue SEPs

Devaluation of SEPs undermines incentives for participation in SSOs

Less innovation, greater reliance on proprietary or *de facto* standards?



ANTITRUST ISSUES IN DOING BUSINESS IN CHINA

BAKER & McKENZIE

Antitrust Issues in Doing Business in China

Fourth Annual Chicago Forum on International Antitrust Issues



Steve Harris

June 13, 2013

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The China Anti-Monopoly Law: Overview

The Anti-Monopoly Law (AML)

- Effective 30 August 2008
- 4 Main Policies:
  - Prohibiting and Preventing Anti-Competitive Mergers and Acquisitions (“Concentrations”)
  - Prohibiting and Punishing Anti-Competitive Agreements (“Monopoly Agreements”)
    - Horizontal and Vertical
  - Prohibiting and Punishing Abuses of Dominance
  - Prohibiting Abuses of Administrative Power that Harm Competition

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Pre-existing Related Laws

- Anti-Unfair Competition Law
- Price Law
- Bidding Law
- Contract Law
- Foreign Trade Law
  - Each may conflict with AML in certain cases

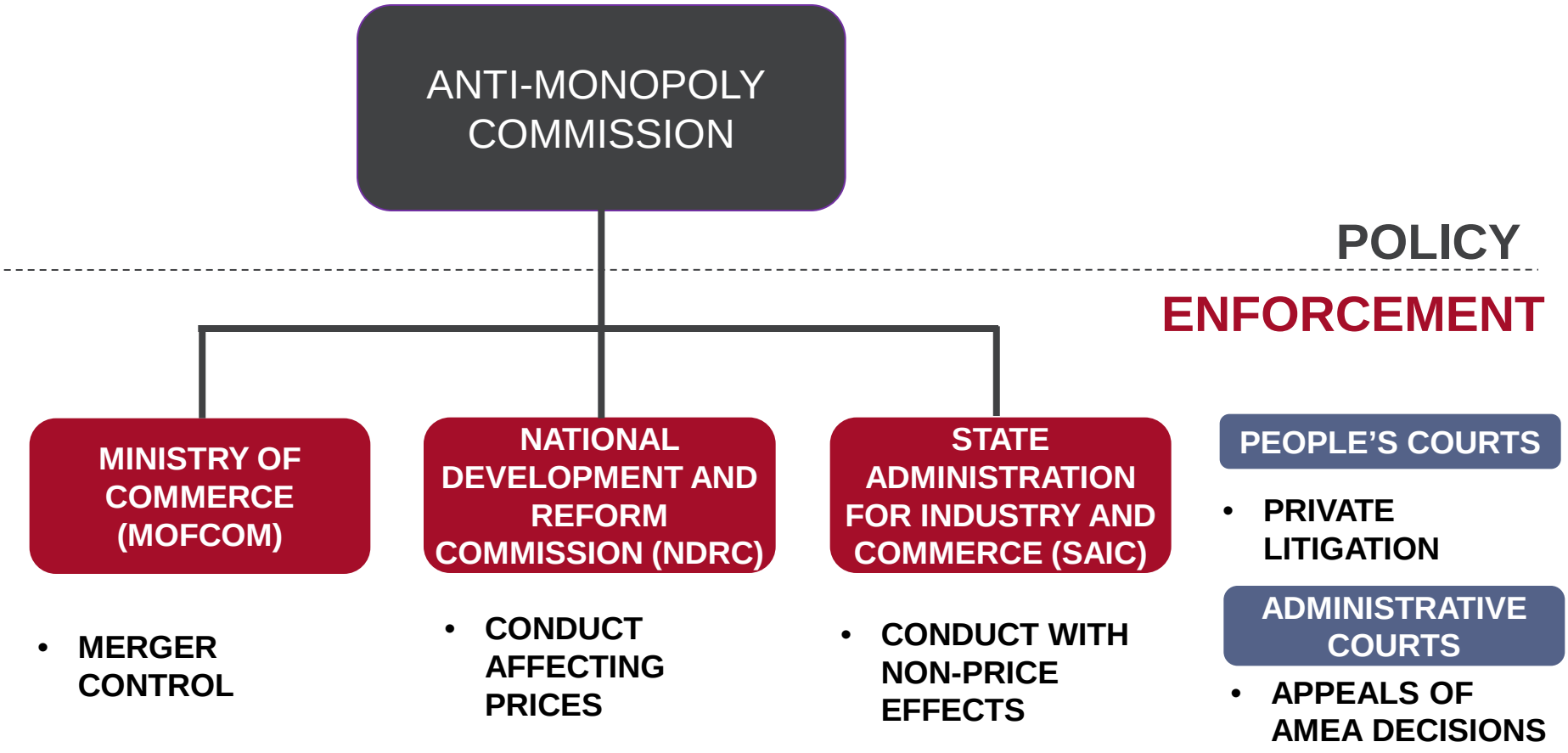
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Enforcement of the AML

- 1 Policy Agency (AMC)
- 3 Anti-Monopoly Enforcement Authorities (AMEAs)
  - MOFCOM
  - NDRC
  - SAIC
- People's Courts (IP Tribunals)
  - Private Litigation
- Administrative Courts
  - Appeals of AMEA Decisions

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AML Enforcement Structure



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IP in the AML

- AML Art. 55
  - "This Law is not applicable to conduct of undertakings to exercise their intellectual property rights in accordance with the intellectual property laws and relevant administrative regulations; however, this Law is applicable to conduct of undertakings that abuses their intellectual property rights to eliminate or restrict competition."
  - Art. 55 is in the miscellaneous chapter, not monopoly agreement or abuse of dominance chapters. So, to violate Art. 55, entity may not need to be dominant.
  - Abuse not defined yet.

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IP in the AML

- AML Art. 13(4)
  - Prohibits license that requires licensee to agree not to license technologies from the licensor's competitors.
  - Prohibits "restricting the purchase of new technology" or "restricting the development of new technology."
  - May be used to require license where needed for company using technology of licensor to develop newer technology.

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IP in the AML

- AML Art. 13(5)
  - Prohibits joint boycotting.
  - Does this require standard-setting organizations to allow all companies to join?
  - Does this prohibit patent pools from refusing to license to all?

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IP in the Contract Law

- Contract Law Art. 329
  - Renders invalid any agreement that illegally monopolizes technology, impairs technological advancement or infringes on the technology of a third person

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Competition in the Patent Law

- Patent Law Art. 48(2) authorizes SIPO to grant compulsory (patent) licenses if a patentee eliminates or restricts competition

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IP and Foreign Trade Law

- Regulation on Administration of Import and Export of Technologies (RAIET)
  - Art. 27 vests ownership of improvements to licensed technologies in the party making improvements

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SAIC Draft Intellectual Property Guidelines

SAIC Draft IP Guidelines

- Art. 4: Abuses of IP rights that eliminate or restrict competition constitute three kinds of violations of the AML:
  - Abuses of IP rights to arrive at monopolistic agreements (patent pooling; possibly SSO activities)
  - Abuse of a dominant position that is based mainly on IP rights
  - Mergers and acquisitions involving IP rights that may create the ability to eliminate or restrict competition
- Article 6 – Reaches abuse of IP rights outside China which eliminates and restricts competition in China

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SAIC Draft IP Guidelines

- Article 8 - Will consider technology markets, as well as product markets
- Article 9 – As in the U.S., market power is not automatically assumed from the presence of IPR.
- Article 12 – Creates safe harbors where:
  - An agreement is between two competitors with total market share of 20% or less and there are at least four other competitors possessing alternative IPR; or
  - The companies are not competitors, the combined market share is less than 30% and there are at least two other companies having alternative IPR.

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SAIC Draft IP Guidelines

- Art. 16: Where a company holds a dominant position achieved largely through IPR, SAIC can determine whether
  - the license royalties are unfairly high prices
  - there is a justifiable reason to refuse to license
  - there is a justifiable reason for differential license fees to comparable trading counterparts
- Art. 17: Refusals to license IP rights may constitute an abuse of dominance if a dominant IP owner:
  - Unfairly or discriminatorily refuses to license their IP

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SAIC Draft IP Guidelines

- Refuses to license IP rights that are an essential element for the licensee to compete in the relevant market, and the refusal to license will prevent the licensee from competing effectively, with adverse impact on competition and innovation, preventing satisfying the reasonable demands of customers
- Uses the refusal to license to engage in tying (requiring parties to buy an unwanted product, or license unwanted IP in order to license the desired IP)

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SAIC Draft IP Guidelines

- Art. 19: Unreasonable trading conditions involving IP rights refers to IP owners imposing the following conditions contrary to the wishes of the licensee:
  - Grantback provisions
  - No-challenge provisions
  - Precluding the licensee, after expiry of license, from manufacturing, using, or selling competing goods or technologies
  - Other “unreasonable trading conditions” as identified by the AMEAs

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SAIC Draft IP Guidelines

- Art. 21 – “Patent Pools”
  - Recognizes the benefits of patent pools, e.g., integrating complementary technologies, eliminating patent barriers, reducing infringement litigation.
  - Certain terms in a patent pool license may be viewed as eliminating or restricting competition:
    - Prohibiting patentees from independently licensing patents outside the pool
    - Forcing licensees to give exclusive grantbacks of improvements

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SAIC Draft IP Guidelines

- Prohibiting challenges to validity of patents in the pool
- Charging different royalties to licensees in the same market without valid justification
- Restricting licensors or licensees from conducting R&D in competing technologies
- Requiring grantbacks from licensees

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SAIC Draft IP Guidelines

- Art. 22 provides that certain standard-setting behavior may violate the AML, including:
  - Where the patent holder knows or should have known that its patent may be included in the standard;
  - The patent holder fails to disclose its patent per the SSO policy;
  - The patent holder, after the release of the standard, asserts its patents; and
  - The conduct causes or is likely to have an adverse effect on competition or innovation.

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SAIC Draft IP Guidelines

- Examples given:
  - Refusal to license on reasonable terms
  - Discriminating by imposing different royalties or license terms

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Proposed Regulation on Standards for Simple Mergers

Proposed Regulation for Simple Cases of Mergers

- Article 2 – Simple Cases:
  - Where the parties are in a horizontal relationship, they total less than 15% of the relevant market
  - Where they are in a vertical relationship, each party has less than 25% of the related vertical markets
  - Where there is no horizontal or vertical relationship and each party has a market share of less than 25%

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Proposed Regulation for Simple Cases of Mergers

- Article 3 – Expedited treatment would not be available where:
  - Joint venturers combine and the JV and a party to the JV are competitors in the same relevant market;
  - Where the relevant market is difficult to define;
  - Where the concentration may have a detrimental impact on market access and/or technological progress

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Proposed Regulation for Simple Cases of Mergers

- Comments are centering around:
  - The difficulty of defining relevant markets in many cases
  - Vagueness of the standard that a merger “may have a detrimental impact on market access and/or technological progress”
  - A challenge of administering the rule and how that would be done
  - Will “simple status” be considered only if the parties seek it, or will it be determined by MOFCOM regardless of whether the parties request it?

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Proposed Regulation for Simple Cases of Mergers

- At what point in the review process will the determination of “simple status” be made?
- What will the consequences of that determination be?

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Draft Rules on Merger Remedies

Draft Rules on Merger Remedies

- Types of Remedies
  - Structural – Asset Sales, Divestiture of Intellectual Property Rights
  - Behavioral remedies such as mandating access to network infrastructures or platforms, licensing of key technologies
- Article 7 – Generally the parties would be asked to make remedy proposals, which are then subject to negotiation with MOFCOM

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Draft Rules on Merger Remedies

- Article 10 – MOFCOM may seek views from other government departments, industry associations, business operators and consumers
- Article 15 – The purchaser of a divested business must be independent of the parties and equipped with the necessary resources and capabilities to operate the divested business as a competitive force in a market
- Article 18 – MOFCOM can require a signed sales agreement with a purchaser of divested assets or stock before a concentration is cleared

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Draft Rules on Merger Remedies

- Articles 23-29 – In the absence of a pre-closing divestiture, there are provisions to appoint a divestiture trustee
- Comments are centering around:
  - The difficulty of monitoring and enforcing behavioral remedies over time
  - The preference for transparency if it is sought from other government departments, industry associations and companies

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Draft Rules on Merger Remedies

- How a negotiation with respect to remedies will finally be concluded if the parties and MOFCOM cannot come to agreement
- Requests that the remedies regulation provide greater details as to timing and process for implementing remedies
- Whether key personnel can be mandated to accompany an asset or stock sale on divestiture

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Recent MOFCOM Merger Decisions

Marubeni Acquisition of Gavilon Holdings, LLC April 22, 2013

- June 19, 2012 – July 31, 2012: Preliminary questions before MOFCOM determined that the filing was completed
- During the review, MOFCOM determined a possible adverse affect in China's soybean import market
- As of the extended deadline, January 27, 2013, these concerns were not resolved

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Marubeni Acquisition of Gavilon Holdings, LLC April 22, 2013

- Therefore a withdrawal and re-file procedure was used.
  - The filing was withdrawn on January 25, 2013, resubmitted on January 31, 2013, and cleared on April 22, 2013
- The transaction was an acquisition by a Japanese trading company of a privately held U.S. company headquartered in Omaha, Nebraska

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Marubeni Acquisition of Gavilon Holdings, LLC April 22, 2013

- Remedy required establishing two independent legal entities for export of soybeans to China, continuing the competition in soybean sales and distribution from the two parties

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Glencore Acquisition of Xstrata

- April 1 – May 17, 2012: Time to determine filing was complete
- Twice extended review period on consent of notifying party
- Notifying party withdrew and refiled
- MOFCOM reviewed the authenticity, completeness and accuracy of documents and materials submitted by consulting other government agencies, industry associations and competitors

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Glencore Acquisition of Xstrata

- MOFCOM determined the acquisition eliminated and restricted competition in copper concentrate, zinc concentrate and lead concentrate. Therefore, the deal was approved on conditions:
  - Divestiture of Glencore's interest in a copper ore project in Peru; to be done after closing the larger transaction
  - Program of selling the project to begin within three months from the date of MOFCOM's decision; regular reports to MOFCOM about Glencore's efforts to seek a buyer

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Glencore Acquisition of Xstrata

- Details of potential buyer to be submitted to MOFCOM before August 31, 2014; binding sale agreement by September 30, 2014.
- If no binding agreement by September 30, 2014, and no completed sale by June 30, 2015, a divestiture trustee shall be appointed who shall sell Glencore's interest in any of four other projects through an unreserved auction within a three month time period.

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Recent Court Decision Imposing Compulsory License

Huawei v. Interdigital

- Huawei sued Interdigital alleging that Interdigital abused its dominant position as the owner of standard essential patents (SEPs) for mobile telephone technology
- Interdigital had reportedly offered a royalty rate consistent with terms regarded by ETSI as FRAND

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Huawei v. Interdigital

- The Shenzhen Intermediate Court court held that:
  - Interdigital's royalty rate was not FRAND
  - Even if it was FRAND, the royalty rate was excessive and should not exceed 0.019% of the sale price of each Huawei product using the patent
  - Interdigital tied the licensing of essential patents to the licensing of non-essential patents
  - Interdigital abused its IP rights by requiring that Huawei agreed to grant back certain patent rights

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Thank you!

Contact information:

stephen.harris@bakermckenzie.com

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EVALUATING THE EFFECTS OF MERGER POLICY

Assessing the Quality of Competition Policy: The Case of Horizontal Merger Enforcement

*William E. Kovacic**

This article suggests how a jurisdiction might best go about evaluating the quality of its competition policy system. It urges that competition agencies and collateral institutions strive to improve the ability to measure the economic effects of merger control and to verify the consequences of different approaches to enforcement. The article uses merger control in the United States as its main illustration, but the article's observations apply to other areas of competition policy oversight, as well. The article seeks to encourage the recent trend within the global competition policy community of accepting a norm that focuses greater attention on the evaluation of the economic effects of enforcement decisions—especially by developing better quantitative measures of actual economic effects—and the assessment of the processes by which competition agencies examine individual transactions.

*The author is a Commissioner of the U.S. Federal Trade Commission, on leave from the George Washington University Law School. The views expressed here are the author's alone.

I. Introduction

Horizontal merger policy is an important focus of contemporary discussions about the quality of competition policy.[1] It should be. Horizontal merger policy attempts to forestall combinations that otherwise would permit the merged entities to exercise substantial market power, and it tries to curb the creation of market environments that encourage coordination by rival firms through tacit coordination or the formation of express agreements. Because society also has a major stake in allowing business restructurings that improve economic performance, both in individual transactions and in the preservation of a robust market for corporate control, merger policy ought to go about these tasks without blocking combinations that are benign or procompetitive.

The fulfillment of these objectives has important links to other areas of competition law.[2] If merger control misses the dominance issue, mergers can create durable market power with consequent adverse effects on prices, quality, and innovation. If merger control overlooks a transaction's contribution to oligopolistic interdependence, a merger can contribute to a market configuration in which the surviving firms either find it easier to establish effective cartels by a direct exchange of assurances or to use indirect means to realize the results that express agreements yield. Because competition law has not addressed dominance or tacit collusion with great success, it matters that merger policy make proper choices about when to intervene.[3]

In most jurisdictions, the competition agencies evaluate transactions before the parties complete them.[4] This process is unavoidably predictive and, in a number of instances, speculative. In a wide range of matters, no analytical calculus provides a sure way to distinguish transactions that pose anticompetitive dangers from those which promise to be benign or procompetitive. The examination of a proposed transaction often involves difficult, probabilistic assessments of future commercial developments. This is especially true in markets that display high levels of dynamism owing to technological or organizational innovation, or to developments in trade, transport, and communications that link previously isolated geographic regions into unified commercial markets.

Each possible course of action by a competition agency poses risks. Block the deal improvidently, and valuable economic benefits from consolidation are lost. Accept the wrong divestitures or conduct-related undertakings as conditions of allowing the deal to proceed, and the agency creates an illusion of effective intervention that masks future anticompetitive results. Unwisely allow the deal to proceed as proposed, and consumers suffer the costs of diminished economic performance. The public statements of agencies concerning specific decisions to intervene or take no action ordinarily either acknowledge no risks associated with the choice taken or assert that all risks were thoughtfully and correctly weighed. It takes a high and unusual level of institutional self-assurance to state that the chosen course of action could be wrong.

Seen in the aggregate, public enforcement decisions over time reflect more humility about the analytical quandaries and difficult judgments associated with merger control than do the agencies' portrayal of individual episodes of review. The history of merger review has featured what best can be seen as a series of experiments through which the public agencies have used various analytical and procedural measures to improve the accuracy of the predictive process. Modern commentary tends to accept the view that contemporary analytical methods are superior to predecessor techniques, but that may be because many contemporary commentators played some part in creating the modern techniques. The field is still a work in progress, and much remains to be done to improve procedures and substantive analysis, particularly for what might generally be labeled as the hard cases.

So how are we to tell if a competition system is doing a good job of the important, forward-looking exercise of merger control? A popular and seemingly irresistible technique is to measure the worth of a competition agency by studying how often it blocks deals, allows deals, or subjects proposed transactions to elaborate analysis.[5] Commentators lean on this method so often and so heavily that they forget its frailties. To say that an agency is doing a lot of things or only a few things does not tell us whether it is doing the right things. In sport, coaches admonish athletes not to equate activity with accomplishment.[6] So it should be for merger control.

In sport, coaches admonish athletes not to equate activity with accomplishment. So it should be for merger control.

There is a debate worth having, and that is whether antitrust oversight of mergers is improving or retarding economic performance. Answers to questions about actual economic effects will not emerge from the study of activity levels, unless we bravely (and dubiously) assume that specific levels of enforcement activity invariably or typically beget good results. Especially amid larger contemporary debates about the correct form of government intervention in the economy, we cannot rely on these feeble proxies to assess effectiveness. When competition policy agencies ask external audiences to accept the value of antitrust intervention on faith, they are likely to hear variants of the aphorism: In God we trust; all others provide data.[7] The relevant data cannot be found in simple counts of merger reviews and challenges.

This article suggests how a jurisdiction might best go about evaluating the quality of its competition policy system. It urges that competition agencies and collateral institutions strive to improve the ability to measure the economic effects of merger control and to verify the consequences of different approaches to enforcement.[8] The article uses merger control in the United States as its main illustration, but the article's observations apply to other areas of competition policy oversight, as well. The article seeks to encourage the recent trend within the global competition policy community of accepting a norm that focuses greater attention on the evaluation of the economic effects of enforcement decisions—

especially by developing better quantitative measures of actual economic effects[9]—and the assessment of the processes by which competition agencies examine individual transactions.[10]

The article begins the treatment of evaluation with several normative propositions about what is good merger policy. Part III sketches the pendulum narrative of modern U.S. antitrust enforcement. This narrative figures prominently in discussions about the quality of U.S. merger policy since the early 1960s and relies chiefly on activity-based measures of efficacy to identify dramatic changes in policy over time. The pendulum narrative attributes the observed variations in activity to changes in political leadership. Part IV suggests future focal points for evaluation and means for assessing the quality of merger review. Among other sources, it draws upon the results of a recently completed self-study of the U.S. Federal Trade Commission (FTC).[11]

II. What Is "Good" Merger Policy? Three Suggested Criteria

Discussions about competition policy tend in a colloquial way to ask whether public enforcement agencies are doing a "good" job of carrying out their responsibilities. This form of discourse seldom involves a careful specification of what constitutes "good" performance. Expressly or implicitly, levels of enforcement activity are the foundation for judgments.

In the case of merger policy, an appropriate assessment of the quality of merger policy should focus on three criteria. First, has merger policy improved economic performance by reducing the price or improving the quality of goods or services? This is the essential question about the effectiveness of merger policy. It is worth asking and debating regularly. A merger review system accomplishes this result by intervening to correct or preclude transactions that pose serious competitive dangers and by allowing combinations that promise to have benign or procompetitive effects.

The second criterion is whether individual competition systems minimize unnecessary implementation costs within and across jurisdictions. Enforcement agencies should seek to achieve a given level of monitoring and enforcement at the lowest possible cost to society.[12] Among other means, a jurisdiction can eliminate unnecessary burdens associated with its own notification procedures and investigations, promote international standardization based on superior techniques, and raise levels of interoperability across competition systems.

The third criterion is whether a competition system has committed itself to a process of continuous reassessment and improvement.[13] This has two dimensions. The first deals with the testing and improvement of methods to assess (a) the economic consequences of individual decisions to intervene or not to intervene

and (b) the aggregate effects of a system of merger review. The second involves an examination of the procedures for merger review and an analysis of whether the jurisdiction can achieve a given level of oversight at lower cost. Improvements in both dimensions require competition authorities to make meaningful disclosures about decisions to prosecute or not prosecute, to maintain and reveal informative data sets about activity levels, and to refine techniques—with the agency's resources and in cooperative ventures with external bodies such as research institutions—for measuring actual economic effects of intervention decisions.

III. Modern U.S. Merger Policy: Alternative Narratives

Discussions about the quality of merger policy ought to dwell upon whether a system of competition law satisfies the criteria sketched above. Such discourse frequently does not. In many instances, assessments of merger policy neither define normative criteria clearly nor apply them systematically. In other cases, problems associated with the measurement of merger enforcement consequences cause commentators to run away from the issue of actual economic effects. The means for determining the economic effects of merger policy are not ideal.[14] In practice, it can be difficult to determine how merger control, in individual cases or across a range of intervention opportunities, affects economic performance.

Owing to problems of measurement, the antitrust community ordinarily succumbs to the temptation to duck the ultimate question of economic effects.[15] Discussions about the quality of merger enforcement instead use a variety of effectiveness proxies. Three stand out. The primary fallback is to trace and analyze levels of activity, such as the total number of government interventions over a period of time or the percentage of all transactions in which the competition agency conducts an elaborate inquiry or takes action to modify or block a deal. By this measure, enforcement quality is inferred from rates of action or inaction.

OWING TO PROBLEMS OF MEASUREMENT, THE ANTITRUST COMMUNITY ORDINARILY SUCCUMBS TO THE TEMPTATION TO DUCK THE ULTIMATE QUESTION OF ECONOMIC EFFECTS.

A second popular evaluation technique is to seek out the opinions of practitioners about the quality of the competition authority's performance. Is it challenging too many deals, or too few? Are remedies too weak or too strong? Does the agency have sound processes in place for sorting out the good and the bad? Compared to other eras of competition policy, is it easier, or more difficult, today to get a merger approved by the enforcement agency?

In principle, practitioner views can be valuable source of information, and commentators and competition authorities ought to seek them out. As present-

ed in the literature on merger control, practitioner views tend to be qualitative, unsystematic, and unverifiable. As a group, the accounts of practitioner views generally provide a haze of unattributed impressions that no outsider can test rigorously. Some commentary offers the vastness of the narrator's own experience as authority that an asserted proposition captures a broad, important reality.[16] Other articles and press reports quote unidentified individuals with the suggestion that the speakers have revealed universal, fundamental truths.[17] There have been some efforts to conduct surveys of larger numbers of practitioners, but these seldom specify or discuss the transactions that provide the basis for the participants' qualitative views, and the identities of the participants invariably are anonymous. The anonymity may be necessary to avoid retribution by a competition agency that dislikes the speaker's opinion, but anonymity also relaxes the speaker's incentives to portray events fully and accurately.

The third approach is to present specific enforcement episodes as exemplars of the competition agency's philosophy about merger control. By offering an exemplar, the commentator asks the reader to draw broader conclusions about whether the competition agency's analytical methods and ultimate conclusions are sound.[18] Case studies can be informative in what they say about the agency's philosophy, analytical perspectives, and methodology. Yet individual enforcement episodes too often are analyzed in isolation. To be reliable as a way to make larger judgments about the quality of merger enforcement, one needs a sufficiently large number of case study observations to know how the agency is performing in any single period or across periods. For example, comparisons of enforcement choices in specific sectors over time can help illuminate adjustments in policy and technique, and can offer insights about how a collection of consolidation events affected sectoral performance.

Activity levels, practitioner perspectives, and the occasional case study provide the main ingredients for discussions of U.S. merger policy. Below I describe the most popular approach —the pendulum narrative—that commentators use to assess the quality of merger policy. In this narrative, federal merger enforcement swings dramatically from extraordinary intervention to extraordinary permissiveness as a consequence of political appointments to the two U.S. antitrust authorities, the Department of Justice ("DOJ") and FTC. The discussion then presents an alternative interpretation of U.S. experience.

A. THE PENDULUM NARRATIVE OF MODERN MERGER ENFORCEMENT

The leading narrative about modern U.S. antitrust enforcement policy uses the metaphor of a swinging pendulum to describe shifts in the government's approach to intervention.[19] This metaphor is popular among academics, journalists, and practitioners as a way to explain patterns of public antitrust enforcement and to assess the quality of merger control in individual eras. The pendulum narrative posits a fundamental instability in U.S. competition policy. Pendulum narrators attribute this instability largely to changes in the country's political lead-

ership, although streaks of raw enforcement agency irrationality divorced from political forces also receive some credit. Thus, in its attempts "to balance possible threats to competition against merger benefits," modern U.S. merger policy often "has careened from one extreme to another in this balancing process."[20] This is not a flattering characterization of U.S. experience. Reckless drivers careen. Good public policy does not.

As applied to merger policy, the pendulum narrative divides the modern U.S. enforcement experience into four periods. Public enforcement policy toward mergers is said to have been too aggressive in the 1960s and 1970s, too lenient in the 1980s, just right in the 1990s, and too cold again in the first decade of the 21st century. This mimics the classification scheme first introduced in the account of Goldilocks and her encounter with the three bears: U.S. merger policy is first too hot (1960s-1970s), then too cold (1980s), then just right (1990s), and then too cold again (2000s).

RECKLESS DRIVERS CAREEN. GOOD PUBLIC POLICY DOES NOT.

Scholarly and popular commentary that embraces the pendulum narrative emphasizes what are said to be indefensible lapses in decision making, other than in the just-right era of the 1990s. In the other periods, government enforcement officials and judges appear incapable of well-reasoned, sober-minded thought. Thus, in the 1960s, federal enforcement policy is set by "antitrust witchdoctors,"[21] "trust-busting zealots … who saw evil in every big company or merger,"[22] and "excessively intrusive Populists."[23] With this collection of economic primitives in control, the government agencies "challenged everything."[24]

In the pendulum narrative's depiction of the 1980s, federal enforcement policy swings dramatically away from the mindless interventionism of the 1960s and the "extraordinary activism" of the Carter administration in the 1970s.[25] Thus begins the modern ice age of antitrust policy that is Ronald Reagan's presidency. During the Reagan administration, the federal antitrust agencies "trivialized" the U.S. antitrust laws[26] and produced "the most lenient antitrust enforcement program in fifty years."[27] In this era, federal antitrust "[e]nforcement ceased;"[28] "U.S. Federal merger enforcement ground to a halt;"[29] and the federal agencies achieved the "emasculation of the nation's merger policy."[30] The Reagan appointees responsible for these developments were characterized as "extremists"[31] given to "lawlessness"[32]—a "garbage barge of ideologues."[33] Their influence stemmed from brute political force, not the power of ideas. The Reagan administration's success in altering U.S. antitrust policy was "largely a political victory, not an intellectual or legal one."[34]

In the pendulum narrative, the wild swings in merger policy – from the hyperactive 1960s and 1970s to the indolent 1980s—ceased temporarily in the 1990s. Antitrust policy had a lucid interval during the Clinton administration. Through a series of prosecutions and non-litigation policy adjustments in the 1990s, the federal agencies "restore effective and sensible merger enforcement—avoiding the

undue activism of the 1960s and the extreme under-enforcement of the 1980s."[35] Spurring this temporary transformation was the appointment of new leadership to the federal agencies. "Beginning in the 1980s," observes one account, "we entered a period of calm on the merger front. This was particularly true at the Federal Trade Commission, which was seen as a sleepy agency. Then along came the appointment of Bob Pitofsky as Chair of the FTC [and] the appointment of Jon Baker as the Director of the FTC's Bureau of Economics."[36] Through the efforts of these appointees and the guidance of Justice Department officials such as Joel Klein, the enforcement pendulum came to rest at a thoughtful, moderate equilibrium.[37] Many authors who say federal enforcement policy attained a sensible, moderate equilibrium in the 1990s served as high officials in the antitrust agencies during the Clinton administration and helped mold the antitrust policies of the just-right era.[38]

MANY AUTHORS WHO SAY FEDERAL ENFORCEMENT POLICY ATTAINED A SENSIBLE, MODERATE EQUILIBRIUM IN THE 1990S SERVED AS HIGH OFFICIALS IN THE ANTITRUST AGENCIES DURING THE CLINTON ADMINISTRATION AND HELPED MOLD THE ANTITRUST POLICIES OF THE JUST-RIGHT ERA.

In the latest chapter of the pendulum narrative, the presidency of George W. Bush destroys the sensible balance of the 1990s and returns federal merger enforcement to the ice age. Like the experience in the 1980s in the Reagan administration, merger enforcement in the Bush administration features an "extraordinarily low level of government merger enforcement."[39] As the Bush presidency draws to a close in 2008, the merger policy "pendulum has swung too far in the direction of nonintervention."[40] The capacity of merger policy to swing toward excessive permissiveness is "particularly evident in the minimalist enforcement agenda of the Antitrust Division during the second term of the Reagan administration and during the George W. Bush administration."[41] On a good day, the public officials responsible for these developments are merely captives of "the excesses and rigidities of extreme theoretical economic analysis."[42] On a bad day, they are intellectually unprincipled. Not only do they employ "extreme interpretations and misinterpretations of conservative economic theory," they also engage in a "constant disregard of the facts."[43]

The three proxies for effectiveness mentioned earlier in this section serve as the factual foundations for the pendulum narrative's assessment of federal merger enforcement since 2001. First, several commentaries contend that enforcement policy during the George W. Bush administration was significantly more "lenient" than enforcement policy during the Clinton administration.[44] This deviation from past periods of enforcement is taken to show that the quality of merger policy has deteriorated.[45]

Second, Professors Jonathan Baker and Carl Shapiro surveyed twenty practitioners whose responses are said to indicate agreement with the view that DOJ and the FTC were more likely to approve mergers under the Bush administration than they had been in the previous decade.[46] In this survey, DOJ is reported to be more permissive than the FTC.[47] Professors Baker and Shapiro also present

quotations from news accounts saying that the Bush administration offers the best opportunity for firms to attempt anticompetitive transactions in the hope that permissive Bush antitrust appointees will not attack them.[48] As with activity rates, the greater permissiveness reported in the survey of practitioners and in the news accounts is said to show that the quality of merger policy has declined.

Third, Professors Baker and Shapiro offer a case study of the Whirlpool-Maytag merger, which DOJ approved in 2006. Professor Shapiro acted as a consultant for the Justice Department and urged DOJ to block the combination of the two producers of washing machines. DOJ did not do so. Professors Baker and Shapiro say DOJ's non-intervention in Whirlpool-Maytag reveals how the DOJ during the Bush administration embraced analytical techniques that improperly biased enforcement decisions toward non-intervention.[49]

In their review of Bush administration merger enforcement policy, Professors Baker and Shapiro expressly embrace the pendulum narrative[50] and conclude that "the pendulum has swung too far in the direction of nonintervention."[51] Criticizing "the too-ready acceptance by some courts and enforcers of unproven non-interventionist economic arguments about concentration, entry, and efficiencies," they propose measures to "reinvigorate horizontal merger enforcement."[52]

B. TOWARD AN IMPROVED INTERPRETATION OF MODERN U.S. MERGER POLICY

The pendulum narrative of modern U.S. merger enforcement policy portrays a system whose instability robs it of legitimacy. As Thomas Leary has observed, "How much credence could be given to merger policy if it really were so susceptible to change, depending on the outcome of Presidential elections?"[53] President Barack Obama may choose, as he promised during his campaign for the presidency, "to reinvigorate antitrust enforcement" and "step up review of merger activity."[54] If the narrative correctly interprets American antitrust experience, the U.S. system is so prone to politically-driven variations in enforcement that future presidential elections could send the merger policy pendulum swinging wildly again. There is no reason to expect that the just-right enforcement approach of the 1990s is the norm rather than an exceptional interlude.

IF THE NARRATIVE CORRECTLY INTERPRETS AMERICAN ANTITRUST EXPERIENCE, THE U.S. SYSTEM IS SO PRONE TO POLITICALLY-DRIVEN VARIATIONS IN ENFORCEMENT THAT FUTURE PRESIDENTIAL ELECTIONS COULD SEND THE MERGER POLICY PENDULUM SWINGING WILDLY AGAIN.

To study the pendulum narrative carefully is to see that, in its struggle to accentuate the swings of the pendulum, it provides an unsupportable, unreliable interpretation of modern U.S. merger control. With repeated telling, the pendulum narrative ignores discordant facts and obliterates troublesome complexities in merger enforcement policy. This is a serious obstacle to

effective public administration. Without an interpretation that more faithfully recounts actual events and forswears superficial explanations in favor of deeper exploration of causes, the antitrust community will neither understand why policy evolved as it did, nor will it identify paths for improvement going ahead. This section discusses some of the pendulum narrative's main faults and offers an alternative interpretation of modern U.S. merger policy that suggests important elements of continuity and progressive, cumulative development.

1. Failings of the Pendulum Narrative

The narrative depends crucially on fractured accounts of antitrust history to highlight the asserted reasonableness of merger policy in the just-right 1990s. To accomplish this result, the narrative must frame the just-right era between periods of indefensible extremism—the too-hot era of the 1960s and 1970s, and the too-cold periods of the 1980s and the current decade. There is an evident compulsion in the pendulum narrative to achieve rough symmetry in the swings away from the sensible middle of the 1990s—to show that the too-hot and too-cold periods displayed comparable levels of extremism.

The effort to achieve symmetrical, massive swings away from a sensible mean requires unacceptable distortions in the presentation of antitrust history. The narrative depicts the too-hot era as a time of irrational, fanatical intervention undisciplined by sound analysis of individual mergers or thoughtful reflection upon recent experience. For commentators who endorse the pendulum narrative's account of merger policy and its treatment of the 1990s as a sensible mean between periods of extremism, there appears to be a felt need to single out and disavow the too-hot 1960s as a way of signaling the reasonableness of their views.[55]

> Did merger policymaking in the United States in the 1960s, as the pendulum narrative suggests, simply and inexplicably lose its mind?

Did merger policymaking in the United States in the 1960s, as the pendulum narrative suggests, simply and inexplicably lose its mind? To be sure, merger enforcement standards were highly interventionist.[56] The interesting question is why they came to be so. Was merger enforcement policy "careening" because it was driven by what the pendulum narrative calls antitrust witchdoctors, zealots, or populist extremists? To reflect upon who made the policy is to see that the pendulum narrative's fundamental weaknesses. The epithets of irrationality poorly describe FTC Commissioner Philip Elman, who applied his formidable intellect in the 1960s to shape conglomerate merger enforcement doctrine that attracts intense rebuke today.[57] Nor does Donald Turner resemble the enforcer who single-mindedly seeks to expand the government's ability to "challenge everything." In DOJ's 1968 merger guidelines, Turner took critical steps to retrench the existing zone of government merger enforcement. This self-correcting measure, which existing trends in judicial analysis did not compel DOJ to undertake, proved to be an enormously influ-

ential exercise in wise self-assessment and prudential self-restraint.[58] Turner and his 1968 guidelines fit awkwardly in a narrative in which enforcement extremists, zealots, or witchdoctors careen out of control. The pendulum narrative seizes up if such complexities are acknowledged and the apparent capacity of public enforcement agencies to reassess policy and make appropriate refinements is taken into account.

The second pillar of the pendulum narrative's effort to highlight the sensibility of the just-right 1990s is to portray merger enforcement policy in the 1980s and in the 2000s as dramatic swings toward non-intervention. To achieve the desired stark contrasts, the pendulum narrative must side-step or flatten out phenomena that suggest continuity across periods or otherwise reduce the degree of variation. This explains demonstrably false observations that federal merger enforcement "ground to a halt" in the 1980s,[59] and that the FTC was a "sleepy agency" when it came to merger control.[60] It also accounts for the perceived imperative to say that enforcement officials from these periods were extremists and ideologues.[61] If their thinking was so cramped, it would have been difficult for these enforcement officials to devise policy measures such as the 1982 DOJ merger guidelines, whose intellectual vision brought about enduring changes in U.S. policy and changed, by way of persuasion, how the world's competition agencies think about merger policy.[62] Few of the world's merger guidelines today do not owe an intellectual debt to William Baxter and his DOJ guidelines team.

The recent Baker & Shapiro paper evaluates horizontal merger enforcement policy since 2001 with the assistance of the pendulum narrative. The paper is more measured than some in its assessment of the enforcement agencies during the administration of George W. Bush, and its claims are more nuanced than much of the pendulum narrative literature. Professors Baker and Shapiro properly draw attention of the antitrust community to issues associated with the future development of judicial doctrine governing horizontal mergers. The Baker/Shapiro paper usefully helps define issues for future debate about the role of structural presumptions. Their discussion of enforcement agency policy could bring more attention to the pursuit of better techniques for measuring the consequences of merger enforcement choices. These are useful contributions to future policy making.

In its discussion of the work of the federal enforcement authorities since 2001, the Baker/Shapiro paper does little to improve our understanding of the quality of modern merger enforcement policy generally or of the merger programs of the DOJ and the FTC. The paper's findings rest heavily upon an examination of levels of federal agency enforcement activity. It detects a decline in enforcement activities, and it treats this trend as a reliable indication that the quality of merger enforcement policy deteriorated during the presidency of George W. Bush.[63]

These conclusions, which use activity levels as proxies for the quality of merger control, place unsupportable faith in the reliability and meaning of data on

rates at which the federal agencies engage in enforcement related activities—for example, how often they issue second requests or intervene to block or modify mergers. Assembling an informative data set that permits meaningful comparisons of activity rates between presidential administrations is a difficult undertaking. Calculations based on activity levels require extraordinary care in determining whether observed activity levels across periods are genuinely comparable.[64] Among other steps, this demands close examination and classification of the type of transactions coming before the agencies at any one time. Relatively small adjustments to account for various factors can change the results materially. The effort to amass activity-related data sets with high levels of comparability is worthwhile for the agencies and collateral institutions, such as research institutes, as one part of the effort to assess merger policy. At best, existing data sets permit conclusions about activity levels that require careful, and perhaps debilitating, qualification.

THESE CONCLUSIONS, WHICH USE ACTIVITY LEVELS AS PROXIES FOR THE QUALITY OF MERGER CONTROL, PLACE UNSUPPORTABLE FAITH IN THE RELIABILITY AND MEANING OF DATA ON RATES AT WHICH THE FEDERAL AGENCIES ENGAGE IN ENFORCEMENT RELATED ACTIVITIES.

Let's suppose that we had absolutely precise and meaningful comparisons of activity over time. It is not clear that variations in activity across periods tell us anything about the larger question posed earlier in this article: How has public merger enforcement affected economic performance? Activity levels say nothing about whether an agency's work has positive or negative economic effects. It is one thing to say that enforcement has become "tougher" or "more lenient" in the sense that the agency is intervening more often or less often as a percentage of all matters to come before it. It is another thing to say that a given level of activity begets specific economic results.

Professors Baker and Shapiro supplement their examination of activity levels with a survey of 20 distinguished practitioners with extensive experience in competition law. The authors do not identify the participants by name, but their identities can be reverse engineered from information provided in the paper. Surveys and interviews can provide useful information about merger enforcement—especially about the effectiveness of the processes by which agencies study individual transactions. On the question of economic effects, surveys have nothing to say, unless the participants have specific data to offer about individual transactions. A general statement that is easier or more difficult to get deals through does not improve our understanding of economic effects unless the speaker at least identifies specific transactions to provide a concrete basis for knowing which deals ought to have been modified or stopped.

The participants in the Baker/Shapiro survey presumably knew what hypothesis the authors were testing and knew how the authors were likely to portray the survey result. Are the authors confident that the participants, owing to past serv-

ice with a specific presidential administration or a preference for a political party in the 2008 elections, would not answer questions in any way strategically to bias the results? The participants provided narrative answers to the survey questions, and the authors coded them on a five-point scale. The aggregate scores are offered as evidence of greater Bush administration permissiveness and, by inference, of weaker enforcement policy quality. Are the authors confident that their own preferences—both worked for the Clinton antitrust agencies in the 1990s—did not affect their scoring of the responses?

The third measurement technique in the Baker/Shapiro paper is a case study of the Whirlpool/Maytag transaction. The authors say they "are deeply concerned that the Whirlpool case is indicative of an overly lax approach to merger enforcement at the current Justice Department."[65] Case studies can be informative tools for understanding what an enforcement agency has done and for making judgments about the soundness of its analytical approach. First-person accounts, such as Professor Shapiro's observations from his perspective as a consultant to DOJ on Whirlpool/Maytag, can be enlightening.

IT TAKES EXTRAORDINARY SELF-DISCIPLINE FOR A FIRST-PERSON NARRATOR TO AVOID THE TEMPTATION TO SKEW THE NARRATION IN WAYS THAT, AT LEAST TO SOME DEGREE, UNDERSCORES THE APPARENT REASONABLENESS OF THE NARRATOR'S VIEWS.

For all of their positive attributes, case studies informed by first person accounts of events also present problems that affect their value. It takes extraordinary self-discipline for a first-person narrator to avoid the temptation to skew the narration in ways that, at least to some degree, underscore the apparent reasonableness of the narrator's views.[66] One such problem is selectivity in singling out a case study as the informing exemplar. An example of this selectivity is to take an individual merger review episode in isolation and attribute great significance to that episode alone. When the narrator presents the single episode as the informing example, is the attitude toward risk exhibited in that episode unique to the incumbent agency leadership, or might their predecessors have made decisions that showed a similar tolerance for risk?

There is a way to avoid misinterpretations of single merger review episodes, and that is to do comparisons over time. A useful way to test whether an agency at any one moment is taking unacceptable risks in allowing mergers to proceed is to use other case studies from other periods to get a rough sense of how the agency in other periods assessed risk and accounted for risk. Did DOJ gamble excessively in allowing Whirlpool and Maytag to combine? We can ask: compared to what? One approach to seeing if Whirlpool/Maytag tells us something important and distinctive about DOJ decision making since 2001 is to look more closely at transactions approved by the Clinton administration in the just-right 1990s.

For example, what does the FTC's decision to allow Boeing to purchase McDonnell Douglas in 1997 tell us about the Clinton administration's treatment of risk in merger analysis? Professor Baker was the FTC's chief economist when Robert Pitofsky and his colleagues reviewed and approved the transaction with no modifications. I consulted for McDonnell Douglas in this merger, and I believe that the FTC properly declined to take any action. Yet the merger involved many defense and commercial aerospace markets that were close calls.[67] In approving the deal, the Commission took risks about the future of competition in commercial aircraft production and military systems (such as fighter aircraft, aerial refueling tankers, and innovation in the design of weapons generally) that are at least as great as those DOJ took in allowing Whirlpool to buy Maytag. A right-minded person reasonably could have voted to block the Boeing/McDonnell Douglas merger on the ground that these risks were unacceptable. If DOJ behaved unreasonably in Whirlpool/Maytag, was the FTC's decision in Boeing/McDonnell Douglas appropriate?

IF DOJ BEHAVED UNREASONABLY IN WHIRLPOOL/MAYTAG, WAS THE FTC'S DECISION IN BOEING/MCDONNELL DOUGLAS APPROPRIATE?

The same question about enforcement agency risk-taking across time periods can be posed in connection with the Clinton administration's review of mergers involving the petroleum industry. No sector of FTC competition policy responsibility has received more intense and critical congressional scrutiny in this decade. Since 2001, FTC officials have made many appearances before congressional committees to answer questions about the agency's review of mergers involving petroleum companies, especially transactions that took place during the Clinton administration in the 1990s. A much-repeated charge by members of Congress is that the FTC oversight of mergers in the 1990s was lax—that the Commission improvidently allowed, albeit with substantial divestitures in some cases, Exxon to buy Mobil, Chevron to buy Texaco, BP to buy Arco and then Amoco, and many others. Imagine that these transactions had taken place during the George W. Bush presidency. What would the pendulum narrative have to say if the FTC in the Bush administration had made exactly the same choices as the Clinton administration made in the 1990s? By further point of comparison, recall also that it was during the too-cold period of the Reagan administration that the FTC sued to bar Mobil from buying Marathon Oil Company, the 16th largest U.S. refiner.[68]

In 2004, the Government Accountability Office ("GAO") published a study that sought to measure the price effects of eight mergers that took place during the Clinton administration. It concluded that six of the eight mergers—including Exxon/Mobil—caused prices to increase.[69] Professors Baker and Shapiro are familiar with a number of the transactions that have received criticism from Congress and from the GAO. Many of the relevant transactions took place during Professor Baker's tenure as the head of the FTC's Bureau of Economics, and

Professor Shapiro advised British Petroleum in support of its acquisition of Amoco.

On the FTC's behalf, I have testified on several occasions since 2001 to defend the Commission's petroleum industry program and to rebut the GAO's criticisms of Clinton administration merger enforcement policy in this sector.[70] On those occasions I have said, and I believe today, that the FTC's choices in these matters were correct. Even if my assessment is right, there remains the question of how the chances the FTC took in those cases compare to the chances taken by DOJ in Whirlpool/Maytag. How should we assess the competitive risks of the FTC's decision to allow some transactions (e.g., Unocal/Tosco) to proceed without modification, or the risks associated with divestitures required as a condition for allowing other transactions to go through (e.g., Exxon/Mobil)? How do those risks—as well as the sector-wide risks associated with the many petroleum transactions that the Clinton FTC approved in whole or in part—compare to the risks taken by the DOJ in Whirlpool/Maytag?

To consider the wisdom of the enforcement agency's decisions about what risks to take and when to intervene, single episodes of merger review—such as Whirlpool/Maytag—should be analyzed in a larger context when the enforcement agency has made judgment calls no less problematic in other periods that are depicted as eras of sound public administration. The potential adverse economic and social consequences of the FTC getting things wrong in the aerospace and defense sector and in the petroleum industry in the 1990s are at least as grave as the hazards of having DOJ improvidently permit two leading producers of washing machines to merge. In the Baker/Shapiro account of Whirlpool/Maytag, one gets no idea that the Clinton antitrust agencies might have taken risks of equal or greater magnitude. Measured by risks taken and risks avoided, Boeing/McDonnell Douglas and the petroleum deals of the 1990s are as damning of FTC enforcement under Bill Clinton as Whirlpool/Maytag is of DOJ's work under George W. Bush. They ought to be part of the story.

2. An Alternative Interpretation: The Role of Continuity

Horizontal merger policy has changed considerably since the early 1960s. The process of change has involved a significantly greater degree of continuity that the pendulum narrative suggests. The first ingredient has been a gradual narrowing of the zone of liability.[71] This narrowing has been largely continuous rather than sharply discontinuous. Using a rough structural measure, the threshold at which the federal agencies could be counted on to apply strict scrutiny and to be most likely to challenge involved a reduction of the number of significant competitors in the following manner: 1960s (12 to 11), 1970s (9 to 8), 1980s (6 to 5), 1990s (4 to 3), 2000s (4 to 3). These thresholds can be derived from parsing the cases which the government agencies chose to litigate. It is reasonable to debate whether a 4 to 3 deal had a better chance of getting through in this decade than it did in the 1990s. The main point is that the perimeter the feder-

al agencies have been defending has shrunken substantially over the decades. This is a function of the agencies' own reassessments of policy and of interpretations of merger law in the lower federal courts.[72]

The second ingredient has been an increased willingness on the part of the agencies to engage in fact-intensive analysis that qualifies the application of structural criteria. This is evident in decisions taken in matters such as Boeing/McDonnell Douglas and in Whirlpool/Maytag. It is entirely appropriate to ask whether the agencies have applied qualifying factors correctly. The key point here is that modern experience, especially since the issuance of the 1982 DOJ merger guidelines, has involved greater consideration of non-structural criteria and more willingness to experiment with enforcement approaches short of outright prohibition to resolve competitive concerns.

THE MAIN POINT IS THAT THE PERIMETER THE FEDERAL AGENCIES HAVE BEEN DEFENDING HAS SHRUNKEN SUBSTANTIALLY OVER THE DECADES.

Seen this way, modern U.S. enforcement policy toward horizontal mergers has not resembled a wildly swinging pendulum. There instead has been a relatively steady progression toward a narrower zone of enforcement for horizontal transactions. The pendulum narrative and its emphasis on enormous periodic policy swings deflect attention away from the larger question raised above: Is this trend of enforcement policy, combined with reinforcing doctrinal developments in the courts, producing desirable economic effects? That question, rather than an examination of aggregate activity levels or single cases, ought to occupy the attention of the competition policy community.[73]

III. Conclusion: Institutional Arrangements for Evaluation

The development of a performance evaluation methodology for horizontal merger enforcement and other forms of competition policy can take advantage of a growing body of experience and scholarship with the subject.[74] Improvements in existing evaluation programs and extensions of the methodological state of the art might proceed along several paths. One is to engage competition authorities and researchers in more extensive collaborative discussions about existing projects and in explorations about evaluation techniques. This can take place in a variety of multinational and regional forums such as the International Competition Network and the Organization for Economic Cooperation and Development. In recent years, these and other organizations have shown an increased interest in operational issues, including performance management. Another way is for competition agencies to form partnerships with major research institutions.

A second element is for competition authorities to expand resources devoted to performance measurement. Agencies can ensure that, in every budget cycle, there are outlays for evaluation. These performance measure exercises can be carried out by agency insiders, external consultants, or some combination of the two. Competition authorities with common interests and common investigations usefully could cooperate to do relevant research. Focal points for collaboration would include the assessment of economic effects and of the processes for merger control. In making budget outlays, agencies should view performance measurement as an integral element of the policy-making life cycle and not simply as a luxury. Performance measurement investments are part of the policy research and development ("R&D") by which a public competition authority grows smarter.

A third element is to continue and extend the trend of publishing fuller data sets on merger enforcement activity.[75] For the DOJ and the FTC, this means an acceleration of the recent trend to publish accounts of decisions not to prosecute and to issue reports on major variables affecting the decision to prosecute. These transparency measures could be coupled with workshops and seminars that rely on these and other materials to discuss enforcement trends and effects.

GOOD POLICY RUNS ON AN INFRASTRUCTURE OF INSTITUTIONS, AND BROADBAND-QUALITY POLICY CANNOT BE DELIVERED ON DIAL-UP-QUALITY INSTITUTIONS.

All of these measures will help to build and reinforce an ethic of self-assessment and continuous improvement. They underscore the importance of institutional improvement as a necessary complement to advances in doctrine or theory. Good policy runs on an infrastructure of institutions, and broadband-quality policy cannot be delivered on dial-up-quality institutions. If one asks whether the U.S. antitrust agencies have got things just right today, the answer yesterday and today is no. If one asks whether there are measures in place to get there, the answer is emphatically yes. Better answers to the question of how to assess actual economic effects of enforcement will be key ingredients of reaching that destination.

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1 For a representative discussion of current issues, *see Roundtable Discussion on Developments—and Divergence—in Merger Enforcement*, 23 ANTITRUST 9 (Fall 2008).

2 *See* William E. Kovacic et al., *Quantitative Analysis of Coordinated Effects*, ANTITRUST LAW JOURNAL (forthcoming 2009) (discussing connections between merger policy and learning from antitrust enforcement against cartels).

3 In an unpublished lecture at the Federal Trade Commission in the early 1980s, I recall Phillip Areeda borrowing a Cold War metaphor from George Kennan to describe merger control. Areeda said merger policy was antitrust law's program of "containment" because it sought to avoid the expansion of dominance and the growth of oligopolistic market structures which invited tacit coordination that yielded cartel-like results but generally evaded effective intervention by competition bodies.

4 Many competition policy regimes oblige the parties to notify the public enforcement agency of a proposed transaction. In these systems, the parties may not complete the consolidation until the agency has had a period of time to analyze the likely competitive effects. In a number of other systems, premerger notification and review are optional, but many companies choose to report proposed mergers in advance and allow the authority to review them before the integration of assets takes place.

5 In U.S. parlance this is the "second request." In the European Union, it is the second phase inquiry.

6 This advice seems to have primeval, untraceable antecedents.

7 I thank David Hyman for bringing this caution to my attention.

8 For an earlier treatment of this theme, *see* William E. Kovacic, *Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy*, 9 George Mason L. Rev. 843 (2001).

9 The case for increased efforts to conduct quantitative studies of the effects of merger policy is presented in Dennis W. Carlton, *The Need to Measure the Effect of Merger Policy*, 22 Antitrust 39 (Summer 2008).

10 These trends are reviewed in William E. Kovacic, *Using Ex Post Evaluation to Improve the Performance of Competition Policy Authorities*, 31 J. Corp. L. 503 (2006).

11 The Federal Trade Commission at 100: Into Our 2d Century (January 2009), available at http://www.ftc.gov/os/2009/01/ftc100rpt.pdf.

12 For statements of this normative aim and critical assessments of the efforts of the U.S. enforcement agencies to achieve this goal, *see* Joe Sims et al., *Merger Process Reform: A Sisyphean Journey?*, 23 Antitrust 60 (Spring 2009); Joe Sims & Deborah Herman, *The Effect of Twenty Years of Hart-Scott-Rodino on Merger Practice: A Case Study of Unintended Consequences Applied to Antitrust Legislation*, 65 Antitrust L. J.865 (1997).

13 The Federal Trade Commission at 100, *supra* note 11, at 22-23.

14 *See* Carlton, *supra* note 9, at 23 (noting that the dearth of quantitative studies and measures of effectiveness "means that there is no reliable guide for determining whether our antitrust policy is too lax in some areas and too stringent in others").

15 Professor Carlton observes: "Antitrust analysis of proposed mergers has become increasingly sophisticated. Evaluation of antitrust policy has not." *Id*. at 42.

16 *See*, e.g., Thomas G. Krattenmaker & Robert Pitofsky, *Antitrust Merger Policy and the Reagan Administration*, 33 Antitrust Bull. 211, 228 (1988) ("Our experience has been that the U.S. business community has read the enforcement actions of the Reagan administration as an invitation to everyone to merger with anyone.").

17 *See*, e.g., Thomas L. Greaney, *Merger Mania Has Gone Too Far*, St. Louis Post-Dispatch, Feb. 27, 1991, at 3B ("At the height of the Reagan administration's permissiveness toward corporate mergers, a former assistant attorney general with the Carter administration summarized the advice he was giving clients: 'I simply tell them that there's no merger not worth trying.'").

18 *See*, e.g., Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in How Chicago Overshot the Mark 235, 248-51 (Robert Pitofsky ed., 2008) (discussing DOJ decision not to oppose the merger of Whirlpool and Maytag).

19 The popularity of the pendulum metaphor is traced in William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 Antitrust L.J. 377 (2003).

20 Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 Geo. L.J. 195, 196 (1992).

21 Arthur Austin, *Antitrust Reaction to the Merger Wave: The Revolution vs. the Counterrevolution*, 66 N. C. L. Rev. 931, 939 (1988).

22 The New Enforcers, The Economist, Oct. 7, 2000, at 79, 80.

23 Robert A. Skitol, *The Shifting Sands of Antitrust Policy: Where It Has Been, Where It Is Now, Where It Will Be in Its Third Century*, 9 Cornell J. L. & Pub. Pol'y 239, 253 (1999).

24 *Klein Spurs Consumer Action to Address Challenges of Information Age, Globalization*, 76 Antitrust & Trade Regulation Report (BNA) 559, 560 (May 20, 1999) (*hereinafter* Kein Spurs Consumer Action) (quoting Joel Klein, Assistant Attorney General for Antitrust, U.S. Department of Justice).

25 Janet L. McDavid & Robert F. Leibenluft, *What Impact Will Bush Have?*, Nat'l L.J., Feb. 5, 2001, at B8.

26 Eleanor M. Fox & Robert Pitofsky, *The Antitrust Alternative*, 62 N.Y.U. L. Rev. 931, 931 (1987).

27 Robert Pitofsky, *Does Antitrust Have a Future?*, 76 Geo. L.J. 321, 321 (1987).

28 Lawrence A. Sullivan & Wolfgang Fikentscher, *On the Growth of the Antitrust Idea*, 17 Berkeley J. Int'l L. 197, 206 (1998).

29 Eleanor M. Fox, *Can We Control Merger Control? – An Experiment, in* Policy Directions for Global Merger Review 79, 84 (Global Competition Review: Special Report by the Global Forum for Competition and Trade Policy, 1999). *See also* Jonathan B. Baker & Robert Pitofsky, *A Turning Point in Merger Enforcement: Federal Trade Commission v. Staples*, in Antitrust Stories 311, 315 (Eleanor M. Fox & Daniel A. Crane eds., 2007) ("during the second term of the Reagan Administration, merger enforcement came close to disappearing").

30 Walter Adams & James W. Brock, *Reaganomics and the Transmogrification of Merger Policy*, 33 Antitrust Bull. 309, 309 (Summer 1988).

31 *See* Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust – Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. Rev 936, 945 (1987) (describing the role of William Baxter, Reagan's first Assistant Attorney General for Antitrust, in altering federal enforcement policy in the 1980s: "It is often said that extremists are necessary to move tradition a short step. This is, perhaps, what Baxter and the Chicago School have done.").

32 Lloyd Constantine, Remarks Concerning How Antitrust Should Assess the Role of Imports in Market Definition 1, 1 (Oct. 19, 1995) (statement at Federal Trade Commission Hearings on Global and Innovation-Based Competition), available at http://www.ftc.gov/opp/global/speech.htm.

33 *ABA Annual Meeting Emphasizes Competitiveness, International Trade*, 53 Antitrust & Trade Regulation Report (BNA) 311, 315 (Aug. 20, 1987) (remarks of Senator Howard Metzenbaum).

34 Fox & Sullivan, *supra* note 31, at 947.

35 Baker & Pitofsky, *supra* note 29, at 315-16.

36 Eleanor M. Fox & Daniel A. Crane, *Introduction*, in ANTITRUST STORIES 1, 4 (Eleanor M. Fox & Daniel A. Crane eds, 2007).

37 Klein Spurs Consumer Action, *supra* note 24, at 560 (reporting that Joel Klein "expressed belief that the antitrust 'pendulum' on his watch had swung back to the 'middle,' where 'big was not necessarily bad' but government prudently cracked down on anti-consumer deals and practices"); James Toedtman, *Ball Is in His Court*, NEWSDAY, June 7, 1998, at F8 (quoting Joel Klein, Assistant Attorney General for Antitrust: "The pendulum is in the middle.").

38 *See*, e.g., Baker & Pitofsky, *supra* note 29, at 315-16. During their tenure with the enforcement agencies, the Clinton antitrust officials took pains to position their program as occupying the sensible middle ground. *See* Robert Pitofsky, Chairman, Federal Trade Commission, An Antitrust Progress Report for the FTC: Past, Present, and Future, Remarks Before the Antitrust 1996 Conference of Business Development Associates Inc. 2 (Mar. 4, 1996) ("The Commission of the 1990s has tried to strike a middle ground between what many people believe was an excessively active enforcement in the 1960s and the minimalist enforcement of the 1980s."), available at http://www.ftc.gov/speeches/pitofsky/speech4.htm.

39 Robert Pitofsky, *Reinvigorating Merger Enforcement That Has Declined as a Result of Conservative Economic Analysis*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 233, 233 (Robert Pitofsky ed., 2008).

40 Baker & Shapiro, *supra* note 18.

41 *Id*. at 269 n. 31.

42 Pitofsky, *Reinvigorating Merger Enforcement That Has Declined as a Result of Conservative Economic Analysis*, *supra* note 39, at 234.

43 Robert Pitofsky, *Introduction: Setting the Stage, in How the Chicago School Overshot the Mark* 3, 6 (Robert Pitofsky ed., 2008).

44 Baker & Shapiro, *supra* note 18, at 251.

45 *Id.* at 244-46.

46 *Id.* at 247-48.

47 *Id.* at 247.

48 *Id.* at 244.

49 *Id.* at 248-51.

50 *Id.* at 269 & n. 31.

51 *Id.* at 240.

52 *Id.* at 266-67.

53 Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 ANTITRUST L.J. 105, 106 (2002).

54 Statement of Senator Barack Obama for the American Antitrust Institute 1 (Feb. 20, 2008), available at http://www.antitrustinstitute.org/Archives/obama2.ashx.

55 *See*, e.g., Baker & Shapiro, *supra* note 18, at 266 ("We certainly do not propose a return to the horizontal merger control policies and precedents of the 1960s.").

56 The standards of legality established by Supreme Court merger decisions and government enforcement policy in the 1960s and through the early 1970s are described in Kovacic, *Enforcement Norms*, *supra* note 19, at 433-34.

57 Among other contributions, Elman authored the Commission decision that the Supreme Court ultimately upheld in Federal Trade Commission v. Procter & Gamble Co., 386 U.S. 568 (1967). For a summary of modern criticism of *Proctor & Gamble*, especially its suggestion that efficiencies caused by a merger either were irrelevant to the assessment of legality or might serve to condemn the transaction, *see* Ernest Gellhorn et al., ANTITRUST LAW AND ECONOMICS IN A NUTSHELL 462-63, 466-67 (5th Ed. 2004).

58 Turner's role as Assistant Attorney General for Antitrust from 1965 to 1968 and his contributions to improving the economic foundations of DOJ antitrust enforcement are examined in Oliver E. Williamson, *Economics and Antitrust Enforcement: Transition Years*, ANTITRUST 61 (Spring 2003), available at http://groups.haas.berkeley.edu/bpp/oew/Spring03-Williamson.pdf (last viewed 4/12/09).

59 Fox, *supra* note 29, at 84. Federal merger enforcement activities from 1981 to 1986 are documented in Ronald W. Davis, *Antitrust Analysis of Mergers, Acquisitions, and Joint Ventures in the 1980s: A Pragmatic Guide to Evaluation of Legal Risks*, 11 DEL. J. OF CORP. L. 25 (1986). Other surveys of the federal enforcement experience in this period include Leary, *supra* note 53, at 111-21 and Kovacic, *supra* note 19 at 435-47.

60 Fox & Crane, *supra* note 36, at 4. One gets a sense of the alertness of the FTC in the 1980s by reading noteworthy court of appeals opinions involving some of the enforcement decisions. These include Hospital Corp. of America v. Federal Trade Commission, 807 F.2d 1381 (7th Cir. 1986); Federal Trade Commission v. PPG Industries, 798 F.2d 1500 (D.C. Cir. 1986); Federal Trade Commission v. Warner Communications, Inc., 742 F.2d 1156 (9th Cir. 1984). These are not obscure cases.

61 *See supra* notes 31-33 and 42-43 and accompanying text.

62 The contributions of the 1982 DOJ merger guidelines to competition policy are examined in William B. Blumenthal, *Clear Agency Guidelines: Lessons from 1982*, 68 ANTITRUST L. J. 5 (2000); Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 ANTITRUST L.J. 253 (2003).

63 Another recent paper that travels largely the same path, with similar conclusions, based on activity levels is John D. Harkrider, *Antitrust Enforcement During the Bush Administration—An Economic Estimation*, 22 ANTITRUST 43 (Summer 2008).

64 These frailties are examined in Timothy J. Muris, *Facts Trump Politics: The Complexities of Comparing Merger Enforcement over Time and Between Agencies*, 22 ANTITRUST 37 (Summer 2008); *Roundtable Discussion, Advice for the New Administration*, 22 ANTITRUST 8, 13 (Summer 2008) (remarks of Timothy Muris).

65 Baker & Shapiro, *supra* note 18, at 250.

66 For a discussion of this pitfall and other limitations of first-person narrations of antitrust history, *see* William E. Kovacic, *Review of Antitrust Stories*, 4 Competition Policy International 241 (2008).

67 The transaction's competition issues are examined in detail in William E. Kovacic, *Transatlantic Turbulence: The Boeing-McDonnell Douglas Merger and International Competition Policy*, 68 ANTITRUST L. J. 805 (2001).

68 The FTC's opposition to Mobil's attempted purchase of Marathon and to Gulf Oil's attempted purchase of Cities Service is discussed in Kovacic, Enforcement Norms, *supra* note 19, at 444.

69 U.S. Government Accountability Office, Energy Markets: Effect of Mergers and Market Concentration in the U.S. Petroleum Industry (2004).

70 *See*, e.g., Market Forces, Anticompetitive Activity, and Gasoline Prices: FTC Initiatives to Protect Competitive Markets: Hearing on the Status of the U.S. Refining Industry Before the House Committee on Energy and Air Quality (July 15, 2004) (prepared statement of William E. Kovacic, FTC General Counsel), available at http://www.ftc.gov/os/2004/07/040715gaspricetestimony.pdf.

71 *See* Kovacic, *Norms*, *supra* note 19, at 433-438 (discussing merger enforcement trends over time); Kovacic et al., *supra* note 2.

72 The relevant jurisprudential developments are described in Kovacic, Enforcement Norms, *supra* note 19, at 433-47; Andrew I. Gavil et al., Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy 436-38, 451-55, 467-68, 553-54 (2d Ed. 2008).

73 Kovacic et al, *supra* (discussing how recent judicial merger decisions may underestimate competitive dangers).

74 Kovacic, Ex Post Evaluations, *supra* note 10, at 516-32; FTC at 100, *supra* note 11, at 146-53, 166-69.

75 For a discussion of initiatives in the United States, *see* FTC at 100, *supra* note 11, at 100-09.



BASIC ECONOMIC CONCEPTS ARISING IN ANTITRUST MATTERS

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MARKET DEFINITION AND UNILATERAL COMPETITIVE EFFECTS IN ONLINE RETAIL MARKETS

*Michael R. Baye**

ABSTRACT

Although the basic principles used to define a relevant market or to analyze unilateral competitive effects in traditional retail settings also apply in online retail markets, several features of the online environment add complexities to the analysis. This paper examines some of the results in the economics and marketing literatures that can influence market definition and competitive effects analysis in online retail settings. I argue that a failure to account properly for certain aspects of online markets can lead to erroneous definitions of the relevant market and, more importantly, erroneous conclusions regarding the unilateral competitive effects of horizontal mergers.

JEL: K21; L81

I. INTRODUCTION

Online retail markets are often portrayed as textbook examples of perfect competition. A 1999 article published in *The Economist*, for instance, promised that the Internet would bring "a new age of perfectly competitive markets."[1] The thinking was that the Internet would permit consumers to obtain perfect information about prices, which in turn would force firms to set prices at marginal cost.

Nearly a decade of economic research, however, reveals that the prices that online retailers charge for products ranging from books and CDs to more expensive consumer electronics such as printers, personal digital assistants, and TVs are hardly consistent with the perfectly competitive paradigm.[2] Different online sellers tend to charge significantly different prices

* Director, Bureau of Economics, Federal Trade Commission; Bert Elwert Professor of Business, Kelley School of Business, Indiana University. E-mail: mbaye@ftc.gov. I thank Liz Callison, Chris Metcalf, and Dan O'Brien for very helpful comments and discussions. The views expressed in this paper are those of the author and do not necessarily reflect those of the Federal Trade Commission or any of the individual Commissioners.

[1] *The Economist*, November 20, 1999, p. 112.

[2] For instance, there is evidence that the prices that Internet retailers charge for the same item differ by 33 percent for books and 25 percent for CDs; *see* Eric Erik Brynjolfsson & Michael D. Smith, *Frictionless Commerce? A Comparison of Internet and Conventional Retailers*, 46 MANAGEMENT SCIENCE 563–85 (2000). There is evidence that the average range in prices for consumer electronics products is even larger, about 40 percent; *see* Michael R. Baye, John

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for the same item.[3] Even at the most transparent of all online retail markets—a price comparison site—price dispersion is the rule rather than the exception and the "law of one price" is routinely violated. Unlike many offline markets, the identity of the firm offering the best deal tends to change very frequently. Frequent changes in the number of firms that sell a given product also contribute to the dynamics of many online markets. Furthermore, some online consumers tend to exhibit a degree of "loyalty" to branded e-retailers, and buy from their preferred e-retailer even when they are aware that a competitor is offering what would appear to be the same physical product at a lower price.[4] Other shoppers view a product sold by different sellers to be homogenous, and always buy at the lowest price that they find online.

In light of these observations, how does one go about defining a relevant market in online settings? Conceptually, the same principles articulated in the *Guidelines* also apply to online retail markets:

> A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price [SSNIP], assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.[5]

But, as we shall see, the nature of online competition affects a number of the fundamental ingredients required for defining a relevant market and in analyzing the unilateral competitive effect of a horizontal merger.

For instance, one of the distinguishing features of online markets is the ease with which online buyers can search for sellers offering the same

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Morgan & Patrick Scholten, *Price Dispersion in the Small and in the Large: Evidence from an Internet Price Comparison Site*, 52 JOURNAL OF INDUSTRIAL ECONOMICS 463–96 (2004).

[3] For a review of additional empirical studies that document significant online price dispersion, and a synthesis of a variety of theoretical models that rationalize price dispersion in online as well as traditional markets, *see* MICHAEL R. BAYE, JOHN MORGAN & PATRICK SCHOLTEN, *Information, Search, and Price Dispersion*, in HANDBOOK IN ECONOMICS AND INFORMATION SYSTEMS (Amsterdam: Elsevier 2006).

[4] *See*, for instance, Erik Brynjolfsson & Michael D. Smith, *The Great Equalizer? Consumer Choice Behavior at Internet Shopbots* (MIT Sloan Working Paper No. 4208-01, October 2001).

[5] Section 1.0 of the *Horizontal Merger Guidelines* at http://www.ftc.gov/bc/docs/horizmer.htm. Market definition is an analytical framework for analyzing consumer responses and demand substitution. However, the ultimate objective of merger analysis is to determine whether the acquisition is likely to lessen competition substantially. Not infrequently, particularly in cases that entail unilateral effects theories, there is evidence that can more directly test for the likelihood of competitive effects. In such cases, this information is also used simultaneously to define the relevant market. Indeed, some view the process as backing into a definition of the relevant market after determining competitive effects.

physical item (such as a specific model and brand of camera), and these search costs are virtually "free" within the confines of a price comparison site that lists the prices that many different sellers charge for the same physical product. On the surface, this opens a Pandora's box of potentially relevant substitutes that could lead to a more broadly defined relevant market and potentially mitigate the competitive effects of horizontal mergers. But the reality is that this is not necessarily the case, and in any event formal economic models suggest that certain features of online markets greatly complicate estimation of relevant demand elasticities and other "fundamentals" that are central to market definition and/or competitive effects analysis.

As in traditional market environments, the underlying nature of competition can also have an effect on market definition and competitive effects analysis in online retail markets. But unlike traditional markets, where the implications of different economic models (for example, Hotelling, Cournot, or Bertrand oligopoly)[6] for market definition or competitive effects are reasonably well understood, it is not widely recognized that different models of online competition (for example, Varian, Rosenthal, and Baye-Morgan)[7] have dramatically different implications for market definition and competitive effects analysis. For this reason, I also provide an overview of recent models that have been used to analyze competition in online retail markets, and show that subtle differences in these formal models can influence market definition and competitive effects analysis.

II. AN OVERVIEW OF COMPETITION AT RETAIL PRICE COMPARISON SITES

With this background, I now turn to online markets. Let me emphasize at the outset that there are many flavors of online markets ranging from auctions to markets for diverse types of advertising to a plethora of different types of e-retail markets. My focus here is on retail competition at price comparison sites—not because I view these markets to be more important than other online markets, but because these markets accentuate the informational features and low consumer search costs that are present in online markets more generally. My approach is stylized and designed to highlight

[6] Harold Hotelling, *Stability in Competition*, ECONOMIC JOURNAL 41–57 (1929); Antoine Cournot, RECHERCHES SUR LES PRINCIPES MATHÉMATIQUES DE LA THÉORIE DES RICHESSES (Paris: Hachette, 1838); Joseph Bertrand, *Review of Théorie Mathématique de la Richesse Sociale par Léon Walras: Recherches sur les Principes Mathématiques de la Théorie des Richesses par Augustin Cournot*, 67 JOURNAL DES SAVANTS 499–508 (1983).

[7] Hal R. Varian, *A Model of Sales*, 70 AMERICAN ECONOMIC REVIEW 651–59 (1980); Robert W. Rosenthal, *A Model in Which an Increase in the Number of Sellers Leads to a Higher Price*, 48 ECONOMETRICA 1575–80 (1980); Michael R. Baye & John Morgan, *Information Gatekeepers on the Internet and the Competitiveness of Homogeneous Product Markets*, 91 AMERICAN ECONOMIC REVIEW 454–74 (2001).

the relation between formal economic models of online competition and market definition/competitive effects analysis.

A price comparison site is an online marketplace where sellers—located in different physical locations that might range from Maine to California—compete in the same virtual location (the price comparison site's website) for consumers wishing to purchase a given product. Consumers or potential buyers also may be domiciled in different physical locations, but can visit the same virtual location (either in lieu of, or in addition to, visiting physical businesses in their locales) to purchase a specific item. Although items may be physically identical, retailers' services may differ and thus induce a degree of product differentiation in the eyes of some consumers. To the extent that different online consumers live in different locations (be they cities, states, or potentially even different countries), they may enjoy different offline options. They may also face different effective online prices due to differential shipping costs or sales taxes based on their domiciles. Thus, substitution possibilities may vary across consumers, and hence the degree of competition may vary across different retailers.

To illustrate the information available to consumers at price comparison sites, the results of a search for a Canon PowerShot SD900 digital camera at Shopper.com are displayed in Figure 1. At this "virtual" piece of real estate, six online retailers sell the same camera at six different prices ranging from a low of $309.00 to a high of $499.00.[8] It took only a few keystrokes and less than four seconds to obtain this comparative price information, which illustrates the virtually frictionless manner in which online buyers can find the best deals online. And despite the ease with which consumers can comparison shop, the prices exhibit significant price dispersion—competition has not driven all firms to charge the same price.

Importantly, and as discussed in the introduction, price dispersion is not unique to this particular item, website, or point in time; over the past decade, a host of studies in economics and marketing have documented ubiquitous price dispersion for thousands of other consumer products sold online. These studies also document that firms' prices tend to vary unpredictably, that the identity of the firm charging the lowest price tends to vary over time, and that there is little evidence that dispersion has declined over the past decade.[9]

With this background, I now highlight some of the issues and complications that can arise in defining a relevant market or evaluating competitive effects in an online setting.

[8] These prices include shipping and taxes (based on my zip code).
[9] *See*, for instance, Baye et al., *supra* note 2.

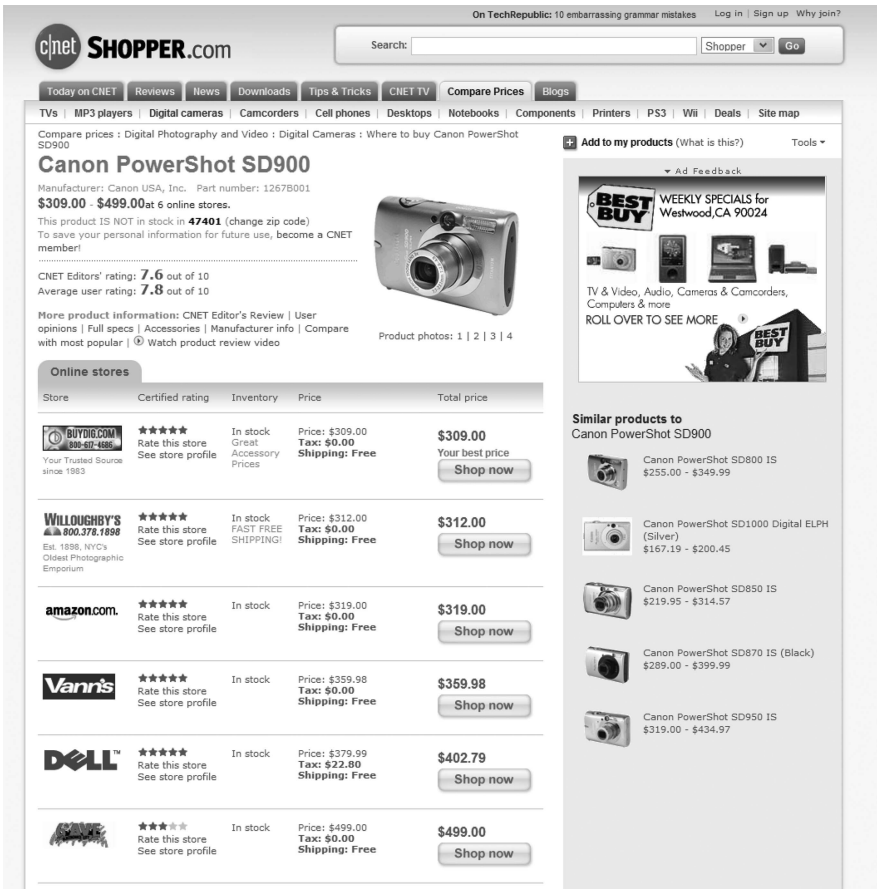


Figure 1. A screenshot from a price comparison site.

III. ISSUES THAT POTENTIALLY INFLUENCE MARKET DEFINITION AND COMPETITIVE EFFECTS "ONLINE"

Consider the issue of identifying the relevant geographic market. In the context of the example in Figure 1, one possibility is that the virtual real estate represented by the screenshot is the relevant geographic area. But there are certainly other online and offline locations where consumers might identify alternative sellers of this particular item. These alternatives include other price comparison sites (such as Nextag.com, Shopping.com, Kelkoo.com, and Pricegrabber.com), the websites of firms that eschew comparison sites altogether in favor of direct online sales through their own websites, and retailers who are purely brick-and-mortar operations. Some firms may use several of these channels, and either charge a uniform price

across all of these channels or price discriminate across them.[10] All of these factors can affect the definition of a relevant market.

Of course, even if there are options other than those displayed in Figure 1, some of these options may be attractive to some consumers but not others. For instance, U.S. consumers may find the transaction costs associated with purchasing the item from a seller that uses the European price comparison site, Kelkoo.com, prohibitive. Some consumers may prefer getting the item immediately at their local brick-and-mortar store, whereas consumers in rural areas may view online shopping as the only viable option given their location and transaction costs of using offline markets.

Even in traditional markets, a relevant market may exclude some sellers that offer the exact same physical item.[11] The same is true in online markets. Thus, even if other retailers sell the same item "outside" of the virtual real estate displayed in Figure 1, or sell closely related models of cameras, this need not be a deal-breaker for defining a relevant market that excludes these alternatives. It all boils down to whether the presence of these alternatives would significantly discipline the pricing decision of a hypothetical monopolist e-retailer at this particular virtual location.

To illustrate some of the complications that can arise in defining a relevant market in an online setting, I begin with a highly stylized hypothetical that ignores potential substitutes outside of the "virtual" market displayed in Figure 1. As will soon become apparent, even in this highly simplified environment—one that exclusively focuses on competition for this particular item sold within the confines of this specific comparison site (and thus ignores potential competition with retailers selling related products elsewhere)—it is hardly a trivial task to define a relevant market or to analyze competitive effects.

A. Establishing Market Fundamentals

Formal economic models indicate that market fundamentals—firms' marginal costs, demand elasticities, numbers of competitors, initial constellations of prices, and so on—can play a critical role in defining a relevant market and/or analyzing competitive effects. I next discuss features of online competition that can potentially distort perceptions of market fundamentals.

[10] Market definition differs in the case of price discrimination; *see* Section 1.12 of the *Guidelines*.

[11] Using the Guidelines definition, it is straightforward to construct a theoretical example of homogeneous product Cournot oligopoly such that a firm controlling only a subset of the identical products could profitably impose a small but significant and nontransitory increase in price, regardless of whether one permits rivals to adjust their prices and outputs. In practice, the *Guidelines* are rarely pushed this far, but it is not uncommon to exclude from the relevant market *some* firms that sell identical *physical* products (for example, paper or pens in the Staples–Office Depot case).

1. Relevant Costs of Competing at Comparison Sites

One of the striking features of price comparison sites is that they permit entrepreneurs domiciled in distant and even obscure locations to compete for consumers located in different cities around the world. The costs of establishing an online presence are typically perceived to be lower than those of establishing a brick-and-mortar presence because online sellers do not incur many of the costs that traditional brick-and-mortar establishments incur in opening and operating their businesses. However, it can be costly and take time for a new online seller to establish the reputation required to compete effectively against established retailers. Although these and other entry costs are potentially important in analyzing competitive effects in online markets, they are not relevant for market definition because that exercise presumes that a hypothetical profit-maximizing firm is "the only present and future producer or seller of those products in that area." However, there are other costs that are somewhat unique to online markets, and it is important to take them into account when estimating an online seller's relevant unit costs.

For instance, shipping costs can affect an online seller's marginal cost, and accounting for such costs is important because online sellers sometimes quote prices that include "free" shipping and handling. Additionally, some online sellers may enjoy tax advantages over their competitors (stemming from their physical locations) that permit them to sell products to consumers located in other states without directly collecting sales taxes. Significantly, one of the more important, and sometimes overlooked, components of an online seller's marginal cost is the click-through fees that it pays to the price comparison site for directing potential buyers to its own website to consummate a transaction.

More specifically, price comparison sites typically charge firms a fee each time that a consumer clicks on a link at the comparison site that directs the consumer to a particular retailer's website. This fee is paid regardless of whether the consumer ultimately makes a purchase. Click-through fees generally vary for different types of products but often range from 40 cents to $1 per click.[12]

Of course, not all consumers who click through to a retailer's website ultimately decide to make a purchase. Conversion rates—the fraction of those consumers clicking through to a given firm's website that ultimately makes a purchase—tend to vary across products. One source estimates that a typical online retailer must receive 20–30 clicks to generate a single sale.[13] At a cost

[12] *See* Michael R. Baye, J. Rupert J. Gatti, Paul Kattuman & John Morgan, *A Dashboard for Online Pricing*, 50 CALIFORNIA MANAGEMENT REVIEW (2007). Some price comparison sites set *minimum* fees that range from $.05 for books to $1.00 for consumer electronics products, but merchants pay more than these minimums to obtain more favorable screen locations. *See*, for instance, https://merchant.shopping.com/enroll/app?service=page/RateCard.

[13] *See* http://www.marketingexperiments.com/ppc-seo-optimization/comparison-search-engines-tested-analysis.html.

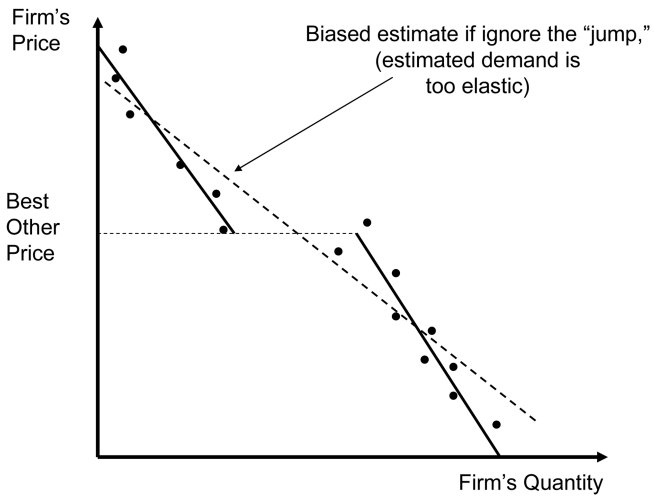


Figure 2. The presence of "shoppers" and "loyals" in online markets can result in biased estimates of the elasticity of demand.

of $1 per click, this would imply that click-through fees add $20–$30 to an e-retailer's marginal cost because, on average, it takes $20–$30 in clicks to sell a single item. Even abstracting from labor and other variable costs, this means that an online seller's marginal cost of selling an item online can be significantly higher than the e-retailer's wholesale cost of the item.

Failure to account for click-through fees, shipping costs, and other relevant components of online sellers' marginal costs tends to bias downwards estimates of online retailers' marginal costs. Other things equal, this biases upwards estimates of a hypothetical monopolist's profits from a given SSNIP and may lead to distortions in market definition and/or the analysis of competitive effects.

2. Demand Elasticities

Although e-retailers sell physically identical items at price comparison sites, economic and marketing research indicates that some online consumers view the same item sold by different sellers as differentiated products. As a consequence, some consumers are loyal to a particular seller up to a reservation price.[14] But there is also evidence that other consumers—as many as 13 percent—do not view online retailers as differentiated and buy purely on the basis of price.[15] As illustrated by the solid demand curve displayed in Figure 2, the presence of these two types of consumers leads to a

[14] Erik Brynjolfsson & Michael D. Smith, *The Great Equalizer? Consumer Choice Behavior at Internet Shopbots* (MIT Sloan Working Paper No. 4208-01, October 2001).

[15] Michael R. Baye, J. Rupert J. Gatti, Paul Kattuman & John Morgan, *Clicks, Discontinuities, and Firm Demand Online* (Cambridge University Working Paper, July 2007).

discontinuity in a retailer's demand when its price moves from the second lowest price to the lowest price at the site: As a retailer lowers its price, its quantity demanded increases continuously as it enjoys more sales from its loyal base of customers. But once it lowers price slightly below the best other price at the site, it enjoys a discontinuous jump in demand because it attracts all of the price-sensitive shoppers, who always purchase from the firm charging the lowest price at the comparison site.

Even if both types of consumers have the same underlying elasticity of demand for the item (observe that this common elasticity corresponds to the one facing a hypothetical monopolist serving the entire virtual market), a firm that lowers its price below the "best other price" charged in the market enjoys a rightward jump in its demand. For prices higher than the best other price at the comparison site, the firm's demand consists purely of its base of loyal customers, who view purchasing the product from this firm as sufficiently different to justify paying a price premium. But once its price falls below the best price charged by its rivals, the firm not only sells to its loyal customers but also attracts *all* of the price-sensitive shoppers.[16]

Given data on the firms' prices and quantities (represented by the black dots in Figure 2), econometric analysis that does not account for a firm's jump in demand when it succeeds in charging the lowest price at the comparison site will yield an estimated demand function corresponding to the dashed line in Figure 2. Econometric analysis that recognizes that there are two types of consumers, and that a firm's demand jumps when it happens to charge the lowest price, will properly estimate the demands of both shoppers and loyal consumers. The proper estimate is represented by the solid black lines. As shown in the figure, ignoring the jump in demand due to the presence of shoppers and loyal consumers tends to result in biased estimates of both types of consumers' elasticity of demand for the underlying product.

In short, failure to account for the mix of shoppers and loyals results in a biased estimate of the hypothetical monopolist's elasticity of demand. This is not merely a theoretical possibility; recent empirical evidence suggests that failure to account for the jump in demand caused by the mix of shoppers and loyal consumers can lead to econometric estimates of the elasticity of *market* demand in a virtual market that is about twice as elastic as that obtained by accounting for the jump properly.[17]

[16] Such a jump in demand when a firm offers the lowest price is also consistent with empirical evidence by Aninyda Ghose, Michael Smith & Rahul Telang, *Internet Exchanges for Used Books: An Empirical Analysis of Product Cannibalization and Welfare Impact*, 17 INFORMATION SYSTEMS RESEARCH 3–19 (2006).

[17] Baye et al., *supra* note 15. The empirical evidence in this paper is based on clicks data rather than final sales data, but their Proposition 1 reveals that a demand elasticity may be inferred from a clicks elasticity.

In the context of market definition, this suggests that failure to account for discontinuities in demand that stem from low search costs in online markets tends to result in definitions of relevant markets that are too broad. For a given SSNIP, an upward bias in the estimated market elasticity of demand generally results in a downward bias in a hypothetical monopolist's change in profits.

3. Number of Competitors

Formal economic models of traditional markets indicate that competitive effects depend on the number of competitors. Intuitively, demand tends to be more elastic when there are more available substitutes.[18] At a purely theoretical level, the same principle applies in virtual markets: The more rivals selling a given product at a comparison site, the more elastic any given e-retailers' demand. Recent empirical evidence by Baye, Gatti, Kattuman, and Morgan corroborates this empirically—at least for a select set of products sold at a particular price comparison site.[19] Their results are illustrated in Figure 3, where the vertical axis indicates a representative retailer's elasticity of demand (in absolute value) and the horizontal axis indicates the number of rivals selling the same item at the comparison site. The estimates reveal that a representative retailer at the comparison site faces a more elastic demand when it competes against more rivals at that particular site. For instance, for products where only a single firm listed the product at the comparison site, a representative retailer's demand elasticity was about 2.5. Notice that this corresponds to the elasticity of demand of a hypothetical monopolist selling at the site. For products where six firms sold the same item, the estimated elasticity was about 10. Interestingly, these estimates imply that a firm's elasticity of demand in this virtual market is not as sensitive to the number of rivals as would be the case if firms were competing in a classical homogenous product Cournot fashion.[20] Moreover, these results represent empirical evidence that an individual firm's elasticity of demand in this virtual market depends on its number of rivals, and that a firm's demand is *not* perfectly elastic (as would be the case under perfect competition).

Importantly, the number of online competitors does not only have a bearing on market definition and competitive effects analysis through its potential impact on estimates of the elasticity of demand. The number of competitors can also directly have an effect on levels of price dispersion and

[18] *See*, for instance, Chapter 3 in MICHAEL R. BAYE, MANAGERIAL ECONOMICS AND BUSINESS STRATEGY (McGraw Hill 6th ed. 2009).

[19] Baye et al., *supra* note 15.

[20] In a symmetric Cournot model with homogenous products, an individual firm's elasticity of demand is n times the market elasticity (the elasticity faced by a monopolist), where n denotes the number of Cournot firms (*see* Chapter 11 in Baye, *supra* note 18). The dotted line in Figure 3 shows this implied elasticity.

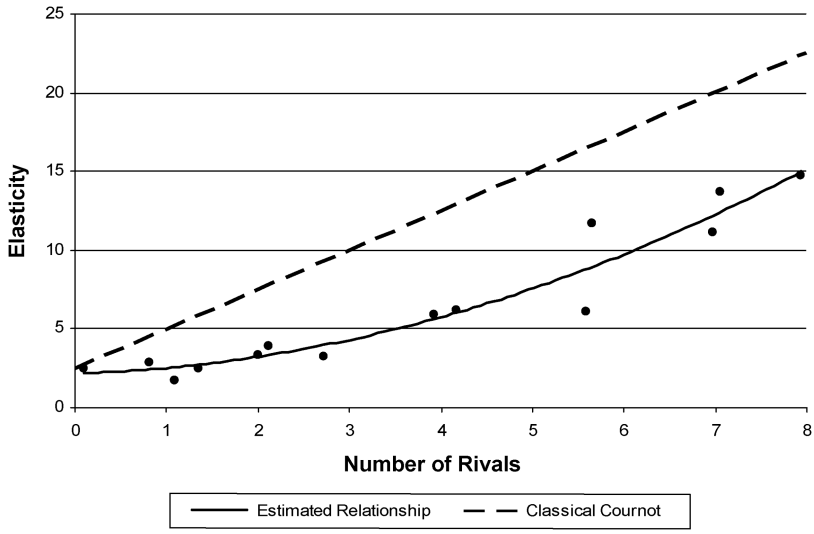


Figure 3. Estimates of a firm's actual elasticity of demand in an online market compared with that predicted under the classical Cournot model (source for data: Michael R. Baye, J. Rupert J. Gatti, Paul Kattuman, and John Morgan, *Clicks, Discontinuities, and Firm Demand Online* (Cambridge University Working Paper, July 2007)).

the average price that a firm charges at a comparison site. Additionally, as a result of day-to-day variation in an online retailer's decision to post its price at a comparison site, the actual number of firms that directly compete at a particular price comparison site generally exceeds the number of firms that might list their prices for a particular item on any given date. To understand these and other subtleties that arise in online markets better, it is necessary to take a brief journey into alternative models of competition at price comparison sites.

B. The Model Matters: Competitive Effects on Whom?

As in traditional markets, market definition and competitive effects in an online context depend on the underlying model of competition that reflects the behavior of consumers and firms. Consider, for instance, the models of Varian and Rosenthal, which have been used to analyze competition at price comparison sites.[21] These models presume that there are two types of consumers, which one may think of as shoppers and loyal consumers. Both types of consumers have no alternative but to shop at the comparison site, and have a common reservation price for the product, which is assumed to be the monopoly price. Shoppers always purchase from the firm offering the

[21] For a more detailed discussion of these and other models of online price competition, *see* Baye et al. (*supra* note 2) as well as Baye et al. (*supra* note 3).

lowest price, whereas loyal consumers always purchase from their preferred retailer because they have a preference for its differentiated characteristics. Because a retailer cannot identify which type of consumer is clicking and therefore cannot price discriminate across consumers, it charges a single price.

The presence of these two types of consumers creates a tension for retailers. On the one hand, if all consumers were loyal consumers, each firm would price at the reservation price, which corresponds to the firm's monopoly price based on its private stock of loyal consumers. In this case, each firm fully exploits its market power over captive loyal consumers (it cannot attract consumers who are loyal to the characteristics of other firms by cutting price). On the other hand, if all consumers were shoppers, homogeneous product Bertrand competition would ensue and firms would price at marginal cost in a symmetric equilibrium.[22] But with a mix of both shoppers and loyal consumers, the only equilibrium is for each firm to randomize its price to prevent its rivals from being able to predict its price systematically and undercut that price to capture all of the price-sensitive shoppers. The equilibrium has the property that prices are dispersed—a phenomenon that Varian calls "temporal price dispersion." Similarly, a retailer's position in the distribution of prices changes randomly over time. Because retailers' prices vary randomly over time, it is appropriate to base competitive effects analysis on each firm's average price rather than a particular price that is realized on any given date.

The equilibrium distribution of prices (and hence the average price charged by each retailer) in these models depends on all of the market fundamentals discussed earlier, including the number of retailers. Because a change in the number of retailers competing at the site changes the equilibrium distribution of prices, one could in principle define a relevant market or examine competitive effects based on an analysis of the impact of changes in the set of competitors on the average prices paid by consumers who use the comparison site. Rather than work through the rather tedious arithmetic required for such calculations, it is instructive to discuss more broadly some of the conceptual issues that can arise in these and other online markets.

First, subtle differences in formal economic models can lead to profoundly different competitive effects. In the Rosenthal model, for instance, each firm is assumed to bring its own base of loyal customers into the market. Consequently, as the number of firms shrinks, any one firm's base of loyal customers remains unchanged.[23] Other things being equal, the

[22] More generally, two firms would price at marginal cost and the other firms would set prices at or above this level, but in any event all transactions would occur at marginal cost.

[23] This modeling convention may be appropriate in situations where traditional branded retailers entering or exiting an online market bring their own stock of loyal consumers with them.

fewer firms that compete at a comparison site, the more likely it is that any one of them will succeed in charging the lowest price. As a consequence, a reduction in the number of firms in the Rosenthal model causes them to price more aggressively, and this alters the equilibrium distribution of prices such that the average prices paid by both shoppers and loyal consumers actually *declines* as the number of retailers using the comparison site decreases. This feature of the Rosenthal model turns the usual intuition regarding unilateral competitive effects on its head.

In contrast, the Varian model essentially assumes a fixed overall number of loyal consumers, and any one firm's share of loyal consumers increases as the number of firms selling at a comparison site declines. A reduction in the number of competitors thus changes the equilibrium distribution of prices in a manner that harms shoppers but benefits loyal consumers. In particular, shoppers always purchase at the lowest price at the comparison site, and the expected minimum price rises as the number of retailers at the site declines. But on average, loyal consumers pay the average price listed at the comparison site, and the average price declines as the number of retailers at the site decreases. In short, a reduction in the number of retailers in the Varian model increases the average prices paid by shoppers but decreases the average price paid by loyal consumers. As a consequence, the competitive effects of a merger differ in this instance depending on whether one analyzes the impact of the competitive effects on loyal consumers, shoppers, or some weighted average of the two.

Further complicating an analysis of competitive effects is the fact that a reduction in the number of competing retailers in these models also depends on whether loyal consumers "reposition" themselves such that each retailer maintains a symmetric number of loyal consumers. Equilibrium analysis (and the analysis of competitive effects) in related models with asymmetries is even more complex.[24]

Finally, it is important to note that all of the models described thus far assume that the number of competitors "inside" the virtual market—that is, the number of firms that list on the site at any point in time—is the competitively relevant number of firms. Thus, in our simple hypothetical, there are six retailers listing prices at the comparison site so there are at most six retailers in the relevant market. Whether one can further narrow the market to a subset of these retailers depends not only on which model is used and whether one evaluates the impact on shoppers, loyal consumers, or some weighted average of the two, but also on whether loyal customers reposition themselves.

The Baye-Morgan model generalizes the above models of competition in two respects. First, the model explicitly accounts for the price comparison

[24] For an analysis of the asymmetric case, *see* Michael R. Baye, Dan Kovenock & Casper G. de Vries, *It Takes Two to Tango: Equilibria in a Model of Sales*, 4 GAMES AND ECONOMIC BEHAVIOR 493–510 (1992).

site's incentive to price the use of its "virtual" real estate optimally. The authors show that comparison sites have incentives to charge low (often free) fees to consumers who access the site to attract as many consumers as possible to their site. This creates a virtuous circle: A large number of consumers visiting the site makes it advantageous for retailers to use the site to attract online shoppers from more distant locales. Comparison sites earn their profits through the fees charged to retailers who sell products through their sites.

Secondly, retailers in the Baye-Morgan model can opt out of using the comparison site by simply listing their prices at their own website or (if they have a physical presence) their brick-and-mortar operation. Likewise, consumers have the option of purchasing the product directly from a retailer's own website or its physical brick-and-mortar store.

Accounting for the fees that retailers pay to use the comparison site, as well as both firms' and consumers' ability to transact outside of the "virtual" market located at the comparison site, has potentially important implications for market definition and competitive effects analysis. First, as in the Varian and Rosenthal models of online price competition, the prices observed at the comparison site are dispersed, and firms' positions in the distribution of prices change over time. As before, this implies that it is appropriate to base the hypothetical monopolist test or competitive effects analysis on appropriately determined average prices, and that the results may depend on whether one focuses on shoppers, loyal consumers, or a weighted average of the two.

Secondly, retailers in the Baye-Morgan model also randomize the timing of their listings at the site to prevent rivals from being able to predict the intensity of online competition systematically. Consequently, the Baye-Morgan model implies that the number of retailers that actually list their prices at a comparison site on any given date is a random variable, and thus can vary randomly over time. Furthermore, the average number of retailers listing prices at a comparison site on any given date is *less* than the total number of relevant competitors in the market. In the context of the screenshot in Figure 1, the Baye-Morgan model implies that there are likely to be significantly more than six relevant competitors at this particular site—even when one abstracts from potential competition created by the presence of other price comparison sites or retailers that sell other varieties of cameras.

IV. CONCLUSIONS

This paper has highlighted a few aspects of online markets that complicate market definition and competitive effects analysis. In concluding, it is important to stress two points. First, market definition is merely a methodological tool and not an end in itself. Although debates regarding market definition should not sidetrack an evaluation of unilateral competitive effects—the heart of horizontal merger analysis—the reality is that

complexities and misperceptions regarding the competitiveness of online markets may heighten disagreements about market definition and/or competitive effects analysis in horizontal merger cases.

Secondly, I stress that the issues discussed here are not exhaustive. Nor do they necessarily apply to all online markets. A variety of other factors can affect market definition and competitive effects analysis in online markets, such as cost heterogeneities, firms' screen locations at a price comparison site, or locations of banner ads, reputation, certification, product depth, whether an online seller also has an offline presence, and so on.[25] And as in traditional markets, potential entry and efficiency considerations can affect bottom-line assessments of likely competitive effects.

[25] *See*, for instance, Paul Resnick & Richard Zeckhauser, *Trust Among Strangers in Internet Transactions: Empirical Analysis of eBay's Reputation System*, 11 ADVANCES IN APPLIED MICROECONOMICS 127–58 (2002); Pei-Yu Sharon Chen & Lorin M. Hitt, *Measuring Switching Costs and the Determinants of Customer Retention in Internet-Enabled Business: A Study of the Online Brokerage Industry*, 13 INFORMATION SYSTEMS RESEARCH 255–74 (2002), and Baye et al., *supra* note 15.

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Unilateral Competitive Effects of Mergers Between Firms with High Profit Margins

BY ELIZABETH M. BAILEY, GREGORY K. LEONARD, AND LAWRENCE WU

WHILE THE 1992 HORIZONTAL Merger Guidelines mention profit margins only once, and only in passing, the 2010 Horizontal Merger Guidelines have brought profit margins to the center of attention in merger review. Indeed, the 2010 Guidelines state that "if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern . . .) or that the firm and its rivals are engaged in coordinated interaction."[1] This new emphasis on gross profit margins (i.e., the percentage margin of price over marginal or incremental cost) raises the important question of what inferences may be drawn about the competitive effects of a merger from information about the merging parties' profit margins.

In this article, we focus on high margins in the context of unilateral effects analysis.[2] We give guidance to antitrust practitioners who, when faced with a merger between firms that have high profit margins, must evaluate the antitrust risk associated with the merger or analyze the merger's competitive effects. A crucial point is that high margins on their own are not definitive indicators of adverse post-merger unilateral price effects. In particular, margins by themselves do not imply anything about the degree of substitution between the merging firms' products, the existence of barriers to entry and/or repositioning, or the efficiencies that are likely to be generated by the proposed transaction. In addition, pre-merger margins may appear high simply because margins based on financial accounting measures fail to equate to the economic margins used in merger analysis.

As we discuss with reference to closing statements recently issued by the antitrust Agencies in Google's 2010 acquisition of AdMob, Microsoft Corporation and Yahoo! Inc.'s 2010 advertising and Internet search agreement, and the 2008 merger between XM Satellite Radio Holdings Inc. and Sirius Satellite Radio Inc., profit margins alone reveal very little about the competitive impact of a proposed merger. Rather, only through a careful development of facts related to buyer substitution patterns, entry, repositioning, and efficiencies, can an antitrust practitioner provide a unified and more complete and informative analysis of unilateral competitive effects.

The authors are economists at NERA Economic Consulting. Elizabeth Bailey is an Associate Editor of ANTITRUST.

The Relationship Between Pricing and Profit Margins

We start with three initial points about high profit margins. First, the 2010 Guidelines state that, coordinated interaction aside, a high margin normally means the firm perceives that it has a low own-price elasticity of demand. This statement is grounded in the unilateral effects framework familiar to antitrust practitioners. The intuition is that a firm sets its price at the point where a further increase in price would not lead to greater profit.[3] Based on this intuition, when a firm sets a price that results in a high margin, it can be inferred that the firm was expecting to lose relatively few sales by increasing its price further (which it chooses not to do, however, because the profit margin on those few lost sales would be large). Losing relatively few sales in response to an increase in price means the price-sensitivity of demand, or the own-price elasticity of demand, is relatively low.

The second point is that one must distinguish between what the 2010 Guidelines say and do not say about profit margins. The 2010 Guidelines do not say that a firm with a high profit margin necessarily has antitrust market power.[4] As we discuss further below, in an industry with substantial fixed costs, price will exceed incremental cost even if the industry is competitive. As the 2010 Guidelines note, high margins "can be consistent with incumbent firms earning competitive returns" and "are not in themselves of antitrust concern."[5]

The third point is that, in the economic models commonly used by the antitrust Agencies to assess likely unilateral effects,[6] the predicted adverse unilateral effects (if any) are generally greater if the merging parties' pre-merger profit margins are higher, everything else being equal. For example, to evaluate the competitive effects of a merger of firms A and B, the gross upward pricing pressure (UPP) approach that is

mentioned in the 2010 Guidelines involves calculating gross UPP (i.e., before consideration of efficiencies) for product A as the pre-merger per unit margin of price over incremental cost for product B multiplied by the diversion ratio from product A to product B.[7] In this model, holding the diversion ratio constant, there will be greater pressure to raise price as the margin increases. Similarly, most merger simulation models will predict larger post-merger price increases the larger the merging firms' pre-merger margins, everything else being equal. Again, the intuition flows from the basic model of unilateral effects familiar to antitrust practitioners. The merged firm has an incentive to increase the price of product A (whereas the independent firm A did not before the merger) if the merged firm is able to "recoup" a portion of the resulting decrease in sales of product A with increased sales of product B (where the extent of the recoupment is determined by the diversion ratio from A to B). The financial recoupment is larger, and thus the incentive to increase the price of product A is larger, when the profit margin on product B is higher.

In light of these initial observations, it is important to understand how to address the unilateral competitive concerns that antitrust Agencies may raise in mergers between firms that have high pre-merger gross profit margins. In our experience, there are four general areas of analysis to consider, which are discussed below.

Calculate the Margin of Price Over Incremental Cost

Measuring a firm's margin of price over incremental cost can be difficult. As a result, margins may appear high simply because they have been measured incorrectly. There is a long literature on how one should estimate or calculate incremental cost and the margin of price over incremental cost. The central issue is that the economic cost concepts that underlie incremental cost rarely equate to the accounting cost concepts that underlie companies' financial reporting.[8]

In practice, it is common in a merger analysis for antitrust practitioners to use a measure readily available from the merging companies' financial data, such as the margin of price over the "cost of goods sold" (COGS), as a proxy for the profit margin of price over incremental cost. COGS, however, may or may not be a reasonably accurate measure of incremental cost in a given situation. For example, consider a pharmaceutical manufacturer that has a long-term, fixed-price per unit contract to purchase a particular petroleum-related input. For financial accounting purposes, the firm may use this fixed price when calculating the cost of goods sold. For the purpose of calculating the economic margins relevant to merger analysis, however, using this fixed price per unit as a component of incremental cost may substantially underestimate the true incremental cost of the input (and thus overestimate the margin of price over incremental cost) if the spot-market price of the product has increased substantially since the long-term contract was signed. The error in simply relying on COGS as a measure of incremental cost in this example comes from ignoring an important economic component of incremental cost, namely opportunity cost.[9] As this example illustrates, there can be a fundamental problem of measurement when drawing inferences from a high profit margin: an observed "high" profit margin based on accounting cost measures such as COGS may not accurately reflect the true economic profit margin of price over incremental cost.

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In addition to properly accounting for opportunity costs, there are other issues that affect how to measure incremental cost. For example, it is important to determine the appropriate increment of output for which to calculate the incremental cost (e.g., the incremental cost of the next airline seat sold is not the same as the incremental cost of operating another flight). Similarly, it is important to determine the appropriate time frame for the analysis (e.g., long run versus short run). In addition, it is important to consider accounting for a risk-adjusted rate of return. If these issues are not dealt with appropriately, a firm's profit margin may appear high simply because it has been measured incorrectly.

Measuring margins correctly is an important and sometimes quite complex task. For the remainder of this article, however, we will assume that a firm's profit margin can be and has been measured correctly, and thus the issue facing the antitrust practitioner is how to develop an informative analysis of the post-merger unilateral price effects when the margin is, in fact, high.

Determine Whether the Merging Parties Are Close Competitors

The economic models commonly used by the antitrust Agencies to evaluate the potential for adverse competitive effects do not depend solely on margins. As a result, high margins alone are not determinative of the unilateral competitive effects of the merger. For example, in the context of UPP, if the diversion ratio is zero, there will be zero UPP, even if profit margins are high. More generally, a lower diversion ratio offsets the effects of a higher margin in the UPP formula. The same is true in more complex merger simulation models.

For the same reason, evidence that the merging firms have low pre-merger margins does not, by itself, imply that the

proposed transaction is either procompetitive or competitively neutral. This is because, even if the margins are low, a unilateral effects model could predict a post-merger price increase if the diversion ratio between the merging firms' products is sufficiently large. For example, if the reason that the merging firms have low margins is the strength of the competition between them, the diversion ratio between them would be high, and as a result the combined entity might have a substantial incentive to increase prices.

A flawed line of reasoning may lead some to draw the unwarranted inference, based on profit margins alone, that a merger between firms with high pre-merger margins is presumptively or highly likely to be anticompetitive. This line of thought proceeds as follows: (1) the merging firms have high margins, which means that each has a low own-price elasticity of demand; (2) as a result, the relevant market in which the firms participate must be narrow because the market elasticity of demand for a narrowly defined market also must be low; (3) in a narrow relevant market comprised of relatively few participants, the merging firms' shares of this relevant market may be relatively large; and (4) with the firms' market shares used as proxies for diversion ratios,[10] both the pre-merger margin and the diversion ratio may be large in the UPP formula (or a merger simulation model), which, as described above, is more likely to generate a prediction of a positive UPP (or a merger-induced anticompetitive effect), all else equal.[11] This reasoning breaks down because, in general, there is no link between profit margins, market shares, and diversion ratios in economic models.[12] For this reason, the profit margin and the diversion ratio must be separately quantified and analyzed before they are incorporated into a UPP analysis or any other unilateral effects model.

A flawed line of reasoning may lead some to draw the unwarranted inference, based on profit margins alone, that a merger between firms with high pre-merger margins is presumptively or highly likely to be anticompetitive.

In our experience, firms in high-technology industries tend to have high profit margins, often reflecting the firms' substantial fixed costs. As we discussed above, a low diversion ratio can offset the effect of a high margin in the typical economic models used by the antitrust Agencies to assess unilateral effects. The DOJ's 2010 closing statement in its investigation of Microsoft's agreement with Yahoo! illustrates that a low diversion ratio can overcome a potential unilateral effects concern in a high-technology industry.[13] In announcing its decision to close its investigation, the DOJ indicated an important component of its analysis was that the diversion ratios between Microsoft and Yahoo! were low. In particular, the DOJ stated that "[m]ost customers view Google as posing the most significant competitive constraint on both Microsoft and Yahoo! . . . ."[14]

Similarly, the DOJ's closing statement in the merger between XM and Sirius suggests that evidence of low diversion ratios was an important reason why the DOJ decided to close its investigation.[15] As noted by the DOJ in its closing statement, "there has never been significant competition between [XM and Sirius] for customers who have already subscribed to one or the other service . . . [and] competition for new subscribers is likely to be substantially more limited in the future than it was in the past."[16]

Evaluate the Competitive Impact of Entry and Repositioning

There is a second reason why a high profit margin should not lead to a presumption of an anticompetitive effect. Most unilateral effects models—including the UPP approach and many merger simulation models—explicitly or implicitly are "static" in that they assume that no entry or repositioning is possible. Without first analyzing the likelihood that entry or repositioning would defeat an attempt by the merged firm to raise price after the merger, it would be premature to rely solely on the predictions of an anticompetitive effect from a static model.

To assess whether entry or repositioning would defeat such an attempt by the merged firm, it is useful to think about the relationship between margins and the potential existence of barriers to entry and repositioning. Profit margins may be higher in markets that are characterized by entry barriers or factors that make repositioning more difficult. However, if there are other potential reasons why profit margins are high, high margins would not, by themselves, imply the existence of some impediment to entry or repositioning. Thus, if the merging firms have high profit margins, it is important that the antitrust practitioner understand why they are high, as the explanation will have implications for whether the merger will create market power for the merged firm.

For example, one potential explanation for high profit margins is the presence of significant ongoing fixed costs that a firm must incur to participate in the market. Ongoing fixed costs are expenses that remain at the same level regardless of how much output the firm produces and that can be eliminated only if the firm shuts down. In such an environment, it is not a sustainable outcome for price to equal incremental cost (for a small increment of output) because firms would lose money and have no incentive to continue operations. In the long run, the firm would rather exit than incur losses. With "free entry," the competitive equilibrium would be reached when a sufficiently large number of firms had entered such that each firm earns zero total profits. In equilibrium, each firm charges a price sufficiently above incre-

mental cost to just cover its fixed costs. Generally speaking, the greater the ongoing fixed costs incurred by each of the firms in the industry, the greater the pre-merger profit margin even in a competitive equilibrium.

On the other hand, profit margins may be high due to the existence of barriers to entry.[17] For example, if incumbent firms have already incurred substantial up-front fixed costs, and those costs are unrecoverable (i.e., sunk), entry by a new firm that did not yet sink those fixed cost may be deterred and, as a result, the incumbent firms may earn high profit margins and positive total profits.

Because high profit margins can exist with and without barriers to entry, high margins by themselves do not imply the existence of significant barriers to entry or repositioning. Thus, when the merging parties have high profit margins and a non-trivial diversion ratio, the antitrust practitioner should examine why margins are high in the first place. If margins are high due to the need for firms to incur substantial ongoing fixed costs, but entry is easy, the merger may well have no anticompetitive effect because, in the language of the 2010 Guidelines, entry or repositioning may be timely, likely, and sufficient. Similarly, even if the parties to a merger have high margins, a high diversion ratio between them, and compete in a market in which de novo entry is unlikely, one must still evaluate existing competitors' ability and incentive to reposition their products post-merger to compete more closely with the merging parties' products.

The FTC's 2010 statement regarding the closing of its investigation of Google's acquisition of AdMob provides a useful illustration of the importance of entry in defeating the potential for unilateral effects in a transaction where the merging parties have potentially high margins and high diversion ratios.[18] While the FTC stated that its investigation "yielded evidence that each of the merging parties viewed the other as its primary competitor," which suggests that the diversion ratios between Google and AdMob were high, the FTC also indicated that the entry by Apple into mobile advertising networks "should mitigate the anticompetitive effects of Google's AdMob acquisition."[19]

Assess the Potential for the Transaction to Achieve Cost Savings and Other Efficiencies

As with entry and repositioning, efficiencies resulting from a merger can offset the effect of a high margin and a non-trivial diversion ratio. Cost savings, as well as output-enhancing activities, such as the introduction of new and improved products, are as much a competitive effect of the merger as is any adverse unilateral price effect. For example, the net UPP approach weighs an index of possible adverse unilateral price effects (the gross UPP) against the likely incremental cost savings that would result from the transaction.[20] This net UPP approach makes clear that the presence of substantial cost savings can offset potential adverse competitive concerns resulting from high margins and high diversion ratios even when entry and repositioning are unlikely post-merger.

Similarly, even if the firms are assumed to have high margins and high diversion ratios, most merger simulation models will typically predict small or negative post-merger price increases with sufficiently high incremental cost savings. Merger simulation models will also predict overall consumer welfare gains from a merger between firms with high margins and diversion ratios if the merger will lead to sufficiently large increases in demand due to improvements in product quality or the introduction of new products.

For this reason, when faced with a transaction involving firms with high gross profit margins, the antitrust practitioner should seek to understand the procompetitive rationale for the transaction. In our experience, the antitrust Agencies have given weight to efficiencies when credible analyses quantify the likely magnitude of such efficiencies, demonstrate that the efficiencies derive from complementarities between the parties to the transaction (or are more generally merger-specific), and document the necessary steps and costs associated with achieving such efficiencies.

The DOJ's 2010 closing statement in its investigation of Microsoft's agreement with Yahoo! and the DOJ's 2008 closing statement in its investigation of XM's merger with Sirius demonstrate that efficiencies can overcome unilateral effect concerns when the merging parties have potentially high margins. For example, in the Microsoft/Yahoo! closing statement, the DOJ states that the transaction may result in "more rapid innovation of potential new search-related products" and that "[t]his enhanced performance, if realized, should exert correspondingly greater competitive pressure in the marketplace."[21] Similarly, in the XM/Sirius closing statement, the DOJ stated that the proposed merger is not likely to substantially lessen competition for several reasons, including the "efficiencies likely to flow from the transaction that could benefit consumers."[22]

Conclusion

The 2010 Guidelines place a greater emphasis on analyzing the merging firms' profit margins when evaluating the unilateral competitive effects of a proposed merger. As the 2010 Guidelines point out, in a differentiated products setting where unilateral effects may be the central competitive issue, high profit margins generally imply that the merging firms each face a relatively low own-price elasticity of demand. By themselves, profit margins do not imply anything about the degree of substitution between the merging firms, the existence of barriers to entry and/or repositioning, or the efficiencies likely to be generated by the proposed transaction. Thus, margins—high or low—are not definitive indicators of post-merger competitive effects. A careful analysis of diversion ratios, conditions for entry and repositioning, and efficiencies, in conjunction with the proper measurement of pre-merger profit margins, is necessary to reach a reliable conclusion about a merger's competitive effects, and it is the approach that is described in the 2010 Horizontal Merger Guidelines. ■

[1] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 2.2.1 (2010), *available at* http://ftc.gov/os/2010/08/100819hmg.pdf.

[2] As the 2010 Guidelines point out, a high profit margin could be due to the existence of pre-merger coordinated interaction. No conclusions can be drawn from margins alone as to whether high margins are indicative that firms will be better able to coordinate their pricing post-merger. It is the interaction of margins with other factors that are changed by the merger that determines whether coordinated interaction will be more likely or more effective post-merger.

[3] An incremental increase in price has two effects—the firm receives a higher price on each sale that it makes, but it loses the entire profit margin on each sale that it loses. A firm will choose to set its price where the two effects offset each other so that an additional incremental change in price does not lead to higher profits.

[4] We use the term "antitrust market power" to distinguish this concept from the concept of "economic market power," which is often interpreted as price above marginal cost. *See* DENNIS CARLTON & JEFFREY PERLOFF, MODERN INDUSTRIAL ORGANIZATION 93 (4th ed., 2005).

[5] 2010 Guidelines, *supra* note 1, at nn.3 & 6.

[6] The 2010 Guidelines discuss the Agencies' reliance on upward pricing pressure and merger simulation methods to evaluate unilateral price effects that may result from a proposed merger. *See id.* § 6.1.

[7] *See* Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, 10 B.E. J. THEORETICAL ECON. art. 9 (2010); *see also* Elizabeth M. Bailey, Gregory K. Leonard, G. Steven Olley & Lawrence Wu, *Merger Screens: Market Share-Based Approaches Versus "Upward Pricing Pressure,"* ANTITRUST SOURCE, Feb. 2010, http://www.abanet.org/antitrust/at-source/10/02/Feb10-Leonard2-25f.pdf; Serge Moresi, *The Use of Upward Pricing Pressure Indices in Merger Analysis*, ANTITRUST SOURCE, Feb. 2010, http://www.abanet.org/antitrust/at-source/10/02/Feb10-Moresi2-25f.pdf; Gopal Das Varma, *Will Use of the Upward Pricing Pressure Test Lead to an Increase in the Level of Merger Enforcement?* ANTITRUST, Fall 2009, at 27.

[8] *See, e.g.*, Franklin M. Fisher & J.J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 AM. ECON. REV. 82 (1983).

[9] Opportunity costs are the costs associated with opportunities that are forgone by not putting the firm's resources to their best alternative use.

[10] For example, a proxy for the diversion ratio from firm A to firm B might be B/(1 – A), where B is the share of firm B and A is the share of firm A. This will be incorrect on its face in most cases as it assumes a zero "market" elasticity of demand (i.e., no diversion to any goods outside of the relevant market).

[11] As we discuss further below, a prediction of an anticompetitive effect may be offset by entry, repositioning, and/or sufficiently large efficiencies.

[12] For a general discussion of the issue and additional references, see Elizabeth M. Bailey, Gregory K. Leonard & Lawrence Wu, *Comments on the 2010 Proposed Horizontal Merger Guidelines* (June 3, 2010), *available at* http://www.ftc.gov/os/comments/hmgrevisedguides/548050-00012.pdf.

[13] Press Release, U.S. Dep't of Justice, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of the Internet Search and Paid Search Advertising Agreement Between Microsoft Corporation and Yahoo! Inc. (Feb. 18, 2010) [hereinafter DOJ Statement in Microsoft/Yahoo!], *available at* http://www.justice.gov/atr/public/press_releases/2010/255377.htm.

[14] *Id.* at 1.

[15] Press Release, U.S. Dep't of Justice, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc. (Mar. 24, 2008) [hereinafter DOJ Statement in XM/Sirius], *available at* http://www.justice.gov/atr/public/press_releases/2008/231467.htm.

[16] *Id.* at 2.

[17] It is important to note that barriers to entry are not a sufficient condition for a high margin. For example, two competitors that sell homogeneous products in Bertrand competition will have zero profit margins. This is because in this environment, firms will compete by lowering their prices to marginal cost, even if there are barriers to entry. For this reason, some other mechanism must be combined with barriers to entry to produce high profit margins, such as product differentiation, capacity constraints, or some degree of oligopoly interaction.

[18] Statement of the Commission Concerning Google/AdMob, FTC File No. 101-0031 (May 21, 2010), *available at* http://www.ftc.gov/os/closings/100521google-admobstmt.pdf.

[19] *Id.* at 1.

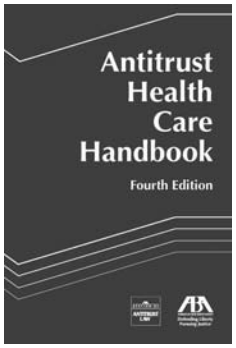
[20] *See* Farrell & Shapiro, *supra* note 7.

[21] DOJ Statement in Microsoft/Yahoo!, *supra* note 13, at 1.

[22] DOJ Statement in XM/Sirius, *supra* note 15, at 1.

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Horizontal Mergers of Online Firms: Structural Estimation and Competitive Effects*

Yonghong An
Johns Hopkins

Michael R. Baye
Indiana University

Yingyao Hu
Johns Hopkins

John Morgan
UC Berkeley

Matt Shum
Caltech

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Abstract

This paper (1) presents a general model of online price competition, (2) shows how to structurally estimate the underlying parameters of the model when the number of competing firms is unknown or in dispute, (3) estimates these parameters based on UK data for personal digital assistants, and (4) uses these estimates to simulate the competitive effects of horizontal mergers. Our results suggest that competitive effects in this online market are more closely aligned with the simple homogeneous product Bertrand model than might be expected given the observed price dispersion and number of firms. Our estimates indicate that so long as two firms remain in the market post merger, the average transaction price is roughly unaffected by horizontal mergers. However, there are potential distributional effects; our estimates indicate that a three-to-two merger raises the average transaction price paid by price sensitive "shoppers" by 2.88 percent, while *lowering* the average transaction price paid by consumers "loyal" to a particular firm by 1.37 percent.

Keywords: Antitrust, E-Retail, Stuctural Estimation, Mergers

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1 Introduction

Empirical competitive effects analysis is a fundamental tool for assessing the impact of horizontal mergers on consumer welfare.[1] Frequently, such analysis is used to "rationalize" definitions of relevant antitrust markets that outside observers sometimes view as being too narrow. For example, in *FTC v. Staples-Office Depot*, the FTC defined a "narrow" relevant product market that included only office superstores (Staples, Office Depot, and Office Max), while the merging parties argued that the relevant product market included a number of other retail outlets (including Walmart) that also sold office supplies. Ultimately, Judge Hogan agreed with the narrow definition advanced by the FTC based in part on empirical evidence that Staples and Office Depot charged significantly lower prices in markets where they competed head-to-head compared to markets where the only competitors were non-superstore players such as Walmart. Judge Hogan's decision ultimately blocked the merger because of empirical competitive effects analysis indicating that prices would rise as a result of the merger.

Virtually identical economic issues arose in the recent Whole Foods-Wild Oats matter, where the FTC argued that "premium natural organic supermarkets" are a separate product market that excludes traditional supermarkets. While the FTC initially lost in District Court, an appeal ultimately led to a consent agreement in which Whole Foods agreed to divest 32 stores. These examples illustrate the controversial nature of and economic challenges associated with market definition and competitive effects analysis in even fairly simple brick-and-mortar retail environments.

The present paper is motivated by our view that new-economy e-retail markets further complicate market definition and competitive effects analysis in horizontal mergers. One complication is the question of the relevant number of competitors, including whether online and traditional retailers selling similar products are in the same product market. Unfor-

[1] Antitrust enforcement in the UK, US, and virtually all other jurisdictions (except Canada) are based on a consumer welfare standard rather than a total welfare standard.

tunately, this analysis requires fairly detailed information; antitrust agencies (and private parties) expend considerable resources to obtain (or to comply with requests for) these data. In a number of instances, agencies have concluded that online and offline markets are separate antitrust markets based on these data. For instance, on 13 February 2008 the Australian Competition and Consumer Commission concluded that online and offline markets for books were separate antitrust markets.[2] Likewise, Christie and Terry (2002) suggest that in the FTC's review of a merger between Monster.com and HotJobs.com, the FTC "...determined that the 'relevant market' within which to evaluate the competitive impact of the transaction included only online job services," and that "...FTC staff appears to have concluded that bricks (traditional methods) do not sufficiently compete with clicks (online methods), so as to be in the same relevant market, at least in some instances."

Even in environments where the online channel comprises a separate relevant antitrust market, to the best of our knowledge there are no ready tools available to assess potential competitive effects of mergers involving online retailers. The absence of such tools or analyses stems, in part, from the fact that (1) e-retail sales are still relatively modest; (2) online prices display considerable price dispersion, which substantially complicates predicting the price effects of mergers; and (3) the number of (potential) competitors in the online channel is typically an unknown. Finally, as is the case in traditional markets, (4) there are a variety of models one might reasonably use to assess competitive effects, and it is known that competitive effects analysis can be sensitive to the model.[3]

This paper represents a first attempt to empirically examine the competitive effects of horizontal mergers in an online retail market. We stress at the outset that, like the early literature on mergers in traditional markets that heavily relied on implications of the sym-

[2] See Australian Competition and Consumer Commission (2008).

[3] For instance, it is well-known that the competitive effects of horizontal mergers in traditional markets depend not only on the number of firms and whether they are symmetric, but whether the relevant oligopoly model is Cournot, Bertrand, or Hotelling. Even for a given market model, merger simulation results frequently reveal that competitive effects are sensitive to the assumed functional form for demand. See Weinberg and Hosken (2009).

metric Cournot model, our framework is best viewed as a "benchmark" that is based on stylized assumptions about the nature of online competition. These assumptions, which are discussed in more detail in the next section, include (1) online firms are symmetric, pure-play e-retailers; (2) the number of (potential) online competitors at any point in time is known to firms but not to the econometrician; and (3) online buyers may be segmented into two types: price sensitive "shoppers," who rely on a price comparison site to find the best deal, and price insensitive "loyals," who simply visit their preferred online firm's website. This benchmark environment is the standard framework for modeling e-retail competition; see Baye, Morgan, and Scholten (2006) for a survey of this literature.

Section 2 presents a general model of online price competition that nests standard models ranging from Varian (1980) to Iyer *et al.* (2005) as special cases. The model enriches existing models of online price competition, including Baye and Morgan (2001), by adding two realistic features: (1) firms pay platforms for clicks; and (2) not all clicks result in sales. Section 3 shows how we can structurally estimate the parameters of the model using only price data when, as is typically the case in antitrust investigations, the actual number of competing firms is unknown or in dispute. Section 4 reports structural estimates of the model based on UK data for personal digital assistants, while Section 5 uses these estimates to simulate the competitive effects of horizontal mergers in this market.

Our results suggest that, at least in some instances, competitive effects in online markets are more similar to those predicted by the simple homogeneous product Bertrand model than might be expected given the price dispersion observed in (and predicted by theoretical models of) e-retail markets. More specifically, our estimates indicate that so long as two firms remain in the online market post merger, the average transaction price is roughly unaffected by horizontal mergers. However, there are potential distributional effects: Our estimates indicate that a three-to-two merger raises the average transaction price paid by price sensitive "shoppers" by 2.88 percent, while the average transaction price paid by consumers "loyal"

to a particular firm *declines* by 1.37 percent.[4] Section 6 discusses the implications of our findings for market definition and competitive effects, and highlights a number of caveats. Finally, the Appendix contains results demonstrating that our methodology closely estimates the parameters of the model with simulated data, as well as miscellaneous proofs.

2 Model of Online Price Competition

As discussed in the introduction, we assume that the online channel comprises the relevant product market. To fix ideas, suppose this market consists of a commonly known number of firms ($N > 1$) that produce at a constant marginal cost of $m \geq 0$. Firms offer identical products for sale through their individual websites, which may have different characteristics or provide different types of service. Some consumers, who we call "loyals," value these services and purchase by directly visiting the website of their preferred firm. Other consumers, who we call "shoppers," care only about price. They first access a price comparison site to obtain a listing of the prices charged by sellers advertising at the site and click through to the firm offering the lowest price. If no prices are listed, they visit the website of a randomly selected firm.[5] All consumers have unit demand and a maximal willingness to pay of r.

It is widely recognized that conversion rates in online markets are low—only a fraction of consumers that click on a price at a comparison site follow through by making a purchase. To account for this, we assume that consumers are in the mood to buy with probability $\gamma \in (0, 1]$ and in the mood to merely "look" with probability $(1 - \gamma)$. Thus, γ may be interpreted as the conversion rate—the fraction of clicks that are converted into sales. Finally, we assume that each firm attracts $L \geq 0$ loyals and that there are a total of $S > 0$ shoppers.

We now turn to the details of firm behavior. To advertise at the comparison site, a firm

[4] Armstrong (2008) points out that similar distributional effects are theoretically possible in the context of consumer protection policy, while Baye (2008) notes that this is a theoretical possibility in antitrust.

[5] See Proposition 1 in Baye and Morgan (2001) for the sorts of arguments required to ensure that this is an optimal decision rule for shoppers.

must pay an (explicit or implicit) amount $\phi > 0$ to list its price, plus a cost per click (CPC) of $c \geq 0$ each time a consumer clicks on its price advertisement (listing). Thus, firm i's strategy consists of a continuous pricing decision (p_i) and a zero-one decision to advertise its price at the comparison site. Let α_i denote the probability that firm i chooses to advertise on the comparison site. A firm that does not advertise its price on the comparison site avoids paying listing and clickthrough fees, but at the potential cost of failing to attract the shoppers visiting the comparison site.

When platform fees are not too high, there is an active market for listings at the comparison site. For this case, we characterize the symmetric equilibrium pricing and advertising strategies of firms competing in this online environment (see Appendix A for a proof).

Proposition 1 *Suppose* $0 < \phi < S\left((r-m)\gamma\frac{N-1}{N} - c\right)$ *and* $0 \leq c < (r-m)\gamma\frac{N-1}{N}$. *Then in a symmetric Nash equilibrium:*

(a) Each firm lists its price on the comparison site with probability

$$\alpha^* = 1 - \left(\frac{\phi}{S\left((r-m)\gamma\frac{N-1}{N} - c\right)}\right)^{\frac{1}{N-1}} \in (0,1)$$

(b) Conditional on listing a price at the comparison site, a firm's advertised price may be viewed as a random draw from

$$F^*(p) = \frac{1}{\alpha^*}\left(1 - \left(\frac{(r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}\left((r-m)\gamma - c\right)}{S\left((p-m)\gamma - c\right)}\right)^{\frac{1}{N-1}}\right) \tag{1}$$

on $[p_0, r]$, *where* $p_0 = m + \frac{1}{(S\gamma+L\gamma)}\left(\gamma L(r-m) + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}\left((r-m)\gamma - c\right) + Sc\right) \in (m, r)$.

(c) A firm that does not advertise on the comparison site charges a price of $p_i = r$ *on its own website.*

(d) Each firm earns expected profits of

$$E\pi = (r-m)\gamma L + \frac{\phi}{N\left(1 - \frac{c}{(r-m)\gamma}\right) - 1}$$

Notice that this model extends the original Baye and Morgan (2001) model to an environment in which all transactions take place online, and accounts for clickthrough fees as well as conversion rates that are potentially less than unity. Consistent with the empirical literature, the model implies that prices listed at the comparison site are necessarily dispersed in equilibrium, and that the number of firms actually listing prices at the comparison site on any given date is generally less than the total number of firms in the market.[6] This model nests a variety of other models as special cases, including Rosenthal (1980), Varian (1980), Narasimhan (1988), Iyer and Pazgal (2003), Baye, *et al.* (2004), and Iyer, *et al.* (2005). Unlike some of these special cases, the general model is flexible enough to allow differing effects of mergers on consumer welfare.[7]

Under the maintained hypothesis that firms' listed prices are distributed according to equation (1), it is, in principle, possible to estimate the underlying parameters of the model. Unfortunately, data from price comparison sites reveal A, the realized number of firms choosing to list prices at the site at a given time, but not N, the total number of firms in the market. The model indicates that A is a binomially distributed random variable with parameters (α, N) whereas N is a constant. The extant literature mostly finesses this problem. For example, Baye, Morgan and Scholten (2006) as well as Moraga-Gonzalez and Wildenbeest (2008) use the number of observed prices as a proxy for N, in effect assuming that $N = A$. Hong and Shum (2006) assume that $N = +\infty$ in their identification of price dispersion models.

The problem of the unobservability of N presents econometric challenges, especially when it varies over time or across products. Perhaps more importantly, it poses a serious problem for performing competitive effects analysis of mergers where the number of "potential" competitors is often disputed by the antitrust agency and the merging parties. The next section

[6] See Baye *et al.* (2006) for a survey of about twenty studies documenting price dispersion of 10 to 50 percent in online markets.

[7] For instance, the Rosenthal model implies that when there are two or more competitors, average prices paid by all consumers *rise* with the number of competing firms.

offers a two-step estimation procedure that explicitly accommodates the unobservability of N.

3 Identification and Estimation

The above model of online price competition is essentially a low-bid auction in which the firm offering the lowest price secures the price sensitive shoppers when it lists on the comparison site. As such, we can adapt the techniques of structural estimation of auction models to our setting. Specifically, in this section we show that the equilibrium distribution of prices in Proposition 1 (along with one additional but rather mild condition) implies the identification conditions for standard auctions pioneered by Hu (2008) and An, Hu and Shum (2010).

Following these authors, suppose the maximum number of (potential) firms is K, and is known to the econometrician. The actual number of firms ($N > 1$), which may vary, is common knowledge to the firms but unknown to the econometrician. For reasons that will become clear, consider only dates in which two or more firms listed prices, and let A denote the number of price listings on a given date. For these dates, randomly select one of the listed prices. Partition prices into $K-1$ bins, and let Z denote a discretization of the randomly selected price. Thus, $Z = K - i$ means that the randomly selected price lies in the ith highest bin.

From the econometrician's point of view: (a) N, A, and Z share the same support $\{2, ..., K\}$; (b) r, m, ϕ, γ, L, and S are unknown parameters; and (c) N is unobservable or in dispute.[8] If we let $\theta \equiv (r, m, \phi, \gamma, L, S)$, then under the hypothesis that the price data at the comparison site are generated according to F^* in equation (1), we may write the underlying (undiscretized) distribution of prices as $F(p|N)$ and the associated density as $f(p|N)$.[9] The lemma below shows that the equilibrium density of listed prices is independent of A and Z:

[8] In the application that follows, the cost-per-click (c) is data and hence is not included in the set of parameters to be estimated.

[9] To ease the notational burden, we have suppressed θ in this notation.

Lemma 1 $f(p|N) = f(p|A, Z, N)$.

Proof. Follows directly from the fact that firms' prices are determined prior to their knowing realizations of A and Z. ■

Next, notice that, given the data and the model, conditional on the fact that at least two firms list prices the probability that exactly A firms list at the comparison site is

$$g(A|N) = \frac{\binom{N}{A}(\alpha)^A(1-\alpha)^{N-A}}{1-(1-\alpha)^N - N\alpha(1-\alpha)^{N-1}} \text{ for all } N \geq A \geq 2$$

It immediately follows that

Lemma 2 $g(A|N) = g(A|Z, N)$

Lemma 1 implies that auxiliary variables A and Z only affect the equilibrium density of prices through the unobservable number of firms, N. Analogously, Lemma 2 implies that the instrument Z affects the number of listed prices only through N.

Let $h(p, A, Z)$ denote the observed joint density of p, A and Z. Let $\psi(N, Z)$ denote the joint density of N and Z, which is unobserved because N is unobserved. This specification allows for the possibility that the true number of firms N might vary across products and over time without placing parametric restrictions on the data-generating process in this respect. Now, the law of total probability implies the following relationship between the observed and latent densities:

$$\begin{aligned} h(p, A, Z) &= \sum_{N=2}^{K} f(p|N, A, Z)g(A|N, Z)\psi(N, Z) \\ &= \sum_{N=2}^{K} f(p|N)g(A|N)\psi(N, Z), \end{aligned} \tag{2}$$

where the second equality follows from Lemmas 1 and 2.

Define:

$$\begin{aligned} H_{p,A,Z} &= [h(p, A = i, Z = j)]_{i,j} \\ G_{A|N} &= [g(A = i|N = k)]_{i,k} \\ \Psi_{N,Z} &= [\psi(N = k, Z = j)]_{k,j} \end{aligned}$$

and

$$F_{p|N} = \begin{pmatrix} f(p|N=2) & 0 & 0 \\ 0 & ... & 0 \\ 0 & 0 & f(p|N=K) \end{pmatrix} \tag{3}$$

All of these are $K-1$-dimensional square matrices. Then equation (2) may be written in matrix notation as:

$$H_{p,A,Z} = G_{A|N} F_{p|N} \Psi_{N,Z} \tag{4}$$

Next, consider the observed joint density of A and Z. Again, the law of total probability together with Lemma 2 implies that

$$b(A,Z) = \sum_{N=2}^{K} g(A|N)\psi(N,Z) \tag{5}$$

or, using matrix notation analogous to that above,

$$B_{A,Z} = G_{A|N} \Psi_{N,Z} \tag{6}$$

Identification requires that the following rank condition be satisfied:

Condition 1 $\text{Rank}\left(B_{A,Z}\right) = K-1$.

Since both A and Z are observable, Condition 1 may be verified from the data. Equation (6) implies

$$\text{Rank}\left(B_{A,Z}\right) \leq \min\left\{\text{Rank}\left(G_{A|N}\right), \text{Rank}\left(\Psi_{N,Z}\right)\right\}, \tag{7}$$

and hence, Condition 1 implies that $G_{A|N}$ and $\Psi_{N,Z}$ are invertible. This induces our key identifying equation:

$$H_{p,A,Z}\left(B_{A,Z}\right)^{-1} = G_{A|N} F_{p|N} \left(G_{A|N}\right)^{-1} \tag{8}$$

The matrix on the left-hand side can be formed from the data. The right-hand side matrix represents an eigenvalue-eigenvector decomposition of the left-hand side matrix since $F_{p|N}$ is diagonal (cf. equation (3)). This representation allows us to estimate the unknown matrices $F_{p|N}$ and $G_{A|N}$.

The theory model implies:

Lemma 3 *The eigenvalue-eigenvector decomposition in equation (8) is unique.*

Proof. Since, for all N, the distribution of equilibrium prices contains a common interval in the neighborhood of r, it then follows that for any $i, j \in \mathcal{N}$, the set $\{(p) : f(p|N=i) \neq f(p|N=j)\}$ has nonzero Lebesgue measure whenever $i \neq j$. This immediately implies the uniqueness of the eigenvalue-eigenvector decomposition. ■

With Lemma 3 in hand, it then follows that an eigenvalue decomposition of the observed $H_{p,A,Z}\left(B_{A,Z}\right)^{-1}$ matrix recovers the unknown $F_{p|N}$ and $G_{A|N}$ matrices. Here, $F_{p|N}$ is the diagonal matrix of eigenvalues, while $G_{A|N}$ is the corresponding matrix of eigenvectors. Of course, $F_{p|N}$ and $G_{A|N}$ are only identified up to a normalization and ordering of the columns of the eigenvector matrix $G_{A|N}$. There is a clear, appropriate choice for the normalization of the eigenvectors because each column of $G_{A|N}$ should add up to one. The model also implies a natural ordering for the columns of $G_{A|N}$, since in the model $A \leq N$ with probability one. This implies that for any $i < j \in \mathcal{N}$, $g\left(A = j|N = i\right) = 0$. In other words, $G_{A|N}$ is an upper-triangular matrix, which, since it is invertible, has non-zero diagonal entries, i.e. $f\left(A = i|N = i\right) > 0$ for all $i \in \mathcal{N}$.

Finally, having recovered $G_{A|N}$, from equation (6) , we have

$$\Psi_{N,Z} = \left(G_{A|N}\right)^{-1} B_{A,Z}$$

and hence $\Psi_{N,Z}$ is also recovered. To summarize, we have shown:

Proposition 2 *Suppose Condition 1 holds. Then $F_{p|N}$, $G_{A|N}$ and $\Psi_{N,Z}$ are identified (with $F_{p|N}$ pointwise in p).*

We now describe how one may use the identification argument to estimate the model, given data from a price comparison site. Let t index each set of price observations. For each t, we observe A_t, the number of firms choosing to list their prices at the comparison site. Let $p_{it},\ i = 1, \ldots, A_t$ denote the A_t listed prices of product i. Our estimation procedure

accounts for the fact that N_t is known to the competing firms at time t but is, in effect, a random variable from the perspective of the econometrician. While we cannot recover the specific value of N_t pertaining to each set of prices at each point in time, we are able to recover its marginal distribution.

To estimate the vector of parameters θ, we use the following two-step estimation procedure: In the first step, we use our key equation (8) to nonparametrically estimate $G_{A|N}$. In the second step, based on the parametric form of $F(p|N;\theta)$ in equation (1) and the estimation in the first step, we recover the vector of parameters θ by MLE.

Step One We first describe how to use observable data on prices (p) and the number of listing firms (A) to estimate $G_{A|N}$. Our methodology closely parallels the approach taken in An, Hu and Shum (2010). While the key identification equation (2) is stated in terms of the joint density $h\left(p,A,Z\right)$, faster convergence is achieved if instead we take the expectation over all prices given (A,Z). Specifically, let $E[p|A,Z]=\int p\frac{h(p,A,Z)}{b(A,Z)}dp$, i.e. the expected price conditional on some realization A, Z. It then follows from equation (8) that

$$E\left[p|A,Z\right]b\left(A,Z\right)=\sum_{N=2}^{K}E\left[p|N\right]\times g(A|N)\psi(N,Z)$$

where $E[p|N]=\int pf\left(p|N\right)dp$.

Now define the matrices:

$$H_{Ep,N,Z}\equiv\left[E\left(p|A=i,Z=j\right)b(A=i,Z=j)\right]_{i,j}, \tag{9}$$

and

$$F_{Ep|N}\equiv\begin{pmatrix} E\left[p|N=2\right] & 0 & 0 \\ 0 & ... & 0 \\ 0 & 0 & E\left[p|N=K\right] \end{pmatrix}.$$

Then, we have

$$H_{Ep,A,Z}=G_{A|N}F_{Ep|N}\Psi_{N,Z}$$

which is analogous to equation (4). Similarly, we can obtain the estimating equation by postmultiplying both sides of this equation by $B_{A,Z}^{-1}$. This yields the analogous identification equation:

$$H_{Ep,A,Z}\left(B_{A,Z}\right)^{-1} = G_{A|N} F_{Ep|N} \left(G_{A|N}\right)^{-1} \tag{10}$$

Consequently,

$$G_{A|N} = \zeta\left(H_{Ep,A,Z}\left(B_{A,Z}\right)^{-1}\right),$$

where $\zeta(\cdot)$ denotes the mapping from a square matrix to its eigenvector matrix.[10] Following Hu (2008), we may estimate the relevant matrices using sample averages:

$$\widehat{G}_{A|N} \equiv \zeta\left(\widehat{H}_{Ep,A,Z}\left(\widehat{B}_{A,Z}\right)^{-1}\right), \tag{11}$$

where

$$\widehat{H}_{Ep,A,Z} = \left[\frac{1}{T}\sum_{t}\frac{1}{A_j}\sum_{i=1}^{A_j} p_{it}\mathbf{1}(A_t = A_j, Z_t = Z_k)\right]_{j,k}. \tag{12}$$

Finally, let $\mathbf{g}(A)$ be a vector of marginal probabilities over the number of listings and let $\mathbf{\Gamma}_N$ denote the vector of the unknown frequency distribution of N. Then

$$\mathbf{g}(A) = G_{A|N}\mathbf{\Gamma}_N$$

and we may estimate the unknown distribution $\mathbf{\Gamma}_N$ using the data as follows:

$$\widehat{\mathbf{\Gamma}}_N = \left(\widehat{G}_{A|N}\right)^{-1}\hat{\mathbf{g}}(A) \tag{13}$$

where $\hat{\mathbf{g}}(A)$ denotes the empirical frequency of the number of listings.

Step Two In the first step, we obtained estimates of $G_{A|N}$ and Γ_N nonparametrically. In the second step, we combine these estimates with the equilibrium restrictions on the price distribution from Proposition 1 to obtain estimates of the model's structural parameters, θ.

[10] Note that if the distribution of listed prices is such that the average price is monotonically ordered in N, then an analog of Lemma 3 holds for expected prices as well. This guarantees that ζ is a unique mapping.

Let $l(p, A; \theta)$ denote the joint density of prices and number of listings, and let $\Gamma(N)$ represent the unknown frequency distribution of N. In equilibrium, A and p are independent conditional on N. Thus, this density may be written as

$$\begin{aligned} l(p, A; \theta) &= \sum_{N=2}^{K} g(A|N) f(p|N; \theta) \Gamma(N) \\ &= e_A G_{A|N} F_{p|N;\theta} \mathbf{\Gamma}_N \end{aligned}$$

where $e_A = (0, 0, ..., 1, ..., 0)$ is a row vector where the 1 appears as the Ath element. Hence the likelihood function $\mathcal{L}$ for the t-th set of prices is

$$\begin{aligned} \mathcal{L} &= \prod_{i=1}^{A_t} l(p_i, A_t; \theta) \\ &= \prod_{i=1}^{A_t} e_{A_t} G_{A_t|N} F_{p_i|N;\theta} \mathbf{\Gamma}_N \end{aligned}$$

Using the first step estimates, we can write this as

$$\begin{aligned} \ln \mathcal{L} &= \ln \widehat{l}(p_i, A_t; \theta) \\ &= \sum_{i=1}^{A_t} \ln \left(e_{A_t} \widehat{G}_{A_t|N} F_{p_i|N;\theta} \widehat{\mathbf{\Gamma}}_N \right) \end{aligned} \tag{14}$$

where $F_{p_i|N;\theta}$ is a diagonal matrix with diagonal element $f(p|N; \theta)$. From equation (1), it may be shown that the density associated with $F^*(p)$ is given by

$$\begin{aligned} f^*(p|N; \theta) &= \frac{1}{N-1} \left(F^*(p|N; \theta) - \frac{1}{\alpha^*} \right) \\ &\quad \times \left(\frac{\gamma L}{(r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)} ((r-m)\gamma - c)} - \frac{\gamma}{(p-m)\gamma - c} \right) \end{aligned}$$

for $p \in [p_0, r]$ and zero otherwise. Note that $\widehat{G}_{A_t|N}$ and $\widehat{\mathbf{\Gamma}}_N$ are estimated using the data, whereas $F_{p_i|N;\theta}$ is based on the theory model (we have added θ to the subscript of $F_{p_i|N}$ to emphasize the dependence on θ, which will be selected so as to maximize the likelihood function).[11]

[11] We do not estimate c because we have data on clickthrough fees, as discussed below.

4 Data and Parameter Estimates

We apply the above estimation procedure to UK online price data obtained from Kelkoo.com for firms selling personal digital assistants. These data, which are described in detail in Baye *et al.* (2009), include the daily transactions prices (inclusive of taxes and shipping) charged by firms selling 18 models of personal digital assistants (PDAs) over the period from 18 September 2003 through 6 January 2004. During this period, an average of four firms sold each product at the comparison site, so on the surface this market might appear to be fairly concentrated. Our estimation is based on clickthrough fees at Kelkoo.com of $c = .20$ (20 pence per click).

Our data consists of $1,591$ product-dates. For $1,229$ of these product-dates, two or more firms listed prices, and we use these data in the estimation. Since our estimation procedure requires a large number of observations, we pool across all 18 products in both the first and second step of our estimation procedure to estimate a common parameter vector, θ. Owing to a paucity of observations where the number of listings exceeds 10, we combine observations where more than 10 firms list prices into a single bin.[12] Hence, $G_{A|N}$ is a 10×10 matrix for purposes of estimation, with the first 9 columns corresponding to $N = 2, ...10$ and the last bin corresponding to $N > 10$.[13] Appendix B demonstrates that despite our limited sample size and the consequent need to pool over certain values of N and A, our procedure works well at recovering the deep structural parameters of the model with simulated data.

Table 1 reports the results of the first-stage estimation. Each cell in the table corresponds to the estimated probability (in the data used) that there are A firms listing prices on the comparison site when the population of firms is N. Although the estimation procedure places no constraints requiring that the resulting estimates are well-defined probabilities, Table 1 reveals that the resulting estimates do, in fact, have this property.

[12] The maximum number of listings observed is 15.

[13] Baye and Morgan (2009) show that in an analogous model, the equilibrium price distribution as $N \to \infty$ is similar to that for finite values of N near the lower end of this last bin.

We now turn to the step 2 results. Recall that c is known data and not a parameter to be estimated. Following Baye and Morgan (2001), we set $L \equiv M/N$, so that M (the parameter to be estimated) represents the total number of loyal consumers in the market, and L is the (unobserved) number of loyals per firm on a given product-date. The resulting parameter estimates, along with bootstrapped standard errors, are reported in Table 2. The monetary parameters (r, m and ϕ) are denominated in GBP. As the table reveals, all of the parameters are precisely estimated. One potential concern is that likelihood function in equation (14) depends on an estimated $G_{A|N}$ matrix that uses only observations where two or more firms listed prices. Lemma 1, however, implies $f(p|N, A \geq 2; \theta) = f(p|N; \theta)$; thus, our estimates of θ remain consistent even with this restriction. Another potential worry is small sample properties of the estimates; Appendix B provides simulation results showing that the approach performs well even when the sample size is modest, as it is here.

The parameter estimates in Table 2 indicate that, on an average day, a total of $M = 26.04$ consumers in the UK who are loyal to some online firm were interested in purchasing a PDA online, while $S = 13.16$ consumers were interested in purchasing online from the firm charging the best price. These estimates imply that about 34 percent of consumers in this online market are price-sensitive shoppers, while 66 percent are loyals. It is interesting to contrast our estimates with those of Brynjolfsson, Montgomery, and Smith (2003), who find that around 13% of consumers in US e-retail markets are shoppers. Given the relatively less-developed state of e-retail in the UK compared to the US at the time our data was collected, it is not altogether surprising to find that fewer UK customers had become "attached" to a particular online retailer.

The estimated conversion rate, $\gamma = .15$, implies that a firm listing on Kelkoo.com has to receive, on average, 6.67 clicks in order to generate one sale. At a cost of 20 pence per click, this translates into an average cost per sale of 1.33 GBP in addition to the fixed listing fee of $\phi = 4.88$ GBP. Finally, notice that the estimated monopoly markup for a PDA, $(r - m)/m$,

is about 66 percent.

5 Competitive Effects Analysis

The econometric framework described above, along with the structural estimates of the model of online price competition, permits us to address a number of issues that arise in the evaluation of the competitive effects of a potential horizontal merger of online firms. As discussed above, the data obtained from Kelkoo.com might lead one to conclude that the PDA market on Kelkoo.com is highly concentrated, since only four firms list prices for a given product on an average day. The heart of many disagreements between antitrust agencies and merging parties centers around the "correct" number of potential competitors in the relevant market, as well as the "correct" definition of the relevant market to use in conducting an analysis of the merger. In the case at hand, discussions between parties and the agency would involve the extent to which other retailers—those not presently listing at the site or utilizing other platforms (such as other comparison sites, pure-play brick and mortar firms, or the websites of individual firms)—should be included in the set of potential competitors. It is, of course, costly for parties and agencies to document the exact number of competitors in the market at the time of a proposed merger, to obtain historical information on the number of competitors and to predict potential entry. Our econometric framework permits us to recover deep structural parameters without this information.

Of course, were the UK e-retail market well-approximated by the homogenous product Bertrand model of competition, uncertainty regarding the number of firms would be moot for purposes of merger analysis. So long as at least two firms remain in the market post-merger, consolidation produces no unilateral competitive effects. This begs the obvious question—is Bertrand competition a good model for this UK e-retail market? Recall that a key implication of the homogeneous product Bertrand model is the law of one price. This prediction, however, is grossly at odds with a number of studies that have documented price

ranges of 30 to 50 percent for "identical" products; see Baye, Morgan, and Scholten (2006) for a survey. Moreover, the degree of price dispersion is known to vary with the number of firms in the market. Thus, one might expect a merger to impact price dispersion, market power, and consumer welfare.[14] Our structural approach permits us to quantify competitive effects with limited data, as is the case when an antitrust agency does not wish to burden third parties with significant data requests.

To accomplish this, we first substitute the parameter estimates reported in Table 2 into the expressions summarizing equilibrium behavior in Proposition 1; below we use carets to denote the resulting estimates. Next, we calculate the implied average prices conditional on a given number of firms and display them in Table 3. Column (a) in Table 3 indicates the total number of firms in the relevant market (N), which is potentially in dispute. Column (b) provides the estimated average price listed at the comparison site conditional on different numbers of competitors, where the average listed price is

$$E[p] = \int_{\widehat{p_0}}^{\widehat{r}} p d\widehat{F^*}(p).$$

As would be expected, Table 3 shows that the estimated average listed price declines as the number of firms increases—rather abruptly as one moves from monopoly to a duopoly, and modestly thereafter. Column (c) reports the estimated average minimum listed price, which is given by

$$E[p_{\min}] = \frac{1}{1-\left(1-\widehat{\alpha^*}\right)^N} \sum_{A=1}^{N} \binom{N}{A} \left(\widehat{\alpha^*}\right)^A \left(1-\widehat{\alpha^*}\right)^{N-A} \int_{\widehat{p_0}}^{\widehat{r}} pA\left(1-\widehat{F^*}(p)\right)^{A-1} d\widehat{F^*}(p)$$

Notice that this calculation takes into account the effect of a change in N on the equilibrium distribution of prices, firms' propensities to advertise prices at the comparison site, and the impact of a larger number of listings on the minimum order statistic. Accounting for this, Column (c) of Table 3 shows that the estimated average minimum listed price also declines as the number of firms increases.

[14] See Baye, et al. (2004) for evidence of the relationship between various measures of price dispersion and the number of competing e-retail firms.

While it might be tempting to base competitive effects analysis on these average prices (presuming the average prices are relevant for loyals and the average minimum prices are relevant for shoppers), this would be incorrect: Neither of these averages represents average transaction prices. To calculate the average transaction price paid by loyals, one needs to account for a firm's propensity to list prices on the comparison site. In particular, when a firm does not list on the comparison site, it charges the monopoly price at its own website. Thus, the average transaction price paid by a loyal customer is

$$E\left[p^L\right] = \widehat{\alpha^*} E\left[p\right] + \left(1 - \widehat{\alpha^*}\right) \widehat{r}.$$

Column (d) of Table 3 reports the estimated average transaction prices of loyal consumers. Notice that it declines abruptly as one moves from monopoly to duopoly, but then rises as the number of firms increases further.

Likewise, the average transaction price for shoppers must also account for listing decisions: The average transaction price paid by a price-sensitive shopper is given by

$$E\left[p^S\right] = \left(1 - \left(1 - \widehat{\alpha^*}\right)^N\right) E\left[p_{\min}\right] + \left(1 - \widehat{\alpha^*}\right)^N \widehat{r}$$

Column (e) of Table 3 reports the estimated average transaction price of shoppers, which declines as the number of firms increases.

Columns (d) and (e) highlight that shoppers and loyals are impacted differently by heightened competition: So long as there are at least two firms in the market, loyal consumers are harmed by heightened competition, while shoppers are unambiguously made better off by increased competition. The overall transaction price, reported in Column (f) of Table 3, is merely a weighted average of the shoppers' and loyals' estimated transaction prices, where the weighting factor is determined by the estimated fraction of consumers who are shoppers and loyals:

$$E\left[p^T\right] = \frac{\widehat{M}}{\widehat{S} + \widehat{M}} E\left[p^L\right] + \frac{\widehat{S}}{\widehat{S} + \widehat{M}} E\left[p^S\right]$$

In summary, the estimates in Table 3 reveal that the average listed price and the average minimum listed price both decline as the number of firms declines. This is consistent with standard reasoning, which suggests that heightened competition leads to lower prices. However, this ignores the endogenous listing decisions of firms, which is, of course, relevant for the *transaction* prices paid by consumers. Here, a more subtle story emerges. Both shoppers and loyals pay lower average transaction prices as the online market moves from monopoly to duopoly. Thereafter, the effects of increased competition diverge: Loyal consumers are harmed (pay higher average transaction prices) as the number of firms further increases, while shoppers benefit from heightened competition.

Table 4 uses the results in Table 3 to simulate the competitive effects of a merger from N to $N-1$ firms, where column (a) represents the post-merger number of firms. Obviously, the direction of the price changes is identical to that in Table 3, but it is instructive to examine the implied percentage changes in prices to highlight the potential value of our methodology. Suppose first that the antitrust agency and the parties agree that the appropriate welfare standard is one that aggregates shoppers and loyals, such that the average transaction prices displayed in column (f) of Table 4 are relevant. Then so long as there is agreement that the merger does not result in monopoly, a merger between two online firms will not harm the "average" online consumer. This conclusion is based on the assumption that firms in the online channel do not compete against firms in other channels. Thus, there is no need for the agency to examine claims by the parties that "there are many potential online firms" or that "brick and mortar firms are also in the relevant market." In effect, column (f) reveals that—even though models of online competition are more complex than standard homogenous product Bertrand competition and the "law of one price" does not hold online—the conclusions based on our estimates are similar to what one would have concluded based on the simple Bertrand model, at least in this particular online market: There are no adverse competitive effects of a horizontal merger in this online market so long as it stops short of

merger to monopoly.

Notice that since our analysis takes as its maintained hypothesis that the relevant market is the online channel, our approach is "biased" in favor of finding competitive effects. Since the evidence suggests there are none, there would appear to be little value to an antitrust agency (or to the parties) of expending resources collecting the additional information needed to determine whether offline firms discipline the prices charged by online firms.

The results in Table 4 also highlight a potential problem that could arise in the evaluation of horizontal mergers, owing to differences in price effects for shoppers and loyals. Recall that, in the estimated model, loyals never frequent the comparison site, while shoppers always shop there first. As a consequence, the plot thickens when an antitrust agency opts for a more narrowly defined relevant market (the price comparison site only) or focuses on harm to a subset of consumers (shoppers only). In these circumstances, the estimates in columns (c) and (e) of Table 4 become relevant.

Notice that column (c) represents the average price paid by a shopper that buys through the comparison site, and this rises as the number of (post-merger) firms shrinks. It follows that if the agency and the parties agree that the merger is not a merger to monopoly, so long as the agency's tolerance for a price increase is 3 percent, there is again no value in examining whether other channels also compete or in conducting a detailed analysis of the actual number of firms in the market—even if the agency's focus is on a narrow market definition that includes only transactions through the comparison site. This is because, regardless of the actual number of firms, there is agreement that the estimated transaction price at the comparison site would rise by no more than 2.93% post merger.

Similarly, if the agency focused on consumer harm to one consumer group—price sensitive shoppers—the estimates in column (e) become relevant. In this case, so long as the agency's tolerance for a price increase is at least 2.88% and there is agreement that at least one competitor remains in the market post merger, there is no need for either party to spend

resources attempting to resolve uncertainty regarding the actual number of competitors or whether other channels are in the relevant market.

6 Discussion

Our results suggest that: (1) Online markets are less vulnerable to adverse competitive effects from horizontal mergers than one might expect given the plethora of papers documenting significant price dispersion in online markets; (2) mergers in online retail markets harm price sensitive shoppers but help customers who are loyal to a particular firm; and (3) the harm to shoppers is no greater than 3 percent and is almost exactly offset by benefits to loyals. We stress, however, that these findings are based on data from one e-retail market in the UK. While the model and econometric techniques developed in this paper are useful more generally, it would be a mistake to infer from our analysis that horizontal mergers are never problematic in online retail markets. We conclude with some specific caveats and highlight directions that we hope our framework might ultimately be stretched.

First, the econometric techniques developed in this paper are very data intensive. Among other things, this precluded us from incorporating additional parameters to account for downward sloping demand. While our unit demand assumption implies that overall welfare is unaffected by industry structure, the analysis offers policy-relevant insights into the effects of online mergers on consumer welfare—the welfare standard that guides antitrust policy in both the US and the UK. Extending the analysis to cover downward sloping demand might impact the magnitude of effects on consumer welfare, and would be especially helpful for analyzing competitive effects in Canada, which uses a total welfare standard to guide antitrust enforcement.

Data limitations also necessitated our pooling across different PDAs. Obviously, this is far from ideal and somewhat limits the scope for directly applying our analysis to antitrust policy. Nevertheless, it illustrates the potential value of our techniques to antitrust agencies

and parties, who typically do not face such data constraints in conducting competitive effects analysis.

Additionally, our structural estimation is based on a model with *symmetric* firms: Firms have identical marginal costs and numbers of loyal consumers. This implies that all firms reposition post merger such that they each get an equal share of the (fixed) number of loyal consumers. As a purely theoretical matter, it is quite difficult to obtain closed-form solutions for equilibrium price distributions in the presence of asymmetries.[15] For these reasons, our competitive effects analysis does not account for changes in industry structure that might arise as a result of a firm gaining a disproportionate share of loyals through mergers.

There are several other potential limitations of the analysis. We do not have consumer choice data outside the price comparison site; thus we are relying entirely on the theory model and structural estimation to infer the total number of loyal consumers in the market. We are also using firm pricing behavior at the comparison site to infer pricing behavior at the firms' own websites. The model ignores the possibility that a firm might price discriminate between consumers visiting its site directly and those routed there through the price comparison site. In principle firms could do this; in practice they do not (probably for reputational reasons). Allowing for price discrimination would obviously affect equilibrium pricing behavior and estimates of competitive effects.

For all of these reasons, our analysis should be viewed as a first step towards better understanding the competitive effects of horizontal mergers in online retail markets rather than the final word on the subject.

[15] See Arnold *et al.* (forthcoming) for an asymmetric version of the Baye and Morgan (2001) model with two firms.

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A Proof of Proposition 1

As in Baye and Morgan (2001), it is readily seen that equilibrium has the following two key properties: (1) A firm must be indifferent between listing its price at the clearinghouse or not; and (2) a firm must earn the same expected payoff from posting any price $p \in [p_0, r]$ at the clearinghouse.

A firm that eschews the comparison site earns profits of

$$\pi_0 = (r-m)\,\gamma L + (r-m)\,(1-\alpha)^{N-1}\,\frac{\gamma S}{N} \tag{15}$$

A firm that advertises a price r on the site earns

$$\pi = (r-m)\,\gamma L + (r-m)\,(1-\alpha)^{N-1}\,\gamma S - c\,(1-\alpha)^{N-1}\,S - \phi$$

Since firms must be indifferent between listing or not, it then follows that $\pi = \pi_0$. We may use this equality to obtain a closed-form expression for α:

$$(r-m)\,\gamma L + (r-m)\,(1-\alpha)^{N-1}\,\frac{\gamma S}{N} = (r-m)\,\gamma L + (r-m)\,(1-\alpha)^{N-1}\,\gamma S - c\,(1-\alpha)^{N-1}\,S - \phi$$

Simplifying, this reduces to

$$\phi = (1-\alpha)^{N-1}\,S\left((r-m)\,\gamma\frac{N-1}{N} - c\right)$$

Or equivalently,

$$\begin{aligned}(1-\alpha)^{N-1} &= \frac{\phi}{S\left((r-m)\,\gamma\frac{N-1}{N} - c\right)} \\ &= \frac{N\phi}{S\left((r-m)\,\gamma\,(N-1) - Nc\right)}\end{aligned}$$

Hence, the equilibrium advertising propensity is:

$$\alpha^* = 1 - \left(\frac{\phi}{S\left((r-m)\,\gamma\frac{N-1}{N} - c\right)}\right)^{\frac{1}{N-1}} \tag{16}$$

The conditions on ϕ and c identified in Proposition 1 imply that $\alpha^* \in (0,1)$.

Substituting for α^* in equation (15), we obtain equilibrium profits of :

$$\begin{aligned}\pi_0 &= (r-m)\gamma L + (r-m)\frac{\phi}{S\left((r-m)\gamma\frac{N-1}{N}-c\right)}\frac{\gamma S}{N} \\ &= (r-m)\gamma L + \frac{\phi}{N\left(1-\frac{c}{(r-m)\gamma}\right)-1}\end{aligned}$$

It remains to determine the equilibrium distribution of listed prices. Recall that a firm listing a price p, earns expected profits of

$$\pi(p) = (p-m)\gamma L + (p-m)(1-\alpha F(p))^{N-1}\gamma S - c(1-\alpha F(p))^{N-1} S - \phi$$

Such a firm must be indifferent between charging p and not advertising at all, i.e. $\pi(p) = \pi_0$. It is convenient to express π_0 in terms of α for the moment. Hence, we have:

$$\begin{aligned}\pi(p) &= (p-m)\gamma L + (p-m)(1-\alpha F(p))^{N-1}\gamma S - c(1-\alpha F(p))^{N-1} S - \phi \\ &= (r-m)\gamma L + (r-m)(1-\alpha)^{N-1}\frac{\gamma S}{N} = \pi_0\end{aligned}$$

Solving this expression for $(1-\alpha F(p))^{N-1}$, we obtain

$$\begin{aligned}(1-\alpha F(p))^{N-1} &= \frac{(r-p)\gamma L + (r-m)(1-\alpha)^{N-1}\frac{\gamma S}{N} + \phi}{S((p-m)\gamma - c)} \\ &= \frac{(r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c)}{S((p-m)\gamma - c)}\end{aligned}$$

which implies

$$F(p) = \frac{1}{\alpha}\left(1 - \left(\frac{(r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c)}{S((p-m)\gamma - c)}\right)^{\frac{1}{N-1}}\right)$$

To verify that $F(p)$ is a well-defined atomless probability distribution, we will first show that $F(r) = 1$, or equivalently, $(1-\alpha F(r))^{N-1} = (1-\alpha)^{N-1}$. To see this, note that

$$\begin{aligned}(1-\alpha F(r))^{N-1} &= \frac{\frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c)}{S((r-m)\gamma - c)} \\ &= \frac{N\phi}{S((r-m)\gamma(N-1) - Nc)} \\ &= (1-\alpha)^{N-1}\end{aligned}$$

where α is defined in equation (16).

Next, we determine the lower support of the equilibrium listed price distribution; that is p_0, where $F(p_0) = 0$. Equivalently, p_0 satisfies $(1 - \alpha F(p_0))^{N-1} = 1$, or

$$\frac{(r - p_0)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c)}{S((p_0 - m)\gamma - c)} = 1$$

Cross-multiplying and collecting the p_0 terms:

$$\gamma Lr + \frac{N\phi}{((r-m)\gamma(N-1) - Nc)}((r-m)\gamma - c) + S\gamma m + Sc = p_0(S\gamma + L\gamma)$$

Solving for p_0 gives

$$p_0 = m + \frac{1}{(S\gamma + L\gamma)}\left(\gamma L(r-m) + \frac{N\phi}{((r-m)\gamma(N-1) - Nc)}((r-m)\gamma - c) + Sc\right)$$

which exceeds m.

Finally, we verify that F is strictly increasing, or equivalently, that $(1 - \alpha F(p))^{N-1}$ is strictly decreasing in p. Recall that

$$(1 - \alpha F(p))^{N-1} = \frac{(r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c)}{S((p-m)\gamma - c)}$$

and define $num \equiv (r-p)\gamma L + \frac{N\phi}{((r-m)\gamma(N-1)-Nc)}((r-m)\gamma - c) > 0$ and $den \equiv S((p-m)\gamma - c) > 0$. Differentiating with respect to p reveals

$$\frac{\partial(1 - \alpha F(p))^{N-1}}{\partial p} = -\frac{\gamma L(den) + S\gamma(num)}{(den)^2} < 0$$

B Simulation

We report results of a simulation study demonstrating that our estimation procedure performs well in a controlled, small-sample environment that mirrors that analyzed in the paper. Taking the "true" parameter values $\left(\theta^{True}\right)$ to be the estimates reported in column (b) of Table 2, we construct a simulated dataset based on the underlying theoretical model as follows.

For each simulated period, t, we randomly draw a number of firms for that period, $N_t \in \{2, 3, ..., 15\}$ from a discrete uniform distribution. Notice that the upper bound of this distribution corresponds to the maximum number of listings we observed across all product-dates in the actual data. Next, we make N_t Bernoulli draws with parameter $\alpha^*(N_t; \theta^{True})$ (defined in Proposition 1) to simulate whether each of these N_t firms listed or not. Let A_t denote the number of firms listing prices in simulated period t. For each of these A_t firms, we next draw a listed price from the distribution $F^*(p|N_t; \theta^{True})$ defined in Proposition 1. Following the estimation procedure in the paper, we retain data for this simulated period only if $A_t \geq 2$. We repeat this process until we have retained exactly $1,229$ simulated periods—the sample-size used in our actual estimation in the text.

Next, following the approach in the paper, we pool simulated observations where $A_t \geq 11$ into a single bin, and use the simulated data to estimate the model via our two-step estimation procedure. These estimates are presented in Table A1, along with standard errors obtained via bootstrapping (with 200 resamples employed). As Table A1 reveals, the parameters are precisely estimated, and very close to the true values.

Table 1: Estimated $G_{A/N}$ Matrix

Number of Listings (A)	Number of Firms (N)									
	2	3	4	5	6	7	8	9	10	> 10
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
2	1.0000	0.9068	0.7141	0.7526	0.6775	0.3143	0.7010	0.6528	0.2585	0.2532
3	0	0.0932	0.2358	0.1311	0.1180	0.1425	0.0458	0.0427	0.1245	0.1220
4	0	0	0.0501	0.0459	0.0413	0.1293	0.0002	0.0002	0.1749	0.1713
5	0	0	0	0.0704	0.0634	0.1517	0.1172	0.1092	0.1381	0.1353
6	0	0	0	0	0.0998	0.1243	0.0225	0.0209	0.1040	0.1018
7	0	0	0	0	0	0.1380	0.0939	0.0874	0.1077	0.1055
8	0	0	0	0	0	0	0.0194	0.0181	0.0419	0.0411
9	0	0	0	0	0	0	0	0.0687	0.0279	0.0273
10	0	0	0	0	0	0	0	0	0.0225	0.0221
> 10	0	0	0	0	0	0	0	0	0	0.0205

Table 2: Parameter Estimates and Bootstrapped Standard Errors

Parameter	Estimate	Standard Error
(a)	**(b)**	**(c)**
φ	4.88	*0.109*
r	415.26	*85.097*
m	250.09	*17.651*
M	26.04	*1.742*
S	13.16	*0.574*
γ	0.15	*0.004*

Table 3: Estimated Transaction Prices

Number of Firms	Estimated Avg. Listed Price	Estimated Avg. Minimum Listed Price	Estimated Avg. Transaction Price Loyals	Estimated Avg. Transaction Price Shoppers	Estimated Avg. Transaction Price
(a)	(b)	(c)	(d)	(e)	(f)
1	415.26	415.26	415.26	415.26	415.26
2	366.57	354.60	368.06	354.65	363.56
3	365.71	344.49	373.19	344.73	363.64
4	363.23	336.43	377.40	336.87	363.79
5	360.46	329.93	380.79	330.53	363.92
6	357.77	324.59	383.56	325.33	364.01
7	355.25	320.11	385.87	320.96	364.08
8	352.92	316.29	387.84	317.25	364.14
9	350.76	312.99	389.53	314.03	364.18
10	348.77	310.10	391.00	311.23	364.22
11	346.93	307.56	392.30	308.75	364.25
12	345.22	305.30	393.45	306.54	364.27
13	343.63	303.26	394.48	304.57	364.30
14	342.14	301.43	395.41	302.78	364.31
15	340.75	299.77	396.25	301.16	364.33

Table 4: Percentage Change in Post-Merger Transaction Prices

Number of Firms	Estimated Change in Average Listed Price	Estimated Change in Avg. Minimum Listed Price	Estimated Change in Average Transaction Price Loyals	Estimated Change in Average Transaction Price Shoppers	Estimated Change in Average Transaction Price
(a)	(b)	(c)	(d)	(e)	(f)
1	13.28 %	17.11 %	12.82 %	17.09 %	14.22 %
2	0.24	2.93	-1.37	2.88	-0.02
3	0.68	2.40	-1.12	2.34	-0.04
4	0.77	1.97	-0.89	1.92	-0.03
5	0.75	1.65	-0.72	1.60	-0.03
6	0.71	1.40	-0.60	1.36	-0.02
7	0.66	1.21	-0.51	1.17	-0.02
8	0.61	1.05	-0.43	1.02	-0.01
9	0.57	0.93	-0.38	0.90	-0.01
10	0.53	0.83	-0.33	0.80	-0.01
11	0.50	0.74	-0.29	0.72	-0.01
12	0.46	0.67	-0.26	0.65	-0.01
13	0.43	0.61	-0.24	0.59	-0.01
14	0.41	0.56	-0.21	0.54	0.00

Table A1: Simulation Parameter Estimates and Standard Errors

Parameter	"True" Value	Estimate	Standard Error
(a)	(b)	(c)	(d)
φ	4.88	4.10	*1.831*
r	415.26	421.68	*25.868*
m	250.09	258.94	*46.814*
M	26.04	25.33	*3.236*
S	13.16	9.20	*5.205*
γ	0.15	0.14	*0.081*

Hypotheticals and counterfactuals: the economics of competition policy

Mark Williams and A Jorge Padilla
NERA

The increasing role of economics in competition policy

The textual brevity of Articles 81 and 82 of the EC Treaty stands in sharp contrast to the degree of complexity of modern competition policy. Yet it is hardly surprising that an area of law that is, to a significant extent, effects-based should encompass a large number of possible mechanisms of anti-competitive harm, and an abundance of models that—depending on the underlying assumptions—might point in one direction or the other. This reflects the general proposition that, as far as detailed prescriptions are concerned, there are very few 'one size fits all' competition policy provisions.

In most cases, a detailed fact-based analysis of the specific circumstances of a case is required. The findings then determine the assumptions to be used in the modelling of the economic situation. Using the correct factual assumptions may be critical to effective competition policy analysis, since many results in economics may not be robust to a change in the assumptions used.

However, modern competition policy is not satisfied merely with conducting a fact-finding exercise. Rather, it goes beyond that stage and aims at understanding how markets work, explaining economic relationships, estimating effects on consumer welfare, and extrapolating the hypothetical. In the course of this move towards understanding the true forces that underlie how competition works, the use of economics has emerged as the driving force behind modern competition policy.

The advent of rigorous economic analysis is reflected in recent personnel developments at various regulatory bodies, both at national level and at the European Commission. Commissioner Mario Monti, himself an economist, has made it one of his key aims to further develop the careful application of economic principles in European competition policy. The appointment of Professor Lars-Hendrik Röller as Chief Economist at DG Comp and the recruitment drive for industrial economists are a clear indication of the Commission's determination. Economic analysis is now more crucial than ever before. Even the European Courts no longer shy away from getting involved in economic debates, as illustrated by the *Airtours*, *Tetra Laval* and *Schneider* cases before the Court of First Instance.

Hypotheticals and counterfactuals

The primary need for economics arises from the fact that competition policy typically has to consider counterfactuals and hypothetical situations that are not directly observable. For example, in a merger inquiry the competition policy practitioner is required to assess the effect of the merger by comparing the situation that would result if the merger went ahead with the situation that would obtain in the absence of the merger, and where the no-merger scenario is not necessarily a continuation of the pre-merger situation. Similarly, in a cartel investigation the relevant question is what would have happened 'but for' the cartel.

In such hypothetical situations, which are by their nature not directly observable, it is imperative to understand how markets work, so that the underlying economic relationships can be applied to the hypothetical situation.

Since economic agents are interrelated and a change can cause ripple effects, it is not possible simply to change one feature of an economic situation and to assume that nothing else is affected and the initial equilibrium has not otherwise been affected. Although economists often use the phrase 'ceteris paribus' ('all else being equal'), it is precisely this linking together of all economic agents into an interrelated model, where all else adapts itself to the new circumstances rather than being equal, that makes economics so indispensable to modern competition policy.

Economics is a key part in most elements of competition policy. But in two areas of competition analysis, merger simulation and computation of cartel effects and damages, the determination of the correct hypothetical or counterfactual is especially important, and it is these that are the focus of this chapter.

Merger simulation

In merger inquiries it is necessary to extrapolate from observed facts into the hypothetical situation of the post-merger world, and to compare this with the post no-merger world. Traditional analyses have often relied heavily on measures of market concentration such as market shares, concentration ratios and the Herfindahl-Hirschman Index (HHI).

This traditional approach has two key drawbacks. First, reliance on concentration measures placed great emphasis on the process of market definition. But the question of where to draw the boundaries of the market is often highly contested, particularly in differentiated goods industries where there is a spectrum of product varieties or qualities. Second, it is normally the effect of a merger on prices which is of most direct concern to consumers. There is no simple relationship between the degree of market concentration and prices that is valid across a range of diverse business sectors: the effect of an increase in concentration depends on a number of other factors, including the degree of substitutability between products within the market, the market elasticity of demand and cost savings arising from the merger. It is therefore more satisfactory to address the effect on prices directly.

Antitrust authorities have increasingly focused their efforts on such a direct examination of the effects of a merger, with the standard steps of market definition and the calculation of market shares and concentration measures subsiding to mere routine procedures in establishing the background and general framework. The central development in this shift towards a direct assessment of the effects of a merger is undoubtedly the simulation of mergers, which seeks to extrapolate the counterfactual on the basis of observed economic relationships prior to the merger.

Merger simulation is probably the most important recent development in merger analysis. (While there are some models of vertical mergers, the main focus has been on the assessment of horizontal mergers.) Simulation has been made possible by new economic research, but crucially also the development of ever more sophisticated numerical methods and statistical software used in the computation of equilibria.

In the US, simulation played an important role in the analysis of *Kimberly-Clark/Scott Paper*, *Staples/Office Depot* and *L'Oréal/Maybelline*. The technique is also beginning to be used in European merger control: a merger simulation was conducted to analyse the effects of the proposed merger between Volvo and Scania on the prices of heavy trucks, although the final prohibition decision did not ultimately rely on it.

An outline of the technique

Simulations are designed to examine the unilateral effects of a merger. When a firm raises price some of the lost demand will be diverted to its competitors. Accordingly, when one firm acquires a rival, it will have an incentive to increase price since it will benefit from the increase in demand experienced by its former competitor. The increase in price by the merged business is in turn likely to lead to an increase in the prices by its rivals in response, and so a market-wide price increase will often result. Merger simulation predicts the size of the price increases of the merged business and its competitors.

The approach to all merger simulations is essentially one of two stages. First, the elasticities and cross-elasticities facing the firms in the market are estimated on the basis of observed behaviour like pre-merger price and cost data. These are combined with the post-merger ownership structure to simulate the effect of the merger on prices. In order to perform the simulation it is necessary to make assumptions primarily about three factors:

First, a particular model of oligopolistic competition needs to be chosen. Most simulations assume that non-cooperative price-setting (also known as Bertrand-Nash competition) prevails both before and after the merger. This is not an innocuous assumption, as it rules out, for example, the possibility that the merger could trigger tacit coordination (or that it already exists). It would also rule out the possibility that competition takes some other form, such as quantity-setting (also known as Cournot competition).

Second, pricing decisions depend on marginal costs and a merger may enable a firm to produce at lower marginal costs. In the absence of such efficiency gains, simulation models normally predict an increase in price of the merged business. However, using such models, it is possible to investigate how large the necessary efficiency gains would need to be to offset this anti-competitive effect.

Third, the functional form of the demand system needs to be chosen. This refers to the shape of the demand curves for the market as a whole and each of the products in the market. A number of different demand systems of varying complexity have been investigated in the literature, not least because they have different data requirements but also may produce significantly different results.

A recent extension has been to apply simulation techniques to industries with capacity constraints. Under such circumstances a situation may arise whereby a 5 per cent price rise is not profitable for the merged entity, since a large number of customers switch to its competitors. Yet, a 10 per cent price rise may be profitable since the merged entity's competitors at some stage will no longer be able to accommodate the diverted demand, so that customers are captive to the merged entity, which can accordingly afford to raise prices significantly.

Limitations of simulation

Simulation quantitatively examines the unilateral effects of a merger on price competition between the existing players in an industry. While this is often a key question in merger analysis, a number of limitations must be pointed out:

There are many dimensions of rivalry between firms other than competition on prices which may be dulled by a merger, for example, competition in the introduction of entirely new products, production technologies and marketing techniques.

While price competition between existing players is examined, simulation models typically do not address the critical question of whether entry would foil any price rises. In some cases, whether a merger is significantly anti-competitive hinges more on the magnitude of entry barriers than the intensity of competition between existing players.

Simulation models have almost exclusively addressed the unilateral effects of a merger; as yet the literature on quantifying coordinated effects is in its infancy.

The results may hinge on the modelling assumption as to the demand system or shape of the cost function and it may be difficult to determine empirically the appropriate assumption. Nevertheless, simulation models may help here to focus attention on the critical empirical parameters in a case.

Despite these areas that require further research, the use of computer simulations is a breakthrough in merger analysis, enabling quantitative predictions as to price effects of horizontal mergers through a direct estimation of the correct counterfactual. The technique has a number of decisive advantages over the traditional approach which focuses on market definition and measures of concentration in the defined market. With the new emphasis on rigorous economic analysis in European merger control it will be interesting to observe developments. Indeed, although simulation can only form part of a full merger analysis, the technique is nevertheless probably the most exciting advance in the economic analysis of mergers of the last 10 years.

Counterfactuals in cartels and damages

In merger analysis the question of the correct counterfactual asks what would happen if two parties were to combine and act as a single entity. The consideration of cartels is very much the other way round: what would have happened if the parties in question had not acted as a single entity but instead had competed and taken their decisions unilaterally? In that sense, a cartel investigation is a reverse merger inquiry.

While hardcore cartel agreements are prohibited per se, so that an assessment of the effect of the agreement is not necessary for an infringement decision, the cartel's impact on the market (and the additional proceeds to the colluding parties) is still relevant for the imposition of fines and the calculation of damages. This is also acknowledged in the European Commission's Guidelines on the Method of Setting Fines: 'The basic amount [of the fine] will be determined according to the gravity and duration of the infringement, which are the only criteria… . In assessing the gravity of the infringement, account must be taken of its nature, its actual impact on the market, where this can be measured, and the size of the relevant geographic market.'

Therefore, in spite of the classification of an agreement as an infringement of Article 81(1) as having as its object the restriction of competition, some quantitative analysis of the impact of an agreement on the market may still be relevant.

The increasingly aggressive stance that competition authorities around the world have adopted towards cartels in recent years has pushed cartel analysis into the spotlight, and the amounts of money involved have underlined the need to take cartels very seriously.

This need is further exacerbated by damage suits, certainly in the US where firms may be liable for 'treble damages', but also in Europe and under the various national jurisdictions.

'But for' prices

The damage that colluding firms inflict on their customers arises from the fact that the collusive price is typically above the competitive price. The 'overcharge' is the difference between the actual price and the 'but-for' price, that is the price that would have prevailed but for the cartel. Economics and counterfactual analysis are required to determine this but-for price since it cannot be directly observed, and needs to be estimated.

While counterfactual prices can be constructed from data on the past history of the market, complications in the estimation of the cartel overcharge may arise due to the fact that not all of the price increases during a price-fixing period are attributable to the cartel. Other demand and supply-side factors, such as income movements, improvements in production technologies, or currency fluctuations, may have an impact on prices. The fact that numerous economic-related factors other than the cartel affect prices confronts all involved parties with the question of exactly how much of a price rise is in fact due to price-fixing.

This difficulty has not always enjoyed the importance it deserves. For example, in *Ohio Valley Electric Corp v General Electric Co*, a US case from 1965, as a first step to measure the price overcharge, the difference between the cartel price and the price that obtained outside the cartel period was taken. Underlying this approach was the assumption that the competitive prices during the cartel would have been the same as the prices outside the price-fixing period. Clearly this method fails in any world where prices move over time due to perfectly innocent reasons. The direction of the bias, however, is not clear: with an underlying trend of falling prices the effect of the cartel would be understated in a comparison of pre-cartel and cartel prices, whereas with a trend of rising prices the impact of the cartel would be overstated in such a comparison.

An alternative, but arguably equally inappropriate approach was followed in the lysine cartel investigation in the US. But-for prices were set equal to estimates of marginal costs even though the lysine market was not a simple 'competitive' market but essentially an oligopoly of four firms with some degree of market power.

The problem of constructing valid counterfactual but-for prices is a topic of which the European Commission seems to be fully aware. In its decision on the Citric Acid cartel the Commission notes at paragraph 211: '… [the extent to which prices differed from those which might have been applied in the absence of these agreements] cannot always be measured in a reliable manner, since a number of external factors may simultaneously have affected the price development of the product, thereby making it extremely difficult to draw conclusions on the relative importance of all possible causal factors.'

A correct analysis of the economic impact of a cartel needs to take into account the influence of various economic factors on price. Econometric methods are well-suited for the task of decomposing a cumulative effect which may arise as a result of various influencing factors, into the individual component causes.

Regression analysis

The econometric estimation technique generally used to construct but-for prices is regression analysis. In the assessment of cartels, price variations in the regression equation are accounted for by certain explanatory factors, which are called regressors. These are relevant variables other than the cartel agreements, such as demand variables (GDP, economic growth etc) and supply-side variables (input costs, capacities etc). Regression analysis assumes that the dependent variable, ie the price in our case, is explained in a linear and additive way by its regressors, each of which is weighted by a corresponding coefficient (to be estimated).

An important feature of the regression analysis is that the estimated coefficients describe 'partial' correlations of the explanatory variables with the price. In other words, the regression coefficients describe the net effect of an explanatory variable on the price variable, controlling at the same time for the effects of other factors in the model. The regression model thus provides results on the cartel impact that assume all effects other than the cartel are unchanged. The technique is thus able to 'isolate' the cartel impact from the effects that are unrelated to the cartel.

Within this methodology, there are broadly two approaches that can be employed for the estimation of but-for prices by means of regression analysis: the 'Dummy variable' approach and the 'Prediction' approach.

The dummy variable approach directly estimates the impact of the cartel on prices by employing data that cover both cartel and competitive periods. The effect of the cartel on prices is thereby captured by a dummy variable. A dummy variable takes a value of 1 for all observations during the cartel period and 0 for observations during the competitive period. The estimated impact of the cartel dummy variable indicates the average overcharge due to price-fixing. But-for prices of the first type can then be computed by subtracting the estimated effect of the cartel dummy variable from the actual cartel prices.

While the dummy variable approach is applied over a time horizon that includes both cartel and competitive periods, the prediction approach looks at either one or the other. There is accordingly no 'regime shift' present within the sample under consideration, so that no dummy variable is required. The only determinants of the price that are taken into consideration in the model are demand and supply side factors.

The prediction model can either be estimated from data that exclusively cover the cartel period or it can be estimated from data that exclusively cover the competitive period. The resulting estimates of the parameters are then used to predict what the price would have been in the other period.

Notwithstanding the complex issues that arise in econometric analysis, the need for a clear assessment of the effects of cartels is strong. The magnitude of fines, especially under some national jurisdictions, and the level of damages is linked to the effect of the cartel on the market and the additional proceeds enjoyed by the parties to the cartel. The fact that an estimate will never be perfect is intrinsic in the concept of an estimate, and is certainly no reason for dismissing advanced estimation techniques in favour of an ad hoc method which may suffer from very substantial drawbacks.

Despite some difficulties, the estimation of counterfactual but-for prices, with the use of sophisticated econometric techniques that make the best use of the available data, arguably represents the least imperfect approach in the evaluation of the impact of price-fixing arrangements.

The increased focus of competition authorities on cartels, enhanced by the modernisation programme at the European Commission, and the leniency schemes in an increasing number of jurisdictions, is likely to shift the estimation of counterfactual prices that would have resulted but for a cartel further towards the centre stage of competition policy analysis.

Further developments

Economics has over the years played an increasing role in competition policy analysis. By now, there are hardly any areas other than per se prohibitions which have remained untouched, and even here, as with cartels, economics is assuming a greater role.

The economic toolbox has equally developed at a high pace. Market definition is by now routine, and the focus has shifted to approaches that directly address the questions of economic relevance. In merger assessment and cartel analysis the primary new analytical developments are merger simulation and the econometric estimation of but-for prices.

There are other areas where counterfactual analysis is equally appropriate. An increasing number of agreements, both vertical and horizontal, are analysed with the use of models, often calibrated by observed parameters. This is conceptually very similar to merger simulation, and the lessons from merger analysis will no doubt inform further developments in the assessment of agreements. Intellectual property disputes equally benefit from counterfactual analysis. For example, in a patent infringement case, the question under investigation is what the patentee's profits would have been in the hypothetical situation of no patent infringement.

The list goes on, for example, to abuse of dominance cases, and the effect of State aid. Virtually all areas of competition policy are about the interaction of economic agents, so that models of some complexity are required to understand how markets work.

NERA

15 STRATFORD PLACE
LONDON W1C 1BE
TEL: +44 20 7659 8500
FAX: +44 20 7659 8501

CONTACT: MARK WILLIAMS AND A JORGE PADILLA

WEBSITE: WWW.NERA.COM

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Horizontal Merger Guidelines





U.S. Department of Justice

and the

Federal Trade Commission

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1. Overview

These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agencies") with respect to mergers and acquisitions involving actual or potential competitors ("horizontal mergers") under the federal antitrust laws.[1] The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Most particularly, Section 7 of the Clayton Act prohibits mergers if "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.

These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. They are not intended to describe how the Agencies analyze cases other than horizontal mergers. These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement decisions. They may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.

These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.[2]

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[1] These Guidelines replace the Horizontal Merger Guidelines issued in 1992, revised in 1997. They reflect the ongoing accumulation of experience at the Agencies. The Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines. These Guidelines may be revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning. These Guidelines do not cover vertical or other types of non-horizontal acquisitions.

[2] These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation.

The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm's behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

These Guidelines principally describe how the Agencies analyze mergers between rival suppliers that may enhance their market power as sellers. Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called "monopsony power," has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers. See Section 12.

2. Evidence of Adverse Competitive Effects

The Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition. This section discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers. The list provided here is not exhaustive. In any given case, reliable evidence may be available in only some categories or from some sources. For each category of evidence, the Agencies consider evidence indicating that the merger may enhance competition as well as evidence indicating that it may lessen competition.

2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or "natural experiments," that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative.

The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties' market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a "maverick" firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to

disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

2.2 Sources of Evidence

The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.

2.2.1 Merging Parties

The Agencies typically obtain substantial information from the merging parties. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct and decisions. Documents created in the normal course are more probative than documents created as advocacy materials in merger review. Documents describing industry conditions can be informative regarding the operation of the market and how a firm identifies and assesses its rivals, particularly when business decisions are made in reliance on the accuracy of those descriptions. The business decisions taken by the merging firms also can be informative about industry conditions. For example, if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern, see Section 4.1.3[3]) or that the firm and its rivals are engaged in coordinated interaction (see Section 7). Incremental cost depends on the relevant increment in output as well as on the time period involved, and in the case of large increments and sustained changes in output it may include some costs that would be fixed for smaller increments of output or shorter time periods.

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies. The Agencies give careful consideration to the views of individuals whose responsibilities, expertise, and experience relating to the issues in question provide particular indicia of reliability. The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm's stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies.

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[3] High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.

2.2.2 Customers

Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself.

Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers. In evaluating such evidence, the Agencies are mindful that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.

When some customers express concerns about the competitive effects of a merger while others view the merger as beneficial or neutral, the Agencies take account of this divergence in using the information provided by customers and consider the likely reasons for such divergence of views. For example, if for regulatory reasons some customers cannot buy imported products, while others can, a merger between domestic suppliers may harm the former customers even if it leaves the more flexible customers unharmed. See Section 3.

When direct customers of the merging firms compete against one another in a downstream market, their interests may not be aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase. A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger's harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.

> *Example 1:* As a result of the merger, Customer C will experience a price increase for an input used in producing its final product, raising its costs. Customer C's rivals use this input more intensively than Customer C, and the same price increase applied to them will raise their costs more than it raises Customer C's costs. On balance, Customer C may benefit from the merger even though the merger involves a substantial lessening of competition.

2.2.3 Other Industry Participants and Observers

Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry. The interests of firms selling products complementary to those offered by the merging firms often are well aligned with those of customers, making their informed views valuable.

Information from firms that are rivals to the merging parties can help illuminate how the market operates. The interests of rival firms often diverge from the interests of customers, since customers normally lose, but rival firms gain, if the merged entity raises its prices. For that reason, the Agencies do not routinely rely on the overall views of rival firms regarding the competitive effects of the

merger. However, rival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.

> *Example 2:* Merging Firms A and B operate in a market in which network effects are significant, implying that any firm's product is significantly more valuable if it commands a large market share or if it is interconnected with others that in aggregate command such a share. Prior to the merger, they and their rivals voluntarily interconnect with one another. The merger would create an entity with a large enough share that a strategy of ending voluntary interconnection would have a dangerous probability of creating monopoly power in this market. The interests of rivals and of consumers would be broadly aligned in preventing such a merger.

3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

First, the suppliers engaging in price discrimination must be able to price differently to targeted customers than to other customers. This may involve identification of individual customers to which different prices are offered or offering different prices to different types of customers based on observable characteristics.

> *Example 3:* Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.

In other cases, suppliers may be unable to distinguish among different types of customers but can offer multiple products that sort customers based on their purchase decisions.

Second, the targeted customers must not be able to defeat the price increase of concern by arbitrage, e.g., by purchasing indirectly from or through other customers. Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers. Arbitrage is inherently impossible for many services. Arbitrage between customers at different geographic locations may be

impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.

The Agencies' analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

> *Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term "market."

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the

hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms.[4] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

> *Example 5:* Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> *Example 6:* In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

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[4] If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.

satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

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[5] Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;

- information from buyers, including surveys, concerning how they would respond to price changes;

- the conduct of industry participants, notably:

  - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;

  - industry participants' behavior in tracking and responding to price changes by some or all rivals;

- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;

- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;

- evidence from other industry participants, such as sellers of complementary products;

- legal or regulatory requirements; and

- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a "critical loss analysis" to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. While this "breakeven" analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price.[6] Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> *Example 11:* Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a

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[6] While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.

hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller's location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers.[7] Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage,

[7] For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring

significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

> *Example 16:* Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.
>
> *Example 17:* Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant.[8] However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm's historical market share

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[8] If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.

overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms' future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm's market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms' readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

> *Example 18:* The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X's market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X's market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm's market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.

5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares,[9] and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies

[9] For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.

consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.[10]

Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- *Small Change in Concentration:* Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Unconcentrated Markets:* Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

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[10] For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$).

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view

products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

> *Example 19:* In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.[11]

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

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[11] For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product's price.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers' information about one another's costs and about buyers' preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

> *Example 20:* Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable.[12] This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm's ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

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[12] Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by

retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a

coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[13] Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[14] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price

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[13] The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

[14] The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

increases in that market.[15] In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

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[15] The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

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[16] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

[17] Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

> *Example 24:* Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

13. Partial Acquisitions

In most horizontal mergers, two competitors come under common ownership and control, completely and permanently eliminating competition between them. This elimination of competition is a basic element of merger analysis. However, the statutory provisions referenced in Section 1 also apply to one firm's partial acquisition of a competitor. The Agencies therefore also review acquisitions of minority positions involving competing firms, even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction.

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such

influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.



TYING, BUNDLING, EXCLUSIVITY, MFNS AND OTHER DISTRIBUTION ISSUES

The Chicago Forum on International Antitrust Issues

Tying, Bundling , Exclusive Dealing, & Loyalty Discounts: Basics of the Analysis Under US Antitrust Law

Mark McLaughlin

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I. Introduction

- The principles by which the courts/agencies evaluate tying and exclusive dealing claims are basic tools in the life of lawyers who counsel clients in the manufacturing and distribution arenas.
- Every question in this area requires a return to first principles, and then looking at significant recent activity, as a reminder that there is always something new in this area.

First Principles - Tying

- As to tying, for example, the Supreme Court issued a major decision in *Kodak v. Image Technical Services*, back in 1992 – and we'll discuss the impact that Kodak has had as the lower courts have worked to apply it over the past two decades.

First Principles – Exclusive Dealing

- As to exclusive dealing, the key issue in analyzing an exclusive dealing arrangement is whether it has the effect of foreclosing competitors of the seller from the opportunity to get their products to market.
- We'll see how the Third Circuit applied that principle in its 2005 decision in *U.S. v. Dentsply*, one of the relatively few recent decisions in the exclusive dealing area.

First Principles – Evolving Applications

- Recent activity shows how the courts and agencies apply the same foreclosure principles to arrangements like:
  - Bundling arrangements.
  - Loyalty discount programs.

Tying

Tying

- Put simply, it is a Seller's requirement that:
  - Before it will sell Product A to a customer (the tying or highly desired product)…
  - …The customer also must agree to buy a separate product, Product B (the tied product), from the seller.

- What has caused courts to condemn tying arrangements:
  - Concern that a seller with a dominant position in one market will be able to use that dominant position (and the fact that customers don't have wide alternatives to its products) to extend its power into the second market and reduce competition there.

Tying

- Historical examples:
  - USM – string.
  - IBM computers – processing cards.

- Tying agreements are subject to challenge under:
  - § 3 of the Clayton Act (when both of the products are tangible commodities), or,
  - § 1 of the Sherman Act (as contracts in unreasonable restraint of trade).

Tying – Elements Considered

- Based on that concern, and on its sense that there generally are not any pro-competitive justifications for tying, the Supreme Court has long held that tying arrangements are *per se* unlawful upon proof of the four elements.

Tying – Element One

- Conditioning (in contrast to voluntary availability of package).

Tying – Element Two

- That the tying and tied products are separate and distinct:
  - Note that this element has led to some theological-type debates over the years, in the effort to distinguish components that are associated with a single product, where the components obviously are sold together, from a problematic tie of two different products.
    - For example, left shoe/right shoe problem.
    - Franchise cases – product franchise v. business format franchise (2 products) (but other problems make tying claims difficult to assert in those cases).

Tying – Element Two (cont.)

- Supreme Court brought some clarity to analysis in ’84 decision in *Jefferson Parish*.
  - Surgery to anesthesiological services.
    - Hospital said one product – used together – not one without other (don’t have surgery without anesthesia).
  - Supreme Court said two products: don’t look at functional relationship, but on character of demand:
    - People shopped for the products separately; anesthesiological services were billed separately, and patients requested separate doctors for anesthesiology.
- In *Kodak* (more later), Supreme Court elaborated on the “separate demand” standard – products separate when sufficient consumer demand such that efficient for firm to sell each separately.

Tying – Element Three

- Seller must have sufficient economic/market power in the market for the tying product to restrain competition in market for second product.
  - No competitive problem if seller doesn't have power to force buyers to take the product.
  - For example, milk and eggs.
  - *Jefferson Parish* – no unlawful tying – even though surgery/anesthesiology were two products, there were enough other hospitals around (*e.g.*, other providers of surgical services) that patients who did not want to use the anesthesiologists at Jefferson Parish Hospital could go elsewhere.

Tying – Element Four

- A not insubstantial amount of commerce in the tied product – the second market – is foreclosed to other sellers by the tie.
  - Typically easy to satisfy.

Tying

- When those elements are present, a tie is *per se* unlawful.
  - Courts, as a practical matter, often conduct a rule of reason analysis in order to decide if practice is *per se* (*e.g.*, detailed analysis of whether seller has market power in properly defined relevant market).
  - That observation led four concurring Justices in *Jefferson Parish* to say that the Court should reject *per se* analysis for tying, and apply the rule of reason.
  - That view of the world has not prevailed.

Tying – *Microsoft*

- In *Microsoft*, the D.C. Circuit chipped away at the breadth of the *per se* rule.
  - Tying claim arose from bundling Internet Explorer with Windows operating system.
  - Court of Appeals acknowledged prospect that integration of browsers with O/S might serve some legitimate purpose – reversed District Court decision and announced rule:
    - Where tying product is software and tied product is complementary software functionality, courts are unable to conclude that there are no redeeming features – therefore, it would not be appropriate to condemn all ties involving software under the *per se* rule – Court of Appeals sent the case back for full blown rule of reason treatment.

Tying – *Kodak*

- *Kodak* – another key tying case.
  - In the tying analysis, the question at the heart is market power: is the seller in position to force the buyer to accept the tie?
  - Kodak sold replacement parts only to those copying machine owners that used Kodak for service.
  - ISOs had grown before Kodak imposed the policy and offered services to equipment owners.

Tying – *Kodak* (cont.)

- ISOs sued: claimed that *Kodak* tied sale of service to sale of parts – that is, in order to get parts, customer also must take service.
  - SJ on truncated record – theory was that no power in original equipment market, so no ability to impose tie.
  - Put another way, if Kodak raised parts prices too much or imposed onerous conditions on the purchase of parts, people wouldn't buy Kodak copiers anymore, defeating effort to exercise "market power" in aftermarket.

Tying – *Kodak* (cont.)

- Ninth Circuit reversed and Supreme Court agreed, finding:
  - District Court had granted summary judgment on a very truncated record, without much discovery.
    - Granted on Kodak theory that absence of market power in OE market – copiers – necessarily meant that Kodak could not have market power in aftermarket (here, for sale of parts for its machines).
- Supreme Court found that there may be facts that kept that economic theory from becoming a reality:
  - Consumer difficulty in obtaining "lifecycle pricing" info at initial purchase, making informed decision difficult.
  - Locked in customers – heavy investment in equipment make switch difficult. Customers might be forced to absorb high service prices in order to get parts.

Tying – *Kodak* (cont.)

- Supreme Court concluded that those facts – *potentially* – could create an environment in which Kodak could impose a tie.
- Thus, the Court refused to dispose of the case on the theoretical proposition articulated by Kodak.
- Remanded for development of the record:
  - To see if ISOs could prove the evidence of a lock-in sufficient to create power in market for the tying product.

Tying – After *Kodak*

- Predicted flood of cases based on theory of single seller's products as relevant market or based on presence of "locked in customers":
  - E.g., franchise cases – claim based on mandatory purchases of supplies.
  - But no franchisor has market power on market for sale of franchise.
- Lock in theory generally has failed in post – *Kodak* era:
  - If tie is known/or easily knowable at the time the franchisee enters into the arrangement.
- Generally failed also in non-franchise tying cases.

Tying – After *Kodak*

- More recent case involving IBM (SDNY) and *Commercial Data Services*, demonstrate difficulty in defining narrow/single product market.
  - No information costs – at time of purchase, buyer knows that a particular product will have certain consequences.
  - Also, although it might be costly, people can switch.

Tying – After *Kodak*

- Legacy of *Kodak*:
  - Illustrates risk of seeking summary judgment on a doctrinal point, without benefit of factual record that supports the point.
  - Decision raises prospect of circumstances in which tying claims might succeed, but *Kodak* has not been followed by flood of new, successful tying claims.

Tying – More Recent Development – *Independent Ink*

- In March 2006, Supreme Court issued new decision on the economic power issue: *Illinois Tool Works v. Independent Ink*.
  - Classic facts: maker of patented product (barcoding equipment) conditioned sale of product on customers' commitment to buy ink.
  - Ct. App. for Fed. Cir. held, consistent with some old cases, that existence of patent gave rise to presumption of economic power – *i.e.*, because of patent, you necessarily had market power.

Tying – More Recent Development – *Independent Ink* (cont.)

- Supreme Court reversed, noting essentially that there were millions of patents in the world, many without any real value to the owner.
  - The Court rejected abstract presumption of market power for patented products.
  - Held that ". . . in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product."

Tying – More Recent Development – *Brantley*

- *Brantley v. NBC Universal* (9th Cir. 2012)
  - Plaintiffs alleged programmers required distributors purchasing high-demand channels also purchase their low-demand channels.
  - Increased consumer prices alone cannot be the basis for antitrust liability.
  - Plaintiffs did not allege tying arrangement forced them to forego purchase of substitutes for the tied product.
  - Court would not prohibit tying arrangements allowing a company to exploit its market power by enhancing the price of the tying product.
  - Despite reduced end consumer choice resulting from tying arrangement, no antitrust claim without specific injury to competition.
- *Per se* rule still lives, but it applies to a smaller range of cases.

Bundling

Bundling

- What is bundling?
  - An offer by a supplier to provide quantity discounts based on a customer's combined purchases in more than one product category.
- Advantages for supplier: promotes the creation of a broader relationship with customers, fosters the sale of multiple products with one sales call, one shipment, and one bill.
- Advantages for the customer: lower prices through a discount, advantages of “one-stop-shopping;” allows the buyer to deal with fewer sales calls, fewer deliveries, and fewer accounts payable.
  - Saves the time and expense of “qualifying” a greater number of vendors.
- Common throughout the U.S. economy.

Bundling – Legal Standard

- Antitrust laws give wide latitude to manufacturers in deciding how to market and price their products.
- Three issues to consider:
  - The existence of a "must have" product and the degree of market power inherent in that product.
  - Definition and size of the market from which competitors seeking to sell the bundled products are foreclosed.
  - Actual foreclosure, and degree of foreclosure.

Bundling – Legal Standard (cont.)

- Bundled discounts will be legal in most circumstances.
  - "Few people dispute that antitrust's core mission is protecting consumers' right to the low prices, innovation, and diverse production that competition promises" (*Antitrust Modernization Commission Report and Recommendations* (April 2007), at 35).
  - "[C]utting prices in order to get more business often is the very essence of competition" (*Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986); *see also Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 337-38, 341 (1990)).
  - "Because they involve lower prices, bundled discounts and bundled rebates typically benefit consumers" (*Antitrust Modernization Commission Report and Recommendations* (April 2007), at 94).

Bundling – Legal Standard (cont.)

- To violate the antitrust laws, a bundled discount must include in bundle a "must have" product and a "competitive" product.
- A must have product is:
  - A product where supplier controls IP rights to exclude others.
  - A product where supplier has a high market share (70 percent or higher).
  - If the "bundle" does not include a "must have" product, then there is no antitrust problem.
- A competitive product is a product where supplier faces significant competition from other suppliers.

Bundling – One early approach – *LePage's*

- *LePage's Inc. v. 3M* (324 F.3d 141 (3d Cir. 2003))
  - 3M offered higher discounts where customers purchases across several product lines. Reduced overall price to market of its private label tape.
  - LePage's tape (only product), could not keep up.
  - 3M argument regarding overall lower prices and pricing above cost (i.e. *Brooke Group*) was unsuccessful.
- Third Circuit ignored price to cost comparison – looked to bundle as exclusionary conduct.

Bundling – "Competitive Products"

- In 2007, the Antitrust Modernization Commission recommended the following three-part test for bundling:
  - After allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product;
  - Defendant is likely to recoup these short-term losses; and,
  - Bundled discount or rebate program has had or is likely to have an adverse effect on competition (*Antitrust Modernization Commission Report and Recommendations* (April 2007), at 99).
- These are necessary elements of an antitrust violation <u>but not sufficient</u> to establish a violation; there are many ways to structure discount programs to avoid antitrust liability.
- The next year, the Ninth Circuit in *PeaceHealth* adopted this test, with a slight modification.

Bundling – *PeaceHealth*

- *Cascade Health v. PeaceHealth*, 515F.3d 883 (9th Cir. 2008):
  - Defendant hospital offered bundled discounts to insurers if they made PeaceHealth their exclusive preferred provider for primary, secondary, and tertiary care.
  - Ninth Circuit adopted the "discount attribution" standard:
    - Where full amount of discounts given by defendant on the bundle are allocated to the competitive product or products…
    - If the resulting price of the competitive product or products is below the defendant's incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of Section 2.
  - According to the Ninth Circuit, under this standard, PeaceHealth's bundled discounts are legal unless discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product.
- The court vacated the jury verdict against the defendant.

Bundling – After *PeaceHealth*

- *Pacific Bell v. Linkline* (555 U.S. 438 (2009))
  - "Price Squeeze" case – Linkline paid fee to Pac Bell for use of phone lines, also sells DSL service downstream – in competiton with Pac Bell.
  - Contend that Pac Bell can raise use fees and lower downstream prices, squeezing profits.
- Supreme Court refused to create an antitrust "duty to deal" where defendant is unilaterally setting prices at both wholesale and retail level.
  - Noted that courts are ill-suited to act as "central planners" re: prices, quantities, etc.
- Consider whether *Linkline* could extend to other unilateral pricing actions (e.g. bundled discounts, tying) – courts shy away from "central planning" under § 2?

Bundling – Key Questions

- Considerations before offering bundled discounts:
  - Are any of the products in the bundle "must have" products?
    - If no "must have" products, then no bundling.
  - What bundle could competitors offer?
    - Can any competitors be excluded by supplier's bundle?
    - Could different competitors partner to offer a full-line bundle?
  - What is the business case for offering bundled discounts?
  - What impact do you expect bundling to have?
  - Do customers ask for bundled rebates?
  - Do competitors bundle?

Bundling – Conclusions

- Bundling will be legal in most circumstances.
- Beware of deep discounts applied only to the "competitive products."
- The test for bundling is not very useful as a counseling device, except in the simplest of settings.

Exclusive Dealing

Exclusive Dealing – Background

- A retailer who is bound to purchase its requirements for a product from one manufacturer.

AND/OR

- A manufacturer agrees to sell all or a substantial portion of its products to a particular retailer.

Exclusive Dealing – Legal Standard

- Rule of Reason – whether the arrangement forecloses other sellers from the market in substantial enough fashion to adversely affect competition.
- Consider:
  - Duration.
  - Ability to terminate relationship on short notice.
  - Availability of other distribution channels.
- Difficult to attack exclusive distribution arrangement in an environment in which there are plenty of other actual/potential distributors or other ways (like direct sale, mail order) to get product to market.

Exclusive Dealing – The *Dentsply* Case

- *U.S. v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005), reversing 277 F. Supp. 2d 387 (D. Del. 2003).
- Allegations:
  - Dentsply prohibited dealers from carrying competitors' false teeth (Dentsply market share of 75-80%).
  - No written contract requiring exclusive dealing & dealers allowed to terminate relationship any time.

Exclusive Dealing – The *Dentsply* Case

- Challenged by DOJ under §1 Sherman, §3 Clayton, and §2 Sherman (conduct that enabled a monopoly).
- Trial court judgment:
  - No meaningful foreclosure because direct distribution to dental labs is viable alternative means of getting to market.
  - Manufacturers could use other dealers and dealer could leave.
  - Note no pro-competition justification.

Exclusive Dealing – The *Dentsply* Case (cont.)

- Third Circuit Reversal:
  - DOJ did not appeal judgment on §3 Clayton or §1 Sherman.
  - Alleged Dentsply used exclusive dealing arrangements to thwart emergence of competitors and unlawfully preserve monopoly power, in violation of §2 Sherman.
- Third Circuit found ability of competitors in false teeth business to bypass dealer level (where Dentsply had stranglehold) and sell directly to dental labs (the ultimate consumer) was more theoretical than real, because for sellers it was much, much more efficient and less costly to sell to dealers in bulk than to sell in small lots to hundreds of dental labs.
- For their part, the labs preferred to do business with dealers, which offered one stop shopping and other services.

Exclusive Dealing – The *Dentsply* Case (cont.)

- Third Circuit further acknowledged that existence of other means by which competitors can get their products to market will negate any anticompetitive effect from an exclusive dealing arrangement.
- Found on the factual record that "the undeniable reality . . . is that dealers have a controlling degree of access to the laboratories," and that the prospect of direct distribution to labs was an "impracticable" alternative.
- *Dentsply* shows that it is difficult to attack exclusive distribution arrangement in an environment in which there are plenty of other actual/potential distributors or other ways (like direct sale, mail order) to get product to market.

Exclusive Dealing – The *Intel* Case

- *In the Matter of Intel Corporation* (Compl., Dec. 16, 2009).
- Allegations that Intel sought to induce customers to buy computer central processing units (for which Intel had a market share of 75-85%) and graphics processing units (for which Intel had a 50% share) entirely or mostly from Intel.
- Alleged Tactics:
  - Quantity discounts.
  - Bundled discounts resulting in sales below cost, threats and discrimination against non-compliant customers.
  - Dissemination of misleading information about rivals, predatory product design to impede rivals and raise their costs.
  - Manipulation of industry standards – i.e., textbook practices designed to encourage exclusive dealing plus some garden variety "dirty tricks."

Exclusive Dealing – The *Intel* Case (cont.)

- Relief Sought:
  - To prohibit discrimination/threats of discrimination against customers that do not agree to purchase exclusively from Intel, or at least to purchase minimum volumes or percentages of their requirements from Intel.
    - Price discrimination/promotional discrimination (Robinson-Patman Act).
    - Additional discrimination in such areas as technical support and product allocations.
  - To prohibit tying products together.
  - To require Intel to make certain technology available to rivals.
  - To provide advance notice of future acquisitions and certain advertising material available to the FTC for prior inspection.
  - To prohibit Intel from suing its rivals' suppliers or forcing customers to disclose their plans to use rivals' products.

Exclusive Dealing – The *Intel* Case (cont.)

- Regarding the Complaint:
  - Alleges that bundled discounts resulting in sales below cost can violate the FTC Act even if there is no prospect of recoupment where the seller already possesses monopoly power or is likely to achieve it.
  - Alleges that a seller has a "duty to deal" with competitors after it has begun to cooperate with them and then reverses that cooperation. Allegation appears to apply Supreme Court's holding in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), from which the Court subsequently has distanced itself.
  - Embraces the theory of "raising rivals' costs" as the basis for a claim of monopolization. Theory of liability is found in the literature, but has made its way into only a limited number of cases so far.

Exclusive Dealing – The *Intel* Case (cont.)

- FTC Act reaches beyond the limits of the other antitrust laws.
- Complaint asserts a "stand alone" violation of the FTC Act as well as what would amount to a violation of the Sherman Act.
  - Concurring Statement (Leibowitz and Rosch) explains some courts have been giving anticompetitive conduct a "free pass" for fear of the "collateral consequences" of private litigation.
  - Commissioner Rosch dissented from including monopolization and attempted monopolization claims along with the FTC Act claims in the complaint, on the ground that the standards for monopolization claims are no better settled than the standards under the FTC Act.

Exclusive Dealing – The *Intel* Case (cont.)

- FTC settled with Intel in August 2010.
- Per the FTC, settlement prohibited Intel from:
  - conditioning benefits to computer makers in exchange for their promise to buy chips from Intel exclusively or to refuse to buy chips from others; and
  - retaliating against computer makers if they do business with non-Intel suppliers by withholding benefits from them.
- The approach the FTC has taken already provides insights into how it will confront matters in the future.

Exclusive Dealing – Other Recent Developments

- American Antitrust Institute, *The Next Antitrust Agenda*:
  - October 2008 transition report on competition policy issued to the new presidential administration.
  - Exclusive Dealing: Exclusive dealing by a "dominant" supplier or distributor should be *prima facie* unlawful without a showing of a high degree of foreclosure; for less dominant firms, exclusive dealing should be *prima facie* unlawful where rivals are foreclosed from needed inputs or outlets, subject to rebuttal.
- The approach has not gained traction since its presentment.

Loyalty Discounts

Loyalty Discounts – *Concord Boat v. Brunswick*

- Brunswick used increasing discounts that based on percentage of a customer's purchases devoted to the seller's brand. For example:

60% = 1% discount
70% = 2% discount
80% = 3% discount

⇨ 1984-1994

60% = 1% discount
65% = 2% discount
70% = 3% discount

⇨ 1995-1997

Loyalty Discounts – *Brunswick* (cont.)

- Brunswick discounts, further detail:
  - No additional discounts for purchases in excess of 80% (70% in some years).
  - No long term commitment.
  - Boat builders could change buying practices at any time and would not lose discounts on past purchases.

Loyalty Discounts – *Brunswick* (cont.)

- Twenty-one boat builders sued Brunswick alleging violations of §§ 1 and 2 of the Sherman Act and § 7 of the Clayton Act, arguing that:
  - Brunswick's market share discount programs for the stern drive engines that it sold to boat builders and Brunswick's acquisition of two big boat builders (substantial users of stern drive engines) foreclosed other engine manufacturers from access to customers.
- At trial, jury found that Brunswick's discount program, coupled with its acquisitions, effectively foreclosed other sellers from the market—judgment was entered for $133 million, representing supposed overcharges paid by plaintiffs.

Loyalty Discounts – *Brunswick*, Section 7 (cont.)

- On appeal, the Eighth Circuit held that:
  - Plaintiffs' challenge to Brunswick's acquisitions under § 7 of the Clayton Act were time barred.
  - District Court should have granted Brunswick's motion to bar plaintiffs' liability and damages expert because his economic theory did not fit the facts of the case.

Loyalty Discounts – *Brunswick*, Section 1 (cont.)

- Specifically, the Eighth Circuit found:
  - As to the § 1 claim, this was not an exclusive dealing case.
  - Nevertheless, Court accepted plaintiffs' proposition that claim alleging "*de facto* exclusive dealing may be viable."
  - Proceeded to apply same rule of reason test that governs exclusive dealing cases, looking at three factors:
    - The extent to which competitors arguably were foreclosed from the stern drive engine business.
    - The duration of the market share discount program.
    - Whether entry barriers existed that limited the entry of new stern drive engine sellers.

Loyalty Discounts – *Brunswick*, Section 1 (cont.)

- Regarding the § 1 claim, the Court concluded that the facts showed boat builder plaintiffs could not prove a violation under a rule of reason standard because:
  - Brunswick's program did not require exclusivity:
    - Builder could buy almost 40% of its stern drive engines from a competitor and still receive the discounts.
  - The program *did not bind* builders for any length of time.
    - Builder could switch suppliers when a competitor offered a better deal, and there was evidence that showed boat builders regularly did so.

Loyalty Discounts – *Brunswick*, Section 1 (cont.)

- The Court further concluded, regarding § 1, that facts showed the boat builder plaintiffs could not prove a violation under a rule of reason standard:
  - There were no barriers to prevent new competitors from emerging to bid for builder business.
- *"Brunswick's discounts, because they were significantly above cost, left ample room for new competitors such as Toyota to enter the engine manufacturing market and to lure customers away by offering superior discounts."*

Loyalty Discounts – *Brunswick*, Section 1 (cont.)

"Brunswick's discounts, because they were significantly above cost, left ample room for new competitors such as Toyota to enter the engine manufacturing market and to lure customers away by offering superior discounts."

- The Court did not provide sweeping, doctrinal grounds for its decision.
- Rather, the Eighth Circuit treated the case like any other rule of reason matter involving a vertical arrangement.
- Plaintiffs' case failed on the facts.

Loyalty Discounts – *Brunswick*, Section 2 (cont.)

- The boat builders claimed that Brunswick's market share discount pricing program constituted exclusionary conduct that enabled Brunswick to obtain or maintain a monopoly power.
- Citing a "strong presumption of legality" for prices that are above cost, the Eighth Circuit held that it would be counter to fundamental antitrust principles to condemn discounting practices as long as the discounted prices were above cost.
  - District Court had refused to apply the presumption of legality, citing a number of cases finding antitrust violations when a defendant offered bundled prices for different products.
- Eighth Circuit held that these cases had no application in *Concord Boat*, which did not involve bundling.

Loyalty Discounts – *Brunswick*, Section 2 (cont.)

- Same facts that doomed the § 1 claim were also applicable here:
  - Customers could walk away from the discounts at any time—no obligation to purchase engines from Brunswick.
  - There were no significant barriers to entry as evidenced by the entrance of other stern drive engine manufacturers into the market during the relevant period.
  - Brunswick's discounts were significantly above cost, which creates a "strong presumption of legality" of the discounts.
  - Many customers purchased more engines from Brunswick than was necessary to qualify for the maximum discount.
  - Brunswick gained market share after a recall of a competitor's engines and other mistakes by competitors.

Loyalty Discounts – *Brunswick*, Takeaway

Even after citing the broad principle described above, the Eighth Circuit cited the Supreme Court's reminder that in cases such as this, "the focus [is] on the actual facts or realities of the marketplace rather than on hypotheticals."

Loyalty Discounts – Market Share Discounts

- Recently Third Circuit considered market share discounts.
- *ZF Meritor v. Eaton* (696 F.3d 254).
  - Meritor attacked market share discounts as coercive.
  - Court agreed, found discounts to be "de facto exclusive dealing arrangement," without determining whether discounts led to below cost pricing.
- *Amici* brief to Supreme Court on cert:
  - "Distinctions between penalties and rewards are often slippery and depend entirely on some preconceived baseline."
  - "A dollar awarded for loyalty and a dollar withdrawn for disloyalty are equivalent."
  - Thus, true measure who be economic substance of offered price – *i.e.* cost-price test.
- Supreme Court <u>denied</u> cert.

Loyalty Discounts – *Eaton* (cont.)

- While a disconcerting approach, the Third Circuit reasoning is not shared by many other circuits in the areas of market share or loyalty pricing, including the First, Second, Sixth, and Eighth Circuits.



IDENTIFYING AND RESOLVING CONFLICTS OUTSIDE THE US

MAYER·BROWN

Abbott
A Promise for Life

Identifying and Resolving Conflicts Outside the US

Fourth Annual Chicago Forum on International Antitrust Issues

Jason H. Staples
Senior Counsel
International Legal Operations
Abbott Laboratories
Abbott Park, Illinois

Charles F. Regan, Jr
Partner
Mayer Brown LLP
Chicago, Illinois

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Global Conflicts – Introduction

- Like the clients they serve, large law firms have an increasingly global footprint.
- Both clients and law firms therefore often need to consider conflict rules both inside and outside the US.
- Topics to be covered:
  - US conflict rules.
  - Non-US conflict rules, using the rules of England and Wales.
  - How the rules interact.
  - A client's perspective.

US Conflict Rules

- US conflicts are based on the duty of loyalty and, secondarily, the duty of confidentiality.
- They create a regime that is client-centered.
- Model Rules of Professional Conduct.
  - State implementation.

Rule 1.7(a)(1) – Direct Adversity to Current Clients

- Rule 1.7(a)(1) implements the duty of loyalty.
- It bars representation that "will be directly adverse to another client," unless both affected clients consent.
- Two components:
  - Cannot be adverse to client, even in an unrelated, non-contentious matter, unless both clients consent.
  - Where a firm represents client against an adversary, cannot take on representation of adversary, even in unrelated matter, without both clients' consent.

Rule 1.7(a)(1) – Direct Adversity to Current Clients

- Adversity does not turn on contentiousness.
- Antitrust cases sometimes require careful consideration of who is adverse.
  - Company and officer or employee?
    - Even if no conflict at beginning, unforeseen adversity may arise.
    - Confidentiality considerations.
    - Sometimes, it is necessary to alert officers or other "constituents" of client that it is the company you are representing, to avoid later claim that you were also representing the constituent. See Rule 1.13(f).
  - Other members of alleged cartel?

Rule 1.7(a)(2) – Material Limitation on Representation

- Rule 1.7(a)(2) says a conflict exists, requiring consent from the affected client, when
  - "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."
- "[S]ignificant risk" and "materially limited".
- Responsibilities to another client.
- Personal interests of lawyer or firm.

Corporate Family Issue – When Can a Law Firm Be Adverse to the Affiliate of a Client?

- This is probably the most difficult issue conflict lawyers face on a daily basis.
- By itself, corporate affiliation will not create a conflict.
  - Comment [34] to Rule 1.7: "A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary."
  - Similarly, ABA Op. 95-390: "The fact of corporate affiliation, without more, does not make all of a corporate client's affiliates into clients as well."

Corporate Family Issue – When Can a Law Firm Be Adverse to the Affiliate of a Client?

- Exceptions:
  - Where "circumstances are such that the affiliate should also be considered a client" – a fact and circumstances test
  - Where "lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client"
  - Where lawyer and client have an understanding that lawyer will avoid representation adverse to affiliates

Rule 1.10 – Imputation of Conflicts of Interest

- As a general matter, if one lawyer in a firm has a conflict, all lawyers in the firm have a conflict.
  - Rule 1.10(a): "While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless the prohibition is based on a personal interest of the disqualified lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm."

Waivers

- Under Rule 1.7(b), a lawyer may represent a client, notwithstanding a conflict, if four conditions are met:
  - "(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
  - "(2) the representation is not prohibited by law;
  - "(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
  - "(4) each affected client gives informed consent, confirmed in writing."

Waivers

- Is the conflict one that can be waived?
  - Model Rule 1.7 cmt [15]: "Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest."
- Consent must be "informed."
- Waivers are narrowly construed.
- In most jurisdictions, consent must be confirmed in writing.
- Advance waivers are generally considered effective.
- Except where the conflict is caused by a lateral lawyer, screens are not sufficient by themselves to cure a conflict.

Rule 1.9 – Duties to Former Clients

- Lawyer cannot be adverse to former clients in matters that are substantially related to the work done for them, unless consent obtained.
  - Rule 1.9(a): "A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing."
- Is the client a former client?
  - Often answer is not clear.

Rule 1.9 – Duties to Former Clients

- Substantially related
  - Where two matters "involve the same transaction or legal dispute or if there otherwise is a substantial risk that confidential factual information as would normally have been obtained in the prior representation would materially advance the client's position in the subsequent matter. " Comment [3]
  - This indicates the rule is a means of protecting client confidences.
- Materially adverse

Rule 1.18 – Duties to Prospective Client

- Lawyer generally cannot reveal confidences learned.
- Lawyer who met with prospective client may not be adverse in discussed matter if information learned "could be significantly harmful" to prospective client, unless prospective client agrees, either before or after consultation.
- Even in absence of such agreement, other lawyers in firm may act adversely if first lawyer avoided learning too much in discussion with prospective client and is screened from subsequent matter.
  - Some jurisdictions require notice to prospective client.

Conflicts Outside the United States

- We will use the rules of England and Wales, implemented in the Solicitors Regulation Authority Code of Conduct of 2011.
  - http://www.sra.org.uk/solicitors/handbook/code/part2/content.page
- Relevant provisions are:
  - Chapter 3 – Conflicts of Interest
  - Chapter 4 – Confidentiality and Disclosure

Conflicts Outside the United States

- While the US rules are client-centered, the rules in England and Wales are matter-centered, and based on duty of good faith.
- Thus, the ethics rules in England and Wales do not include a duty of loyalty, and allow a law firm to be adverse to clients in matters not related to firm's work for them.
  - Focus on whether matters are related eliminates questions like whether client is current or former client, whether law firm can be adverse to affiliates of client, and whether advance waiver is effective.
  - Obviously, client relation issues remain, especially in contentious matters.

Conflicts Outside the United States

- Exception
  - Cannot act for multiple parties in same or related matter if conflict or significant risk of conflict.
  - This conflict is not waivable save in limited circumstances.
    - Substantial common interest.
    - Competing bidders for same asset.
    - In both cases, informed consent required.
- Tension between duty of confidentiality and duty (on individual lawyer) to disclose material information to client.
  - Usually resolved by agreement in advance to waive duty to disclose.

Conflicts in Cross-Border Matters

- How to apply the differing rules is a difficult question.
- Often, business or client relations considerations, or agreements with the client, will obviate the need to consider the conflict rules. A law firm usually has little interest in suing a substantial client even if the rules would allow it.
  - Increasingly, clients located outside the US are insisting that the law firms representing them get consent before acting adversely to them.

Rule 8.5(b) – Choice Of Law

- "(b) Choice of Law. In any exercise of the disciplinary authority of this jurisdiction, the rules of professional conduct to be applied shall be as follows:
  - "(1) for conduct in connection with a matter pending before a tribunal, the rules of the jurisdiction in which the tribunal sits, unless the rules of the tribunal provide otherwise; and
  - "(2) for any other conduct, the rules of the jurisdiction in which the lawyer's conduct occurred, or, if the predominant effect of the conduct is in a different jurisdiction, the rules of that jurisdiction shall be applied to the conduct. A lawyer shall not be subject to discipline if the lawyer's conduct conforms to the rules of a jurisdiction in which the lawyer reasonably believes the predominant effect of the lawyer's conduct will occur."

Rule 8.5(b) – Choice Of Law

- Rule 8.5(b) by its terms applies only to disciplinary questions; it may not be given effect in disqualification motions.
- Comment [7] states that "[t]he choice of law provision applies to lawyers engaged in transnational practice, unless international law, treaties or other agreements between competent regulatory authorities in the affected jurisdictions provide otherwise."

Rule 8.5(b) – Choice Of Law

- At the recommendation of its Ethics 20/20 Commission, the ABA added the following to comment [5]:
  - "With respect to conflicts of interest, in determining a lawyer's reasonable belief under paragraph (b)(2), a written agreement between the lawyer and client that reasonably specifies a particular jurisdiction as within the scope of that paragraph may be considered if the agreement was obtained with the client's informed consent confirmed in the agreement."
  - Not yet adopted by any jurisdiction.
  - New language does not seem to change the law in any way, since parties were always free to agree to waivers.

Cross-Border Issues

- 1. Where Paris office acts adversely to client represented by Berlin office.
- 2. Where Dallas office acts in transaction against client or affiliate of client represented by Hong Kong office.
- 3. Where Hong Kong office acts in transaction against client or affiliate of client represented by Dallas office.
- 4. Where London office acts adversely in litigation to client or affiliate of client represented by Atlanta office.
- 5. Where Atlanta office acts adversely in litigation to client or affiliate of client represented by London office.

A Client's Perspective

- Importance of keeping client informed.
- Clients are sometimes reluctant to provide advance waivers, especially for litigation.
- When waivers are given for transactional matters, law firm to agree not to represent either party if litigation results.