FOREIGN AND INTERNATIONAL COMPETITION LAW AND POLICY DEVELOPMENTS

A PROGRESS REPORT ON THE INTERNATIONAL COMPETITION NETWORK

By: Chris Martin
Acting Assistant Deputy Commissioner of Competition International Affairs Division, Competition Bureau

In its first year, the International Competition Network ("ICN") made significant progress in advancing one of its main objectives, soft convergence of international competition laws.

Four of the ICN's major accomplishments are discussed below: its ability to attract new members; its first annual conference in Naples, Italy; the involvement of non-governmental advisors (NGAs); and the endorsement of its work products by ICN members. A preview of what to expect in the lead up to the next annual conference (Mérida, Mexico in June 2003) is also included.

Membership

The ICN was launched in October 2001 with 16 member agencies. Today, that number has grown to 75 members from 65 jurisdictions. It is a remarkable accomplishment, given that the total number of competition agencies worldwide is approximately 90. Fifty-nine ICN members attended our first conference, held in September 2002 in Naples, Italy. By the time of our second conference this coming June, it is hoped that all competition authorities will be ICN members, and all will be able to attend the conference.

First Annual ICN Conference

As Chair of the ICN's Steering Group, Commissioner von Finckenstein had the honour of co-chairing the first annual conference with Giuseppe Tesauro, Chairman of the Italian Antitrust Authority. Certainly, Naples was one of the most inclusive gatherings of antitrust officials ever. What was gratifying was seeing many new faces in the room representing agencies from around the world, and they were there as full members, not observers or invited guests. They were entitled to participate on an equal basis with the so-called "mature" agencies, and they did.

The conference program addressed the issues of Competition Advocacy and Merger Review. It was a balanced program, designed to appeal to agencies from both developing and developed countries. Many of the member agencies represented in Naples came from jurisdictions that either do not have mandatory merger notification systems or merger laws at all. Naples thus provided an excellent learning opportunity for those who are considering establishing or revising merger laws. They heard first-hand from peers which best practices they could adopt. At the same time, members from developed countries found out how crucial the advocacy role is for newer agencies and how the ICN can lend a hand in this regard.

Role of NGAs

In addition to the tremendous turn out by member agencies in Naples, close to fifty NGAs from around the world, including several Canadians, came to Naples.

We could have welcomed even more if not due to space constraints. In June in Mérida, we will be exploring ways to widen the circle of NGA participants, including greater and more diverse participation.

The ICN has achieved a great deal by incorporating into its work – and its annual conference – the expertise of NGAs. They participate in the ICN in their capacity as representatives of relevant international organizations (e.g., World Bank, OECD, UNCTAD) or private associations (e.g., Canadian Bar Association, American Bar Association, etc.), or in their personal capacity based on their individual authority and expertise in the field of antitrust.

In practice, NGAs who are willing to play an active role in volunteering their time and effort to the development of the ICN become involved by contacting the relevant chairs of the working groups and indicating their desire to participate. Member agencies may also seek advice on ICN-related issues from NGAs of their own choosing. Anyone who wishes to offer his or her expertise and become involved is encouraged to do so. Contact information for the working group chairs is available at the ICN web site, www.InternationalCompetition Network.org.

Joint Work Products Endorsed

The ICN's most tangible achievement to date is that members and NGAs collaborated to produce four very thoughtful, practical, and detailed work products. Only eleven months after the launch of the ICN, members agreed on eight guiding principles for merger review and three detailed recommended practices for merger notification procedures. They also endorsed the Advocacy & Competition Policy Report and the discussion paper on the Analytical Framework for Merger Review.

By international standards, this agreement was reached at the speed of light. The endorsed projects can be summarized as follows:

Guiding Principles

The Notification and Procedures subgroup proposed eight guiding principles around which a merger review regime should be built:

- sovereignty;
- transparency;
- non-discrimination on the basis of nationality;
- procedural fairness;
- efficient, timely, and effective review;
- coordination;
- convergence; and
- protection of confidential information.

These guiding principles are intended to make the merger review process more efficient and effective, as well as reduce delay and the investigative burden on merging firms. ICN members whole-heartedly endorsed these guiding principles.

Recommended Practices

The Notification and Procedures subgroup also developed a set of Recommended Practices for Merger Notification Procedures.

Recommendation 1(A) suggests that there be "an appropriate nexus with the jurisdiction concerned." In recommendation 1(B), "appropriate nexus" contemplates standards of materiality as to the level of local nexus required, so that transactions unlikely to have appreciable anticompetitive effects will be screened out. Recommendation 1(B) also advises that worldwide

revenues or assets (as opposed to sufficient sales or assets in the territory) should not be a sufficient trigger, and that the required local sales and assets should be limited to those of the business being acquired. Recommendation 1(C) states that nexus should be measured by the local activities of at least two parties to the transaction or "by reference to the activities of the acquired business in the local territory."

Recommendation 2 seeks clear and understandable notification thresholds based exclusively on objectively quantifiable criteria (sales and assets, not market share) which can be examined based on information readily accessible to the merging parties.

Recommendation 3 suggests that jurisdictions allow parties to file upon the certification of a good faith intent to consummate the transaction, rather than a date tied to the execution of a definitive agreement. This is meant to facilitate the coordination of multi-jurisdictional filings. In addition, the third recommendation suggests that jurisdictions that prohibit the closing of the transaction until after agency review should not impose filing deadlines.

Public and private sector representatives identified these three areas as the most pressing. The format of the recommended practices consists of a short statement of the practice, followed by explanatory commentary by the subgroup.

Members endorsed the Recommended Practices with the understanding that one of the sub-principles on jurisdictional nexus (Recommendation 1(C)) would be discussed further during the course of this year's work.

With regard to both the Guiding Principles and Recommended Practices, it is now time for members to review their laws and processes and consider adopting measures that reflect these notions. The ICN will not be striking a working group to deal with implementation. It is anticipated that competition agencies will recognize that ICN proposals are optimal practices recommended by antitrust experts from around the world. Naturally, they will want their own national regimes to reflect these practices and principles.

Other Merger Work

Web links and Templates

To increase the transparency of merger review processes, the Mergers group also undertook to have member agencies create web links to the ICN web site containing information about their own merger control regimes. Members were also asked to complete a common "template" with information about their merger regimes, including details on notifications and procedures. This information is posted on the ICN web site as it becomes available, creating a one-stop-shop for merger review information.

Analytical Framework

The Analytical Framework subgroup presented a very engaging discussion paper on the objectives and analytical framework for merger review. As EU Commissioner for Competition Mario Monti noted when introducing this topic in Naples, "the paper asks all the right questions in examining the purpose of merger control." It considers both economic and public-interest goals pursued in ICN members' jurisdictions, presents suggestions as to which merger transactions should be reviewed, and discusses how qualifying mergers should be assessed. The paper does not provide recommendations, since it was only meant to flesh out the appropriate issues that should be considered when looking at merger control systems.

As part of its project, questionnaires were sent to members and an annex has now been compiled which details the analytical framework in place in each ICN

jurisdiction. This information can also be found on the ICN web site.

Advocacy Report

The Competition Advocacy Working Group presented its report on Advocacy & Competition Policy. The Advocacy Report addresses a number of key topics, including the role of advocacy, political influences on advocacy, advocacy in developing countries, institutional settings which can promote or hinder advocacy, and the international dimensions of advocacy. Demonstrating again the practical nature of the ICN's work products, the Advocacy Report synthesizes 53 questionnaire responses received from members and is useful as a quick snapshot of how ICN members focus their advocacy efforts.

One of the objectives of the ICN is to produce clear, concise and pragmatic guidance for developed and developing competition agencies. The Naples Conference documents, which are available on the ICN web site, were prepared with these goals in mind.

Future Work

The future work programs for each of the subgroups were confirmed at the Naples Conference. Highlights of these plans are set forth below:

Mergers

The Merger Notification and Procedures subgroup will continue to work on its web links and template projects and will produce additional recommended practices. It also plans to promote the Guiding Principles and Recommended Practices, and encourage subgroup members to lead by example in reviewing their own systems for consistency with the principles and practices.

The subgroup on the Analytical Framework of Merger Review will compile and analyze existing merger guidelines in order to identify similarities and differences, and they will consider developing model merger guidelines. They will also undertake a small-scale project examining how efficiencies are treated around the world.

The Investigative Techniques in Merger Review subgroup held a workshop for members in Washington, D.C. on November 21-22, 2002. The purpose of the workshop was to train competition officials and staff in the most effective ways to investigate and review mergers. This subgroup will also begin to develop an investigative techniques manual.

Advocacy

The Competition Advocacy working group will create four subgroups to develop a toolkit on practical advocacy techniques, collect model statutory provisions that empower a competition agency to advocate competition to other sectors of government, compile sectoral studies, and establish an on-line information resource center to facilitate access to this information.

Capacity Building and Competition Policy Implementation

The members established a new working group on Capacity Building and Competition Policy Implementation, to be co-chaired by the EU and South Africa. The mission of this group includes building the case for effective competition in developing countries; advocating the need for independent competition authorities and methodologies for building the institutions necessary to support the competition mission; considering whether regional institutions should be encouraged; considering how to bring the competition message to the business community and civil society; considering how the authority might attract sufficient funding and staffing; and developing methodologies for

the above tasks that will be useful to national authorities and appropriate to their stage of development.

Review of the Operational Framework

Canada and Italy will co-chair a new working group reviewing the ICN's Operational Framework to address issues such as how to establish the next steering group at the 2003 conference in Mexico, and to address concerns about the lack of a formal mechanism through which the ICN can raise and disburse funds to support both its ongoing activities and provide funding for developing countries to attend the annual conferences and workshops.

Conclusion

The ICN model works. Bringing together competition agencies from around the world on an equal basis has created a unique dynamic. Not being constrained by formal, enforceable obligations has fostered a remarkably productive exchange of ideas between agencies. The close involvement of NGAs, in practically all activities, means that they play an active role in shaping the ICN's work products.

With the ongoing contributions of the ICN's NGA partners, its second year will be even more successful than its first.

AUSTRALIAN NEWSLETTER

By: Hank R. Spier, Spier Consulting Pty Ltd., Canberra, Australia and
Robert Baxt and Brooke Johnson, Allens Arthur Robinson
Melbourne, Australia

THE DAWSON REVIEW OF THE *TRADE PRACTICES ACT*

On May 9, 2002, the Treasurer of the Australian Federal Government, the Right Honourable Mr. Peter Costello MP, announced a formal review of the *Trade Practices Act 1974* (Cth) ("TPA") (the "Dawson Review") to be conducted by a committee chaired by Sir Daryl Dawson, AC KBE CB, former Justice of the High Court of Australia (1982-1997), Jillian Segal and Curt Rendall (the "Review Committee"). Jillian Segal has recently retired from her position as Deputy Chair of the Australian Securities and Investment Commission ("ASIC") (she was a former partner in the firm of Allen, Allen & Hemsley now part of the firm Allens Arthur Robinson). Curt Rendall is chairman of the Australian Federal Government's Small Business Consultative Committee and a member of the Institute of Chartered Accountants and New South Wales Small Business Development Corporation.

This broad ranging and comprehensive review focused on the competition provisions of the TPA which are housed in Part IV (and the associated penalty provisions) and the authorization provisions contained in Part VII. The inquiry by the Review Committee "implements the commitment made by the Government in its *Securing Australia's Prosperity* policy during the last Federal Election".[1]

The Dawson Review also provided a unique opportunity for Australian business to comment on the reform of one of Australia's most far reaching laws. There have

been reviews of specific provisions of the TPA in previous years. However, there has not been a comprehensive review of the competition provisions of the TPA since the Hilmer Committee Review in 1993.

Issues Considered in the Dawson Review

In considering the operation of the competition and authorization provisions of the TPA, the Review Committee was asked to determine whether those provisions:

- inappropriately impede the ability of Australian industry to compete locally and internationally;
- provide an appropriate balance of power between competing businesses and, in particular, businesses competing with or dealing with businesses that have larger market concentration or power;
- promote competitive trading which benefits consumers in terms of services and price;
- provide adequate protection for the commercial affairs and reputation of individuals and corporations;
- allow businesses to readily exercise their rights and obligations under the Act [TPA], consistent with certainty, transparency and accountability, and use compliance or authorization processes applicable to their circumstances; and
- are flexible and responsive to the transitional needs of industries undergoing, or communities affected by, structural and/or regulatory change and to the requirements of rural and regional areas.[2]

The Review Committee was also asked to identify improvements to the TPA, its administration and additional measures to achieve a more efficient, fair, timely and accessible framework for competition law. It could also consider other aspects of the TPA as well as the recommendations of other reviews currently underway or previously completed.

In performing its functions, the Review Committee advertised nationally, and consulted with key interest groups and affected parties, received public submissions and took into account overseas experience. As the States and Territories each apply the competition provisions of the TPA as their own laws, the Review Committee sought the views of the State and Territory Governments. The Review Committee received over 200 submissions.

The Review Committee was asked to report to the Government by the end of January 2003 and the release of its report is imminent.

It is anticipated that the Review Committee will have examined the following critical issues:

Mergers

Many Australian business people have for some time expressed concern about the Australian Competition & Consumer Commission's ("ACCC") treatment of mergers under section 50 of the TPA. There has been some criticism that the ACCC, in its administration of section 50 of the TPA, has been too inflexible in dealing with mergers. The formal authorization process before the ACCC and potential review by the Australian Competition Tribunal (the "Tribunal") are said to take too long. It is argued that many mergers are not pursued with the ACCC because of the parties' concerns about

the length of time it takes to get a merger "through" and the ACCC's desire to "push" certain mergers down the authorization route. It has been suggested that there should be an ability to bypass the ACCC and go directly to the Tribunal for authorization of a merger. Ultimately, there are suggestions that the ACCC should be more accountable for decisions made in respect of mergers.

Misuse of Market Power

The ACCC has suggested that it needs additional powers to effectively carry out its role as competition regulator and consumer protector.

The ACCC supports a number of changes to the misuse of market power provision in section 46 of the TPA.[3] A recent inquiry conducted by the Senate Legal and Constitutional References Committee (the "Senate Committee"),[4] investigated whether section 46 of the TPA should be amended to reverse the onus of proof required to establish a contravention. The Senate Committee also examined whether the current "purpose test" in section 46 should be supplemented by an "effects test".

Ultimately, the Senate Committee noted the imminent Dawson Review and agreed to "stay" its report. In the Senate Committee's view, the proposed section 46 amendments are "inextricably linked" to other sections of the TPA.[5]

Reversal of Proof – Aim of the Proposed Amendment

The Senate Committee identified the purpose of the proposal to reverse the onus of proof in section 46 as being to increase the ACCC's likelihood of success in actions brought under section 46 of the TPA.

Arguments in Favour

The ACCC argued before the Senate Committee that the reversal of the onus of proof would be beneficial to the economy generally by promoting competition, as well as being of assistance to companies harmed by a dominant competitor.

The ACCC indicated that it believes that companies subject to investigation often destroy evidence of their conduct which makes it almost impossible to successfully prosecute section 46 cases.

Arguments Against

One of the main arguments against the reversal of the onus of proof is that it would dispense with the fundamental legal principle that a person is innocent until proven guilty. In addition, it is felt that it would create an enormous burden on a company defending a claim that it has breached section 46 of the TPA, a provision that has been the subject of a number of cases heard by the High Court and the Federal Court (although some of the cases are currently on appeal). The relevant cases are as follows:

- *AICCC* v. *Boral Besser Masonry Limited & Ors* (2001) ATPR ¶41-803;
- *ACCC* v. *Rural Press Limited* (2001) ATPR ¶41-804;
- *ACCC* v. *Safeway Stores Pty Ltd (No 2)* (2002) ATPR (Digest) ¶46-215;
- *ACCC* v. *Universal Music Australia Pty Ltd (No 2)* (2002) ATPR ¶41-862;
- *Melway Publishing Pty Ltd* v. *Robert Hicks Pty Ltd t/as Auto Fashions Australia* (2001) ATPR ¶41-805; and

- *NT Power Generation Pty Ltd* v. *Power & Water Authority* (2001) ATPR ¶41-814.

An "Effects" Test

Arguments in Favour

An "effects" test would essentially provide that any conduct with the effect of damaging a competitor, or preventing or deterring a competitor from entering a market, would be conduct constituting a misuse of market power.

The ACCC has argued that an "effects" test would bring Australian law into line with the antitrust laws in other major countries. The ACCC has indicated that it would prefer the introduction of an "effects" test in addition to the current purpose test. In the ACCC's view, the "effects" test would make section 46 consistent with other provisions of the TPA, which have an "effect" or "likely effect" test. The proposal of an "effects" test has often been advocated on the basis that it would provide a better mechanism for distinguishing between pro-competitive and anti-competitive behaviour.

Arguments Against

An argument against the introduction of an "effects" test is that any conduct that is being undertaken for legitimate competitive business purposes could arguably be captured by section 46. Linked to this concern is the degree of commercial uncertainty that an "effects" test would cause. All businesses with a substantial degree of market power would be effectively constrained from engaging in any kind of conduct that might have certain anti-competitive effects regardless of any long term, legitimate and pro-competitive outcomes. Some businesses may censor their commercial "edge" strategies for fear of unintentionally breaching the TPA and this would only lead to an eventual decrease in the very pro-competitive behaviour that the TPA stands to encourage.

In addition, a series of recent cases, referred to above in the discussion on the reversal of the onus of proof in section 46, has made it clear that the current purpose test does, in many cases, involve the courts looking at the effect of the relevant conduct in determining whether the anti-competitive purpose exists.

Penalties

Criminal Sanctions

Another issue considered by the Review Committee, and one which will perhaps have the most serious ramifications for businesses, is the ACCC's call for the imposition of criminal penalties (including jail sentences) for serious cartel behaviour, including price-fixing.[6] The ACCC has argued that the introduction of penalties into Australian law would bring it into line with the antitrust laws of other major countries including the UK which has recently introduced legislation to this effect.[7]

Administration of the TPA by the ACCC

Australian business has been concerned for some time about the way in which the ACCC treats businesses, big business in particular. In a recent House of Representatives' Standing Committee report (the "HR Report"),[8] the Standing Committee raised a number of issues about the conduct of the ACCC and its willingness to listen to the community's concerns about how it administers the TPA.

Some of the administrative issues were considered by the Review Committee. In addition to the HR Report, the recent decision of Finn J. in *Electricity Supply Association of Australia* v. *ACCC*[9] raised questions concerning the ACCC's use of publicity. This was likely a key feature of the Dawson Review, especially following the enormous publicity that was generated by the ACCC's raids on three major oil companies using powers under section 155 of the TPA.

The Standing Committee also acknowledged the positive performance of the ACCC in its operations, describing the ACCC as an "effective regulatory body".[10] The comments were made specifically in relation to the new responsibilities of the ACCC resulting from the introduction of Part XIAA into the TPA on the New Tax System in Australia which came into operation on July 1, 2000. It should be noted that as of July 1, 2002, this part of the TPA ceased to operate.

Necessary Procedural Reforms

It is anticipated that certain areas of procedural reform were also recommended to the Review Committee. An issue that was being watched closely by all Australian lawyers, particularly competition lawyers, was the status of the doctrine of legal professional privilege in respect of its application to the TPA.

In May 2002, before the Full Court of the High Court of Australia, the case of *The Daniels Corporation International Pty Ltd* v. *ACCC*[11] was heard. The Full Court of the Federal Court[12] held that legal professional privilege could not be used as a basis for refusing to supply documents to the ACCC when required to do so under a section 155 notice.[13] Section 155 of the TPA confers extremely broad powers on the ACCC to obtain information, documents and evidence[14] and to enter and search premises,[15] if there is a reason to believe that a person has, or will engage, in conduct that constitutes a contravention of the TPA.

The impact of the Federal Court's decision was such that the already broad ranging powers of the ACCC were further expanded by the removal of this doctrine, and during that uncertain time, the ACCC was subject to less checks and balances than other high profile and powerful Australian regulators, such as ASIC and the Australian Taxation Office, where the doctrine is applicable. However, on November 7, 2002, lawyers and more importantly, clients, sighed with relief when the High Court handed down its long anticipated decision in *Daniels*. The High Court unanimously overruled the Full Federal Court's decision, holding that the ACCC's investigative powers do not extend to compelling the production of privileged communications. The High Court held that legislation will not be interpreted as overriding common law rights, privileges and immunities unless the statute contains clear words indicating that Parliament intends to override the common law, or unless that intention is a necessary implication of the statutory provisions. For various reasons, all seven judges rejected the ACCC's argument that its investigative powers would be frustrated if it could not compel the production of privileged communications. The ACCC's argument that a public interest overrides legal professional privilege was also rejected.

The use of section 87B undertakings is another area of the TPA considered by the Review Committee. Section 87B states that the ACCC may accept written undertakings given by a person and if the ACCC believes that a term of those undertakings is breached at any stage, it may apply to the court to have those undertakings enforced. The operation of the provision where the reason for parties providing undertakings to the ACCC is to avoid penalties, and provision of undertakings as part of a negotiated settlement or as a condition imposed by the ACCC in the grant of an informal clearance or authorization for a merger are all issues that may have been considered by the Review Committee.

Concluding Comments

There is little doubt that the TPA is the most important piece of commercial legislation in Australia. The ACCC is generally regarded as the most powerful regulator in

Australia. In this context, the Dawson Review provided an opportunity for business, business advisers and others to propose a number of changes to the legislation and administration which may have far reaching, long term effects for the Australian community.

The Review Committee's report will be covered in a future issue of the *Record*. It is unlikely that any legislative amendments resulting from recommendations made by the Review Committee will be placed for consideration before Parliament before the second quarter of 2003.

Notes

[1] Press Release from the office of the Honourable Mr. Peter Costello, "Review of the Competition Provisions of the *Trade Practices Act 1974*" (no. 023, 9 May 2002).

[2] Terms of Reference for the Review of the *Trade Practices Act 1974*, http://www.tpareview.treasury.gov.au/ content/ termsofref.asp.

[3] Section 46(1) of the TPA provides that:

> A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
>
> (b) preventing the entry of a person into that or any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

[4] The Senate Legal and Constitutional References Committee, "Inquiry into the *Trade Practices Act 1974*" (May 2002).

[5] *Ibid.* at 35.

[6] ACCC, "ACCC Calls for Stronger Criminal Sanctions Including Jail Sentences for Price Fixing Offences under the *Trade Practices Act*" (http://www.accc.gov.au, 8 June 2001).

[7] UK *Enterprise Bill 2002*, Part 6 Cartel Offence.

[8] House of Representatives Standing Committee on Economics, Finance and Public Administration Report "Competing Interests: Is There Balance? Review of the Australian Competition & Consumer Commission Annual Report" (1999-2000).

[9] (2001) ATPR ¶41-838.

[10] HR Report, *supra* note 8 at 57.

[11] High Court Proceedings S27/2002.

[12] *ACCC* v. *Daniels Corporation International Pty Ltd & Anor* (2001) 108 FCR 123 [hereinafter *Daniels*].

[13] In *Daniels*, the Full Federal Court found that although section 155 of the TPA is silent regarding the doctrine of legal professional privilege, notwithstanding the general principle that a statute will not take away a common law right without express legislative intention to do so, their Honours considered that the words of section 155 impliedly excluded the doctrine of legal professional privilege. The critical words in question were those of section 155(1)(a) which state that a person shall not "refuse or fail to comply with a notice under this section to the extent that the person is capable of complying with it" and each judge determined that these words were inconsistent with the retention of legal professional privilege. See L. Menzies, "The Full Federal Court Removes the Protection of Privilege in ACCC Investigations" (2001) 9 Australian Trade Practices Law Journal 115 at 116.

[14] Section 155(1).

[15] Section 155(2).

EC COMPETITION LAW DEVELOPMENTS

By: Juan A. Rodriguez
Sullivan & Cromwell LLP, London

European Court Strikes Down Golden Share Legislation

In three separate judgments on June 4, 2002, the Court of Justice of the European Communities (the "Court") ruled on the compatibility of certain "golden share" legislation in France, Portugal and Belgium with the European Community ("EC") legal principle of the freedom of movement of capital. The term "golden share" is used to describe various types of stock that confer upon a state special rights with respect to transactions carried out by, or in relation to, the entity in which the golden share is held. Historically, governments in the EU have used golden shares as a device to enable them to retain influence over privatized companies no longer under their control. Ownership of a golden share can be used, and on occasion has been used, to enable governments to prevent foreign purchasers from acquiring control over former state-owned enterprises.

Article 56 of the Treaty Establishing the European Community ("EC Treaty") reflects the fundamental EC principle of the freedom of movement of capital. Article 56 establishes a general prohibition on all restrictions on the movement of capital between EU member states, and between EU member states and non-EU countries. This prohibition is subject to the rights of EU member states to adopt measures (through legislation or other means) that are justified on grounds of public policy or public security.[1] Practical guidance on the application of these rules is set out in the EC Commission's *Communication on certain legal aspects concerning intra-EU investment*.[2] Essentially, golden share legislation in an EU member state will violate Article 56 unless three tests are satisfied:

(i) the legislation must not discriminate against nationals of other EU member states (the "non-discrimination test"); and

(ii) the legislation must have as its objective the protection of a legitimate interest such as public policy, public security or public health (the "legitimate interest test"); and

(iii) the legislation must not go beyond what is necessary in order to achieve its stated objective (the "proportionality test").

These legal tests were applied by the Court in Case C-483/99, *Commission of the European Communities* v. *French Republic*, Case C-367/98, *Commission of the European Communities* v. *Portuguese Republic* and Case C-503/99, *Commission of the European Communities* v. *Kingdom of Belgium*. In each of the cases, the EC Commission sought a declaratory judgment from the Court that the golden share legislation in question did not satisfy the three tests and hence that the respective state was in violation of its obligations under Article 56.[3]

The Court ruled that the golden share legislation at issue in France and Portugal is in violation of the EC Treaty but upheld the Belgian golden share legislation as being in accordance with the EC Treaty. The three judgments mark a decisive stage in the long-running controversy between the EC Commission and the governments of France, Portugal and Belgium with respect to the golden share arrangements at issue, although additional cases are currently pending in relation to golden share legislation in the United Kingdom, Italy and Spain.

The guidance given by these judgments will be relevant for EU member states holding golden shares (or planning to implement such protections in connection with future privatizations) and wishing to ensure that their rights cannot easily be attacked on the basis of Article 56. The Belgian legislation will likely be seen as a model for structuring golden share rights that are likely not to violate Article 56, in particular in its emphasis on proportionality and on post-facto procedures that require the articulation of clear grounds for government action. However, although the Belgian case provides an example of procedures that the Court will find acceptable, it is unlikely as a practical matter that such procedures will provide potential acquirors of privatized companies with significantly increased certainty. Under the Belgian approach, the government retains the ability to block a transaction or a significant portion thereof. Moreover, although judicial review is available and the grounds for government action are relatively narrow and must be clearly articulated, there is the prospect of significant delay due to litigation in the event of dispute over whether the rights have been validly exercised.

Furthermore, although the three judgments taken together provide guidance as to certain forms of golden shares that are, or are not, permissible, the judgments also leave open important questions that may lead to uncertainty in a number of areas. The three judgments provide only moderate guidance as to the extent of

golden share rights that governments may legitimately retain in privatized companies, the scope – beyond the interests specifically identified in the judgments – of what constitutes a legitimate interest and the range of procedures – beyond those set forth in the Belgium legislation – that will satisfy the "proportionality" and "legal certainty" requirements. Given the wide range of rights that various European governments enjoy pursuant to golden shares, significant additional litigation will be required to clarify the contours of permissible rights.

Unfortunately, the judgments also highlight the cumbersome and protracted nature of the procedures through which the EC Commission polices compliance by member states with their obligations under the EC Treaty. The proceedings involving France and Belgium took approximately four years from the Commission's initial written notice to these member states alleging their breach of Article 56 to judgment being handed down by the Court. The proceedings involving Portugal required nearly eight years.

The Court's judgments are also likely to bring renewed attention to attempts to create pan-European rules on takeovers, including permissible defenses to takeovers. The continued existence of various forms of golden shares under the domestic laws of member states is one example of the complex legal framework that potential acquirors of EU companies continue to face. The judgments already have led some commentators to question whether other forms of takeover defenses in force in EU member states similarly fall afoul of EC law, and may give further impetus to those calling for a leveling of the regulatory playing field through the adoption of an EU-wide code to regulate takeovers. The extent to which a target company can avail itself of defenses against a hostile bid continues to be one of the most contentious issues in the current discussions between the EU institutions and member states regarding such a code.

European Court Annuls EC Commission's Prohibition of Airtours/First Choice Merger

In its landmark judgment on June 6, 2002 in Case T-342/99 *Airtours plc* v. *Commission of the European Communities*, the Court of First Instance of the European Communities ("CFI") reversed a high profile merger review decision by the EC Commission. At the time of the judgment, it was only the second time that the CFI had reversed a merger review decision by the Commission.[4] In its decision, the Commission had blocked the proposed merger of two UK holiday companies on the basis of the theory of collective dominance. The CFI annulled the Commission's decision on the ground that the Commission had committed a manifest error of assessment in concluding that, on the evidence submitted to it, the merger would create a collective dominant position and, therefore, should be blocked.

The following summarizes the background to the judgment and discusses some of its noteworthy aspects.

Background to the Judgment

The Theory of Collective Dominance

EC law gives the Commission the power to review mergers involving parties whose turnover exceeds certain thresholds. The EC Merger Regulation (the "ECMR"), which is the principal legislation with respect to merger review by the Commission, embodies a relatively strict substantive legal standard entitling the Commission to prohibit mergers that create or strengthen a dominant position as a result of which competition in all or part of the Common Market will be significantly impeded.[5] This legal standard allows the Commission

to prohibit not only those mergers that lead to single firm dominance on the part of the merged entity, but also those that create or strengthen a so-called collective dominant position. Although there is no explicit reference to collective dominance in EC legislation or in any of the official guidelines hitherto adopted by the Commission, the CFI previously has accepted the theory of collective dominance as a legitimate basis on which the Commission may block a merger. The Commission applies the theory of collective dominance to markets that involve two or three suppliers, each of which, the Commission believes, have the incentive and ability to avoid effective competition by adhering to a policy of tacit collusion. In assessing whether a merger creates or strengthens a collective dominant position, the Commission applies a "checklist" of the different characteristics that it regards as being conducive to collective dominance. According to the Commission, those characteristics are: symmetry in cost structure among the principal sellers, structural links among the principal sellers, stable and inelastic demand for the relevant products, high barriers to entry, homogeneity of the relevant products, transparency with respect to the principal sellers' behavior regarding prices and other competitively sensitive aspects of their conduct, and an incentive, through the existence of a retaliation mechanism, for the principal sellers to adhere to a policy of tacit collusion.

The Commission previously has found collective dominance to arise in various industries, including platinum,[6] petroleum products[7] and electricity.[8]

The Commission's Review of Airtours' Bid for First Choice

In 1999, Airtours plc ("Airtours"), which subsequently changed its name to "MyTravel," launched a hostile bid for First Choice plc ("First Choice"). The transaction fell within the Commission's merger review jurisdiction and, accordingly, was notified to the Commission. On September 22, 1999, at the end of the review period, the Commission adopted a decision (the "Contested Decision"), prohibiting the merger on the ground that it would create a collective dominant position among Airtours and two other UK tour operators (Thomson and Thomas Cook) in the short-haul package holiday market. In the Contested Decision, the Commission concluded that the loss of an independent First Choice as one of the four main suppliers of short-haul package holidays to consumers in the UK would create a market structure in which the three remaining principal suppliers of this type of holiday (Airtours, Thomson and Thomas Cook) would have the ability and incentive tacitly to collude so as to limit the short-haul package holiday capacity available in the market. The Commission concluded that through such tacit collusion, these three tour operators would restrict the supply, and hence increase prices, of short-haul package holidays supplied in the UK. Before the end of the Commission's review period, Airtours submitted remedial undertakings to the Commission with a view to alleviating the Commission's concerns, but the Commission considered those undertakings to be inadequate and rejected them.

At the time of its adoption by the Commission, the Contested Decision aroused significant comment. In particular, the theory of competitive harm reflected in the Contested Decision was considered novel in two respects:

(i) it was the first example of the Commission's prohibiting a merger on the grounds that a market involving more than two sellers could give rise to a situation of collective dominance; and

(ii) the concept of sellers raising prices by tacitly colluding with respect to capacity was a novel application of the collective

dominance theory, which the Commission previously had applied only in connection with the more direct form of tacit collusion on prices.

Airtours appealed the Contested Decision pursuant to Article 230 of the EC Treaty.[9]

The Judgment in T-342/99 Airtours plc v. Commission of the European Communities

Airtours based its application for annulment on four separate pleas.[10] The CFI annulled the Contested Decision solely on the basis of the third plea, namely that the Commission had committed a manifest error of assessment by concluding, on the basis of the submitted evidence, that the merger would have created a collective dominant position.

The CFI reaffirmed the validity of the collective dominance doctrine and highlighted the three essential market characteristics necessary for the incidence of collective dominance:

(i) the market must be characterized by sufficient transparency to enable the sellers to monitor each other and thereby detect any deviation from the policy of tacit collusion;

(ii) an effective punishment mechanism (such as a price war) must disincentivize the sellers from deviating from the policy of tacit collusion; and

(iii) the policy of tacit collusion must be sustainable in the face of any counterreaction by customers or competitors, i.e., customers and competitors must wield insufficient power and influence to prevent perpetuation of the policy of tacit collusion from being sustained.

The CFI concluded that the Commission's analysis failed to prove, to the applicable evidentiary standard, that these three factors were present in the short-haul package holiday market. The CFI found the Commission's analysis to have been defective in a number of aspects. These include the Commission's assessment of any preexisting tendency in the short-haul package holiday market towards behavior reflective of collective dominance, the effect of recent consolidation and vertical integration on the competitive dynamic prevailing in the short-haul package holiday market, the extent of any barriers to entry into the short-haul package holiday market and the likely ability of customers and competitors to counteract the effects of any tacit collusion with respect to short-haul package holiday capacity.

In addition, the CFI found that the Commission had based its finding of low growth in the short-haul package holiday market on an incomplete and incorrect assessment of the evidence. Specifically, the CFI found that the Commission had relied heavily on a one-page extract from a third party study of the UK package holiday market without ever having reviewed the complete study, or even being aware of the period covered by the study. Moreover, the CFI concluded that the Commission had inaccurately interpreted the extract of the study, even though the Commission had cited the extract as crucial evidence in support of its conclusions that the short-haul package holiday market is characterized by a low rate of growth. Having reviewed the evidence on growth in the short-haul package holiday market, the CFI concluded that the extract on which the Commission had relied indicated that the market had experienced considerable growth.

Finding the Commission to have erred in its analysis, the CFI concluded that the Contested Decision, "far from basing its prospective analysis on cogent evidence, is vitiated by a series of errors of assessment as to factors fundamental to any assessment of whether a collective dominant position might be created."

Analysis

Given the judgments in *Schneider/Legrand* and *Tetra/Sidel* discussed below, it appears that the CFI's judgment in *Airtours* marked the beginning of a new era in EU merger review in which there will be rigorous judicial review of Commission determinations.

The judgment in *Airtours* is likely to make the Commission less inclined to challenge mergers on the basis of collective dominance or other novel theories of competitive harm without comprehensive and compelling evidence to support its position. The detailed analysis to which the CFI subjected the Contested Decision provides valuable guidance on the exacting evidentiary standard that the CFI is likely to apply to Commission prohibition decisions – at least to the extent that they are based on the theory of collective dominance. It is noteworthy, however, that the CFI appeared to reaffirm in *Airtours* the conceptual validity of the applicability of the theory of collective dominance to tacit collusion on capacity. It, therefore, should be assumed that the Commission will continue to apply that theory to mergers notified in the future.

European Court Annuls EC Commission's Merger Decisions in *Schneider/Legrand* and *Tetra/Sidel*

In October 2002, the CFI overturned two further high profile merger decisions by the Commission. In its judgment on October 22, 2002, in Case T-310/01, *Schneider Electric SA* v. *Commission* ("*Schneider/Legrand*"), the CFI annulled the Commission's prohibition of Schneider Electric SA's acquisition of Legrand SA. In its judgment on October 25, 2002, in Case T-5/02, *Tetra Laval BV* v. *Commission* ("*Tetra/Sidel*"), the CFI annulled the Commission's prohibition of Tetra Laval SA's acquisition of Sidel SA. In both cases, the CFI found that the Commission had based its analyses on manifest errors of assessment. The judgments have added significance given that they follow the annulment in *Airtours* which, as stated above, was only the second time in its history that the CFI had reversed a merger decision by the Commission. Although the Commission has appealed against the CFI's judgment in *Tetra/Sidel*, the CFI's holdings in that case remain valid unless and until annulled by the Court.[11]

The following highlights the judgments' treatment of several important issues of EC merger review.

The CFI's Judgments in Schneider/Legrand and Tetra/Sidel

The transactions at issue in *Schneider/Legrand* and *Tetra/Sidel* each involved a tender offer for a target company listed on the Paris stock exchange. *Schneider/Legrand* arose from a public exchange offer by Schneider Electric SA ("Schneider"), pursuant to which it acquired 98% of the outstanding shares of Legrand SA ("Legrand"). *Tetra/Sidel* arose from a public bid by Tetra Laval SA ("Tetra"), pursuant to which it acquired 95% of the outstanding shares of Sidel SA ("Sidel").

The Commission reviewed both transactions under the ECMR.[12] The Commission prohibited the transactions, concluding that they would create or strengthen a dominant position on the part of Schneider and Tetra, respectively. Schneider and Tetra each appealed to the CFI requesting annulment of the Commission's decision. In pursuit of prompt resolution, both companies utilized the expedited procedure available for certain actions before the CFI.[13] *Schneider/Legrand* and *Tetra/Sidel* were only the first and second time that this procedure has been used to appeal from Commission decisions under the ECMR. In both cases, this procedure resulted in a resolution of the appeal substantially faster than would have occurred under the standard appeal approach.

Schneider/Legrand

Schneider and Legrand are manufacturers of low-voltage electrical equipment. In its investigation of Schneider's proposed acquisition of Legrand, the Commission found that there were substantial overlaps between the operations and activities of the two companies in the markets for electrical switchboards, wiring accessories (in particular, sockets, switches and connecting equipment) and certain other low-voltage electrical products for industrial use.

On October 10, 2001, the Commission prohibited the proposed combination, concluding that the transaction would considerably weaken competition in various markets for low-voltage electrical equipment in several EC member states. The Commission also found that the transaction would have particularly serious anticompetitive effects in France, where Schneider and Legrand each hold large shares of the markets for low-voltage electrical equipment.

The CFI annulled the Commission's decision on two grounds.

First, the CFI found that the Commission's economic analysis with respect to the effect of the transaction outside France was premised on several errors, omissions and contradictions. In particular, the CFI noted that the Commission had adopted an abstract method of analyzing the transaction that placed excessive emphasis on its transnational aspects, instead of carrying out a detailed country-by-country analysis. Moreover, the CFI found that the Commission had overestimated the position of the merged entity by (i) underestimating the countervailing purchasing power exercised by wholesalers of low voltage electric equipment, which account for a large proportion of Schneider and Legrand's customer base and (ii) disregarding the competitive constraints that the merged entity would face from two of its main competitors, ABB and Siemens. In addition, the CFI found that the Commission had attributed unjustifiably high significance to the portfolio of products that the merged entity would own. The CFI held that the mere fact that the merged entity would own a large number of brands throughout Europe would not necessarily give the merged entity a position of market power in individual national markets.

Second, although the CFI accepted the Commission's substantive economic analysis of the effects of the transaction in France, the CFI reversed that portion of the Commission's decision and remanded the matter to the Commission for further consideration because of certain procedural errors by the Commission. Specifically, the CFI concluded that the Commission had infringed Schneider's rights of defense by inadequately formulating in the statement of objections one of the key grounds upon which the Commission eventually prohibited the merger. The Commission's statement of objections alleged that the proposed acquisition would result in the "overlapping" of Schneider's and Legrand's activities in certain markets and the strengthening of Schneider's position in relation to wholesalers. In its decision prohibiting the transaction, however, the Commission also relied on a "conglomerate effects" analysis that examined the extent to which the merger of the parties' complementary business activities would give rise to dominance. Because the Commission had failed to include the conglomerate effects ground in the statement of objections, the CFI found that Schneider had not been afforded a fair opportunity to address that issue or, in the alternative, to propose appropriate remedial measures to address those concerns.

Following the CFI's annulment of the Commission's decision, the transaction was remitted, by operation of law, to the Commission for further review.[14] However, when at the end of the initial one-month waiting period

the Commission opened a detailed investigation into the transaction, the parties abandoned the transaction. Schneider subsequently sold its shares in Legrand to a third party.

Tetra/Sidel

Tetra is active in the design and manufacture of equipment and consumables used for the packaging of beverages and other liquid food products. It is the worldwide leader in the production of aseptic carton packaging materials and related equipment and used to manufacture and sells certain polyethylene terephthalate ("PET") preforms and stretch blow-molding ("SBM") equipment used in the plastic packaging sector. Sidel is not involved in the carton-packaging sector, but is the worldwide leader in the production and supply of SBM machines used to produce plastic bottles from PET.

On October 30, 2001, the Commission prohibited Tetra's acquisition of Sidel. The Commission based its prohibition on three concerns: (i) the effect of the horizontal overlap between Tetra and Sidel in the SBM market; (ii) vertical effects resulting from Tetra's position in the manufacture and sale of PET preforms that are used to make stretch blow-molded PET bottles; and (iii) conglomerate effects based on the possibility that the merger would enable Tetra to leverage its dominance in the carton packaging sector to the prejudice of its competitors.[15]

The CFI annulled the Commission's prohibition decision, holding that it was based on manifest errors of assessment. The CFI found that the divestiture commitments that Tetra had offered to the Commission during the review procedure would have eliminated the Commission's concerns regarding the potential horizontal and vertical effects of the transaction.

The CFI then turned to a searching review of the evidence upon which the Commission had based its finding of anticompetitive conglomerate effects. The CFI confirmed that it is appropriate for the Commission to evaluate under the ECMR whether a proposed merger or acquisition could result in anticompetitive conglomerate effects. The CFI held, however, that because the effects of a conglomerate-type merger generally are considered competitively neutral or beneficial, the Commission may rely on the "conglomerate effects" doctrine to prohibit a merger only where it is established that, as a result of the proposed transaction, the merged entity would have not only the ability to leverage its market power, but also the incentive to do so.

The CFI further concluded that the Commission had failed to meet the required level of proof to establish that the merged entity would have the ability and incentive to leverage its dominant position in the aseptic carton markets to obtain an advantage in other markets through, among other things, tying, bundling, predatory pricing or loyalty rebates. The CFI held that the Commission erroneously based its leveraging determination on the presumption or expectation that Tetra would violate EC law. Specifically, the Commission's decision presumed that Tetra would employ illegal strategies even though, given Tetra's dominant position in the carton packaging sector, such conduct would violate Article 82 of the EC Treaty. The CFI concluded that the only leveraging practices that the Commission properly could have taken into consideration are those likely not to constitute an unlawful abuse of Tetra's dominant position in the aseptic carton markets.

Moreover, the CFI found that Tetra had not only indicated its willingness to comply fully with the special obligations imposed on it by Article 82 of the EC Treaty as a result of its dominant position in the aseptic carton markets, but also had offered additional commitments that made it unlikely that Tetra would engage in improper

leveraging. In connection with the Commission's review of the proposed transaction, Tetra reiterated its acceptance of obligations that the Commission previously had imposed on it in connection with a prior investigation, including a commitment not to grant any customer discounts or payment terms not justified by objective considerations. In addition, Tetra undertook, in the context of the Commission's review of its acquisition of Sidel, to make no joint offers of its carton packaging products with Sidel's SBM machines. In light of those factors, the CFI found that the Commission lacked sufficient evidence that Tetra would engage in improper leveraging in order to acquire a dominant position in markets other than those for carton products.

Following the CFI's annulment of the Commission's decision, the transaction was remitted, by operation of law, to the Commission for further review. On January 13, 2003, the Commission approved the transaction. Although, as mentioned above, the Commission has appealed against the CFI's judgment, the appeal is without prejudice to the approval although the Commission has stated that such clearance could be affected by the outcome of the Commission's appeal and an eventual re-examination of the Commission's earlier decision by the Court of Justice or the CFI, in the event that the matter would be referred back to it by the Court of Justice.[16]

Other Noteworthy Aspects of the Judgments

The CFI's judgments in *Schneider/Legrand* and *Tetra/Sidel* raise several other interesting issues:

1. The CFI established in *Tetra/Sidel* that as a matter of law the Commission is entitled to assess the potential conglomerate effects of mergers notified under the ECMR. However, the CFI established a seemingly high evidentiary standard that the Commission must meet in order to block a transaction on the basis of its potential anticompetitive conglomerate effects. It remains to be seen whether the Court will endorse the CFI's approach in this area.

2. The CFI's determination that the Commission may not presume that a party to a merger or acquisition would engage in unlawful leveraging conduct appears to require a change in the Commission's approach. To date, when reviewing transactions under the ECMR, the Commission has not been receptive to arguments that a merged entity would be unable to exercise undue market power because of its obligations under the general rules of EC antitrust law.

3. The CFI might refer to, or rely on, those two holdings in deciding pending cases before it, such as General Electric's and Honeywell's respective appeals against the Commission's prohibition of their proposed merger. The CFI's holdings also might affect the results of appeals concerning future transactions in which one party has significant market power in a product market and is acquiring a business that has a position in one or more complementary markets.

4. The *Schneider/Legrand* and *Tetra/Sidel* cases have "road tested" the CFI's expedited procedure for appeals of Commission decisions under the ECMR. Parties, however, should not take for granted that the expedited procedure will be available in all merger cases before the CFI. Rather, the availability of the expedited procedure is subject to the discretion of the court. Indeed, in *Schneider/Legrand*, the CFI agreed to follow the expedited procedure only after Schneider had agreed to reduce and condense the arguments initially put forward

in its written pleadings. In addition, the President of the CFI, Judge Bo Vesterdorf, has stated publicly that the CFI will reject a majority of applications for treatment under the expedited procedure because the court does not have the resources to invoke the procedure in every case.[17]

5. The expedited procedure does not ensure that, in every case, the CFI will be able to review an adverse Commission decision sufficiently promptly to avoid delays that could materially harm, or end, transactions that have been blocked under the ECMR. For example, Schneider filed its merger notification in February 2001. The CFI did not hand down its judgment until 10 months after the filing of the appeal, 12 months after the Commission's prohibition decision and 20 months after Schneider originally announced the deal. The timing in *Tetra/Sidel* was similar.

6. The *Schneider/Legrand* judgment highlights the importance of the statement of objections in the ECMR procedure. In that judgment, the CFI made clear that the Commission may lawfully prohibit a transaction only on grounds that have been clearly articulated and substantiated in the statement of objections.

7. The timing of the judgments is fortuitous because they coincide with the Commission issuing a package of reforms in relation to the merger review process under the ECMR. The proposed reforms will be discussed in a subsequent issue of the *Record*.

Notes

[1] Article 58(1)(b) of the EC Treaty.

[2] OJ 1997 C220/15.

[3] The EC Commission, in its role as "guardian" of the EC Treaty, is entitled to take action against member states that fail to fulfill their obligations under the EC Treaty. The Commission's powers in this context are set out in Articles 226–228 of the Treaty. The procedure under Articles 226–228 comprises several stages. The EC Commission first gives written notice to the member state concerned of its alleged failure to fulfill its obligations. The member state then enters into a dialogue with the Commission with a view to resolving the issue. If, following completion of the dialogue, the Commission continues to believe that the member state is in breach of its obligations, the Commission issues a "reasoned opinion" setting forth in detail the reasons why the Commission believes the member state is in default. If, thereafter, the member state does not take action to remedy the breach (usually by amending its national law to the Commission's satisfaction), the Commission seeks a declaration from the Court that the member state has failed to fulfill its obligations under the EC Treaty.

[4] The first such annulment occurred in Joined Cases C-68/94 and C-30/95 *France and Others* v *Commission*, [1998] ECR I-375.

[5] Council Regulation (EEC) No. 4064/89.

[6] M.619-*Gencor/Lonrho.*

[7] M.1388-*Exxon/Mobil.*

[8] M.1673-*Veba/Viag.*

[9] Article 230 of the EC Treaty provides the legal basis for the CFI to quash, by annulment, decisions and other legally binding acts of the Commission and other EU institutions. Proceedings under Article 230 are analogous to judicial review proceedings. Article 230 sets out four grounds upon which decisions of the Commission or other acts of the EU institutions may be annulled: (i) lack of competence; (ii) misuse of powers; (iii) infringement of an essential procedural requirement; and (iv) infringement of the EC Treaty or of any rule relating to its application.

[10] The four pleas were: (i) incorrect definition of the relevant product market by the Commission; (ii) unlawful extension of the collective dominance theory to encompass tacit collusion with respect to capacity; (iii) manifest error of assessment by the Commission in concluding, on the evidence submitted, that the merger would have created a collective dominant position; and (iv) breach of the principle of proportionality by the Commission in rejecting the remedial undertakings offered by Airtours.

[11] Commission Press Release IP/02/1952. The Commission has stated that it believes the CFI to have erred in law by establishing such a high evidentiary standard that has to be met by the Commission when seeking to prohibit a merger on the basis of conglomerate effects. In addition, the Commission is challenging the CFI's conclusion that the Commission should have attached significance to certain behavioral undertakings initially offered by Tetra Laval with a view to eliminating the Commission's concerns regarding the conglomerate effects of the Tetra Laval/Sidel merger.

[12] The ECMR prohibits completion of a subject transaction until after receipt of clearance. For public tender offers, Article 7(1) of the ECMR allows acquirors to launch public bids and acquire

shares tendered in response to such bids before the Commission has approved the transaction. However, as a general rule, a bidder may not exercise any voting rights attached to the tendered shares until receipt of Commission clearance.

[13] Article 76a of the CFI Rules of Procedure.

[14] Article 10(5) of the ECMR.

[15] The Commission concluded that Tetra's acquisition of Sidel had three foreseeable anticompetitive conglomerate effects. First, the merged entity could use its dominant position in the traditional carton packaging market as a "lever" to enhance Sidel's leading (but not dominant) position in the market for SBM machines and, thereby, establish the merged entity as the dominant producer in that market. Second, the transaction would enhance Tetra's existing dominant position in the market for aseptic cartons and aseptic carton packaging equipment by eliminating potential competition from Sidel in the closely related PET packaging market. Third, the transaction would generally strengthen the merged entity's position in the market for materials and equipment used for the packaging of products that are sensitive to light or oxygen.

[16] Commission Press Release IP/03/36.

[17] See David Lawsky, *EU Court Dismisses as Unlikely Faster Handling of Merger Cases: Complaints Increase That Appeals of EC Vetoes Too Slow*, *National Post* (5 June 2002).

U.S. ANTITRUST LAW DEVELOPMENTS

By: Margaret E. Guerin-Calvert
Competition Policy Associates, Inc.,
Washington, D.C.

Overview

Fall 2002 is a convenient point for assessing recent major trends in U.S. enforcement activity, as October marks the start of a new fiscal year for the antitrust agencies in the U.S. In terms of numbers of mergers, the last two fiscal years had substantially fewer filings than in prior years. The *Twenty-Fourth Annual Report to Congress Regarding the Hart-Scott-Rodino (HSR) Premerger Notification Program* (the "Report"),[1] recently issued by the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), reported that merger filings were down from about 4900 in fiscal year (FY) 2000 to 2376 in FY 2001. This trend continued in FY 2002 with an additional reduction in filings to about 1100 transactions or about half of those in the prior year.[2] Sources of changes in the filing numbers are related to the overall economy and decrease in transactions, as well as changes in the filing requirements, including the threshold level of assets that triggers a filing requirement.[3]

Overall merger enforcement activity in the two periods was roughly comparable, with 32 challenges by the DOJ and 23 by the FTC in FY 2001. There were 21 challenges by the DOJ in 2001 and 2002 during the last 15 months of tenure of Assistant Attorney General James, of which all but one were successful. During the same period, the FTC challenged 24 transactions.[4] While the overall level of merger activity and filings has declined, Fall 2002 provided an unusual wealth of interesting enforcement actions and substantive exposition on merger policy and methodology in the U.S., particularly by the federal antitrust agencies.[5] This article reviews a seminal proceeding celebrating the Merger Guidelines in the U.S., which provided a thorough review of the economic underpinnings and application of these guidelines in a host of circumstances. The article then briefly addresses three major enforcement actions: the first major coordinated effects matter, an unusual case of *per se* illegality claimed in an asset acquisition, and a massive merger involving direct broadcast satellite services. The article concludes with a brief listing of what to watch for in coming months.

Anniversary and Hearings

The second half of 2002 involved considerable attention to both the process and the substance of merger review and enforcement activity. During this period, the FTC held best practices hearings to solicit input on the merger review process from a variety of sources, which culminated in a series of recommendations for streamlining the review process.[6]

The 20th anniversary of the Merger Guidelines was celebrated in mid-2002 with a host of papers by renowned scholars and senior agency officials assessing the effect of the 1982 (and 1992) Guidelines on merger review. These papers and presentations highlighted several themes among the Guidelines that interestingly presaged enforcement activity in the fall. This anniversary celebrated two sets of guidelines – the 1982 Guidelines and their successor Guidelines in 1992. The latter extended the former, particularly in the development of the competitive effects analysis to include detailed exposition of both unilateral and coordinated effects theories. The major developments that were heralded include the hypothetical monopolist paradigm, the application of Critical Loss analysis to market definition and competitive effects, the extensive development of demand estimation and merger simulation in analysis of mergers, particularly those involving unilateral effects theories, and the extension of efficiencies analysis in merger review.[7] Presentations at the 20th anniversary and some subsequently made noted that coordinated effects analysis had perhaps been less well developed during the period, with fewer cases involving extensive empirical analysis of coordinated effects. The Antitrust Division of the DOJ announced that it was undertaking a thorough review of the coordinated effects literature and theories.[8] The anniversary proceedings demonstrated that the analytical framework set out in the Merger Guidelines continues to provide the basis for merger enforcement activity.

Major Enforcement Actions

Cruise Line Mergers

On October 4, 2002, the FTC announced that it was closing its ten month long investigation into the competitive effects of mergers in the cruise industry. The FTC issued a lengthy and detailed statement (along with statements from two dissenting Commissioners) addressing the rationale for its decision.[9] Following on the anniversary of the Guidelines, it is of interest to note the concluding statement of the FTC in its decision on these mergers:

> As applied for the last 20 years, the applicable guidelines require an analysis of the likelihood that a merger would result in the exercise of coordinated or unilateral market power. The dissent suggests a number of different theories of these potential anticompetitive effects. As indicated above, the staff has investigated each of these theories in exhaustive detail and unanimously concluded that any adverse effects were unlikely. (FTC Cruise Statement at 7)

The FTC Cruise Statement is of particular interest to those interested in the detailed application of the Merger Guidelines in a specific factual context. The FTC was investigating the rival merger proposals by Royal Caribbean and Carnival for Princess. The FTC Cruise Statement and an October 2002 speech by Joseph Simons, Director of the Bureau of Competition,[10] provide substantial detail on the rationale for the decision. These documents indicate that the Commission considered coordinated effects theories as relevant to merger analysis, although unilateral effects were reviewed and rejected as being of concern.

The FTC Cruise Statement and the Simons Speech provide substantial insights on the application of coordinated effects theories to merger analysis. They address at length the analysis of relevant market definition, including the application of Critical Loss analysis and price discrimination in market definition. In particular, it was noted in the Simons Speech that:

> Cruising's high demand elasticity presented perhaps the most challenging question for market definition. The analyses conducted by staff as well as by the parties found

> that industry elasticities were very high relative to the Critical Loss. The industry's "Critical Loss" – the number of customers which would have to be lost to make a price increase unprofitable – is extremely low. Because of the high industry elasticity relative to the Critical Loss, an across-the-board price increase would clearly not be profitable.[11]

While this analysis would suggest that the market would be broader, the FTC concluded that cruising "should be considered a viable market" for purposes of the analysis, based on a number of factors. The FTC went on, however, to conclude that the empirical evidence was not consistent with either unilateral or coordinated effects concerns in this market. The FTC indicated that the complexity of the market definition was a factor in its competitive effects analysis (FTC Cruise Statement at 2-3). The conclusion was reached that "[i]n this case, the evidence concerning the nature of the market and of competition in the cruise market developed during the ten-month investigation overcame the presumption of anticompetitive effects." (Simons Speech at 5)

As indicated above, the competitive effects analysis addressed both unilateral and coordinated effects. While, as in most cases, the analysis was industry-specific, the detailed Commission statements provide substantial insights into the standards and empirical evidence that may be considered in other cases. The unilateral effects analysis provides a detailed analysis of price discrimination, brand loyalty, and reduction of capacity in the cruise industry context. In the case of coordinated effects, the Commission addressed factors related to the likelihood of pricing coordination, including transparency of price information, feasibility of price discrimination, maverick theories, and the feasibility and ability to coordinate given the multiplicity of prices. In these mergers, the Commission also focused on assessing the likelihood of capacity coordination among cruise lines, and evaluated the magnitude of capacity restriction, the likelihood that such coordination could be undertaken, and the incentives of firms in the industry to maintain such a hypothetical capacity coordination. The Commission also addressed the role of empirical analysis by the Commission staff in the assessment of the various theories and market definition. The FTC Cruise Statement indicated that: "In this case, the evidence does not support any theory of anticompetitive effects arising from either of the subject transactions" (FTC Cruise Statement at 3), having earlier highlighted the fact that concentration was sufficient to trigger investigation but that additional evidence of anticompetitive effect was required.

The MathWorks – Wind River

One of the most unusual enforcement matters at the DOJ ended with the announcement of a proposed settlement between The MathWorks and the DOJ in August 2002.[12] The matter began with a February 2001 agreement between The Math Works, Inc. and Wind River Systems, Inc. in which MathWorks obtained certain rights with respect to the marketing, sale, and distribution of Wind River's MATRIXx software and an option to purchase Wind River's assets in 2003.[13] The agreement provided that The MathWorks would obtain the right to price and sell MATRIXx for a period of two years and that customer support and development would be shifted to MathWorks and would cease at Wind River. On June 21, 2002, after its initial investigation, the DOJ filed a complaint alleging that the agreement constituted a *per se* attempt between the two parties to allocate markets and fix prices in three markets for dynamic control system software, design, or testing. The complaint alleged that the arrangement constituted an agreement and payment to eliminate MathWork's closest competitor and to eliminate price and discount competition between the two parties.[14] On the same day, the DOJ reached a settlement with

one of the parties – Wind River – and filed a consent decree requiring that Wind River divest all MATRIXx assets to a "buyer acceptable to the United States and the appointment of a trustee to effect the divestiture."[15] The consent decree essentially requires that Wind River either divest the assets itself or, if alternatively a decree were entered between the DOJ and The MathWorks, that Wind River would not impede efforts to divest the MATRIXx assets to a third party. The subsequent settlement reached with The MathWorks required essentially the same terms – e.g., the divestiture of these assets, but provided that the complaint would be dismissed if a suitable purchaser could not be found. It is difficult to ascertain the applicability of this matter to other mergers, failing firm claims, or to licensing agreements. It does suggest, however, that agreements that could be perceived as designed to cause or hasten the exit of a competitor in highly concentrated markets will be given very close scrutiny.

EchoStar-Hughes Electronics

On October 31, 2002, the DOJ filed suit to block the proposed merger of two direct broadcast satellite service providers, Hughes Electronics Corporation and EchoStar Communications Corporation. EchoStar, which owns DISH Network, proposed to acquire Hughes' DirecTV in a transaction valued at about $26 billion, one of the largest to be reviewed by the federal government. The lawsuit was joined by 23 states, the District of Columbia, and Puerto Rico and followed on the October 10, 2002 announcement by the Federal Communications Commission ("FCC") that it had substantive objections to the merger and would commence administrative hearings.[16] The merger was alleged to have a competitive effect in both direct broadcast satellite services and a market for "multichannel video programming." The complaint alleges that the two companies are the major suppliers of direct broadcast satellite services, and that the combined company would be a monopolist in areas in which there is no cable competition and a duopolist in areas in which cable is present (http:www.usdoj.gov/atr/public/press releases/2002/200412.htm). Interestingly, the press release notes that the Antitrust Division found that the parties had demonstrated that certain efficiencies were likely to result from the transactions, but that these were not sufficient to outweigh the alleged anticompetitive effects. In addition, the DOJ apparently considered but then rejected as insufficient a proposed remedy involving restructuring of the transaction, by stating that "even if the proposed concept could be realized, it is unlikely to become a sufficient replacement for the vigorous competition that now exists between Hughes and EchoStar within a reasonable period of time."

What to Watch For

On October 3, 2002, AAG James announced his resignation as head of the Antitrust Division with Hewitt Pate, Deputy Assistant Attorney General, assuming the role of Acting AAG. In addition, Michael Katz, the Deputy Assistant Attorney General for Economics left in January 2003 and has been replaced by David Sibley of the Economics Department of the University of Texas at Austin.[17] The Microsoft decision in the *Tunney Act* proceeding was issued late in the day on November 1, 2002 and essentially approved the settlement that had been reached between the DOJ, nine states and Microsoft. The decision concludes that the proposed settlement was "in the public interest" since it had addressed adequately the competitive issues upheld in the appeals process. A detailed statement of the settlement terms is provided in the final judgment and the related documents concerning settlement at the DOJ website. There have been a number of filings appealing this decision since its November issuance, as well as responses by the DOJ and related parties.[18] Finally, in its health care hearings in September 2002, the FTC

announced that it was undertaking a review of consummated hospital mergers in the U.S. More detailed statements as to the nature and scope of this review and the intended use of the review are likely forthcoming, and are worth watching to ascertain the enforcement actions arising from this review. These and related issues are to be addressed in the extensive FTC hearings on healthcare commencing on February 26-28, 2003 and continuing through the summer.[19]

Notes

[1] http://www.ftc.gov/opa/2002/09/fyi0252.htm; issued 27 September 2002.

[2] D.P. Majoras, "Merger Enforcement at the Antitrust Division" (27 September 2002, http://www.usdoj.gov/atr/public/ speeches/ 200285.htm) at 2.

[3] The Report provides a succinct summary of the changes in the filing requirements at 8-11.

[4] Details of enforcement activity in FY 2001 at both the FTC and the DOJ are provided in the Report. The Report also provides a useful summary of major developments in the merger review process in recent years. The Majoras speech, *supra* note 2, provides detail on the major matters in 2002 for the Antitrust Division of the DOJ. An October 2002 speech by J. Simons, Director, Bureau of Competition, provides comparable information for the FTC, "Merger Enforcement at the FTC" (Keynote Address to the Tenth Annual Golden State Antitrust and Unfair Competition Law Institute, 24 October 2002, http://www.ftc.gov/speeches/other/ 021024mergerenforcement.htm). Additional detail on FTC activities are provided in testimony by Commission Chair Timothy Muris before the Judiciary Committee in September 2002, "An Overview of Federal Trade Commission Antitrust Activities" (http:/ /www.ftc.gov/os/2002/09/020919overviewtestimony.htm).

[5] There were a number of transactions that were approved subject to significant asset divestitures, particularly in the banking and oil industries. These included Shell's acquisition of Penzoil-Quaker State, Phillips/Connoco, and Valero/Ultramar and several bank mergers that involved divestitures of branches. These decisions are detailed at the FTC and DOJ websites. Divestiture policy has been the topic of substantial review at the agencies and is a part of the intensive "Best Practices Analysis" that is underway at the FTC in a series of hearings. The FTC was also particularly active in the pharmaceutical industry in its review and enforcement actions involving generic drugs. While many of the issues are specific to U.S. regulatory structure, the enforcement actions and analytical basis for them are relevant to antitrust and licensing issues in other industries. A summary and cites for the key matters are found at http://www.ftc.gov/os/2002/09/020919overview testimony.htm and in an October 9, 2002 speech by Chairman Muris found at http://www.ftc.gov/opa/2002/10/ generictestimony.htm

[6] See http://ww.ftc.gov/opa/2002/bcfaq.htm and http:// www.ftc.gov/opa/2002/10/merger best practices.htm for a summary of proposed best practices on cooperation in merger investigations.

[7] G. Werden, "The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm" (4 June 2002, www.usdoj.gov/atr/merger/11256.htm); W. Kolasky & A. Dick, "The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers" (www.usdoj.gov); and D. Scheffman, M. Coate & L. Silvia, "20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective" (June 2002, http://www.usdoj.gov/atr/hmerger /11255.htm) are three papers presented at the anniversary proceedings that provide a detailed assessment of these themes. The last includes a review of the application of critical loss, coordinated and unilateral effects, and empirical analyses in cases in the last several years. The efficiencies paper provides a thorough review of both relevant economic and legal standards and the application of efficiencies analysis.

[8] C. James, "Rediscovering Coordinated Effects" (Presented at American Bar Association Annual Meeting, 13 August 2002, www.usdoj.gov/atr/public/speeches/200124.htm) and W. Kolasky, "Coordinated Effects in Merger Review" (www.usdoj.gov/atr/ public/speeches/11050.htm) set out the Division's approach to the review of coordinated effects. In particular, the speech by AAG James provides an assessment of the cases in which the theories have been applied by the Division in recent years.

[9] http://www.ftc.gov/os/2002/10/cruisestatement.htm is the statement of the FTC on the merger decision ("FTC Cruise Statement"); it is an eight page decision detailing the analytics of market definition, competitive effects, and efficiencies analysis. The cruise mergers had also been investigated in the UK and the EU with no challenge issued in these jurisdictions to either merger.

[10] *Supra* note 4 ("Simons Speech").

[11] Simons Speech at 4. Additional papers on coordinated effects in the cruise industry and other industries by FTC economists David Scheffman and Mary Coleman can be found at http://www.ftc.gov/ be/hilites/ftcbeababrownbag.pdf and http://www.ftc.gov/be/ seminardocs/gmucoleman.pdf.

[12] Relevant cites include: http:www.usdoj.gov/atr/cases/f11300/ 11369.htm (complaint); http:www.usdoj.gov/atr/cases/ f11300/ 11374.htm (settlement with Wind River) and http:www.usdoj.gov/ atr/public/press releases/2002/200164.htm (press release concerning settlement with The MathWorks).

[13] The software produced by these two companies is used by customers in the aerospace and automotive industries to design and test control systems Wind River's products were sold under the brand "MATRXx" and were alleged to compete directly with those of The MathWorks which were labeled "Simulink."

[14] The DOJ complaint (*supra* note 12 at 5) alleges that there had been head-to-head competition between the two parties in the form of substantial discounts, customer support and improved products and features (para. 21).

[15] Settlement with Wind River, *supra* note 12 at 3.

[16] http://fcc.gov/edocs_public/attachmatch/DOC-227263A1.pdf is the text of the press release; the cite includes the statements of the FCC commissioners as well.

[17] http://www.usdoj.gov/atr/public/press_releases/2003/200668.htm.

[18] The specifics of the final judgment can be found at the DOJ website at http://www.usdoj.gov/atr/cases/f200400/200457.htm. A listing of related procedural filings related to appeals of the decision can be found at http://www.usdoj.gov/atr/cases/ms_index.htm.

[19] A list of the hearing topics and schedule is available at the FTC website at http://www.ftc.gov/ogc/healthcarehearings/index.htm and at the DOJ website at http://www.usdoj.gov/atr/public/press_releases/2003/200688.htm.