FOREIGN AND INTERNATIONAL COMPETITION LAW DEVELOPMENTS

INSURANCE, INTERNATIONALISM, AND IRONY: A CLOSELY-DIVIDED U.S. SUPREME COURT SPEAKS AMBIGUOUSLY ON SOME KEY QUESTIONS

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The U.S. Supreme Court's anxiously-awaited decision in the *State of California* insurance antitrust cases against the Lloyds reinsurers and others[1] has some good news for the U.S. insurance industry, some bad news for foreign antitrust defendants, and enough tantalizing uncertainty to keep legions of trial lawyers working for a long time.

The case was decided on the very last day of the Court's October 1992 Term: Monday, June 28, 1993. As careful Supreme Court watchers know, last day decisions tend to be close and controversial, with the Justices having wrestled down to the very last moment over how the case should be decided or how the result should be explained. Compromises, bursts of intellectual impatience and delphic footnotes are the order of the day. The Court's *State of California* opinions amply reconfirm this premise and evidence of intense internal dialogue abounds.

Looked at more broadly, the Supreme Court's decision simply represents the latest (but surely not the last) twist in the tortured history of trying to find an intelligent way to apply U.S. federal antitrust law to an often-international insurance business that the United States has chosen, for political reasons, to have regulated primarily at the state level. The full irony is apparent when you realize that the plaintiffs are 19 state attorneys general, using federal antitrust laws, to seek remedies against international reinsurers located 5,000 odd miles from the federal courthouse in San Francisco. Meanwhile, the federal antitrust enforcers, the Department of Justice and the Federal Trade Commission, have largely sat on the sidelines.

The *State of California* cases illuminate the manner in which American federalism and internationalism work (or do not work) in the context of some major commercial insurance markets. Since the relevant statutory provisions are not precise,[2] two slightly-submerged policy questions run through the area. First, how far should our federal *Sherman Act,* which has been characterized by the Supreme Court as "the Magna Carta of free enterprise",[3] be displaced by the often-cozy schemes of state regulation that Adam Smith would have found abhorrent? Second, how far should the United States go in allowing fundamental "consumer protection" policy to be set aside in favor of the permissive regulatory schemes administered by

nosy foreign sovereigns where the alleged cartel-like activities have their primary competitive impact on American consumers?

These core issues are not easy questions to address and the Court was very closely divided on how to answer them. Four justices (led by Justice Antonin Scalia) would be prepared to defer to both the state and foreign governments; to the states under the *McCarran-Ferguson Act* and to the foreign governments under the doctrine of prescriptive jurisdiction and comity. Meanwhile, four others (led by Justice David Souter) would defer to neither government level. The ninth justice (who happened to be Chief Justice William Reinhquist) broke the neat symmetry of his colleagues: he sided with the deferential four justices in finding an exemption for the state-regulated insurers, and with the activist four justices in deciding that no deference should be accorded to a foreign government that merely authorized (but did not compel) alleged anti-competitive activity by its nationals.

The net result is that the London reinsurers potentially face broader U.S. antitrust liability than state-regulated American insurers and reinsurers. That this could happen, is one of those odd accidents with which the annals of modern political history are papered in our ever smaller and more interdependent world. Politics tend to be much more parochial than markets.

The State Cases

Nineteen state attorneys general (most of whom are elected officials) charged that the U.S. and foreign defendants had conspired to reduce the scope of commercial general liability (or CGL) insurance in the United States in the mid-1980s. It is important to remember that the Supreme Court was only considering allegations in this appeal. The defendants had moved to have the states' complaints dismissed for failure to state any cause of action over which the federal court had jurisdiction. In dealing with motions for summary dismissal, the courts assumed that the plaintiffs' allegations were true, and left the determination of the ultimate truth of the allegations for a later jury trial which could be held in the District Court if the plaintiffs prevail on the initial appeal. This procedural posture is important in reading the Supreme Court's opinion since the states ultimately may be unable to prove some key allegations which the Court assumed to be true while considering the motions for summary dismissal.

The state attorneys general squarely attack the collective response of insurers and reinsurers to the heavy underwriting losses suffered on U.S. CGL coverages in the early 1980s; losses that may have occurred because the insurance industry had not sufficiently anticipated that American judges and jurors would impose so many large, open-ended liability verdicts. American civil litigation, based on jury trials, has always had something of a populist and redistributive quality about it, and distant insurers are logical targets for jury generosity.

Specifically, the states' complaints charged that four primary insurers (called "ceding insurers" in the industry jargon) conspired to narrow the relevant CGL coverages. In attempting to carry out this scheme, they enlisted the aid of foreign reinsurers who were principally located in London. The four primary insurers (Hartford, Aetna, Allstate and CIGNA) decided that the solution to the problem was to switch the basis for CGL insurance from "occurrence" to "claims made" coverage,

retrospectively; to exclude "sudden and accidental pollution" coverage altogether; and to limit the legal defense costs to be borne by the insurer. The critical "claims made" feature meant that an insurer would only be liable for those claims made during the term of the policy, thus eliminating "long tail" claims filed many years after incidents had occurred.

This group of primary insurers was alleged to have gone to the domestic and foreign reinsurers to urge them to refrain from providing CGL reinsurance of "occurrence" coverage, thereby causing U.S. primary insurers only to write "claims made" coverages. Moreover, as part of this whole scheme, the primary insurers and reinsurers were alleged to have pressured the Insurance Services Office, Inc. (ISO) into revising its forms and data collection to eliminate "occurrence" coverages. ISO is an association of approximately 1400 property and casualty insurers and it constitutes the almost exclusive source of support services for CGL insurance in the United States.

The allegations relating to the London reinsurers were described as follows in the Court's opinion:

> The four primary insurer defendants (Hartford, Aetna, Cigna, and Allstate) also encouraged key actors in the London reinsurance market, an important provider of reinsurance for North American risks, to withhold reinsurance coverages written on the 1984 ISO CGL forms [**providing for occurrence coverage**]. As a consequence, many London-based underwriters, syndicates, brokers and reinsurance companies informed ISO of their intention to withhold reinsurance on the 1984 forms . . . and at least some of them told ISO that they would withhold reinsurance until ISO incorporated all four desired changes . . . .

The reinsurers simply respond that they were attracted to the "tail shortening" and "risk narrowing" features of the proposal, and they vigorously deny the plaintiffs' claims that their acquiescence amounted to a "boycott" designed to prevent other U.S. primary insurers from offering "long tail" and "accidental pollution included" coverage.

The states' allegations raised three key questions that the Supreme Court agreed to review. In substance, these questions are:

1. Do American primary insurers, regulated under state law, lose their *McCarran-Ferguson Act* immunity if they "conspire" with unregulated foreign reinsurers over the terms of insurance coverage to be offered in the U.S. market?

2. Do state-regulated primary insurers lose their *McCarran-Ferguson Act* immunity under its "boycott, coercion, or intimidation" exception, if they enlist other insurers or reinsurers to agree only to underwrite narrower policy coverages for CGL insurance?

3. Should London reinsurers, regulated by the United Kingdom Government, be found to be outside of the U.S. *Sherman Act* jurisdiction based on principles of international law and comity?

The Court answered all three of these questions in the negative. While the Justices were unanimous in their treatment of the first question, the last two were decided by 5-4 votes, with almost entirely different majorities on each issue. To understand how and why this could happen, we have to go back and look at a little history concerning the statutory immunity for the insurance industry, and the long-running and very contentious conflicts over jurisdiction and comity.

The *McCarran-Ferguson Act* of 1945

This statute, in today's European parlance, would be regarded as an exercise in "subsidiarity", an attempt to roll back onrushing federalism. The *Sherman Act* of 1890 provided for federal jurisdiction over any "conspiracy, in restraint of trade or commerce among the several States, or with foreign nations...." At the time it was enacted, the insurance (and other financial services industries) were not regarded as a form of "trade" or "commerce". Indeed, in 1869 in the landmark case of *Paul* v. *Virginia*, the Supreme Court had held that the business of insurance was not interstate commerce, but "local transactions... governed by local law."[4] Based on this ruling, the individual states had erected numerous regulatory and taxing schemes for the insurance industry, while the federal government remained out of the picture. By the 1940s, the general American constitutional approach to "interstate commerce" had vastly expanded, thus providing the basis for such vigorous federal involvement in the economy under Franklin D. Roosevelt's famous "New Deal" program prior to World War II.

Reflecting this view, the Justice Department decided to prosecute criminally various insurance cartels under the *Sherman Act*. This resulted in the celebrated 1944 Supreme Court decision in *United States* v. *South-Eastern Underwriters Association*.[5] In this case, the Court found that the *Sherman Act* should be read expansively in light of the now-accepted broad readings of the Commerce Clause of the *Constitution*. Accordingly, the Justices sustained the Justice Department indictment.

The *South-Eastern Underwriters* decision caused great alarm in the insurance industry as well as some state capitals and the *McCarran-Ferguson Act* was rushed through Congress within a year, providing a somewhat unusual exemption. It stated that the *Sherman Act* would only be applied to the "business of insurance to the extent that such business is not regulated by State Law."[6] However, reflecting the assumed presence of coercive boycotts by reinsurers in the *South-Eastern Underwriters* case, the statute provided a further caveat: the *Sherman Act* will continue to apply to "any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation," even if it involves "the business of insurance" and is "regulated."[7] None of the key concepts are precisely defined by Congress and the past half century has seen a continuing stream of litigation over what constitutes the "business of insurance", whether or not the activity is "regulated by State Law", and finally, whether particular joint action constitutes "an act of boycott, coercion, or intimidation." The *State of California* cases turn particularly on the latter.

The *McCarran-Ferguson Act* Issues

California and its co-plaintiff states alleged that the American primary insurers had lost their exemption on two grounds. First, that the defendants had conspired with non-regulated (and hence non-exempt) reinsurers, and second, that they had engaged in an act of "boycott, coercion, or intimidation" in persuading the ISO and their primary insurers to revise the forms and coverages. The Ninth Circuit Court of Appeals in San Francisco had sustained the states' position on both points.[8] When asked for its views by the Supreme Court, the U.S. Solicitor

General (the Federal Government's chief appellate lawyer) supported the states on the "boycott" issue, but not the so-called "forfeiture" issue.

The key to the "forfeiture" claim was that the four U.S. primary insurers had conspired with unregulated foreign reinsurers in the context of these transactions, and thereby lost their *McCarran-Ferguson Act* exemption. This "conspiracy with strangers" claim is an extraordinarily broad one with sweeping practical implications and, had it been sustained, the effective reach of the *McCarran-Ferguson Act* would have been dramatically narrowed (or alternatively, the business opportunities for foreign reinsurers would have been dramatically reduced in the U.S. market).

The Supreme Court unanimously reversed the Ninth Circuit on this point although its reasoning was less than entirely clear. It said that the statutory phrase, "the business of insurance", was "obviously not meant to refer to a single entity" but rather "is most naturally read to refer to '[m]ercantile transactions; buying and selling; [and] traffic.' " Thus, said the Court, "even if we were to agree that foreign reinsurers were not subject to state regulation (a point on which we express no opinion)", this did not necessarily mean that the relevant "transactions" were outside of the "business of insurance . . . regulated by State law." In other words, " 'the business of insurance' should be read to single out one activity from others, not to distinguish one entity from another." This is an artful analysis which is facially inconsistent with the language in some prior Supreme Court decisions treating statutory exemptions narrowly. The practical question is not how the Court got there, but its unanimous holding that "it was error for the Court of Appeals to hold the domestic insurers bereft of their *McCarran-Ferguson Act* exemption simply because they agreed or acted with foreign reinsurers that, we assume for the sake of argument, were 'not regulated by State law.' "

This resolution forced the Justices to turn to the second question of whether the defendants had been properly charged with "any agreement to boycott, coerce, or intimidate" and thereby lost their statutory exemption. Here the Court split 5-4, with Justice Scalia writing for himself and a group of what are generally regarded as more "conservative" Justices. Justice Scalia, a former law professor, offers an illuminating history of the "boycott" concept, beginning with the terrible tribulations of poor "Captain Charles Boycott, an English agent managing various estates in Ireland" who was "sen[t] . . . to Coventry in a very thorough manner."[9] Armed with this history and a 1989 edition of *The Oxford English Dictionary*, Justice Scalia opined that a "boycott" was "to combine in refusing to hold relations of any kind" in order "to punish [the target] for the position he has taken up, or coerce him into abandoning it." He then went on to distinguish between a "conditional boycott" and the "concerted agreement to seek particular terms in particular transactions." Based on this line of analysis, Justice Scalia then held that the "boycott" concept in the *McCarran-Ferguson Act* did not reach the collective efforts of the primary insurers and reinsurers to (i) seek particular terms in their own insurance contracts or (ii) to seek appropriate terms and statistical support from the ISO.

This is an extraordinarily narrow decision, turning on a special reading of the "boycott" concept which is unique to the *McCarran-Ferguson Act*. In this respect, Justice Scalia explained that:

> . . . under the normal application of the *Sherman Act* the reinsurers' concerted refusal to deal would be an unlawful conspiracy, and the insurers' "prompting" would make them part of that conspiracy. The *McCarran-Ferguson Act*, however, makes that conspiracy lawful (assuming reinsurance is state-regulated), unless the refusal to deal is a "boycott".

In the end, Justice Scalia was still willing to sustain many of the states' "boycott" claims, because (i) the primary insurer defendants were charged with collectively withholding not only the CGL insurance on which they were seeking changes, but other insurance as well; and (ii) the defendant reinsurers were charged with threatening to deny reinsurance across the board in order to put pressure on the ISO and other primary insurers. Whether the states can prove all this is an open question and, in any event, these allegations are a relatively small part of the whole case. In sum, Justice Scalia's narrow "boycott" decision still represented an important victory for the insurer defendants.

Justice Souter (a former state attorney general and judge) strongly dissented on this issue for himself and three other Justices who would generally be labeled as "moderates". He accused the majority of "artificial segmentation of the [defendants'] course of action, and a false perception of the unimportance of the elements of that course of action other than the reinsurers' agreement." He stressed that "the four primary insurers were not acting out of concern for the reinsurers' financial health", but rather that "they simply wanted to insure that no other primary insurer would be able to sell insurance policies that they did not want to sell." Justice Souter also stressed that the Scalia-majority opinion was very different from the Supreme Court's 1978 decision in which the "boycott" concept had been read broadly in another "coverage narrowing" insurance case.[10] To summarize, the Supreme Court's narrow treatment of the "boycott" provision gives the *McCarran-Ferguson Act* more practical breadth than many had thought it had which allows insurers and reinsurers greater flexibility to agree on the terms which they are prepared to follow in underwriting insurance. Of course, such parties must continue to be careful about the risks of coercing competitors and other third parties on the terms of which the latter offer insurance.

A New Look at International Jurisdiction and Comity

The *State of California* opinions have been eagerly awaited because this is the first time that the Supreme Court has faced the contentious question of extra-territorial antitrust jurisdiction since its 1962 decision in *Continental Ore* v. *Union Carbide & Carbon Corp.*, where the Court upheld U.S. jurisdiction over a restraint on U.S. exports allegedly carried out by the Canadian subsidiary of a U.S. competitor.[11] This no doubt explains why the Canadian and U.K. Governments filed amicus briefs in support of the Lloyds' defendants.

Much has happened since the *Continental Ore* case, however. First, the entire membership of the Supreme Court has changed. Second, in 1976 the Ninth Circuit Court of Appeals established the celebrated *Timberlane* doctrine, under which a U.S. court can weigh a set of traditional comity factors in determining whether to exercise U.S. antitrust jurisdiction over an overseas dispute.[12] Third, the United Kingdom, Canada, Australia and various other uranium-producing states, have enacted special legislation to block U.S. antitrust jurisdiction overseas.[13] Fourth, Congress enacted the *Foreign Trade Antitrust Improvements Act of 1982* in order to narrow U.S. antitrust jurisdiction over overseas activity with regard to most export activity.[14]

The problem with the *State of California* cases is that it concerns imports: reinsurance services offered by Lloyds' members and others. The policies involved are in fact tailored to the North American market where a very high proportion of Lloyds' reinsurance is apparently sold. In this context, the anti-competitive effects of any overseas restraints are likely to be direct, substantial, and reasonably foreseeable in the United States. This means that allegations in *State of California* seem to fall squarely within the traditional "effects doctrine" under which the United States, controversially, has long asserted jurisdiction against foreign restraints that injure domestic competitors and consumers. To many of us, it did not seem to be a really close case, and the Supreme Court gave relatively little attention to the international jurisdiction issues during the oral argument last February.[15]

In fact, it was a very close case. Justice Souter restated (but with some confusing wrinkles) the traditional American view of "effects" jurisdiction on behalf of a narrow 5-4 majority. Justice Scalia countered with a strong and (in American terms) fairly novel view that jurisdiction should not be exercised in view of the interest and role of the U.K. Government with respect to the Lloyds' market. The close split becomes even more interesting when one remembers that one of the five members of Justice Souter's majority, Justice Byron White, retired in June and is being replaced by Justice Ruth Bader Ginsburg, who has no known views on this issue. Thus, the eight remaining Justices seem to be evenly split in the event that foreign parties and governments can persuade the Supreme Court to hear another case in this area.

Justice Souter's opinion turns on the proposition that "it is well established by now that the *Sherman Act* applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States." He then notes that the states' complaints allege that the London reinsurers conspired to affect the U.S. market and had a substantial effect. He goes on explain that "Congress [has] expressed no view on the question whether a court with *Sherman Act* jurisdiction should ever decline to exercise such jurisdiction on grounds of international comity . . . we need not decide that question here . . . ." In any event, "international comity would not counsel against exercising jurisdiction in the circumstances alleged here."

Justice Scalia's strong dissent finds a lot more uncertainty in the history of the *Sherman Act* than Justice Souter's majority saw. He explains that:

> There is no doubt, of course, that Congress possesses legislative jurisdiction over the acts alleged in the complaint . . . but the question in this case is whether, and to what extent Congress has exercised that undoubted legislative jurisdiction in enacting the *Sherman Act*.

This brings Justice Scalia to his key point: "though it clearly has constitutional authority to do so, Congress is generally presumed not to have exceeded . . . customary international-law limits on jurisdiction to prescribe."[16] Among these are "what might be termed 'prescriptive comity', the respect sovereign nations afford each other by limiting the reach of their laws."

At this point, Justice Scalia turns to the Restatement of Foreign Relations and asks whether it is "reasonable" for the United States to exercise jurisdiction in circumstances where "Great Britain has established a comprehensive regulatory scheme governing the London reinsurance markets, and

clearly has a heavy 'interest in regulating the activity'." Given the fact that Congress deferred so extensively to the states in the *McCarran-Ferguson Act*, he argues that one must assume the federal interest in the insurance industry to be "slight".[17] He stated:

> Considering these factors, I think it unimaginable that an assertion of legislative jurisdiction by the United States would be considered reasonable, and therefore it is inappropriate to assume, in the absence of statutory indication to the contrary, that Congress has made such an assertion.

This demonstrates the difference between Justice Scalia's dissent and Justice Souter's majority opinion very clearly. For the majority:

> The only substantial question in this case is whether "there is in fact a true conflict between domestic and foreign law" [but] [n]o conflict exists for these purposes, "where a person subject to regulation by two states can comply with the laws of both." . . . [S]ince the London reinsurers do not argue that British law requires them to act in some fashion prohibited by the law of the United States . . . or claim that their compliance with the laws of both countries is otherwise impossible, we see no conflict with British law.

For Justice Scalia, this is a "breathtakingly broad proposition [that] will bring the *Sherman Act*. . . into sharp and unnecessary conflict with the legitimate interests of other countries — particularly our closest trading partners."

Conclusion

The result in the *State of California* cases is anomalous. In fact, Lloyds reinsurers, operating in London, may be subject to broader *Sherman Act* prohibitions than U.S. primary insurers and other reinsurers engaged in exactly the same cooperative activity. The ultimate reality is that the whole *McCarran-Ferguson Act* scheme is poorly suited to the needs of a complicated, competitive and interdependent world filled with changing opportunities and risks. It is parochial in focus, making antitrust immunity turn on state regulation, which has often seemed passive or ineffective in protecting the insured American public. The antitrust exemption scheme fails to take specific account of reinsurance, which is a classic non-local activity, while foreign government regulation is apparently entitled to no serious weight at all in the antitrust equation.

The *State of California* opinions do not establish a stable legal equilibrium. The Supreme Court has, if anything, broadened the assumed scope of the *McCarran-Ferguson Act* exemption for state regulated insurers and reinsurers, which means American, but not necessarily foreign, entities. At the same time, it has restated, by the narrowest of majorities, the traditional American position that the *Sherman Act* represents fundamental national economic policy and that it should be given a very broad jurisdiction vis-à-vis foreign activities that injure U.S. consumers unless such activities were compelled by a foreign government. This opens up the possibility of the issuance of U.S. court injunctions that purport to regulate the London reinsurance market; and, even more strikingly, private treble damage cases by U.S. insureds against foreign reinsurers, while American insurance companies sit on the sidelines protected from the fray by the *McCarran-Ferguson Act*.

This does not seem to be a situation which the Government of the United Kingdom is likely to be able to tolerate for long. It is not one that the U.S. Federal Government should want to tolerate. It may be that the *McCarran-Ferguson Act* immunity will

be repealed by Congress, as the Justice Department has recently urged, thus eliminating at least one aspect of the anomaly. In addition, this decision may force the U.S. Government and the British Government to create by treaty some middle ground between "pure territoriality", a position long-espoused by Britain, and the complete "effects doctrine" accepted by the United States for half a century. There is room, under the principles of comity, for more limited and pragmatic exercises of jurisdiction by either state seeking to protect its consumers from competitive injuries aimed at them by overseas conspirators and monopolists. International reinsurers are very important to competition in U.S. commercial insurance markets; and therefore both the U.S. and the U.K. governments should be interested in encouraging continued strong participation by London entities in these markets.

Meanwhile, in the *State of California* cases, the parties will have to return to the courthouse in San Francisco and struggle over real facts. At trial, the Lloyds defendants may, somewhat to their surprise, find that they are "regulated by state law" for *McCarran-Ferguson Act* purposes and hence are on a level (even if uncomfortable) playing field with U.S. insurers on the "boycott" question. Note that even Justice Souter held open this prospect in his opinion on jurisdiction and comity. Ultimately, the trial court (or jury) must determine whether the states have persuasive evidence in support of their theories of coercion, and whether any proven, non-exempt agreements among insurers and reinsurers have in fact injured insured Americans.

Notes

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1 Two appeals were accepted for review. *Hartford Fire Insurance Co.* v. *California*, No. 91-1111, involved the *McCarran-Ferguson Act* issues; and *Merrett Underwriting Agency Ltd.* v. *California*, No. 91-1128 involved the international jurisdiction and comity issues. For additional background information regarding this case, see D.I. Baker, "U.S. Supreme Court Considers Extraterritoriality" (1993) 14:1 Can. Comp. Rec. 11.

2 These are s. 1 of the *Sherman Act* of 1890 (15 U.S.C. §1); and the *McCarran-Ferguson Act* of 1945 (15 U.S.C. §1011 et seq.).

3 See *United States* v. *Topco Associates, Inc.*, 405 U.S. 596 (1972).

4 75 U.S. (8 Wall.) 168 at 183 (1869).

5 332 U.S. 533 (1944).

6 15 U.S.C. §1012(b).

7 15 U.S.C. §1013(b).

8 *In re Insurance Antitrust Litigation*, 938 F.2d 919 (9th Cir. 1991), reversing 723 F. Supp. 464 (N.D. Cal. 1989).

9 Justice Scalia relied on J. McCarthy, *England under Gladstone* (1886) for this illuminating history.

10 *St. Paul Fire & Marine Insurance Co.* v. *Barry*, 438 U.S. 531 (1978).

11 370 U.S. 690 (1962).

12 *Timberlane Lumber Co.* v. *Bank of America*, 549 F.2d. 597 (9th Cir. 1976).

13 See the *Foreign Extraterritorial Measures Act*, 13 Can. Rev. Stat. 1984 c. 49, and other examples discussed in 1 Fugage, *Foreign Commerce and the Antitrust Laws* (4th Ed. 1991) §§3.11, 3.17.

14 15 U.S.C. §6a.

15 See "Insurers and States Engage in DeSoto on Boycott Issues Before the Supreme Court," 64 Antitrust & Trade Reg. Rep. (BPA) 200 (February 25, 1993).

16 Scalia J. relies heavily on *EEOC* v. *Arabian-American Oil Co.*, 499 U.S. 244 (1991) in which the Court had recently held that the U.S. federal employment discrimination laws did not extend to a claim of discrimination against overseas actions of a foreign subsidiary of U.S. oil companies.

17 It is unclear whether Scalia J. is defining a special position on jurisdiction for the insurance industry or making a specific argument in aid of a broader position.

AUSTRALIAN NEWSLETTER

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Litigation

Grocery Industry

The unusual merger litigation involving the case of the *Attorney-General* v. *Davids Holdings* in relation to Davids' proposed acquisition of QIW Ltd. has now taken a step further from previous reports. In the past, it was indicated that the regulator, the Trade Practices Commission (TPC), had decided not to intervene in this merger in the grocery industry on the basis of a broad market definition but that the Commonwealth Attorney-General had disagreed with this assessment following some urging by the target company, QIW. The Attorney-General then moved to block the merger in the Federal Court.[1]

In his judgment, Mr. Justice Spencer favoured a narrow market definition and found that there was a market for the wholesale supply of groceries to independent retailers in Queensland and Northern New South Wales. As a result, he found a breach of the dominance provisions of the *Trade Practices Act* since Davids and QIW were the only wholesalers in Queensland and Northern New South Wales. It should be noted that merger law in Australia is no longer based on a dominance test but since this case began before amendments to the Act came into effect, it will be decided under the old law. Davids Holdings has since appealed to the Full Federal Court.

Austereo

The Australian broadcasting industry has its own regulator, the Australian Broadcasting Authority, which amongst other things, regulates issues such as who can own radio or TV stations in a particular geographic area as well as the concentration of ownership. There has always been some doubt about the interface between it and competition law and this was recently tested in the Federal Court.

In the Austereo case, a merger of two FM radio chains was proposed. The matter was brought to the TPC's notice and the proposed acquirer, Austereo P/L, requested the TPC to provide its opinion on jurisdiction. When the TPC took the view that it did have jurisdiction to review the proposed merger, despite the specific broadcasting legislation, Austereo P/L took the TPC to court for a declaration under administrative law, where the judge at first instance found for the TPC. On appeal, the Full Federal Court found for the TPC as well. In the meantime, however, another company acquired the target, making the Full Court's decision somewhat academic, although it still has broader long term ramifications.

Administration of Competition Law

Enforceable Undertakings

As of January 21, 1993, the TPC is able to "accept" enforceable undertakings which must be seen in the light of new fines of up to AU $10 million for competition law offences. The TPC is in the process of developing guidelines for use of this new power and will only accept such undertakings where the TPC has information before it that indicates a possible breach of the law. In other words,

enforceable undertakings will not be used as a form of duress. The guidelines will be available in the coming months.

Other Guidelines

Other guidelines that the TPC is about to issue will address:

- the new product liability provisions of the *Trade Practices Act;*
- the new unconscionability in commercial dealings provisions of the *Trade Practices Act*; and
- the use of the TPC's statutory powers to demand information.

Draft merger guidelines are still being developed and will not be rushed. Instead, they will be tested by experience.

Authorizations

This is a process under the *Trade Practices Act* which is unique to Australian competition law. Authorizations can be used by the TPC to permit anti-competitive conduct, otherwise in breach of the law, if there is a countervailing public benefit which can be demonstrated by the parties.

There are a number of important authorizations currently being assessed by the TPC, particularly the national bank clearing house system and the news agency distribution systems in Victoria. Other important applications relate to codes of conduct in franchising, pharmaceuticals, proprietary medicines and the Stock Exchange rules.

Furthermore, the Commission is working through a number of previously authorized matters involving:

- news agency distribution other than in Victoria;
- real estate in all states and territories;
- lorry owner drivers;
- media council of Australia advertising codes and accreditation rules; and
- IATA (International Air Transport Association).

In a climate of deregulation, it is hard to justify having a lot of these "exemptions from the law" still on the TPC's Register without a regular review. However, the onus is on the TPC to prove that there has been a material change in circumstances that would warrant the revocation. Appeal lies from the TPC's decision to the Trade Practices Tribunal.

Interference with other policy instruments

Broadcasting

Besides the Austereo case, which has already been covered, the other important area to take note of is Pay TV. Beginning late last year, any applications for a broadcasting services licence, particularly in the Pay TV area, have to be approved by the TPC based on competition criteria prior to the issue of any licence by the broadcasting regulator. Australia is just introducing Pay TV and a tendering process has been established by the Government based on the highest bidder. The two highest bidders have recently been through the process of the TPC and the broadcasting regulator. In its assessment of the competition issues, the TPC looked at a number of the markets involved but did not find any detriment to competition in any of the relevant areas, in so far as the two applicants were concerned. At this point, the two successful applicants have 30 days to find the money to pay for the license, and if they fail, the next highest bidders will have to go through the same process.

The TPC's function as a vetting agency for competition issues is becoming increasingly the norm and the current national review of competition policy will focus on such issues. That review is due to report to the Government in late August or September and is particularly concerned with the "regulated conduct" defence, the regulation of natural monopolies and anti-competitive policies of governments: federal, state or territorial.

Telecommunications

The TPC's heavy involvement in the "fight" between the two telecommunication carriers for customers has extended to advertising and anti-competitive conduct. As part of the deregulation of a previously highly regulated industry, a duopoly has emerged where previously there was a monopoly.

Shipping

There is a review underway of the special provisions of the *Trade Practices Act* relating to inward cargo shipping. The TPC is making a submission aimed at increasing the industry's exposure to competition law.

Reports

The TPC is about to issue its report on the legal profession in Australia. It has recently issued reports, at the Government's request, on the life insurance and superannuation industry and consumer credit insurance. In respect of the latter two, the TPC's recommendations focus on issues of disclosure of information, commission rates and the state of competition and consumer protection generally.

The TPC is also finalizing a report on port leasing practices which in turn is very important in the microeconomic reform that is occurring in Australian ports. This compliments a number of studies that are being done on other aspects of the waterfront by other agencies which will lead to further reform.

Legislation

It is expected that an exposure bill on mandatory pre-merger notification will be tabled in the Australian Parliament later this year. While it will not be for passage, the Government will be seeking comments on its provisions. There is still a significant ongoing debate on the merger pre-notification thresholds which essentially centres on whether Australia should adopt the higher threshold Canadian model or something closer to the lower threshold American model.

Notes

[1] See H.R. Spier and R. Baxt, "Australian Newsletter" (1993) 14:1 Can. Comp. Rec. 18 at 19.

INTERNATIONAL COMPETITION LAW

The following articles are taken from Update, *a newsletter published by the International Bar Association's Business Law Section (Committee on Antitrust and International Trade Law).*

DENMARK

OECD on Danish Competition and Competition Policy

OECD has in connection with the annual analysis of the Danish economy also analyzed competition and competition policy in Denmark. OECD concludes that although the *Competition Act* of 1990 has strengthened the legal framework for competition, the present *Competition Act* is not sufficient to protect against negative effects of restrictions in competition. The effect of the transparency under Danish competition legislation is not sufficient when competition is limited by horizontal agreements or exclusive agreements. OECD concludes that EEC competition rules are more effective than Danish competition regulations.

Lawyers' Fees

The Competition Council has decided to commence negotiations with the Danish Bar Association on the recommended fee scale. Approximately half of the turn-over of Danish lawyers is in areas regulated by the recommended fee scale and these are normally followed. It is the opinion of the Competition Council that if these recommended fees are abolished, it will open up possibilities for price competition between lawyers based on their own costs and market conditions. It is mandatory for Danish practising lawyers to be members of the Danish Bar Association which sets the recommended fee scale.

EUROPEAN COMMUNITIES

Wood Pulp

The Court of Justice has annulled most of the 1984 Commission decision in which it had established that 43 (associations of) wood pulp producers had infringed art. 85 of the *EEC Treaty*. It is recalled that in its 1988 judgement the Court had already held that the practices did not violate public international law or fall outside the scope of art. 85 merely because the undertakings involved were established outside the EC. According to the recent judgment, the decision was too vague as to many aspects and containedinsufficient evidence.

Equity Interest

The Commission has found that a 1989 deal whereby Gillette acquired an equity interest in a company which owned a competitor infringed both arts. 85 and 86 of the *EEC Treaty*. It therefore ordered Gillette to dispose of the shares acquired within a certain period.

Cars

The Commission has given the green light to a joint venture between Ford and VW to manufacture a new multi-purpose vehicle despite complaints made by Matra, who assembles the market leading *"Renault Espace"*. One of the reasons was that the construction will take place in Portugal, one of the

poorest areas of the EC. Matra has lodged an appeal against both this decision and the decision not to oppose the state aid provided by the Portuguese government.

FRANCE

Law No. 92-1336 of December16, 1992 enters into force on September 1, 1993. Thus, with respect to competition law, legal persons may be held criminally liable for violation of the law on concerted practices, abuses of dominance, transparency and restrictive practices.

By arrêté of March 18, 1993, upon the advice of the Conseil de la concurrence ("Conseil"), the Minister of the Economy authorized a merger within the movie house sector. The operation consisted of a reciprocal transfer of movie houses by GAUMONT and PATHE. The effect of the operation is that only two large groups (GAUMONG and UGC) will remain in the Paris market. In order to re-establish sufficient competition, the Minister ordered GAUMONT to stop programming a certain number of Paris movie houses representing at least a 2.5% share of the profits for the Paris market.

In another case, several long distance sellers of flowers petitioned the Conseil for interim measures. The Conseil, in its March 30, 1993 decision, ordered INTERFLORA, which holds 80% of the French market, to cease all practices whereby members of the network who undertook to belong exclusively to that network were treated more favourably in the execution of their orders.

GERMANY

Gillette/Wilkinson Merger Control Decision

The scope of German merger control has always been considerable. For example, the acquisition of 25% of another company's share capital is considered to be a concentration subject to merger control if the thresholds are met. In 1990 the *German Act Against Restraints of Competition* was amended to extend merger control to cases where the purchaser acquires even less than 25% of a company provided the acquiror can exercise an influence that is material with regard to competition. The Federal Cartel Office (Office) has applied this rule for the first time in the *Gillette/Wilkinson* case. In its July 23, 1992 decision, the Office found that Gillette could exercise such a material influence even though it had only acquired 22.9% of Eemland (Wilkinson) and had no voting rights. The Office relied on the fact that Gillette could (i) influence the ownership structure through its right of first refusal on the remaining Eemland stock, (ii) influence financing because any debt restructuring required Gillette's co-operation, and (iii) influence sales and production because under an exclusive distribution arrangement European Wilkinson products could only be sold to Gillette outside of Europe and the U.S.

The Office prohibited the merger since it created a duopoly in the German market with market shares in excess of 90%. Even though German merger control law by its nature is limited to the territory of Germany, the whole transaction was prohibited because it was impossible to split it into a domestic and a foreign pact while maintaining Wilkinson's full competitive capacity in Germany. The decision is on appeal.

IRELAND

The financial thresholds which govern the application of Irish mergers legislation to mergers and take-overs have been increased by the *Mergers, Take-Overs and Monopolies (Control) Act*, 1978 (Section 2) Order, 1993 (Act).

Under the *Mergers, Take-Overs and Monopolies (Control) Act*, 1978, a merger or take-over is deemed to occur where two or more enterprises, at least one of which carries on business in Ireland, come under common control. Common control will exist where, for example, there is a direct acquisition of more than 25% of the share capital of the target company or, in the case of an indirect acquisition, where there is a change of control within the group pyramid structure.

The *Mergers Act* does not apply to all mergers or take-overs but only to mergers or take-overs involving enterprises which exceed certain financial thresholds in relation to gross assets and turnover, or those where there is an association with the newspaper industry. With effect from May 21, 1993, the financial thresholds are such that, in their most recent financial year, the value of the gross assets of each of two or more of the enterprises involved in the proposal is not less than IR£10 million or the turnover of each of those two or more enterprises is not less than IR£20 million.

ITALY

Law No. 287/90 introduced antitrust legislation into the Italian legal system. After more than two years from its entry into force, all of the Authority's decisions have been based on the guidelines drawn by the Court of Justice of the European Communities. In particular, the Authority has stated that:

- the antitrust law should not be applied following rigid criteria; and

- any abuse of dominant position or restrictive practice, seemingly permissible under the Italian Antitrust Law, but incompatible with EC laws, should not be considered legitimate by the Italian Authority.

Decisions on Agreements and Restrictive Practices

Almost all the examined cases have been directly communicated to the Authority by the involved undertakings. Rarely has the Authority made use of its power to operate on its own initiative.

Abuses of Dominant Position

During 1991, 1992 and January 1993, the Authority examined 14 cases of abuse of dominant position. Five times the Authority held abusive the behaviour of the involved undertakings censuring, inter alia, the excessively high prices exacted by the dominant seller (case ANCIC/CERVED) and the refusal to deal in the ordinary course of business (case 3C COMMUNICATIONS/SIP).

Concentrations Operations

During 1991, 1992 and January 1993, the Authority examined 684 concentrations. With regard to mergers between related companies, the Authority has repeatedly taken the view that they may not create or strengthen a dominant position whenever the merger is meant only to reorganize the economic structure of the group.

JAPAN

Some Cosmetics and Medicine Excluded from the Exemption

The Japanese Fair Trading Commission (JFTC) excluded a part of cosmetics such as perfumes and soaps priced at Y1,030 or less and general medicine of ten kinds from the exemptions from retail price maintenance under art. 24-2 of the *Anti-Monopoly Law* as of April 1, 1993.

Anti-Monopoly Violation on Rice Trade

On April 10, 1993, the Asahi Newspaper indicated that the JFTC has commenced an investigation of the All Japan Farmer's Union Associations and their related economic associations for their distribution of rice.

Anti-Monopoly Law Guidelines on Joint Research and Development Activities

The JFTC published the *Anti-Monopoly Law Guidelines on Joint Research and Development Activities* as of April 20, 1993.

MEXICO

The *Mexican Competition Law* ("*Lay de Competencia Economica*") (Law) published on December 24, 1992, became effective as of June 23, 1993. The purpose of this Law (as stated in art. 2) is to protect free competition by preventing monopolies, unfair trade practices and restraints to the free flow of goods and services.

All economic activities performed by the federal government (i.e. telegraph, oil, electricity) are expressly excluded. A monopoly is defined under art. 9 as any contract, agreement, transaction or any combination thereof between competitors which may (i) fix, increase or manipulate prices (as well as any exchange of information for such purposes), (ii) establish an obligation not to produce, process, distribute, market or commercialize except for a limited amount of goods or services, (iii) divide, distribute, assign or impose portions or segments of an actual or potential market, or (iv) establish, co-ordinate or concentrate offers on public biddings. To establish an unfair trade practice, it is required to prove that (i) the responsible party has substantial control over the specific market, and (ii) it is performed on goods or services within the specific market.

The Law creates the Federal Competition Commission (Commission) which shall have the authority to prevent, investigate and restrict monopolies and unfair trade practices. All claims must be filed before the Commission, which has the authority to pursue claims at the request of any third party and by its own motion. Upon filing a claim, the Commission must serve the defendant with a copy of the complaint. Upon termination of the discovery period, and complete integration of the file, the Commission must render its final resolution within 60 calendar days.

Penalties for violation of this law include severe economic fines and corrective measures, such as assets divestment and suspension of commercial activities.

THE NETHERLANDS

On February 4, 1993 the Dutch government adopted a *Royal Decree* (Decree) concerning a generic prohibition of horizontal price fixing agreements. The Decree will enter into force on July 1, 1993.

The Decree prohibits any horizontal price fixing agreements. Concerted practices do not fall under the Decree itself, but they are covered by art. 15 of the *Economic Competition Act* which prohibits practices having the same affect as agreements falling under a generic prohibition. Agreements in violation of the Decree are null and void, whilst infringements of art. 15 of the Act constitute a criminal offence. The scope of the Decree is limited in that it addresses neither the exchange of information on prices, nor the fixing of advisory prices.

The Decree provides for the possibility of exemptions to be granted by the Minister of Economic Affairs following notification. The Minister has announced that he will only grant exemptions for agreements which meet the criteria of art. 85(3) of the *EEC Treaty*.

The Decree is the first of a series of legislative measures meant to bring the Dutch legal system more in line with EEC competition law. Further generic prohibitions of market sharing and on bid rigging agreements are anticipated to be adopted in the course of this year. These generic prohibitions are meant to constitute an interim regime. Proposals are currently being developed to replace the existing *Act* by a new law which reflects, to a much larger extent, the principles and system of EEC competition law.

NEW ZEALAND

Health Sector Reforms - Competition Law

New Zealand's public health sector is undergoing radical restructuring (albeit falling short of privatization), in which a key plank is the separation of procurer and provider functions and the creation of market disciplines in the provision of hospital and other public health services.

Against this background, the Commerce Commission (Commission) has announced that it "does not envisage" taking antitrust enforcement action under the *Commerce Act* 1986 against participants in the restructured health sector, "for at least 12 months" from July 1, 1993 (being the startup date for the new regime). Instead, it will embark on a programme of "educating" the newly created *Crown Health Enterprises* (CHEs) on the impact of competition law in what has been a highly regulated environment.

The Commission's announcement attracted criticism, focusing on the underlying proposition that the new CHEs, and other participants in the restructured health sector, cannot be expected to operate from the outset in the full glare of competition law.

From a legal perspective, the Commission's announcement raised an interesting issue whether a blanket policy of non-enforcement covering an entire industry otherwise subject to competition law amounts to an improper fettering of the Commission's discretion.

PORTUGAL

Article 3 of the *Decree Law* 422/83 prohibits the imposition of minimum retail prices, not allowing the wholesaler to dictate to the retailer at what price the consumer item should be sold.

In Process No. 3/86 the Portuguese paint manufacturer Dyrup furnished a "recommended sales price table for the public" but Dyrup did not have a dominant position in the market.

The Council found that Dyrup had, for retail sales, their own outlets. However, Dyrup also sold their paints to a large number of independent retailers. Regarding these independent outlets, Dyrup also furnished a "recommended sales price table" for the public. The issuance of the recommended prices was frequent: two in 1984, two in 1985, and one in 1986 when the present process was initiated. Retailers were free to make the discounts to the public they thought proper.

Was the issuance of the recommended sales price a violation of arts. 3 and 4 which prohibit minimum sales prices? Holding no, the Council held that the mere recommendation of prices by a manufacturer which did not have a dominant position in the market "...is not, in itself, a restrictive practice sanctioned by our legal system of competition."

SPAIN

Restrictive Practices by the Seven Largest Spanish Banks Confirmed

The Spanish Court of Defense of Competition issued a resolution dated April 30 declaring that it had verified the existence of a restrictive practice of competition carried out by the large Spanish banks and forbidden by Law 110/63 and by art. 85.1 of the *EEC Treaty*. The violation consisted in concertedly fixing and publishing a list of maximum common commissions and other costs which were consistently applied to clients by all the banks involved. The Court has ordered the parties to stop these practices immediately.

Concerning the application of penalties, the Court ruled that this case was dealt with within the frame of the old Law on Repression of Competition Restrictive Practices of 1963, and it was therefore "...not possible to impose fines", even though it warned that its decision would have been different had the case been heard under current Law 16/1989.

TAIWAN

Fair Trade Law Enacted

Taiwan's *Fair Trade Law* (FTL) became effective on February 4, 1992.

The FTL is ambitious. It incorporates into one piece of legislation two major regimes: antitrust law and unfair competition law. Of the two legal regimes, the antitrust provisions of the FTL have caused more controversy. Nonetheless, the FTL will have a major impact on the business practices of competing firms in Taiwan and its national economy as a whole.

A wide range of market practices are covered by the FTL: monopolies, oligopolies, monopolization, combinations and mergers, discriminatory treatment, horizontal concerted actions affecting competition, vertical restraints, exclusionary practices and pyramid sales programs.

The FTL also prohibits unfair competition practices such as trademark infringement, passing off, intentional mislabelling and other acts that may confuse consumers, trade libel, the misappropriation of trade secrets, and other deceptive and unfair practices.

Violations of the FTL will result in criminal and civil liabilities, including imprisonment and discretionary treble damages. In addition to civil relief and criminal sanctions, the FTL also provides for administrative sanctions.

The FTL is administered by a new agency, the Fair Trade Commission (FTC) set up under the Executive Yuan; i.e., the Cabinet. This independent and semi-judicial agency will play a major role in the enforcement of the FTL.

In February 1993 the FTC published a list of 106 companies in 108 markets whose market share exceed 20%. Of them, 48 companies in 33 markets have been determined to be monopolies.

UNITED KINGDOM

Abuse of market power is not to be made the subject of a per se prohibition, but the existing investigatory system is to be considerably strengthened. This was the conclusion announced last month by the UK Department of Trade and Industry.

Currently both the monopoly provisions of the *Fair Trading Act* 1973, and those dealing with single firm anti-competitive behaviour in the *Competition Act* 1980, are available to control market dominance itself and abuses of market power. No sanctions, however, are available unless adverse findings are made against the complained of practice. Assuming that new legislation follows the first option described in the November 1992 Green Paper, legislative backing will be given to the taking and enforcement of informal assurances accepted in lieu of a formal investigation. Interim prohibition orders are also likely to be extended where there are evident serious effects on third parties if a practice is not stopped quickly. More controversial will be the proposal to put a company complained against on risk of fines and third party actions for damages from the time a formal investigation is announced provided that the formal investigation ultimately concludes in adverse findings against that practice. The announcement also promised replacement of the outmoded UK restrictive trade practices legislation with a domestic version of art. 85 of the *EEC Treaty*.

Two recent decisions have demonstrated that the Secretary of State for Trade and Industry in the merger field is prepared to differ from the Director of Fair Trading. In both GEC/Philips Electronics and Airtours/Owners Abroad, the Secretary declined to follow the recommendation of the Director and refused to make merger references to the MMC.

UNITED STATES

"Sham Litigation" Exception Restricted by Supreme Court

It has long been recognized that governmental actions may favour one competitor—or group of competitors—over another and that this "state action", while admittedly anti-competitive, does not violate the federal antitrust laws. Less clear, however, has been the antitrust status of private efforts to obtain or influence such anti-competitive

government conduct. In 1961 and 1965 the Supreme Court, in the famous *Noerr Freight and Pennington* cases, held that those who seek anti-competitive government actions are generally immune from antitrust liability. *Noerr* involved an effort to obtain favourable legislation and *Pennington* extended the same immunity to efforts to obtain favourable treatment from the executive branch of the government. In the *California Motor Transport* case the immunity was further extended to those who petition administrative agencies or courts for relief against their competitors. The 1972 *California Motor Transport* opinion said, however, that if litigation instituted against a competitor or group of competitors was a "mere sham", i.e., instituted to harass the competition without cause and regardless of the merits of the case, then the party instituting such "sham" litigation would not be immune from antitrust liability.

On May 3, 1993, the Supreme Court, in a unanimous decision (*Professional Real Estate Investors* v. *Columbia Pictures*) significantly restricted the "sham litigation" exception. The Court said that an "objectively reasonable effort to litigate cannot be a sham regardless of subjective intent." In other words, a legal action or lawsuit that has some reasonable basis cannot be the foundation of an antitrust case by the intended victim even if the lawsuit was ultimately unsuccessful and was filed with the specific intent to harass or injure a competitor.

The Court expressly chose not to address the situation where there was fraud or other misrepresentations on the part of those bringing the lawsuit.

VENEZUELA

Law on the Promotion and Protection of Free Competition

The *Venezuelan Competition Law* has a very short history, since it was not until January 13, 1992 when the first law to Promote and Protect Free Competition was enacted. As a complement of the law, in February 26, 1993, the National Executive issued Decree No. 2775 containing the Administrative Regulation.

The law is the result of the intention of the Venezuelan government to eliminate 30 years of state control.

The principal source of law on the promotion and protection of free competition is the EEC. However, certain elements of the U.S. *Sherman Act* have also been included in the law.

The main characteristics of the law are:

1. The law contains a general prohibition which forbids any conduct, practice, agreement, contract or decision which may impede, restrict or limit free competition;

2. The law is divided into those covering activities in restraint of trade and those covering abuses of dominant position;

3. The law contains certain prohibitions concerning unfair competition, such as fraudulent advertising, false promotion, violation of commercial secrets and simulation of products;

4. The law exempts certain limited categories of activities from the application of its provision. Exemptions may be determined by the President of the Republic in Council of Ministers and after hearing the opinion of the Superintendency. In this respect, the government issued on February 26, 1993, the Administrative Regulation dealing with the Regime of Exemptions;

5. The law creates the Superintendency for the promotion and protection of free competition. The Superintendent is appointed by the President of the Republic of Venezuela;

6. The law provides one procedure for cases of prohibited practices and another procedure in the case of authorizations;

7. The administrative sanctions are imposed by the Superintendency, and the law foresees fines up to 10% of the value of the sales made by the infringer, which may be increased to 20%. In the case of reincidences, the fine may be increased to 40%.