International Developments

AUSTRALIAN NEWSLETTER

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Australian Competition Law and Administration – The Times They are a Changing

In the last Newsletter we reported on competition and consumer policy plans by the new Australian Labor Government. Much has happened and much is underway. However, some of the plans have not gone the way the Government hoped.

Trade Practices Act - Predatory Pricing

Until late 2007, predatory pricing behaviour was examined under the general prohibition in section 46 (misuse of market power) of the *Trade Practices Act* 1974 (TPA) which prohibits corporations with a "substantial degree of power in a market" from taking advantage of that power for a proscribed purpose.

Section 46 requires proof of:

- a substantial degree of market power;
- that the conduct is taking advantage of that power; and
- a proscribed purpose.

Late in 2007 (just prior to the Federal Election), the then Conservative Government passed a law introducing a new specific predatory pricing provision as part of the misuse of market power provisions. The language of the new prohibition was quite different, with the key elements being:

- substantial share of a market;
- a price less than the relevant cost;
- conduct for a sustained period; and
- a proscribed purpose.

Taking Advantage Requirement Eliminated

The new section 46(1AA) prohibition does not require a connection between the corporation's substantial market share and the relevant pricing conduct. For example, unlike the existing prohibition on the misuse of market power, there is no requirement that a corporation has "taken

advantage" of its position. It will be sufficient that it has a substantial market share and that it engaged in the relevant conduct with one of the proscribed purposes.

The New Government

The new Government was initially going to wait and see how this predatory pricing law worked but, at the urging of the Australian Competition and Consumer Commission (ACCC) and others, proposed amendments to the predatory pricing provision to bring it into line with section 46 generally (*Trade Practices Legislation Amendment Bill 2008*).

It proposed that:

- substantial market share be replaced by substantial degree of market power;
- taking advantage be part of the prohibition; and
- the recoupment be specifically excluded as a determining factor.

The amending legislation was considered by a Senate Committee which recommended (including the Government members) that the above changes be reconsidered, in particular those replacing the market share test and bringing back taking advantage. The Government did not accept that recommendation. In the Senate, the combined Opposition rejected the Government's amendments to section 46(1AA) and the Bill was ultimately passed without those amendments. As a result, the late 2007 amendments effectively remain.

Other TPA amendments in the 2008 Amendments Bill which were not opposed were:

- clarification of the term "taking advantage";
- the monetary threshold in relation to the unconscionable conduct provisions be totally abolished;
- one of the two Deputy Chairs of the ACCC must be someone with a small business background or experience; and
- extra powers for the ACCC in its enforcement roles.

Trade Practices Act – Component Pricing

The *Trade Practices Amendment (Clarity in Pricing) Act 2008* amends the TPA to require that where a business makes a price representation to a consumer, and that amount is less than what the consumer will actually have to pay to acquire the goods or services, the business must also prominently state a total price as a single figure.

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While the Act received assent in November 2008, the key portion of the Act (Schedule 1) is yet to be proclaimed. In the absence of a proclamation in the government gazette specifying the date of commencement, Schedule 1 of the Act will commence on May 25, 2009.

Grocery Prices Inquiry

During the election campaign, the then Opposition proposed an ACCC enquiry into grocery pricing. After the election, the Government directed the ACCC to undertake an enquiry under the prices surveillance provisions of the TPA to enquire into grocery prices and related issues. The ACCC Report was made public on August 5, 2008: "*ACCC Inquiry into the competitiveness of retail prices for standard groceries*".

According to the ACCC Report, the biggest impediments to improved competition include:

- the high barriers to entry for large supermarkets;
- a lack of incentives for the major supermarkets to compete strongly on price; and
- the limited price competition from independent retailers.

The Government's preliminary action plan in response to the ACCC's recommendations covered four specific areas: zoning and planning laws, unit pricing, the Horticulture Code of Conduct and creeping acquisitions. The Government committed to move in the following areas as a matter of urgency:

- refer the anti-competitive impacts of state and local zoning and planning laws to the Council of Australian Governments (COAG);

- consider the best way to introduce a mandatory nationally-consistent unit pricing regime. The *Unit Pricing (Easy comparison of grocery prices) Bill 2008* setting out the Government's preferred model has been introduced into parliament and is currently before the Senate;

- the Minister for Agriculture will work together with the horticultural industry through the Horticulture Code Committee to carefully consider the ACCC's 13 recommendations to enhance the operation of the Horticulture Code of Conduct (which regulates trade in horticulture produce between growers and traders and provides dispute resolution procedures); and

- the Government will implement a creeping acquisition law. In September 2008, the Treasury released a discussion paper inviting submissions from the public on possible models for this law. The Government is still considering these submissions and is yet to release a Bill or publicly announce its preferred approach.

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As part of the Government's response to the ACCC Report, it has initiated a website giving consumers information about grocery prices. That website is managed by the ACCC and is called *Grocery Choice*.

Petrol

Again as part of the election campaign, the Opposition proposed the appointment of a Petrol Commissioner to the ACCC to specifically concentrate on petrol issues. After the election the Government appointed a Petrol Commissioner, Mr Pat Walker, a former Commissioner of Consumer Affairs in Western Australia. Unfortunately, Mr Walker resigned for family reasons within two months of appointment. The Government has now appointed Mr Joe Dimasi to the position. Mr Dimasi was previously the Executive General Manager of the Regulatory Affairs Division of the ACCC.

As part of the ACCC's petrol role, the Government sought to implement a Fuel Watch system to provide information to consumers about petrol prices and freeze prices for 24 hours from when posted on the Fuel Watch data base. The Government faced severe opposition to this initiative and the necessary legislation to set up the Fuel Watch system was defeated in parliament.

Consumer Policy

COAG is developing an enhanced national consumer policy framework. This followed on from a report by the Productivity Commission on a "*Review of the Australian Consumer Policy Framework*".

Key features of the new national consumer law are:

- it will be based on the current consumer protection provisions of the TPA and also incorporate appropriate amendments reflecting best practices in state and territory legislation;
- the new law should be developed by the agreement of all Australian governments and made law through an application legislation scheme with the Commonwealth as the lead legislator;
- the new generic consumer provisions should apply to all sectors of the economy, with the exception of the financial services sector that will need to retain a distinct legislative framework, however, to the extent that it is practicable, the Australian Government is committed to maintaining consistency between the two laws;
- it will include a provision that addresses unfair contract terms, based on the model outlined by the Productivity Commission. The Minister for Competition Policy and

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Consumer Affairs has recently released an Information and Consultation Paper outlining the proposed new laws which it hopes will be enacted by January 2010:

- amendments to the national consumer law must be agreed by governments according to an Inter-Governmental Agreement which will provide, among other things, for the amendments to be agreed by the Commonwealth plus four other state and territory governments, of which three must be states; and
- joint enforcement of the national consumer law between the ACCC and the State and Territory offices of fair trading, with the Australian Securities and Investments Commission retaining responsibility for administering the consumer law that applies to financial services.

Creeping Acquisitions

The Government has stated its intention to address concerns about "creeping acquisitions". In doing so, the Government has sought public submissions on two possible options: "Creeping Acquisitions – A Discussion Paper".

One approach, referred to as the "aggregation model", would involve a corporation being prohibited from making an acquisition if, when combined with acquisitions made by the corporation within a specified period, the acquisition would be likely to substantially lessen competition in a market.

The aggregation model has been raised during past considerations of this issue. It seeks to prohibit the latest acquisition in a series of creeping acquisitions. Another key feature of the aggregation model is that it would retain the substantial lessening of competition test and is, to that extent, consistent with section 50 of the TPA which prohibits any single merger or acquisition that results in a substantial lessening of competition. The test would be applied to a combination of acquisitions made by the corporation within a specified period.

An alternative model is to add a new prohibition to section 50. A corporation would be prohibited from making an acquisition if it already has a substantial degree of power in a market, and the acquisition would result in any lessening (as opposed to a substantial lessening) of competition in that market. The substantial market power model would supplement the substantial lessening of competition test under section 50. Broadly, the phrase "substantial market power" would mean a significant, but not absolute, freedom from competitive constraint, the extent of which would be considered in light of the factors set out in subsection 50(3), and the ability to raise prices above competitive levels. It is not yet clear which model the Government will adopt.

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Criminal Sanctions in Relation to Cartels

The Australian Government has introduced the *Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008* to create a new regime imposing criminal sanctions for serious cartel conduct. The Bill, if passed, will bring Australian law in this area into line with a number of other jurisdictions which have criminal sanctions for similar conduct.

The proposed legislation is, in a number of respects, quite different from the exposure draft released by the government earlier this year.

The key elements of the Bill are as follows:

- cartel participants may face jail sentences of up to 10 years;
- criminal liability will not be dependent on proof that the person has acted "dishonestly" Rather, the prosecution will only need to show that the person has acted with the knowledge or belief that the contract, arrangement or understanding involves cartel conduct;
- the Bill does not focus only on criminal sanctions. It also creates new civil offences that mirror the criminal offences. The key distinctions are that criminal liability:
    - must be proven beyond a reasonable doubt, and

      can only arise if the party is shown to have the requisite knowledge or belief noted above; and
- the ACCC will have the power to ask the Federal Police to intercept telephone communications (after obtaining a warrant to do so).

The proposed offences prohibit the making of, or giving effect to, a contract, arrangement or understanding (CAU) with a competitor (or potential competitor) to fix prices, restrict output, allocate customers, suppliers or territories or rig bids. However, it offers protection against liability in instances where:

- a collective bargaining notice, or authorisation, is in force, or the conduct is conditional on ACCC authorisation;
- the CAU is between related parties; or
- the CAU is between joint venture parties and was entered into for the purposes of the joint venture.

In the case of price fixing (in contrast to other types of cartel conduct), liability may arise if a CAU has the effect, or is likely to have the effect, of fixing prices regardless of whether it was the party's intention to do so. Specifying a recommended retail price, however (where the retailer concerned is free to decide whether or not to charge that price), will continue to be legitimate conduct.

While the Bill has been passed by the House of Representatives, it is yet to be passed by the Senate. In December 2008, the Senate referred the Bill to the Senate Standing Committee on Economics for a report on the proposed amendments. The Committee is due to report back to the Senate shortly.

Following the Federal Government's proposed criminalisation of cartel conduct, the ACCC and the Commonwealth Director of Public Prosecutions (CDPP) have issued a proposed memorandum of understanding, outlining the roles that each agency will play in the investigation of criminal cartel conduct through to prosecution.

The ACCC has also issued a revised Immunity Policy and Guidelines which will apply to applications for immunity under the proposed civil and criminal provisions.

The criminalisation of cartel conduct had raised the question of whether the CDPP would offer the same level of immunity from prosecution to a cartel member who had taken advantage of the ACCC's immunity policy by reporting its involvement in a cartel and cooperating with the ACCC's investigation and prosecution of other cartel members. The CDPP has confirmed that the two agencies will take a consistent approach to immunity. The CDPP issued an Annexure to the Prosecution Policy of the Commonwealth which states that it will apply the same criteria as the ACCC in considering recommendations by the ACCC that an applicant receive immunity from prosecution.

The ACCC

The new Labor Rudd Government has had a great opportunity to shape the ACCC. Not since 1974 and 1995 has that opportunity presented itself. The earlier date was when the then Trade Practices Commission was formed and 1995 was when the ACCC was formed.

The current opportunity is due to the fact of recent and future expirations of appointment. That is not to say that there are a set number of vacancies. The TPA does not require a set number of ACCC members – there are no upper or lower limits on ACCC membership but there is a probable low number of three, for quorum reasons.

The following are recent or future expirations of terms of appointment:

- Jennifer McNeil – July 2007 (lawyer)
- David Smith – June 2009 (former ACCC senior staff member)

- Ed Willett – January 2008 (economist and former public servant)
- Graeme Samuel – August 2008 (lawyer and business man)
- Louise Sylvan – August 2008 (consumer activist)
- John Martin – June 2009 (economist and former trade association executive)
- Stephen King – June 2009 (economist)

As noted above, the Government has appointed a Petrol Commissioner, following on from an election promise. However, ACCC members cannot be appointed for a limited purpose and hence Mr Dimasi was appointed as a Commissioner as such but was given special duties in relation to petrol.

The Commissioners are the decision makers in the ACCC and set the strategies within the framework of the TPA. Consequently, it is important to make appropriate appointments. Often appointments have been made in isolation without looking at the bigger picture of ACCC membership. Unlike many agencies, the ACCC makes its own final decisions and does not simply advise Governments. Hence it is all the more important to make the proper appointments. The TPA is economic law with a broader public interest overlay through the authorisation/notification process. Its decisions should not be seen as the province of lawyers or the province of economists. It is important to have an appropriate mix.

Issues that must be kept in mind when making appointments are:

- the legal requirement that one Commissioner have knowledge or experience in consumer protection;
- the legal requirement that one of the Deputies has been designated as being someone with a small business background;
- Deputies may act as the Chair, when the Chair is absent;
- Deputies have some specific statutory powers;
- all appointments of Commissioners must be supported by a majority of the participating jurisdictions;
- conflict issues; and
- the Commission has traditionally acted on a consensus basis.

The Government has taken the opportunity offered to it and has appointed a full line-up of Chairman, two Deputies and other members.

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The Chair

Graeme Samuel AO has been reappointed for a period of three years. Mr Samuel has been the Chairperson of the ACCC since August 2003. Prior to that, he was the President of the National Competition Council since 1997.

The Deputies

Peter Kell – Mr Kell was the Chief Executive Officer of Choice (the Australian Consumers' Association). Prior to that, Mr Kell had been an Executive Director of the Australian Securities and Investments Commission (ASIC), and Consumer Protection and New South Wales Regional ASIC Commissioner since 1998. Mr Kell holds a Bachelor of Arts with honours in Economics at the University of Sydney, and a Company Directors Diploma from the Australian Institute of Company Directors.

Michael Schaper – Professor Schaper was the Dean of the Murdoch University Business School in Western Australia. Amongst other things, he was the Small Business Commissioner of the Australian Capital Territory and holds a Ph.D. in Management, a Masters of Commerce, a Graduate Diploma of Business, and a Bachelor of Arts.

The Commissioners

Mr John Martin – has until recently been the small business member of the ACCC. Term expires mid 2009.

Ms Sarah Court – recently appointed for five years and is a former government lawyer.

Mr Ed Willett – recently reappointed for a further five year period.

Mr Joe Dimasi – appointed in 2008 and given special duties in relation to petrol.

Notes:

[1] This article was prepared with the assistance of Gillian McKenzie, solicitor, Freehills.

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EC COMPETITION LAW DEVELOPMENTS

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Settlement Procedure for Cartel Investigations

On June 30, 2008, the European Commission introduced a new procedure that will enable companies under investigation for cartel behaviour to reach settlements with the Commission and thereby terminate their involvement in the investigation.[1]

The aim of the settlement procedure is to give companies under investigation for cartel behaviour the ability and incentive (through a 10% reduction in fine) to reach a settlement with the Commission and thereby end their involvement in the Commission's investigation. Companies wishing to settle will need to submit a "settlement submission" that includes an acknowledgment "in clear and unequivocal terms" of their liability for infringing Article 81, an indication of the maximum amount of the fine they anticipate being liable to pay the Commission and their agreement to a shorter investigatory procedure that does not involve being given access to the Commission's file. To reduce the risk of the settlement submission becoming discoverable in damages litigation against settling companies, it will be possible for the settlement submission (like a leniency application) to be given orally to the Commission staff who will record and make a transcript of the submission.

The settlement procedure is distinct from the possibility for participants in a cartel to seek leniency by providing information to the Commission to help it establish the existence of the cartel.[2] The settlement procedure and the leniency procedure can therefore apply in parallel.

The introduction of a settlement procedure is a significant innovation in the enforcement of EC competition law because the procedure will give companies under investigation a means to short-cut their involvement in the investigation. This could be a significant benefit for companies, as well as for the Commission. The Commission's cartel investigations can last several years, take up substantial resources and expose the companies under investigation to high legal costs. It remains to be seen whether the procedure will result in a significant number of settlements and, as the Commission hopes, will free up the Commission's resources from lengthy investigations. Certain aspects of the settlement procedure are likely to make it less attractive to companies. For example, the relatively modest 10% reduction in fine for agreeing to settle may be insufficient recompense for companies making the admissions as to liability and likely range of fines that are required in settlement submissions. Finally, although the introduction of a settlement procedure brings the EC procedural framework closer to the antitrust enforcement practice in the United States, there are a number of important differences between the new procedure and the plea agreement procedure that is now a well-established part of U.S. antitrust enforcement. It therefore would be inaccurate to consider the amendments as introducing a U.S.-style plea bargaining procedure into EC law.

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The New Remedies Notice

On October 22, 2008, the Commission published a new version of the Notice on remedies acceptable under the Council Regulation (EC) No. 139/2004 and under Commission Regulation (EC) No. 802/2004[3] (the "New Remedies Notice").

The New Remedies Notice replaces the notice on remedies adopted by the Commission in 2000, and reflects the results of an extensive study by the Commission of remedies accepted in past merger reviews. The study highlighted areas of the Commission's remedies practice that required further guidance or amendment. Since the previous remedies notice was published, the EC Merger Regulation has been revised. The New Remedies Notice reflects changes to the Merger Regulation and also takes into account the recent case law of the Community Courts.

The New Remedies Notice requires merging parties wishing to offer remedies to provide detailed information to enable the Commission to assess the proposed remedy. The New Remedies Notice introduces a new form, Form RM,[4] which has to be used to provide the information. The New Remedies Notice provides that, to be acceptable, a proposed remedy must resolve all competition concerns, and be capable of prompt implementation. Among other factors in its assessment, the Commission will assess whether the remedies offered are proportionate to the competition issues identified.

Detailed guidance on the scope of divestments and potential alternatives is provided in the New Remedies Notice. The Commission notes that parties may in exceptional circumstances offer so-called quasi-structural remedies, such as re-branding and licensing of IP rights instead of divestments. Further, the Commission provides an explanation of behavioural undertakings that it may accept, such as access remedies and changes to long-term exclusive contracts, provided that these are as effective as divestments.

The New Remedies Notice notes in relation to divestment remedies, that a period of six months is standard for finding a purchaser, with a further six months to complete implementation of the remedy.[5]

Commission Guidance on Application of Article 82 to Exclusionary Abuses

On December 3, 2008, the Commission published a guidance paper on the application of Article 82 to exclusionary abuses (the "Guidance Paper").[6] The Commission began its review of the enforcement of Article 82 in 2003, and published a discussion paper in December 2005,[7] culminating in the Guidance Paper. The Guidance Paper reflects an economic approach to the enforcement of Article 82 and emphasises the need to examine the actual likely foreclosure effects of particular conduct. The Guidance Paper applies only to so-called "exclusionary" abuses and does not cover "exploitative" abuses.

The Commission does not define "exclusionary abuses" in the Guidance Paper, but notes that its enforcement policy is intended to protect consumers and the process of competition, rather than individual competitors. The Commission sets out its methodology for establishing the existence of a dominant position and for analysing the effect of exclusionary abuses. Finally, it discusses the most common types of exclusionary abuses.

To determine whether a company is dominant, the Commission will assess the competitive structure of the market, in particular the allegedly dominant company's market position and that of its competitors, constraints imposed by actual or potential competitors, and countervailing buyer power.[8] The Guidance Paper does not provide a safe harbour threshold below which dominance will not be found. Indeed, the Commission notes that although it is unlikely that a company with a market share of less than 40% will be considered to be dominant, it cannot be excluded.[9]

The Commission aims to ensure that exclusionary conduct does not foreclose the dominant company's competitors, thus adversely affecting competition and consumer welfare. To assess whether there is evidence that the allegedly abusive conduct will lead to anti-competitive foreclosure, the Commission will consider the dominant undertaking's position and that of its competitors and customers or suppliers, the market conditions, the extent of the allegedly abusive conduct and any evidence of foreclosure actually occurring. The Commission also looks for evidence, such as internal documents, that the company under investigation has been pursuing an exclusionary strategy.[10]

The Commission notes that it will normally intervene only if an equally efficient competitor would be unable to compete with the dominant undertaking.[11] Whether a competitor is equally efficient is determined by examining whether its costs are the same as those of the dominant company.

The Commission states that, if the dominant company can show an objective justification for its behaviour, or that the behaviour will result in substantial efficiencies that will outweigh the negative effects on consumers, the conduct may not be prohibited. To avoid prohibition, four conditions must be satisfied:

1. the efficiencies must be realised or be likely to be realised as a result of the conduct;

2. the conduct must be indispensable for realising the efficiencies;

3. the efficiencies must benefit consumers; and

4. competition in respect of a substantial part of the product concerned must not be eliminated.

The Commission examines how this framework applies to four common types of exclusionary conduct: exclusive dealing, tying and bundling, predation and refusal to supply and margin squeeze. The Guidance Paper provides helpful clarification of the Commission's policy regarding the application of Article 82 to exclusionary abuses. This is most welcome given the dearth of Notices and other types of guidelines regarding Article 82.

The Financial Crisis and State Aid

The global financial crisis has resulted in many financial institutions and other undertakings around the world requesting financial assistance from their governments. In the EU, this can be problematic because Article 87 of the EC Treaty prohibits the granting of state aid by a member state or through state resources where such aid distorts or threatens to distort competition and affects trade between member states. The definition of "aid" includes capital injections to rescue a firm in financial difficulties.

The Commission has recognised, however, that such bail outs are currently necessary to rescue the global financial system and has therefore put in place measures to enable aid to be granted expeditiously, while ensuring that such measures do not unduly distort competition. The guidance is based on the exemptions in the EC Treaty which allow for aid to be given to rescue and restructure firms in difficulty and to remedy a serious disturbance in the economy of a member state. However, the European Competition Commissioner, Neelie Kroes, has made it clear that distortion of competition will continue to be a factor in assessing whether to permit state aid.

Communication on the application of the state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis

In October 2008, the Commission published a Communication on the application of the state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis (the "Communication"). The communication provides guidance on assessing compatibility with the state aid rules where liabilities of financial institutions are being guaranteed, where liquidity assistance is being provided, or where financial institutions are being recapitalised or wound up.

Such measures can receive expedited approval provided certain conditions are met. The conditions are designed to ensure that the measures are targeted and proportionate and do not have any unnecessary negative effects on competition. To be eligible for approval, the aid must be non-discriminatory, limited in time, and clearly defined and limited in scope.[12] Further, there must be appropriate contribution from the private sector and sufficient behavioural constraints to prevent abuse, and there should be an appropriate follow-up by structural adjustment measures.

The guidance applies only to aid to financial institutions and is in addition to the new simplified procedure for the approval of emergency rescue measures.

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Communication on the temporary framework for state aid measures to support access to finance in the current financial and economic crisis

On December 17, 2008, the Commission adopted a temporary framework helping member states to tackle the effects of the credit squeeze on the real economy. It aims to ensure that there is sufficient bank lending to companies and that companies with liquidity problems due to the crisis are given temporary relief through a limited grant. It also aims to encourage companies to invest in a sustainable future, including the development of environmentally friendly products. Under the framework, member states may grant individual subsidised loans, loan guarantees at a reduced premium, risk capital for small and medium sized enterprises and direct aids of up to €500,000. Member states must notify schemes that fall within this type of aid to the Commission, but once the scheme is approved, prior notification of the aid given to individual companies is not required. In some respects, this represents a partial but temporary relaxation of the state aid rules. The framework is expected to remain in place only until 2010, by which time the Commission expects the financial situation to have improved.

Further measures are expected throughout 2009 to allow member states to rescue their economies.

Notes

[1] See Commission Regulation (EC) No. 622/2008 of 30 June 2008 amending Regulation (EC) No 773/2004, as regards the conduct of settlement procedures in cartel cases and Commission Notice on the conduct of settlement procedures in view of the adoption of Decisions pursuant to Article 7 and Article 23 of Council Regulation (EC) No. 1/2003 in cartel cases.

[2] See Commission notice on immunity from fines and reduction of fines in cartel cases.

[3] This is the implementing regulation in relation to the EC Merger Regulation.

[4] The Commission has adopted Regulation 1033/2008 amending the Merger Implementing Regulation. Consequently, the notifying party must use Form RM to submit commitments.

[5] The New Remedies Notice, at paragraph 98.

[6] Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings [Guidance Paper].

[7] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses.

[8] See paras. 12-18 of the Guidance Paper, *supra* note 6.

[9] See para. 14 of the Guidance Paper.

[10] See para. 20 of the Guidance Paper.

[11] See para. 22 of the Guidance Paper.

[12] See paras. 16, 18, 24 and 25 of the Communication.

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UPDATE ON U.S. ANTITRUST ENFORCEMENT

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Introduction

This paper highlights merger review and enforcement actions by the Department of Justice (DOJ) or Federal Trade Commission (FTC); in several cases there were simultaneous or coordinated actions by state or International agencies. Several mergers reviewed during the recent period were challenged, with a number resolved by divestiture of physical assets or intellectual property, while others were litigated by either the FTC or DOJ. There were a number of major cases that were investigated extensively, but not challenged. In several of these cases, the rationale for the decision not to challenge was set forth by the agencies in press releases or statements.[2] The cases were chosen because they represent an array of industries, including differentiated and undifferentiated products; as a general matter, the competitive effects theories tended to be focused on unilateral effects theories.

Overview of Merger Investigations and Enforcement Actions

Proposed Merger of Delta Air Lines Inc. and Northwest Airlines Corporation

After a six-month investigation, the Department of Justice announced that it had decided not to challenge the proposed merger of Delta and Northwest Airlines. The merger had been announced in April and would combine Delta, the third largest U.S. airline with $19.1 billion in revenue in 2007, with Northwest, the fifth largest airline with revenues of $12.5 billion.[3] In announcing its decision, the DOJ provided an assessment of the competitive constraints facing the combining airlines, noting that there was limited overlap due to the airlines' largely complementary route structures internationally and domestically and that there were a number of other legacy as well as low cost airlines on the vast majority of overlapping nonstop and connecting routes served by the carriers.[4] The DOJ expressly took note of potential efficiencies, citing areas such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization with benefits for consumers, and the prospect of improved service made possible by combining under single ownership the complementary aspects of the airlines' networks.[5]

Proposed Acquisition of Enodis by Manitowoc[6]

In October, the DOJ challenged the proposed acquisition of Enodis, a UK corporation involved in the manufacture and sale of numerous products, including ice machines, by Manitowoc, a firm engaged in a range of equipment and maritime products, including commercial ice machines. The

complaint alleged that the parties are two of only three significant manufacturers in an alleged relevant market of "commercial cube ice machines" in the United States.[8] Both companies sold branded machines to a variety of customers such as restaurants, convenience stores, hotels and other businesses that tended to use cube ice in substantial volumes. The proposed settlement required the divestiture of Enodis' entire business related to ice machines, including development, production, distribution and sale of ice machines, parts and related equipment, as well as the Scotsman and Ice-O-Matic brands.[9] Absent divestiture, the DOJ alleged that the transaction would likely result in increased prices and reduced quality and innovation for customers purchasing commercial cube ice machines in the U.S.[10] Among the factors cited by the DOJ in support of its assessment that the transaction would likely lead to adverse effects under an unilateral effects theory were the high shares of the firms (40% and 30%), and conditions that made entry and expansion by new entrants more difficult. The latter include technology, potential difficulty in acquiring sufficient distribution through distributor networks, which tended to be exclusive, and the importance of brand.[11]

The case is of interest for a number of reasons, including the apparent close coordination of both the investigation and the proposed approach to remedy by the DOJ and European Commission, and the prospect of continued coordination through completion of the divestitures.[12] The case provides an interesting example of coordination on trustees as well as divestiture of intellectual property (and IT), as well as a focus on competitive effects theories related to innovation.

InBev's Acquisition of Anheuser-Busch

In another transaction requiring divestiture, DOJ approved the proposed merger of InBev and Anheuser-Busch,[13] which combined the brands such as Budweiser, Busch and Michelob with InBev's brands of Stella Artois, Bass and Beck's, subject to Inbev selling one U.S. subsidiary, Labatt USA. DOJ alleged that two of Anheuser-Busch's brands (Budweiser and Bud Light) competed directly with Labatt Blue and Labatt Blue Light in an upstate New York market. The Department alleged that the transaction, as originally proposed, would likely have led to higher prices for beer in the Buffalo, Rochester and Syracuse, N.Y., metropolitan areas.[14] The companies were regarded as largely complementary with many of their operations in non-overlapping geographies. Anheuser-Busch has most of its operations in the U.S. and Asia while InBev is Europe's and Latin America's leading brewer.[15] Regarding an overlap in China, where Anheuser-Busch holds a stake in the Chinese beer Tsingtao and Inbev in the Zhujiang Brewery Group, China's Ministry of Commerce (MOFCOM), in its first transaction to pass MOFCOM review under the August Anti-Monopoly law,[16] approved the deal contingent on the two parties not increasing their ownership stakes in Chinese beer companies without MOFCOM approval.[17]

The transaction represents additional consolidation in the beer industry, which has seen a number of recent transactions, including Heineken's and Carlsberg's joint takeover of Britain's Scottish & Newcastle in early 2008 and the SABMiller and Molson Coors deal in 2007 (Molson and Coors having merged in 2005).[18] InBev itself was the result of a 2004 merger between the Belgian Interbrew and the Brazilian AmBev.[19]

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Proposed Vertical Agreement Between Fresenius and Daiichi Sankyo[20]

The FTC challenged a long term, exclusive agreement between two companies involved in the provision of services related to dialysis. At issue was an exclusive agreement signed by Fresenius for a 10-year U.S. manufacturing and distribution sublicense for Venofer (an IV product used primarily to treat iron-deficiency anemia in patients with chronic kidney disease undergoing dialysis) with Luitpold Pharmaceuticals (part of Tokyo-based Daiichi Sankyo Co.).[21] Venofer is one of two most commonly used IV products used to treat dialysis patients for iron-deficiency anemia.[22] The contractual arrangement provides Fresenius the exclusive rights to make and sell Venofer in dialysis clinics, while Luitpold would provide it for others (e.g., hospitals as well as hospital dialysis clinics).[23]

The FTC challenged the proposed vertical agreement alleging there no longer would be market prices of purchases of Venofer by Fresenius that the Center for Medicare & Medicaid Services (CMS) could use as a basis for setting reimbursement levels for Medicare. The agreement would result in Fresenius reporting internal transfer prices, which the FTC alleged could be artificially inflated, thereby increasing the costs associated with the treatment of patients under Medicare.[24]

The matter is an interesting one, both because of the infrequency of vertical cases as well as the nature of the consent order with regard to transfer prices. The consent order requires Fresenius to use certain "market" prices specified in the Order effectively as a cap on the internal transfer prices that could be reported to CMS, and placed certain requirements were there to be generic products in the future.[25]

Proposed Acquisition of ChoicePoint, Inc. by Reed Elsevier Inc.[26]

The FTC challenged the proposed acquisition by Reed Elsevier of certain businesses of ChoicePoint, alleging reduction in competition between Reed Elsevier's LexisNexis division and ChoicePoint.[27] The products at issue involved certain electronic public records services provided to law enforcement customers. The FTC expressed the concern that ChoicePoint, through its AutoTrackXP and its newer Consolidated Lead Evaluation and Reporting (CLEAR) products, and LexisNexis were the two largest suppliers of such services with over 80% of a U.S. market for "electronic public records services to law enforcement customers."[28] Electronic public records services (including those provided by the parties to the transaction) involve collection and organization of both public and non-public records of individuals and firms. Examples include credit data and records such as criminal, motor vehicle and property records, and also employment related records.

The challenge was based on concerns that competition between the two companies had resulted in innovation and lower prices, and that it was unlikely that entry would occur within the Merger Guidelines' two year time frame to limit the alleged anticompetitive impact of the proposed transaction.[29]

The matter is of interest with regard to the nature of the assets involved in the divestiture and settlement. The FTC required Reed Elsevier to divest assets related to ChoicePoint's AutoTrackXP and CLEAR electronic public records services; the purchaser of the assets was identified as Thomson Reuters Legal Inc. within 15 days after the proposed acquisition is consummated.[30]

Acquisition of Wild Oats Markets, Inc. by Whole Foods Market, Inc.[31]

A very recent decision by the U.S. Court of Appeals[32] on November 21st that it would not revisit its earlier July decision, after Whole Foods asked for an "en banc" hearing that would have involved all of the appeals court's judges, marks the latest legal development in an almost 2-year period since Whole Foods announced in February of 2007 that it intended to acquire Wild Oats.[33] The case now proceeds forward to a January 2009 date for an administrative hearing at the FTC, where the FTC will pursue its challenge to the (now-consummated) merger of the two supermarkets.

The history of the case starts with the FTC's challenge in June 2007 in federal court[34] alleging that Whole Foods and Wild Oats were the largest operators of certain types of supermarkets (those offering premium, natural and organic foods, including various types of produce, prepared foods and other products, as well as serving specific customer segments.)[35] The FTC claimed that the transaction gave Whole Foods the incentive and ability unilaterally to increase prices because they were differentiated from conventional retail supermarkets on dimensions such as the breadth and quality of their perishables and the array of natural and organic products offered. It was also claimed that "premium natural and organic" supermarkets tend to serve different customers than traditional grocery stores.[36,37] In responding to the allegations, Whole Foods identified expansion of more traditional grocery stores into organic and premium products as well as expansion by smaller firms.[38] The initial decision went in favor of Whole Foods, based on an assessment of the evidence related to market definition and competitive effects, including economic evidence presented by both parties. The merger was consummated with the FTC appealing the ruling.[39]

It was the market definition evidence and framework of analysis in the August 2007 lower court decision that was challenged in the July 2008 decision by the U.S. Court of Appeals which reversed the lower court's decision.[40] The Court of Appeals' decision stated that the district court committed legal error in how it had evaluated market definition issues and what the implications of this error were for its assessment of the FTC's likelihood of success on the merits. Of interest is the assessment concerning marginal versus "core" customers. The three-judge panel said the lower court erred when it ruled that the FTC's market definition for natural and organic foods was too narrow.[41]

The case is of interest due to the product market definition and treatment of new and expanded entry by current market participants.

International Developments

Inova Health System Foundation and Prince William Health System, Inc.

This proposed merger of hospitals in suburban Washington DC is of particular interest for the procedural issues that developed with regard to administrative hearings on mergers before the FTC and the appointment of a sitting Commissioner to serve as an Administrative Law Judge (ALJ) to hear the merger challenge. The FTC challenged the proposed acquisition by Inova of PWHS, stating that if consummated that it would tend to result in higher negotiated rates for commercially insured inpatient services.[42] The challenge was brought in federal court, with the FTC then filing an administrative complaint and appointing Commissioner J. Thomas Rosch as the Administrative Law Judge in the matter. The complaint was ultimately dismissed when the parties abandoned the transaction.[43]

There are no FTC rules against a commissioner acting as an ALJ, but there is no recent precedent for such action. Traditionally, the FTC has tended to appoint an independent ALJ to preside over a trial where FTC-prosecutors would present evidence on their case.

Reports and Hearings

Department of Justice Report on Single-Firm Conduct Under Section 2 of the Sherman Act

Another major antitrust development in the past six months was the release of reports and comments by the federal agencies with regard to Section 2 of the *Sherman Act*. The Department of Justice issued its report on single-firm conduct under Section 2 of the *Sherman Act* in the fall,[44] followed very shortly by separate writings from the FTC that set out differences of view from the DOJ report, on the part of at least some of the FTC Commissioners. The DOJ report followed a series of joint hearings by the FTC and DOJ that included a number of panels with academics, businesspeople and antitrust practitioners on a range of topics concerning unilateral effects. The DOJ report was put forward as an attempt to "synthesize[s] views expressed at the hearings" and "is intended to make progress toward the goal of sound, clear, objective, effective, and administrable standards for analyzing single-firm conduct under section 2."[45] The report includes a number of separate chapters organized along specific theories of potential anticompetitive conduct; and sets out the theoretical and empirical framework considered by the DOJ regarding areas for enforcement. Among the topics are: monopoly power, predatory pricing, tying, bundled and loyalty discounts, refusals to deal with rivals and exclusive dealing.[46]

Shortly after the DOJ report's release, FTC Commissioners Jones-Harbour, Leibowitz and Rosch issued a joint statement saying that the DOJ's report, if adopted by the courts, "would be a blueprint for radically weakened enforcement of Section 2 of the *Sherman Act*."[47] The stated concerns included whether consumer welfare should be the primary goal of antitrust enforcement. According to the FTC, the Department's report "is chiefly concerned with firms that enjoy monopoly or near-monopoly power, and prescribes a legal regime that places these firms' interests ahead of those of consumers." The FTC's second major concern was that the

report "seriously overstates the level of legal, economic, and academic consensus regarding Section 2" and "the testimony gathered during the hearings was not representative of the views of all Section 2 stakeholders."[48] The Commissioners said that "voices representing the interests of consumers were not adequately heard," and that the report relied "too heavily on economic theory in the consideration of applying antitrust law."[49]

These differences in views between the three FTC Commissioners and the DOJ are likely to continue to be an increasing area of interest with regard to U.S. antitrust policy in the next year, particularly with the very recent departure of AAG Barnett, and with likely new appointments at both agencies. Finally, of particular interest for possible upcoming enforcement efforts are papers presented in the October hearings held by the FTC on Section 5 as well as the transcripts of those sessions, which could be released over the course of the next few months or more.[50]

Department of Justice Report on Telecommunications Competition

On November 17th, the DOJ issued its report on competition in the telecommunications industry, following on hearings in late 2007. The report focuses specifically on developments in technology and their implications for future enforcement activity, particularly with regard to whether changes in technologies lead to greater substitution potential among various telecommunications products.[51]

Summary

The merger review and enforcement activity set out above highlight an interesting trend over the past few years, with the evolution of competitive theories for merger review and challenge to an increasing focus on unilateral as opposed to coordinated effects theories. Additionally, the matters above demonstrate a continued commitment to coordination by U.S. and European agencies both in terms of an investigation as well as a remedy.

Notes

[1] This paper was authored with Jeffrey Rudnicki, Economist at Compass Lexecon, and with the assistance of Matthew Gibb.

[2] In some instances, additional perspective on the rationale has been provided with some lag after the decision. See, for example, the March 2006 statement by the DOJ setting out the reasons for not challenging the Maytag-Whirlpool merger, which was followed by a retrospective examination of the merger in a speech by AAG Barnett "Current Issues in Merger Enforcement: Thoughts on Theory, Litigation Practice, and Retrospectives" in June 2008. (The initial statement can be found at: http://www.usdoj. gov/atr/public/ press_releases/2006/215326.htm and the speech at http://www.usdoj. gov/atr /public/ speeches /234537. htm.)

[3] Delta served 73 million passengers and Northwest 53 million. See Press Releases available at: http://www. wa.com/corpinfo/newsc/2008/pr041420081978.html and http://www.usdoj.gov/atr/public/press_releases/ 2008/ 238849.htm.

[4] See News Release available at: http://money.cnn.com/2008/10/29/news/companies/delta_north west. ap/.

[5] See Press Release available at: http://www.usdoj.gov/atr/public/press_releases/2008/238849.htm.

[6] See DOJ Complaint available at: http://www.usdoj.gov/atr/cases/f238300/238388.htm.

[7] The DOJ alleged that the relevant market was limited to certain commercial ice cube machines and excluded either lower capacity machines or "soft" (flake or chip) ice machines: "The Complaint alleges that because of the attributes of commercial cube ice machines, a small but significant post-acquisition increase in the prices of commercial cube ice machines would not cause customers to switch to other ice machines in sufficient numbers so as to make such a price increase unprofitable, and, accordingly, the development, production, distribution, and sale of commercial cube ice machines is a line of commerce and a relevant product market." See, Competitive Impact Statement at Section B.2. The market definition section of the complaint set out that, in the view of the DOJ, there was "[A] significant and distinct segment of cube ice machine customers, including sit-down and fast-food restaurants, bars, and convenience stores, purchase commercial machines capable of producing between approximately 300 pounds to 2,000 pounds of cube ice per day (hereinafter, "commercial cube ice machines"). Although customers can purchase units that produce between approximately 50 and 300 pounds of ice per day, these machines are not able to meet the needs of the large majority of commercial cube ice machine customers. Few customers are likely to meet their needs by purchasing two or more smaller machines because it would be cost-prohibitive to do so. Similarly, large units that produce over 2,000 pounds of ice per day are not substitutes for commercial cube ice machines and are used by customers that need extremely large volumes of ice, such as convention centers, sports arenas, or bagged-ice producers."
See DOJ Complaint available at: http://www.usdoj.gov/atr/cases/f238300/238388.htm.

[8] The transaction was initially made in April 2008 and valued at approximately $2.1billion. See, Manitowoc Press Release available at: http://www.manitowocfsg.com/news/manitowoctoacquireenodis.asp. Manitowoc manufactures commercial ice machines, refrigeration equipment, cranes, ships and other water vessels. In 2007, Manitowoc's total sales were approximately $4 billion and its sales from commercial ice machines in the US accounted for approximately $152 million of that total. Enodis, a United Kingdom corporation, designs, manufactures and sells cooking, food storage and preparation equipment, and ice machines. In 2007, Enodis had revenues of $1.6 billion, with sales from commercial ice machines in the US accounting for $153 million of that total. See DOJ Complaint available at: http://www.usdoj.gov/atr /cases/f238300/238388.htm.

[9] See DOJ Press Release available at: http://www.usdoj.gov/atr/public/press_releases/2008/237997.htm.

[10] See DOJ Competitive Impact Statement available at: http://www.usdoj.gov/atr/cases/f238000 /238030.htm.

[11] See competitive effects section of Competitive Impact Statement available at: http://www.usdoj. gov/atr/cases/f238000/238030.htm.

[12] Both the EU and the DOJ required divestiture of Enodis' operations related to commercial ice cube machine manufacture and sale, with some differences in the specific assets. The DOJ decision and competitive impact statement expressly discusses the coordination of timing, trustees, and nature of the divestiture given coordination with European authorities. See, the Competitive Impact Statement at Section III. Available at: http://www.usdoj.gov/atr/cases/f238000/238030.htm. The EU decision in September is summarized at: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1380.

[13] The new company, but for the divestiture, would have combined sales of more than $36 billion, surpassing the current number one brewer, SABMiller. See Press Release available at: http://www.market watch.com/news/story anheuser-busch-accepts-70-share-52-billion/story.aspx?guid=%7B02125469-49F4-4C21 -824D-01EB0623A817%7D&dist=hplatest.

[14] See DOJ Press Release available at: http://www.usdoj.gov/atr/public/press_releases/2008/239430.htm and http://money.cnn.com/2008/11/14/news/companies/anheuser_busch.ap/index.htm.

[15] See News Coverage available at: http://www.beveragedaily.com/Financial/Interbrew-buys-AmBev-and-becomes-world-number-one.

[16] See News Coverage available at: http://www.chinadaily.com.cn/bizchina/2008-11/19/content_7219360.htm.

[17] See http://english.mofcom.gov.cn/aarticle/counselorsreport/westernasiaandafricareport/200811/20081105904818.html and News Coverage available at:http://www.chinadaily.com.cn/bizchina/2008-11/19/content_7219360.htm.

[18] See Articles: http://www.iht.com/articles/2008/01/25/business/beer.php and http://www.nytimes.

com/2007/10/10/business/worldbusiness/10beer.html.

[19] See Inbev Press Release available at: http://www.inbev.com/go/investors/overview/additional_information.cfm.

[20] See FTC website at: http://www.ftc.gov/os/caselist/0810146/index.shtm.

[21] See FTC Complaint available at: http://www.ftc.gov/os/caselist/0810146/081021freseniuscmpt.pdf.

[22] See FTC Press Release available at http://www.ftc.gov/opa/2008/09/fresenius.shtm.

[23] See News Coverage at: http://www.renalbusiness.com/articles/legal/ftc-questions-fresenius-venofer-deal.html.

[24] See FTC Press Release available at: http://www.ftc.gov/opa/2008/09/fresenius.shtm.

[25] The Order has a number of other conditions, including prohibitions on sharing of information. http://www.ftc.gov/os/caselist/0810133/080916reedelsevierchoicepointanalysis.pdf.

[26] See FTC website at: http://www.ftc.gov/os/caselist/0810133/index.shtm.

[27] See News Release at: http://phx.corporate-ir.net/phoenix.zhtml?c=95293&p=irol-newsArticle&ID= 1110734&highlight.

[28] FTC Complaint available at: http://www.ftc.gov/os/caselist/0810133/080916reedelsevierchoicepoint complaint.pdf.

[29] FTC Complaint available at: http://www.ftc.gov/os/caselist/0810133/080916reedelsevierchoicepoint complaint.pdf.

[30] A number of specific conditions were placed on the divestiture designed to assure that the acquirer of the divested assets would be able effectively to enter and compete. See agreement containing consent order available at: http://www.ftc.gov/os/caselist/0810133/080916reedelsevierchoicepointanalysis.pdf.

[31] See FTC website at: http://www.ftc.gov/os/caselist/0710114/0710114.shtm.

[32] See News Release at: http://money.aol.ca/article/whole-foods-denied-hearing-request-in-ftc-fight/429944/.

[33] See News Release at: http://www.marketwatch.com/news/story/whole-foods-acquire-wild-oats/story.aspx?guid=%7B2636 FA3E-2B29-486D-9E5D-22AB0DD58F32%7D.

[34] The FTC sought a temporary restraining order and preliminary injunction in federal district court pending an administrative trial on the merits. See FTC complaint available at: http://www.ftc.gov/os/adjpro/d9324/070628 admincmplt.pdf.

[35] See FTC complaint at: http://www.ftc.gov/os/adjpro/d9324/070628admincmplt.pdf. See FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1, 28 (D.D.C. 2007).

[36] See FTC complaint available at: http://www.ftc.gov/os/caselist/0710114/070605complaint.pdf.

[37] See FTC complaint available at: http://www.ftc.gov/os/caselist/0710114/070605complaint.pdf.

[38] See news release at: http://www.marketwatch.com/news/story/whole-foods-acquire-rival-wild/story.aspx? guid=%7B7068D3A7-6BF0-4CC9-B3C2-674B394953F0%7D.

[39] See Press Release at: http://media.wholefoodsmarket.com/pr/wf/national/pr07_08-16.aspx.

[40] See Opinion of the Court of Appeals at pages 2-3 at: http://www.ftc.gov/os/caselist /0710114/080729wholefoodsopinion.pdf.

[41] See Opinion at http://www.ftc.gov/os/caselist/0710114/080729wholefoodsopinion.pdf.

[42] See FTC Complaint available at: http://www.ftc.gov/os/adjpro/d9326/080509admincomplaint.pdf.

[43] See FTC Order dismissing complaint available at: http://www.ftc.gov/os/adjpro/d9326/080617 order dismisscmpt. pdf.

[44] See Department of Justice, "Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act", September 2008. Available at: http://www.usdoj.gov/atr/public/reports/236681.htm.

[45] See DOJ Report available at: http://www.usdoj.gov/atr/public/reports/236681.htm.

[46] For instance, in regards to exclusive dealing, the report reads "The Department believes that exclusive-dealing arrangements foreclosing less than thirty percent of existing customers or effective distribution should not be illegal. The Department does not believe that the legality of an exclusive-dealing arrangement should be determined solely by the explicit duration of the contract or agreement. When a firm with lawful monopoly power utilizes exclusive dealing, the Department will examine whether the exclusive dealing contributed significantly to maintaining monopoly power and whether alternative distribution channels allow competitors to pose a real threat to the monopoly before potentially imposing liability." See Executive Summary available

at: http://www.usdoj.gov/atr/public/reports/236681_executive_summary.htm and "Chapter 8: Exclusive Dealing" at: http://www.usdoj.gov/atr/public/reports/236681_chapter8.htm.

[47] See Statement of FTC Commissioners available at: http://www. ftc.gov/os/2008/09/080908section 2stmt. pdf.

[48] See Statement of FTC Commissioners available at: http://www.ftc.gov/os/2008/09/080908section2 stmt. pdf.

[49] See FTC Press Release available at: http://www.ftc.gov/opa/2008/09/section2.shtm.

[50] See the agenda setting out the areas covered by the panels addressing business conduct, history and role of Section 5 enforcement, and relationship of enforcement in Section 5 to *Sherman Act*. A number of papers from panelists are available at: http://www.ftc.gov/bc/workshops/section5, as well as the agenda. Transcripts will be found at this site as well.

[51] See "Voice, Video, and Broadband: the Changing Competitive Landscape and Its Impact on Consumers;" available at: http://www.usdoj.gov/atr/public/reports/239284.pdf.