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Private Antitrust Enforcement in Germany: The Federal Supreme Court Rules on Standing of Indirect Purchasers and Pass-on Defense

Martin Buntscheck & Evelyn Niitvaeli
Buntscheck Rechtsanwaltsgesellschaft mbH, Germany

Compared to the USA, the focus of antitrust enforcement in Germany is still to a large extent on public enforcement. However, after the decisions of the European Court of Justice regarding individuals' rights to compensation in *Courage*[1] and Manfredi,[2] as well as the initiatives taken by the European Commission to promote private antitrust enforcement,[3] Germany took steps to reform its Act Against Restraints of Competition (ARC) with a view to facilitate access to damages actions brought by those who have suffered a loss from breaches of European or German antitrust law.

As a result of such legislative reform and the initiatives of the European Commission and the German Federal Cartel Office to promote private enforcement, the number of private damages claims in Germany has increased substantially in recent years. *Inter alia* due to the comparatively short duration of proceedings and usually moderate costs involved, Germany has become one of "jurisdictions of choice" for claimants in Europe and is probably the closest runner-up to England and Wales in this regard.

However, despite the growing number of private damages actions, there remain several questions which have not yet been resolved by the German legislator or the German courts. Two of these issues have recently been clarified by the German Federal Supreme Court (*Bundesgerichtshof*) in a groundbreaking judgment. In its decision of June 28, 2011, the German Federal Supreme Court (i) explicitly confirmed the standing of indirect purchasers and (ii) allowed the pass-on defense.[4]

Background of the Case

The decision of the Federal Supreme Court concerned a follow-on damages claim based on a decision of the European Commission. In 2001, the European Commission had fined ten papermakers for taking part in price-fixing and market-sharing agreements in the carbonless paper industry. The claimant in the case was a savings bank that pursued damages claims on behalf of an insolvent printing firm. The printing firm had bought carbonless paper from different wholesalers. One of these wholesalers was a 100%-subsidiary from one of the cartel members.

The District Court (*Landgericht*) of Mannheim, which was the competent court of first instance, had dismissed the damages claim arguing that such claims have to be limited to the direct purchasers of a cartel member.[5] On appeal, the Higher Regional Court (*Oberlandesgericht*) of Karlsruhe generally confirmed the lack of standing of indirect purchasers. However, it made an exception for purchases from the wholesaler that was a 100%-subsidiary of a cartel member. According to the Higher Regional Court, such exception was necessary as otherwise cartelists could avoid liability simply by means of vertical integration.[6] As regards the pass-on defense, the Higher Regional Court held that it was generally excluded.[7]

Judgment of the Federal Supreme Court

The Federal Supreme Court did not share the view taken by the lower courts as regards the standing of indirect purchasers and the non-availability of the pass-on defense.

The Federal Supreme Court explicitly clarified that indirect purchasers are entitled to antitrust damages. It pointed out that adverse effects of price-fixing cartels are not necessarily realized on the level of direct purchasers. Rather, direct purchasers may often be able to pass-on such effects to companies further down the purchasing chain. Therefore, effective private antitrust enforcement required that any individual who has suffered harm caused by an antitrust infringement must be allowed to claim damages.

On the flip side of confirming the standing of indirect purchasers, the Federal Supreme Court allowed the pass-on defense. According to the Court, the defendant has the right to show that the claimant has successfully passed on its damage (either completely or part of it) to the next market level. This finding is in line with the fundamental principle of German damages law, according to which compensation shall only be awarded to recover actual losses.

Burden of Proof

The Federal Supreme Court held that – in case of actions brought by the indirect purchaser – the burden of proof as regards damages incurred by indirect purchaser and thereby their standing lies with the claimant.

As regards the pass-on defense in the context of actions brought by the direct purchaser, the solution found by Federal Supreme Court is unfortunately less straightforward. The burden of proof as to a pass-on shall generally be on the defendant. In order to actually take advantage of the pass-on defense, the defendant has to prove that there is a causal link between the infringement and the pass-on. Cartelists shall not benefit from successful commercially motivated efforts of direct purchasers to sell their own products or services to their customers at the highest possible price. Therefore, the defendant has to show that a possible price increase on the downstream market was not caused by other economic factors than the infringement.

However, the Federal Supreme Court recognized that the defendant may often struggle to prove such causal link between infringement and pass-on. Therefore, the Court held that under certain circumstances the burden of proof may shift to the claimant. While the Court stressed the fact that such shift could only be acceptable in exceptional circumstances, it failed to provide detailed guidelines as to when such shift should or should not be applied.

Summary and Outlook

The judgment of the Federal Supreme Court of June 28, 2011 brought the long awaited clarification as regards the pass-on defense and the standing of indirect purchasers. However, the decision not only provides guidance on these two issues that had previously been discussed very controversially, but also raises further questions which will have to be dealt with in future cases and which may constitute a challenge for the future of private antitrust enforcement in Germany. This applies in particular to the general admissibility of the pass-on defense and the principles laid down by the Federal Supreme Court as to the burden of proof. It cannot be excluded that the combination of allowing the pass-on defense and providing for a possible shift in the burden of proof may have a negative effect on the effectiveness of future antitrust damages actions.

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[1] European Court of Justice, decision of September 20, 2001, C-453/99 – *Courage Ltd v. Bernard Crehan and Bernard Crehan v. Courage Ltd and Others,* [2001] E.C.R. I-6297.

[2] European Court of Justice, decision of July 13, 2005, joined cases C-295/04 to C-298/04 – *Vincenzo Manfredi et al. v. Lloyd Adriatico Assicurazioni SpA et al.,* [2006] E.C.R. I-6619.

[3] Initiatives of the European Commission include its Green Paper – Damages actions for breach of the EC antitrust rules, COM (2005) 672 (final), December 19, 2005, and its White Paper on Damages actions for breach of the EC antitrust rules, COM(2008) 165 (final), April 2, 2008. More recently, the European Commission has focused its work on two main areas within the context of antitrust damages actions: (i) collective redress and (ii) quantification of harm.

[4] German Federal Supreme Court, decision of June 28, 2011, KZR 75/10 – *ORWI.*

[5] District Court of Mannheim, decision of April 29, 2005, 22 O 74/04 – *Selbstdurchschreibepapier.*

[6] Higher Regional Court of Karlsruhe, decision of June 11, 2010, 6 U 118/05 (Kart.) – *Selbstdurchschreibepapier.*

[7] This approach confirmed an earlier decision of the Higher Regional Court in Berlin; decision of October 1, 2009, 2 U 10/03 Kart. – *Berliner Transportbeton.*

Wait Three Years and Then Two Come at Once: European Commission Moves Against Pharma Patent Settlements

Matthew Hall
McGuireWoods, Brussels

In July 2012, three years after it published its final report into competition in the pharmaceutical sector in the EU, the European Commission (EC) took a significant step in two pharmaceutical patent settlement cases. Statements of Objections (SO) were sent to a number of companies concerning potentially anticompetitive activities, including principally the use of reverse payment patent settlements, relating to two products: citalopram (an antidepressant) and perindopril (a cardiovascular medicine). SOs, which are not public documents, are preliminary statements of the EC's case, but the fact that they have been sent indicates that the EC has substantial prima facie concerns.

The cases are without doubt high profile since, in particular, they are the first EC cases to address the use of reverse payment patent settlements in the pharmaceutical sector. However, on the facts available, they do not appear to be surprising, given the stance taken by the EC in this area, and in particular on the issue of such settlements.

Background – the EC's 2009 Pharmaceutical Sector Inquiry

In July 2009, the EC published the results of its very important study into competition in the pharmaceutical sector in the EU. The EC's main conclusions were that market entry of generic drugs was being unnecessarily delayed and that the number of novel medicines reaching the market was in decline. Specifically in relation to generics, on the basis of a sample of medicines that faced loss of exclusivity in the period 2000-2007 in 17 EU member states, the inquiry found that in general it took seven months after patent expiry for generic medicines to arrive. The inquiry showed that "originator companies used a variety of instruments to extend the commercial life of their products without generic entry for as long as possible." The principal strategies identified were as follows:

- patenting strategies such as patent clusters;
- disputes and litigation against potential generic competitors;
- patent settlements with generic companies; and
- various interventions before regulators and launch of follow-on products.

So far as concerns the decline of novel medicines reaching the market, the inquiry also "pointed to certain company practices that might have contributed to this phenomenon." In particular, the inquiry identified the following problems:

- patents aimed exclusively against the development of a competing product;
- litigation against other originator companies; and
- opposition against (mainly) secondary patents.

Sector inquiries such as this are a tool under EU competition law and therefore the main focus was on company behaviour. However, the inquiry also considered the regulatory framework in the EU and highlighted three main areas of concern: patents; marketing authorizations; and pricing and reimbursement. With respect to patents, the EC reaffirmed at the time the urgent need for the estab-lishment of an EU patent and for a unified and specialised patent litigation system in the EU.

There have been general policy follow ups to the sector inquiry and in addition the EC has started a number of competition law investigations. The competition law world, however, had been waiting for a patent settlement case to reach a significant stage, and now it has two.

The EC's Concerns in its Two July 2012 Cases

In the citalopram case, the EC's concern is that Lundbeck and several generic competitors entered into agreements that may have hindered the entry of generic citalopram into markets in the EU, causing "substantial consumer harm" in the form of high prices. According to the EC, the companies concluded these agreements when generic entry became possible in principle, because certain of Lundbeck's citalopram patents had expired. The agreements foresaw substantial value transfers from Lundbeck to the four generic competitors. In turn, the generic companies abstained from entering the market with generic citalopram. Lundbeck's value transfers to the generic competitors included direct payments as well as other forms such as purchase of generic citalopram stock for destruction or guaranteed profits in a distribution agreement.

The EC's concerns in the perindopril case are similar. The EC alleged that in exchange for payments by Les Laboratoires Servier, several generic companies agreed not to enter the market with their cheaper generic products and/or not to further challenge the validity of the patents that protected Servier's more expensive medicine. The case differs from that concerning citalopram, however, in that the EC's concerns also relate to unilateral behavior by Servier, since it "appears to be" dominant in the market for perindopril. Servier may have implemented a "comprehensive strategy" to prevent market entry of cheaper generic versions of perindopril, when perindopril was about to reach the end of its patent protection. Among the practices allegedly used by Servier were patent acquisitions that could potentially shut out competitors from the market and "inducing" its generic challengers to conclude the patent settlements.

The Cases Are in Line with Previous EC Thinking

It has taken the EC a long time after the 2009 sector inquiry report to reach this advanced stage in a patent settlement case, but from the facts available in the public domain, it is not surprising that the EC has chosen to proceed in these two. Both concern so-called reverse payment patent settlements of a particular type; the EC has long and consistently expressed the view, including in the report, that if an originator company eliminates or delays cheaper generic competition through significant payments or other benefits to a generic company for discontinuing or delaying the launch of generic medicine challenging the originator's patent, this can lead to substantial anticompetitive consumer harm. The EC considers this to be a form of collusion or cartel since the companies involved in effect share the originator's "monopoly rents."

On the issue of Servier's behavior, again the EC has long held the view that unilateral practices of dominant companies, such as those aimed at shutting out generic competitors from the market, can cause serious competition problems. It is supported in this regard by case law, including the seminal AstraZeneca case. The EC found there that the company had misused the regulatory framework to prevent or, at the very least, delay the market entry of competing generic products. The EU General Court has confirmed the EC's findings that such behavior was illegal, although this is now on appeal to the EU's highest court, the Court of Justice. However, in the Servier case, the EC appears to be proceeding primarily against the settlement agreements, with these unilateral practices as an ancillary or supporting activity.

Conclusion

The EC's citalopram and perindopril cases are reminders to the pharmaceutical industry that the EC is still watching it very carefully. Companies should consider whether their compliance procedures need updating. Competitors potentially affected by the behavior of originator companies have an ally in the EC. It is still looking for cases.

Nowhere to Hide: How Extraterritoriality is a Growing Concern for Multinationals

Timothy Cornell & Katrin Schallenberg
Clifford Chance, United States & France

As the number of jurisdictions enacting antitrust laws surpasses 100, extraterritoriality becomes a significant issue for multi-national and global companies.

First, anticompetitive conduct may be subject to redress in multiple jurisdictions, levying a significant financial cost on defendants, forcing them to make multifaceted leniency decisions, and exposing them to the potential for divergent and/or contrasting legal requirements. And conduct that may be permitted within the host jurisdiction may be found to be actionable in other jurisdictions. Competition authorities around the world have engaged in considerable efforts to cooperate among each other in order to more efficiently detect and deter antitrust violations.

Second, as the number of merger control regimes increases transaction costs associated with having to make merger filings in multiple jurisdictions become a significant concern for the acquisitive multi-national.

We examine below the effects of extraterritoriality from the perspective of US and EU laws, the two bodies of antitrust laws to which many jurisdictions refer in formulating their own antitrust policies.

Conduct Occurring Outside The Jurisdiction

In the US, the ability of the Sherman Act to reach anticompetitive conduct outside the United States is limited by the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA).[1] The FTAIA sets forth the general rule that the Sherman Act does not apply to trade or commerce within foreign nations, but then excepts from that prohibition conduct with "significantly harms imports, domestic commerce, or American exporters."[2] More specifically, anticompetitive conduct that occurs abroad is prohibited by the Sherman Act and the FTAIA if the conduct has a direct, substantial and reasonably foreseeable effect on U.S. commerce, that is on U.S. consumers.[3] The standard was recently reviewed by the US courts in *Minn-Chem*, where the court held : (1) a cartel fixing prices in Brazil, China and other markets with the purpose of using that fixed price as a benchmark for U.S. domestic sales had a reasonable, proximate, and causal (i.e., direct) US nexus; (2) an effect that involved 5.3 million tons of potash (minerals and chemical salts rich in potassium), the vast majority of which was imported to the US and a price increase of 600% over 5 years was substantial; and (3) in the absence of arbitrage, it was reasonably foreseeable that a cartel capturing 71% of the potash supply would affect U.S. consumers.[4]

Theoretically, EU antitrust law similarly applies to all conduct that has an effect on commerce within the EU member states. This effect doctrine is anchored within the principles of international law and EU law more generally. However, there is no case law that clearly sets out under what circumstances the EU Commission and courts would abstain from jurisdiction over anti-competitive behavior. Rather, the EU Commission and courts have systematically confirmed their ability to hear conduct cases. Thus, cartel or abusive conduct cases that involve goods or services sold within the EU will systematically be caught by EU antitrust laws. Even where there are no direct sales within the EU, an effect can still be found to exist if a company obtaining an "anti-competitive benefit" has operations within the EU.

Merger Control

M&A transactions are increasingly complicated by the fact that merger clearances in various jurisdictions are necessary, most of them mandatory before closing and often not that quick to get, even in the absence of any competition issues (and indeed "effect" within the jurisdiction in question).

In the EU, transactions have to be notified to the EU Commission if at least two parties meet a certain turnover thresholds within the EU.[5] In outright acquisitions and mergers with two parties, the test will eliminate any transactions without a sufficient link to the EU. However, it becomes less clear where several parties are involved. For example, suppose Corporation A and Corporation B jointly invest in a shopping mall property owned by Corporation C in South Africa. Under EU rules, the transaction could potentially be subject to merger control if Corporation A and B both generate sufficient revenues in the EU. Because parties have to self-assess whether to file, companies pursuing a zero risk policy will prefer to make a filing to the EU Commission, even though its jurisdiction might be questionable under international law standards.[6]

A nexus is also required under US merger control regulations. The Hart-Scott-Rodino Antitrust Improvements Act of 1976[7] requires that parties to a transaction above a certain size provide notification to the US antitrust agencies and wait a prescribed period of time before closing the transaction. While there is no requirement that either party to a transaction have a US presence, there must be a significant US nexus. Acquisitions of assets located outside the US trigger a US filing if the assets generate sales in or into the US exceeding $68.2 million;[8] acquisitions of foreign voting securities by US purchasers trigger a U.S. filing if the target either holds US assets valued at greater than $68.2 million or made aggregate sales in or into the US greater than $68.2 million.[9] For acquisitions by non-US purchasers and where the above jurisdictional test is met, the purchaser must hold 50% or more of the outstanding voting securities of the target for a filing to be triggered.[10] In forming a joint venture (JV), a notification filing may be required if the contributing parties are ex-US but the JV is US and will hold assets valued at greater than $68.2 million, or where the JV is non-US but will hold either US assets valued at greater than $68.2 million or assets/companies that generated sales in or into the U.S. exceeding $68.2 million.[11]

The Law In Practice

As noted above, companies engaging in cartel behavior outside of the EU and US (e.g., in Asia) may nonetheless face liability in the EU or US if the effects of the conduct can be felt there. The liquid crystal display cases, and specifically AU Optronics, are illustrative of this point. There, four Taiwan LCD manufacturers and two Korean LCD manufacturers allegedly met monthly in Taiwan and engaged in a conspiracy to fix the price of LCDs. Prosecution of the conspirators occurred in the US and the EU. The US court held, "Section One of the Sherman Act applies to wholly foreign conduct which has a substantial and intended effect in the United States," held that the conduct was actionable under the U.S. antitrust laws.[12] The EU Commission similarly explained, "These agreements had a direct impact on customers in the European Economic Area because the vast majority of televisions, computer monitors and notebooks incorporating those LCD panels and sold in the EEA comes from Asia."[13] A similar situation exists around the conspiracy to fix automotive parts, which is being prosecuted in the US, EU and Japan.

Once a company engages in cartel behavior, there is little the company can do to outright avoid liability. However there are practical steps that a company can undertake to mitigate its risk and reduce its exposure:

- Identify the problem early as leniency in most jurisdictions is a race to the agency front steps.
- Assess the extent of the liability and in which jurisdictions exposure lies.
- Develop a coordinated multi-jurisdictional approach to leniency.
- Preserve evidence.
- Be wary of privilege as jurisdictions have varying rule regarding privilege.
- Manage communications.

Following these practical steps can mitigate multi-jurisdictional antitrust liability and ensure that a company facing such liability is not overly exposed.

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1 15 U.S.C. §6a.

2 *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004).

3 *Id. See also* UNITED STATES DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS (April 1995) ("The reach of the U.S. antitrust laws is not limited, however, to conduct and transactions that occur within the boundaries of the United States. Anticompetitive conduct that affects U.S. domestic or foreign commerce may violate the U.S. antitrust laws regardless of where such conduct occurs or the nationality of the parties involved."); *Minn-Chem, inc. v. Agrium Inc.*, 683 F.3d 845, 859 (7th Cir. 2012) ("*Minn-Chem*").

4 *Agrium*, 683 F.3d at 859.

5 EU Merger Regulation, Council Regulation No. 139/2004 of 20 January 2004, Article 1.

6 *See, e.g., Gencor Ltd. v. Commission of the European Communities*, Case no. T-102/96 *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61996TJ0102: EN:HTML (the court confirmed jurisdiction although the target had no production within the EU).

7 15 U.S.C. § 18a.

8 Jurisdictional thresholds are revised in February of each year in accordance with the prior year's change in US gross national product.

9 16 C.F.R. § 802.51(a).

10 16 C.F.R. § 802.51(b).

11 16 C.F.R. §§ 801.40, 802.50, 802.51.

12 Order Denying Defendants' Motion To Dismiss The Indictment, *U.S. v. AU Optronics Corporation*, M-07-1827SI, (N.D.Cal. Apr. 18, 2011) *available at* http://amlawdaily.typepad.com/Illstonauo.pdf.

13 Press Release, European Comm'n, Antitrust: Commission fines six LCD panel producers € 648 million for price fixing cartel, (Dec. 8, 2010). *See also* UNITED STATES DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS (April 1995) ("The reach of the U.S. antitrust laws is not limited, however, to conduct and transactions that occur within the boundaries of the United States. Anticompetitive conduct that affects U.S. domestic or foreign commerce may violate the U.S. antitrust laws regardless of where such conduct occurs or the nationality of the parties involved.").

Revamped Korean Leniency Regime: No More Cheap Way Out for Repeat Cartelists and Second-in-Line Confessors

Cecil Saehoon Chung & Sung Bom Park
Yulchon LLC , Korea

Since its initial introduction of a corporate leniency program in 1997, the Korea Fair Trade Commission ("KFTC") has revised the program a number of times to make it more effective to combat cartels and encourage cartelists to betray their co-conspirators in a mad dash to confess their antitrust sins in return for full immunity from corrective measures, administrative fines and potential criminal prosecution or at least for a substantial reduction in fines and corrective measures. The experiment continues and, in 2012, the KFTC implemented two new significant revisions. First, to reduce recidivism, the KFTC sharply limited the availability of antitrust leniency to repeat offenders. Second, the KFTC made it much stricter for second-in-line applicants to qualify for leniency. These two measures are designed to send a message that crimes don't pay and at the same time to allay critics who charge that sophisticated corporate wrongdoers often escape scot free by simply turning themselves in sooner and more often than other co-conspirators after enjoying a period of ill-gotten gains. It remains to be seen how effective these two changes will be and what new refinements will come out of the KFTC.

Repeat Offenders Need Not Apply Within Five Years

Effective January 1, 2012, the KFTC once again revised its leniency program, this time to stop repeat offenders from abusing the system by exploiting the full benefits of leniency time after time. Under the new system, a leniency applicant is not eligible for leniency if (a) it violates existing corrective measures within five years of the initial imposition of the corrective measures, or (b) it engages in new unlawful concerted conduct within five years of the grant of the initial leniency.

Therefore, a conspirator that is already subject to an existing corrective order or received immunity in the previous five years will no longer have an incentive to report a new conspiracy. The revision reflects the KFTC's enforcement intention to discourage habitual offenders from engaging in illegal concerted conduct again by making it much more costly. While it could indeed help decrease recidivism, one may question whether it would be desirable from a policy perspective to deny leniency for five years when leniency programs serve both to detect and deter illegal concerted conduct. Not only is it difficult to find an empirical support for the new system but the revision may also drive undetected cartels underground to continue to thrive. For example, suppose a company applies for and receives leniency. Then, two years later, a group of rogue employees joins a cartel involving an entirely unrelated product or service despite the company's clear instructions not to engage in such conduct. Then, another two years later, the company uncovers the cartel during an internal antitrust audit. Under the new rule, the company does not qualify for leniency even if it takes prompt action to end its participation and reports it to the KFTC immediately because it is still inside the 5 year "probation" period. On the other hand, if a previous recipient of antitrust leniency engages in a new cartel activity just a little over 5 years after the initial grant of leniency, it can qualify for leniency if other conditions are met. Inflexible application of the new 5-year "probation" rule without regard to any qualitative inquiry may very well prove to be counterproductive.

No More Generous Treatment for Second-in-Line Applicants in Two-Member Cartels and Tardy Second-in-Line Applicants in Other Cases

On June 19, 2012, the KFTC further revised the leniency program to cure what has been criticized as unfairly generous treatment of the second-in-line applicants in certain situations. Under the new system, (a) the second-in-line applicants in two-member cartels are not eligible for formal leniency, *i.e.*, no automatic reduction in fine and corrective measures; and (b) tardy second-in-line applicants that surrender more than two years after the date of the first-in-line applications are not eligible for leniency.

Therefore, in a two-member cartel, the second-in-line conspirator would have a significantly reduced incentive to admit its wrongdoing and apply for leniency early. The second company may still decide to cooperate in the KFTC's investigation and receive cooperation credit. However, a formally accepted second-in-line leniency applicant in three or more member cartels automatically receives a 50% reduction in fines whereas cooperation with the investigation is merely a potential mitigating factor to consider in the KFTC's sole discretion on the amount of administrative fines and confers at best a 30% reduction in administrative fines.

The KFTC revised the rule on two-member cartels because of a rather perverse result in the eyes of critics that all of the wrongdoers of a two-member cartel can enjoy full immunity or substantial reductions in fines and corrective measures. For example, in a recent KFTC case, two companies reported their two-member cartel on home appliances, and received 100% and 50% reductions in administrative fines. When this result was announced, there was a significant amount of public backlash that such a result is consistent with neither the fundamental purpose of the leniency program nor a sense of fairness. Nonetheless, some may still question if this revision reduces the effectiveness of the leniency program to the extent that the KFTC may have to dedicate more resources to prove a violation by the second and the only other member of a two-member cartel.

The new rule on two-member cartels raises a few interesting implementation issues. First, at what point do we know for sure whether we have a two-member cartel or three-member cartel? For example, what if the KFTC begins a particular investigation thinking that a three-member cartel was involved and provisionally accepts two applicants. But the KFTC later determines that it really was a two-member cartel. Even more interestingly, the KFTC determines at its full-Commission hearing that it was a three-member cartel and formally accepts number one and number two leniency applicants. On appeal by the third member of the alleged three-member cartel, the Seoul High Court, which has sole jurisdiction to hear appeals of KFTC decisions, reverses the KFTC and holds that it was really a two-member cartel. What would happen to the second applicant's status who already received leniency under these two scenarios?

Second, presumably, the rule against granting immunity to coercers (those conspirators who coerced others to join or prevented others from leaving the cartel) would still apply to two-member cartels. In some cases, the first applicant may lose its first-in-line status if the second applicant provides convincing evidence to prove coercion on the part of the first applicant. Because only the first applicant receives full immunity, once one of the conspirators decides to turn itself in, there may be a more intense fight or jockeying for position between the two former conspirators to take the one and only available leniency spot. One could argue that at least when it comes to two-member cartels, the Korean system is now a lot like the first applicant only system of the U.S. It will be interesting to see whether the KFTC will extend this "one leniency applicant only" concept from the limited two-member cartel situation to a broader set of cases or even all cases. Indeed, from 1997 to 2001, the KFTC accepted only the first applicant who reported its cartel participation before the date of the KFTC's dawn raid, but it gradually loosened various qualifications to encourage more leniency applications.

The two year deadline rule for second applications is designed to stem co-conspirators' opportunistic timing and strategic gaming of the leniency system. Given that a theoretical difference in fine reductions is 20% (50% for the second applicant and 30% for all others who earn maximum cooperation credit) and formal leniency status recipients have more strict and comprehensive cooperation requirements, in some situations, some companies may find it more advantageous to forego formal leniency applications. On the other hand, some may question whether the two year deadline is unnecessarily or even generously long to offer any meaningful check on some co-conspirators' abuse of the system. At the same time, many international cartels are investigated in multiple jurisdictions but not necessarily on the same time schedule, thereby producing somewhat different leniency application dates at times. Some have defended that the two-year rule is meant to be flexible and to account for time lags among multi-jurisdictional investigations.

Antitrust Enforcement in India: A Review

Kaushal Kumar Sharma
K K Sharma Law Offices, India

The history of cartel enforcement in India predates the enactment of competition law in January 2003.[1] By an order dated April 19, 1976, an inquiry[2] into an agreement among eight tire manufacturing firms was closed after receiving an undertaking from the involved eight firms to the effect that such practice would not be indulged in in the future.[3] Interestingly, this general code of conduct agreement was nothing but a cartel arrangement. However, in terms of the then-existing law (the MRTP Act, 1969), a "cease and desist" order was passed and an undertaking was given and accepted by the MRTP Commission. It is not reliably known whether the involved parties stuck to their promise or not, but allegations of similar conduct against tire manufacturers by the tire dealers' associations survive to date. However, earlier this year, the Press Trust of India (PTI) newspaper reported on January 15, 2012, that Apollo Tires was fined 45 million Rands by the South African Competition Commission for cartelization charges. The company, through a press statement, claimed that the charge related to the period it was being managed by Dunlop before its acquisition by Apollo tires. Incidentally, Dunlop India was one of the eight firms mentioned in the case before MRTPC.

In contrast to this type of history, the business community really woke up to the menace of anti-competitive conduct and its consequences. On June 23, 2011, a little over two years after the Competition Commission of India (CCI) was given power to enforce prohibitions on anti-competitive agreements and abuse of dominant position,[4] the CCI imposed a penalty for predatory pricing in Case No. 13/2009, MCX Stock Exchange Ltd. & Ors. vs National Stock Exchange of India Ltd. & Ors.[5] This type of antitrust violation is very difficult to prove globally and normally requires in-depth economic analysis. What made the job of the CCI easier was the fact that the predatory price was not any finite price but zero-continuing for a long time without any justification. This saved the CCI from needing heavy economic analysis to prove that the price was indeed predatory.

However, this was not the first time that anti-competitive conduct was supported through investigation by the Director General (DG) and accepted by the CCI. In the FICCI Multiplex film industry case (Case No. 1/2009), the DG gathered, among other things, detailed video evidence of meetings, bills for the meetings, and sworn statements of the important cartel members. By an order dated May 25, 2011, penalties of no more than USD $2,000 each were imposed on twenty-seven cartel members.[6]

A penalty of over USD $126 million in the real estate industry on DLF Ltd. followed soon thereafter.[7] In the trend of increasing amounts of fines and a major display of assertion of its new role by CCI, a penalty of USD $1.262 billion was imposed on cement manufacturers and their association for cartelization based on circumstantial evidence. The cement, steel, and tire industries have been the usual suspects across the globe so much so that even before the erstwhile MRTP Commission, the cement cartelization issue had come up . The fact that no penal consequences followed speaks more of the infirmities in that law than the innocence of the alleged cartel members.

Another case of interest is the LPG Cylinders manufacturers case wherein the cartel member felt that he can take the system for a ride. The complaint had been filed by a member of the cartel against the victim Public Sector Undertaking (PSU). Investigation threw up the fact that the complainants' association was indulging in a blatant cartel activity. This led to a penalty order from the CCI.[8]

In totality, it has been a mixed bag. It is good that the violators of antitrust have been made aware that the law does not merely end up with a bark and a paper undertaking, but it has a bite too, if required. However, a more consistent approach, while evaluating evidence, may add sheen to the enforcement agency as it will not leave a feeling – right or wrong – that while some end up with a small rap, others have received large fines on circumstantial evidence.

It is understood that the first rush through the door by any one cartel member, or its fear, creates a good instability in the cartels and helps lure the cartel members leading to better cartel enforcement. The leniency schemes introduced by different jurisdictions have had a great positive impact on the cartel enforcement in those jurisdictions. To date, it appears that CCI's leniency regulations[9] also are not helping it get clinching evidence from cartel members. There is uncertainty for first cartel member asking for leniency due to the regulations' use of the word "may" in place of "shall." Interestingly, the first draft of these regulations released by CCI in 2008 had the certainty, by using "shall" for the first cartel member to break ranks from the cartel and report the matter to the CCI.[10] The final draft regulations available on the website of the CCI now, however, do not give that kind of comforting certainty to the first cartel member for breaking ranks. This, perhaps, has ensured that, except for some frivolous leniency applications, where the leniency was being sought on the basis of publicly known information, no genuine and serious cartel member has yet to come before the CCI, depriving the CCI of a great tool for breaking cartels.

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[1] http://www.cci.gov.in/images/media/competition_act/act2002.pdf?phpMyAdmin=QuqXb-8V2yTtoq617iR6-k2VA8d.

[2] RTPE 1 of 1971 before MRTPC.

[3] Participants to the agreement, titled "General Code of Conduct for Members of the Automotive Tire Industry of India," included Incheck Tyres Ltd., Dunlop India, Good Year India, Fire Stone Tyre, and Rubber Co Ltd.

[4] http://www.cci.gov.in/images/media/notifications/cf_4.pdf?phpMyAdmin=NMPFRahGKYeum5F74Ppstn7Rf00.

[5] http://www.cci.gov.in/May2011/OrderOfCommission/MCXMainOrder240611.pdf.

[6] http://www.cci.gov.in/May2011/OrderOfCommission/FICCIOrder260511.pdf.

[7] http://www.cci.gov.in/May2011/OrderOfCommission/DLFMainOrder110811.pdf.

[8] http://www.cci.gov.in/May2011/OrderOfCommission/LPGMainfeb2.pdf.

[9] http://www.cci.gov.in/images/media/Regulations/regu_lesser.pdf?phpMyAdmin=NMPFRahGKYeum5F74Ppstn7Rf00.

[10] http://cci.gov.in/images/media/presentations/bharatwal_15_16mar08_leniency_20080717112325.pdf.

The Telkom Case: South Africa's Competition Authorities Impose a Record Fine for Abuse of a Dominant Position

John Oxenham & Luke Kelly
Nortons Inc., South Africa

Introduction

The South African Competition Tribunal ("the Tribunal") recently handed down its decision in a case involving South Africa's former monopolist in the fixed line telecommunications market, Telkom. The case before the Tribunal was prosecuted by the South African Competition Commission ("the Commission") and came about as a result of complaints lodged with the Commission by companies alleging that Telkom had abused its dominant position during the period 1999 to 2004.

The companies that initially complained to the Commission were "value added network service providers" ("VANS providers") who compete with Telkom in the market for value added network services ("VANS"). VANS providers include, for example, companies that provide services such as managed IT networks, hosting and virtual private networks ("VPNs") – all services that require some form of access to the fixed line telecommunications infrastructure controlled by Telkom.

The Commission accused Telkom of abusing its dominance by refusing VANS providers access to an essential facility, inducing end-consumers not to deal with VANS providers, the charging of excessive prices to VANS and price discrimination (which should have been formulated as a margin squeeze complaint). The Tribunal upheld the Commission's non-price complaints and dismissed the pricing complaints – essentially for lack of sufficient evidence. The Tribunal imposed an administrative penalty on Telkom of R449m, thus far the highest penalty imposed in an abuse of dominance case in South Africa.

Background

A proper understanding of the case requires a brief explanation of the background to the telecommunications market in South Africa. Telkom was until 1991 a state monopoly regulated by the South African government. In October of 1991 Telkom was "commercialised" in that it was converted into a private company – the state however remained its sole shareholder. During 1995 and 1996 (in the early years of South Africa's democracy) the newly elected government produced a White Paper outlining a gradual process of deregulation and privatisation of the telecommunications industry. This culminated in the promulgation of the Telecommunications Act of 1996 ("the Act") and the establishment of an independent industry regulator.

The Act provided, for the first time in South Africa, for competition in the VANS sector of the market. The Act also provided for a five year period in which Telkom would retain exclusivity over what is referred to as "public switched telecommunications network" ("PSTN") – essentially the backbone of the telecommunications network in South Africa.

The genesis of the Telkom case lies in the fact that whilst the Act provided that the regulator could provide licenses to VANS providers to offer value added services to the market, it did not define what constituted a "value added service." As VANS providers began to obtain licenses and roll out efficient VPNs for customers around South Africa, Telkom, realising it was falling behind in this lucrative frontier market, began a strategy of foreclosure that exploited the ambiguity inherent in the Act.

Telkom's abusive conduct

During 1999 Telkom provided the regulator with its interpretation of the Act. Unsurprisingly, Telkom interpreted the Act as granting it exclusivity over certain value added services offered by VANS providers – in particular VPNs. According to Telkom, VANS providers could not lawfully provide their customers with VPNs on the basis that VPNs were not "value added services" as defined in the Act (and in terms of which companies could obtain licenses to offer to the public) but were PSTNs over which Telkom had exclusive rights. The regulator disagreed.

Dissatisfied with the regulators opinion, and in response to the rapid growth of VANs offering VPNs to a burgeoning customer base, Telkom embarked on the following commercial strategy:

- When approached by a VANS provider requesting access to its facilities, Telkom would send the VANS provider a letter advising them that they prohibited from reselling, subletting or sharing any of the facilities extended to the VANS provider by Telkom. Telkom made sure to remind the VANs provider that it monitored the use of its facilities.

- Telkom refused to permit its existing customers from switching to a VANS provider.

- If an existing customer of a VANS provider required a service that required the VANS provider to obtain access to facilities provided by Telkom,

> Telkom insisted that the customer register directly with Telkom – creating an extra administrative burden for the customer, and giving Telkom access to the customer's details.

Telkom would then selectively enforce its interpretation of the Act by "freezing" access to its facilities. The "freeze" imposed by Telkom precluded the VANS providers from growing their businesses. It did not entail a complete shutdown of their operations – had Telkom done so the general furor that would have ensued would have forced Telkom's hand.

As part of Telkom's strategy to foreclose VANS providers it approached VANS providers' customers with claims that their suppliers were engaged in illegal activities by, for example, offering them VPNs. Consumers of VANS require continuity of supply and it should come as no surprise that they began to doubt their VANS providers, and would in some cases switch to Telkom.

Telkom, in effect, assumed the role of a de facto regulator: it interpreted the Act in a manner that served its own interests (and had the effect of undermining competitors in the VANS sector), it policed its interpretation of the Act by "freezing" access to its facilities (albeit selectively) and it took efforts to advise consumers to be wary of the "illegal" conduct being perpetrated by VANS providers. It bears repeating that this conduct took place in circumstances where the de jure regulator had in fact disagreed with Telkom's interpretation of the Act in the first place.

The Tribunal's findings

Telkom's principal defence before the Tribunal was that its conduct was motivated by a desire to adhere to provisions of the Act that granted it exclusivity. It conceded before the Tribunal that if its interpretation of the Act was incorrect, its defence would fall away.

The Tribunal adopted the view that it did not need to determine whether Telkom's interpretation of the Act was correct. In the Tribunal's view, and based on Telkom's targeted conduct and the discovery of damning internal memoranda that suggested Telkom itself was aware of a "grey area" in the Act regarding the boundaries of its exclusivity, the Tribunal found Telkom guilty of refusing competitors access to an essential facility and of inducing consumers not to deal with downstream competing VANS providers.

One may ask why it took so long to prosecute the case given that the complaint was initially lodged with the Commission in 2004. This was due, in part, to Telkom 's challenge to the Commission's jurisdiction, testing whether the regulator had exclusive jurisdiction to deal with complaints against Telkom arising from conduct pursuant to the Telecommunications Act. Telkom's jurisdictional challenge played out before the South African courts over a period of five years before the Supreme Court of Appeal finally rejected Telkom's argument and ruled that the Commission was vested with jurisdiction to hear the complaint.

By then, events have overtaken the case. By the time the trial came before the Tribunal, Telkom no longer had an outright monopoly on fixed line telecommunications infrastructure and had ceased engaging in the conduct subject to the complaint. However – and the Tribunal noted this in its decision – Telkom's conduct during the period 1999-2004 retarded competition in the market and stifled innovation in a crucial market. In many respects, the damage to South Africa's telecommunications industry had already been done.

Telkom has subsequently indicated that it will appeal, to the Competition Appeal Court, the Tribunal's decision.

The New Brazilian Pre-Merger Control Regime

Amadeu Ribeiro & Marcio Soares
Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados, Brazil

Introduction

The new Brazilian pre-merger control regime has recently completed its first few months since coming into force on May 29, 2012. This article outlines the basic rules of the new regime, including the process and timing for the review of both simple and complex cases.

Basic rules

Under the new pre-merger control regime, transactions that are subject to mandatory filing in Brazil cannot be closed and/or implemented before getting clearance from CADE. The parties must remain independent from each other until they are able to obtain CADE's final approval. Failure to comply with this standstill obligation exposes the parties to fines ranging from R$60,000 to R$60 million (approx. USD29,000 to USD29 million)[1] and formal investigation into their behavior prior to obtaining CADE's approval. CADE also may seek the required administrative and/or judicial remedies in order to have the acts implemented in violation of the standstill obligation declared null and void.

One of the main changes brought by the new regime is the definition of "concentration." The Brazilian pre-merger control rules define "concentration" as:

(a) Merger of two or more previously independent firms;

(b) Acquisition of direct or indirect control or part(s) of one or more firms, whether by purchase of shares, quotas or securities in general, assets, contract or any other means; and

(c) Association agreements, consortia and joint ventures, except if created for the purposes of a given tender process launched by the public administration.

According to Regulation No. 2, issued by CADE on May 29, 2012, the following transactions shall also amount to a "concentration":

(a) Acquisition of a minority stake granting the acquirer the status of the largest individual investor in the target;

(b) Acquisition of a 20% stake in the voting or total share capital, if the transaction does not result in any actual/potential horizontal overlap or vertical integration;

(c) Acquisition by a current shareholder with a shareholding of at least 20% of an additional 20% stake in the voting or total share capital from one single seller, if the transaction does not result in any actual/potential horizontal overlap or vertical integration;

(d) Acquisition of a 5% stake in the voting or total share capital, either by a current or a new shareholder, if the transaction does result in horizontal overlap or vertical integration; and

(e) Acquisition by the controlling shareholder of an additional 20% stake in the voting or total share capital from one single seller.

Although some issues have not been addressed by the new merger regulations (e.g., the concept of "association agreements", which may be subject to notification pursuant to the new law), such regulations increase legal certainty to the extent that they provide clear-cut tests with respect to notification requirements. This is particularly true for minority shareholding acquisitions, which were an area of great uncertainty before the new regulations were enacted.

If the transaction does amount to a "concentration," filing with CADE is mandatory if (i) at least one of the groups involved (seller or buyer) registered gross revenues in Brazil in excess of R$750 million (approx. USD361 million) in the fiscal year immediately prior to the transaction; and (ii) at least one of the other groups involved registered gross revenues in Brazil in excess of R$75 million (approx. USD36 million) in the fiscal year immediately prior to the transaction.

For the purposes of Brazilian merger review, the general definition of "group" includes: (a) all the entities subject to common control; and (b) all the entities in which any of the companies subject to common control hold, directly or indirectly, a shareholding of at least 20%.

If the definition of "group" is to be assessed in relation to an investment fund, the following entities shall be taken into account: (a) the funds subject to a common manager; (b) the manager; (c) the investors holding, directly or indirectly, an interest of at least 20% in any such funds; and (d) the portfolio companies in which any such funds hold an interest of at least 20%.

Lastly, the new Brazilian pre-merger control rules allow for two specific exemptions from the standstill obligation. The first applies to public takeover bids. Under this exemption, a public takeover bid may be notified to CADE following its announcement and can be completed before getting CADE's approval. However, the acquirer may not exercise the political rights attached to the acquired shares before clearance, unless it shows that the exercise of such political rights is necessary to maintain the full value of the investment, and provided that the acquirer obtains CADE's prior consent to exercise those rights.

The other possibility resembles the derogation option under the European Commission's rules, i.e., CADE may authorize the parties to close a notified transaction before clearance if: (i) there would be no irreparable harm to competition resulting from such a derogation; (ii) the situation would be easily reversible in the future if the authority concludes that the notified transaction harms competition; and (iii) the target company would face serious financial losses in the absence of the requested derogation.

Process and Timing

There are two review procedures under the new regime: the fast track and the regular procedure.

The fast track procedure applies to non-complex cases, including, amongst others: joint ventures to offer products and/or services that are not horizontally or vertically related to the activities developed by the parents; transactions resulting in only minor horizontal/vertical overlaps and involving market shares below 20%); and other transactions that CADE concludes that do not merit a detailed review.

Cases falling under the fast track procedure shall be filed on the basis of a short form. The complete filing form that applies to transactions that are not eligible for the fast track procedure requires a much greater volume of information and documents than required under the short form, including internal documents and extensive market data.

CADE may take up to 240 days to review a case. This review period may be extended for additional 60 days at the request of the parties, or 90 days by means of a justified order issued by CADE's Tribunal. The current regulation does not set forth intermediary review periods for non-complex transactions.

The Practical Experience With the New Regime

According to CADE, from May 29 to September 5, 2012, 37 transactions were filed in Brazil under the new pre-merger control regime, out of which 21 were cleared without restrictions in an average review period of 18 calendar days. All such clearance decisions concerned non-complex deals that were notified under the short form.

The above figures represent a promising start. However, it remains to be seen how CADE will address the challenges of complex cases. So far CADE has received a very limited number of cases filed on the basis of the complete form, all of which remain under analysis.

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[1] Based on the exchange rate of September 10, 2012 (Source: Brazilian Central Bank).

Meet the Authors

Timothy Cornell is Counsel in the Washington DC office of Clifford Chance.

Katrin Schallenberg is Counsel in the Paris office of Clifford Chance.

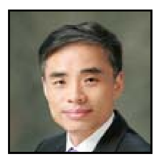
Matthew Hall is a Partner in the Brussels office of McGuireWoods.

Kaushal Kumar Sharma is Founder of K K Sharma Law Offices in New Delhi.

Martin Buntscheck is the Founder and Partner of Buntscheck Rechtsanwalts-gesellschaft mbH in Munich.

Evelyn Niitväli is a Partner of Buntscheck Rechtsanwaltsgesellschaft mbH in Munich.

Cecil Saehoon Chung is Senior Foreign Counsel in the Seoul office of Yulchon LLP.



Sung Bom Park is a Partner in the Seoul office of Yulchon LLP.

John Oxenham is a Co-Founder and Director of Nortons Inc. in Sandton.

Luke Kelly is a Consultant at Nortons Inc. in Sandton.

Amadeu Ribeiro is a Partner in the Rio de Janeiro office of Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados.

Marcio Soares is a Senior Associate in the São Paulo office of Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados.