Competition world

A global survey of recent competition and antitrust law developments with practical relevance

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In an opinion issued on September 20, 2016, In re: Vitamin C Antitrust Litigation,1 the Second Circuit unanimously held that US courts must respect a foreign government’s – in this case, China’s – interpretation of its laws or regulations where the foreign government directly participates in United States (US) court proceedings and demonstrates a true conflict of laws between the two countries. This long-awaited opinion, vacating a 2013 antitrust price-fixing jury verdict against Chinese vitamin C manufacturers, opens US antitrust and other laws to more comity arguments, particularly from businesses in China. In recognizing the unique nature of China’s economic-regulatory system, the Court’s decision represents a victory for the Chinese defendants and offers a possible defense for businesses that face different and contradictory sets of laws or regulations abroad.

**Background**

US purchasers of vitamin C sued Chinese vitamin manufacturers and their affiliates claiming they illegally agreed to fix prices and limit output from China. The trial court denied the defendants’ initial motion to dismiss and denied the defendants’ subsequent motion for summary judgment, rejecting the Chinese manufacturer’s defenses of foreign sovereign compulsion, act of state doctrine; and principles of international comity. The trial court declined to defer to the interpretation of Chinese law contained in an *amicus curiae* brief that the Chinese Ministry of Commerce (MOFCOM) (speaking on behalf of the Chinese government) filed in support of the defendants. This was the first time any Chinese Government entity had appeared *amicus curiae* before any US court.

Ultimately, the case was tried to a jury in the Eastern District of New York. In March 2013, the jury returned a verdict against the Chinese manufacturers. The trial court entered a judgment awarding the plaintiffs approximately US$147 million in damages and enjoining the defendants from engaging in future anticompetitive behavior. The Chinese manufacturers appealed. The Second Circuit heard argument on January 29, 2015, and issued its opinion in September 2016, reversing and remanding the judgment based on principles of international comity.

**Comity balancing test**

The Second Circuit used a comity balancing test. It explained that a court should abstain from exercising subject-matter jurisdiction where compliance with the laws of two countries is impossible, in what the Court described as a ‘true conflict.’ To determine whether a true conflict exists, a court must determine what the law of each country requires. Because US antitrust law clearly prohibits horizontal price-fixing arrangements, the question before the Second Circuit was whether Chinese regulations required the defendants to enter into horizontal price-fixing agreements.

The Second Circuit explained that when a foreign government directly participates in US court proceedings by providing sworn evidence of its laws, the US court must defer to the government’s statements about its own law. Because MOFCOM declared that it required the defendants to engage in the price-fixing at issue in the case, a true conflict existed between Chinese and US law. As a result, the Second Circuit held the trial court abused its discretion when it ruled on the antitrust claims instead of abstaining from exercising subject-matter jurisdiction.

**Impact of decision**

The Second Circuit’s opinion offers some clarity for businesses sued under US antitrust laws if those businesses can prove that they were required to act by foreign regulations in a way that would violate US law if performed in the US. Defendants, particularly Chinese businesses, may try to rely on sworn statements by foreign governments and wield the comity defense to have lawsuits dismissed based on the abstention doctrine. The Second Circuit’s decision is not binding in other circuits around the US, although the decision may be persuasive to other courts considering the same issue.
Highlights of competition law enforcement in Canada, 2016: Civil matters

A number of significant non-criminal matters were concluded in 2016, by way of negotiated settlement or decisions by the Competition Tribunal (the ‘Tribunal’). As a result, businesses and legal advisors now have greater guidance on issues, such as, interim injunctions under the merger provisions of the Competition Act (the ‘Act’) and the application of the abuse of dominance provisions to conduct by trade associations. Also, several matters involving online and offline misleading advertising were settled, providing guidance in particular on how the Competition Bureau (the ‘Bureau’) approaches the presentation of prices where additional fees are imposed and the Bureau’s Made in Canada guidelines. Finally, the Commissioner of Competition (the ‘Commissioner’) continues to encourage all Canadian businesses to adopt compliance programs to ensure they do not contravene the Act. These and other matters are discussed in greater detail below.

Mergers: Competition Act

Interim injunctions and mediated consent agreements

In September 2014, Parkland Fuel Corporation announced its intention to acquire the assets of Pioneer Energy LP. Both parties owned and leased corporate retail gas stations, as well as supplied gasoline to independently owned gas stations. This case has been a ‘pioneer’ for at least two Canadian competition law issues in the past two years: (i) it is the first case where the Tribunal has considered (and granted) an application for an interim injunction pursuant to Section 104 of the Competition Act where an application under Section 92 (final remedial order) had already been filed,¹ and (ii) it is the first case where a consent agreement has been negotiated through a mediation process.²

On May 29, 2015, the Tribunal issued an interim injunction ordering Parkland and Pioneer to hold separate retail gas stations and supply agreements in six markets identified by the Tribunal, for the duration of the Commissioner’s challenge of the proposed merger under Section 92. The Commissioner initially requested a hold separate in 14 local markets, but the Tribunal only granted the interim injunction in six of those 14 local markets as the Commissioner had not satisfied its evidentiary burden to meet the test under Section 104 of the Act in each and every one of those markets.

The Tribunal’s decision confirmed that the threshold for showing a serious issue to be tried is quite low and once it is determined that the application is neither ‘vexatious nor frivolous, it should proceed to the second part of the test’. With respect to producing clear and non-speculative evidence of irreparable harm, the Commissioner must show a clear definition of markets and post-merger market concentration.

In its decision, the Tribunal confirmed that the threshold for showing a serious issue to be tried is quite low and once it is determined that the application is neither ‘vexatious nor frivolous, it should proceed to the second part of the test’. With respect to producing clear and non-speculative evidence of irreparable harm, the Commissioner must show a clear definition of markets and post-merger market concentration.

In light of the Tribunal’s decision, merging parties should remember that transactional uncertainty exists not only in regard to a final order but that interim orders are possible. Thus, parties should plan for the possibility of a hold separate accordingly.

Following the Tribunal’s interim order, the parties opted to resolve the litigation under Section 92 of the Act by going through a mediation process overseen by the Chief Justice of the Federal Court. It is the first time that a consent agreement, in the context of a merger, has been reached through a mediation process. The Tribunal has issued a practice directive that provides guidance on the procedures and other considerations relating to mediation in matters before the Tribunal. It remains to be seen how often parties will choose to proceed by way of mediation.

¹ The Commissioner of Competition v Parkland Industries Ltd, 2015 Comp. Trib. 4.
² The Commissioner of Competition v Parkland Industries Ltd, Court File CT-2015-003, Consent Agreement.
The consent agreement resulted in Parkland agreeing to divest a gas station or supply agreement in six local markets and for Parkland to adhere to price restrictions in the wholesale supply of gas in two other markets. It is worth noting that two of the markets in which a divestiture was required were not part of the six local markets that were subject to the interim hold separate. Again, this shows the uncertainty facing the parties to a merger. The final remedy may vary from that which was sought during the interim remedy stage.

**Mergers: Investment Canada Act**

**Changes to review threshold**

The past year has seen a significant upward trend in the monetary threshold that triggers a mandatory pre-closing review of proposed foreign direct investments in Canada under the Investment Canada Act (the 'ICA'). In such transactions, the Canadian Minister of Innovation, Science and Economic Development must be satisfied that the transaction is 'likely to be of net benefit to Canada' before the investment may be completed. Currently, the baseline threshold for most transactions is CAD 600 million in enterprise value. The threshold was originally slated to be increased to CAD 800 million on April 24, 2017 and to CAD 1 billion on April 24, 2019. However, in the 2016 Fall Economic Statement, the Government of Canada announced that the threshold will be raised to CAD 1 billion in 2017, two years earlier than planned.

Additionally, pursuant to the Canada-European Union Comprehensive Economic and Trade Agreement (the 'Agreement'), signed on October 30, 2016, the threshold will be increased to CAD 1.5 billion for investors from EU member states. Due to the existence of most favoured nation provisions in other free trade agreements, eight other countries will also benefit from this higher threshold – Chile, Colombia, Honduras, South Korea, Mexico, Panama, Peru, and the United States – which is expected to come into effect when the Agreement is provisionally applied as early as spring 2017.

**National security review developments**

Following amendments to the ICA in 2009, any investment in a Canadian business by a non-Canadian is also assessed to determine if it could be injurious to Canada's national security. Little guidance was provided on what could trigger such concerns. In the 2016 Fall Economic Update, the Government of Canada announced that, before the end of the year, it would publish guidelines regarding how investments are examined under the ICA's national security provisions.

This announcement came just days before the Federal Court of Canada made an order on consent setting aside the Governor in Council's decision to require Chinese company O-Net Communications Holdings Limited to divest itself of an investment by which it had acquired control of a Canadian optical components and modules manufacturer as a result of national security concerns. O-Net challenged the decision on the basis that the Minister had not provided O-Net with sufficient details of the Minister's concerns or a meaningful opportunity to respond. In its decision of November 9, 2016, the Federal Court remitted the matter back to the Minister to undertake a fresh review of the acquisition.

**Abuse of dominance**

In Canada, abuse of dominance is a civil offence which requires the Commissioner to show before the Tribunal that (i) one or more persons substantially or completely control, throughout Canada or any part of Canada, a class of business; (ii) that the person has engaged or is engaging in a practice of anti-competitive acts; and (iii) the practice has had, is having, or is likely to substantially prevent or lessen competition in a market. There were several matters of note in 2016.

**Competition Tribunal finds Toronto Real Estate Board abused its dominance**

Five years after the Commissioner started proceedings against the Toronto Real Estate Board (the 'TREB'), the Competition Tribunal ruled in April 2016 that TREB abused its dominance by preventing its members from offering more innovative services to their customers.

TREB is a trade association whose members include most real estate agents in Canada's largest city, Toronto. Through rules and policies it restricted how its members could provide information to their customers, which the Commissioner argued is an abuse of dominance contrary to section 79 of the Act. The application alleged that TREB used its market power to restrict its members from offering various innovative products and services to consumers, and in particular, restrictions on the display and use of information related to real estate listings on password-protected virtual office websites.

The Tribunal found that a competitor is a person who competes in the relevant market and does not have to be a...
The Commissioner alleges that the VAA is engaging in anti-competitive acts by refusing to grant access to the airport airside for new entrants, and by its continued tying of access to the airport airside to the leasing of airport land for catering kitchens. The VAA argues that it does not have any anti-competitive purpose, that it has valid, efficiency-enhancing, pro-competitive business justifications for not permitting new entrants, and that it is acting according to its public interest mandate.

**Investigation discontinued into alleged anti-competitive conduct of TMX Group Ltd.**

On November 21, 2016, the Commissioner discontinued its investigation into TMX Group Ltd. for alleged restrictive trade practices, including abuse of dominance. The Commissioner began an investigation following a complaint that TMX Group was impeding another company’s ability to develop a product delivering consolidated securities market data due to restrictive clauses in TMX Group’s contracts with investment dealers.

In a position statement explaining his analysis, the Commissioner focussed on the third part of the test, and looked at whether the contractual clauses were likely to substantially prevent or lessen competition in a market. Based on the evidence collected it was unlikely that the complainant would have been able to obtain enough data from investment dealers, even absent the TMX Group’s contractual agreements, for the complainant’s product to provide sufficient future competition. On these grounds, the Commissioner determined that the alleged anti-competitive clauses did not likely have the effect of preventing competition substantially in a market, did not finalize his review of the first two parts of the test, and closed his investigation.

**Misleading advertising**

**Price representations: Avis Budget Group**

Following a multi-year investigation and inquiry, in March 2015 the Commissioner commenced proceedings against the Canadian operating subsidiaries of the Avis and Budget car rental businesses, as well as, their US parent company, Avis Budget Group Inc. The Commissioner alleged that the manner in which the companies advertised the prices of its rental cars and certain related accessories was misleading in that the price advertised could not be obtained without the payment of additional mandatory fees, and the description of certain of those fees was misleading. This was also the first case in which the Commissioner sought a penalty under the anti-spam provisions of the Act, which provide (in part) that an email with a misleading subject line can run afoul of the Act regardless of the materiality of the alleged misrepresentation.

In addition to an order seeking to prohibit these representations, and unspecified restitution for consumers expected to total some C$35 million, the Commissioner sought the maximum C$10 million penalty against each of the Canadian entities, as well as, an additional C$10 million from their US parent entities. In June 2016, the parties settled the case, entering into a consent agreement which provided that they would, among other things, no longer make the representations in question and agreed to pay an administrative monetary penalty of C$3 million plus C$250,000 towards the Commissioner’s investigative costs. To implement these changes, the parties changed the manner in which prices are displayed to Canadian residents on their websites and mobile apps so that the initial price shown to consumers includes all fees and taxes, rather than only the base

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7 Commissioner of Competition and Vancouver Airport Authority, CT-2016-015.
rate. They also changed the names of certain of the additional fees.

The lesson to be drawn from this case is that the Commissioner does not consider it sufficient if consumers are shown the estimated total price of a product before confirming their purchase where that price consists of a base price that is advertised but additional fees are disclosed and added later in the transaction process. The Commissioner will consider that to be misleading.

Deceptive marketing: record restitution orders

Until 2009, the Act did not empower the Tribunal to award restitution for consumers affected by deceptive marketing. As a result of an action by the Commissioner against Canada’s three largest wireless carriers, Canadian consumers will receive approximately C$24 million in restitution to settle allegations that the carriers were making or permitting false or misleading representations to be made to customers in third party advertisements relating to premium text messaging services and placing charges for these services on wireless phone bills without prior authorization from their customers.8

The Commissioner commenced a court action against the three carriers, as well as, the Canadian Wireless Telecommunications Association (the ‘CWTA’), in September 2012. In addition to the record restitution orders, the case is noteworthy because of the cooperation between the Bureau and the United States Federal Trade Commission (the ‘FTC’). FTC officials were asked to assist in obtaining evidence from a US-based company that had been contracted by the CWTA to collect and analyze the advertising through which the carriers promoted the premium text messages. Applying the US Safe Web Act, the US District Court of Maryland upheld an order requiring that company to produce relevant records. As such, it was the first case in which a US court has ordered such assistance to aid in an investigation by the Bureau.

Made in Canada claims: another mediated settlement

Following the mediated resolution of the Pioneer/Parkland merger, late in 2016 the Commissioner used mediation to resolve another matter in which litigation had been commenced. The Commissioner had filed an application with the Tribunal in April 2016 alleging that the maker of Moose Knuckles branded premium parkas breached the misleading advertising provisions of the Competition Act by improperly claiming that certain of its parkas were made in Canada.9 The Commissioner alleged that the parkas in question were “mostly manufactured in Vietnam and elsewhere in Asia … [when] only the finishing touches to the jackets, such as adding the trim, zippers and snaps, are done in Canada.” This case turned on the interpretation of the Commissioner’s Bulletin on “Product of Canada” and “Made in Canada” claims. The guidelines provide that the Commissioner will not take issue with Made in Canada claims where the following three conditions are met

• The last substantial transformation of the good occurred in Canada.
• At least 51 per cent of the total direct costs of producing or manufacturing the good have been incurred in Canada.
• The ‘Made in Canada’ representation is accompanied by a qualifying statement, such as ‘Made in Canada with imported parts’ or ‘Made in Canada with domestic and imported parts’. This could also include more specific information such as ‘Made in Canada with 60 per cent Canadian content and 40 per cent imported content’.

Moose Knuckles vehemently denied the allegations, and claimed that they fulfilled the criteria in the guidelines. Had it not settled, the case would have provided useful guidance on the types of costs that could properly be included for the calculation in the second criterion. In the alternative, the company claimed that the guidelines were not legally binding as the criteria are not contained in the text of the Act. The matter had been set for a hearing in February 2017, but on December 7, the Commissioner announced that the parties had resolved the matter through mediation and the terms of settlement are reflected in a consent agreement. Moose Knuckles must publish corrective notices, add qualifying language to its made in Canada claims, pay C$750,000 to various charities over five years, and adopt a compliance policy to ensure that the company complies with the misleading advertising provisions of the Act. The company, as is usual in consent agreements, did not have to admit that it violated the Act.

The push for Compliance Programs in Canada

As part of its ongoing mandate to encourage compliance with all aspects of Canadian competition legislation, the Bureau released its updated Bulletin on Corporate Compliance Programs (the ‘Bulletin’) in mid-2015 and its Competition and Compliance Framework in late 2015 which outline the various outreach, enforcement and advocacy instruments used by the Bureau to promote compliance with the Act. The Bulletin outlines the consideration given by the Bureau to

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8 Bell customers to receive up to C$1.87 million as part of Competition Bureau agreement (May 27, 2016).
9 Commissions of Competition and Moose International Inc., CT-2016-006.
compliance programs and provides guidance on the design of credible and effective compliance programs.

**Advantages of a Compliance Program**

There are several advantages to adopting a compliance program in light of the Bulletin.

First, a compliance program reduces the costs of compliance with Canadian competition legislation because managers and employees are more knowledgeable on the subject.

Second, a compliance program facilitates the early detection of anti-competitive conduct. The early detection of conduct that violates the cartel related provisions of Canadian competition legislation is particularly advantageous, as the first party to disclose to the Bureau a cartel related offence may receive immunity under the Bureau’s immunity program. Subsequent parties that come forward and cooperate with the Bureau may be eligible for a reduction in potential fines under the Bureau’s leniency program, with the amount of the reduction dependent on the order in which each application is received.

Third, the existence of a compliance program may also be considered by the Bureau and courts as a mitigating factor when considering fines and remedies for violations of Canadian competition legislation.

Finally, a compliance program also assists businesses in determining the circumstances in which they may be the victim of anti-competitive conduct by other parties.

The Bureau has emphasized that compliance programs should be taken seriously by management. The fact that a business and relevant individuals knowingly contravened the law, despite the existence of a compliance program, may be considered an aggravating factor when assessing fines and remedies.

**Elements of Credible and Effective Compliance Programs**

The Bureau has stated that compliance programs should be both credible and effective. The Bulletin outlines seven elements of a credible and effective compliance program:

- Management commitment and support.
- Risk-based corporate compliance assessment.
- Compliance policies and procedures.
- Training and education.
- Monitoring, verification and reporting mechanisms.
- Disciplinary procedures and incentives.
- Program evaluation.

All businesses, regardless of size, can benefit from a compliance program. The exact structure of the compliance program should be tailored to the needs of each business and take into account the size and specific risks affecting the business.

In addition, the Bureau has emphasized that compliance programs are not limited to businesses. For example, the Bureau also encourages trade associations to adopt credible and effective compliance programs and other measures to prevent improper conduct.

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Will the GC’s **Lundbeck** decision be overturned on appeal?

**Introduction**

In September 2016, the EU General Court (GC) issued its long-awaited decision in the **Lundbeck case**¹ – the first ever European judgment on the legality of reverse payment patent settlement agreements.

Reverse payment patent settlement agreements are a feature of the pharmaceutical sector, where – in lieu of the risks of trial – a patent holder agrees to settle a patent dispute with a patent challenger with a settlement payment that provides the patent holder’s business with ongoing patent protection. Given the uncertainties of patent litigation, such settlements appear ostensibly sensible commercial arrangements, but have been characterized in a series of cases on both sides of the Atlantic as anticompetitive agreements which foreclose market entry (thereby assuming the settlement payment equates to a recognition of the patent’s invalidity).

The **Lundbeck** decision follows two years after the landmark US Supreme Court’s ruling on reverse payment patent settlement agreements in **Actavis**², and less than a year after the UK CMA imposed significant fines on GSK and certain generic drug manufacturers³ in the context of similar settlement agreements.

It was hoped that the GC’s **Lundbeck** judgment would bring some clarity to the legal standard that applies to reverse payment patent settlement agreements in Europe, but unfortunately the GC has merely upheld the European Commission’s decision in its entirety – a decision which contains conflicting ideas about the interaction of competition law and intellectual property rights in the pharmaceutical sector.

The GC’s judgment now faces a further appeal to the EU’s Court of Justice (CJEU), but for companies involved in patent litigation who may be considering settling a dispute, the GC’s judgment is an important development and continues the trend of antitrust authorities applying competition law to contexts where IP rights would normally dictate that the right holder is legally protected from competition.

**Summary of the facts**

**Lundbeck**’s compound patent for the citalopram molecule (used as an antidepressant medicine) had expired by the time the settlement agreements were entered into, but patents covering processes for the manufacture and crystallization of citalopram remained in place as generic manufacturers started to enter the market. Lundbeck started patent infringement proceedings against certain generic companies (Generics UK, Alpharma, Arrow and Ranbaxy) which eventually led to a variety of settlement agreements. As part of these settlement agreements, the generic companies agreed: (i) not to market citalopram which infringed Lundbeck’s patents; and (ii) to sell existing citalopram stocks to Lundbeck, resell Lundbeck citalopram, or receive payments instead of damages or litigation costs.

The European Commission investigated these agreements and found them to be ‘market sharing’ agreements which restricted competition law ‘by object’, fining Lundbeck and the generic companies €146 million. It was important to the European Commission’s assessment that the value of payments made to the generic manufacturers corresponded to the expected profits of the generic companies following market entry: the Commission found that these payments ‘induced’ the generic company to abandon independent efforts to enter.

It is worth noting that the agreements in **Lundbeck** were not traditional settlement agreements in that they did not finally settle the litigation between the parties. They instead suspended both the litigation and the generic company’s entry for a limited period of time.

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¹ Case T-472/13 Lundbeck v Commission.
³ Paroxetine – Case CE-9531/11.
GC’s decision – points of significance

There were several points in the GC’s decision which were of particular interest, including:

- The GC’s decision to classify the infringing conduct as ‘by object’ (as opposed to under the more burdensome legal threshold of ‘by effect’).
- How the GC evaluated the existence of ‘potential competition’.
- How the GC considered the ‘transfer of value’ under the settlement agreement from Lundbeck to the generic companies.
- The concept of a restriction of competition ‘by object’ must be interpreted restrictively.
- It can only apply to conduct that, in itself, reveals a sufficient degree of harm to competition.
- In order to establish whether there is a sufficient degree of harm it is necessary to consider the relevant restrictions in their context, taking into account their content, objectives and the economic and legal context in which they occur.

We consider each of these points in further detail below.

‘By object’ restriction of competition

According to the GC, patent settlement agreements are a restriction of competition ‘by object’ i.e. they are by their very nature harmful to competition, irrespective of their effects on the market, where:

- They are made between actual or potential competitors.
- They contain a ‘value transfer’ from the patent holder to the patent challenger.
- This ‘value transfer’ is in return for restrictions on the challenger company’s entry on the market (usually in the form of non-compete and/or no-challenge clauses).

The ‘by object’ classification is important in competition law cases as it removes the burden on the competition authority to establish in any precise detail the anticompetitive effects of the conduct in question. It has been a recurring theme in recent years for the Commission to favour the pursuit of cases under the ‘by object’ test, rather than apply the more onerous ‘by effect’ threshold, where the authority is required to spell out the anticompetitive effects of the arrangements in question. However, it is recognized that cases should not be taken forward under the ‘by object’ classification where they involve ‘novel’ infringements. The Commission’s trend of expanding the range of behaviors which were caught within the ‘by object’ box was recently noted by the CJEU in Cartes Bancaires where it set out the key elements of a restriction of competition ‘by object’

The CJEU’s judgment in Cartes Bancaires has been characterized as a welcome check on a tendency, for procedural efficiency, for the Commission to push more challenging cases through the ‘by object’ channel. However, the GC’s Lundbeck decision does not appear aligned with the Cartes Bancaires trend, in that there are a number of complex issues – not least the validity of Lundbeck’s IP rights – which are skated over in this decision.

Potential competition

A particularly significant aspect of the Lundbeck case is the idea that the generic companies were potential competitors of Lundbeck regardless of the existence of a ‘blocking position’ (i.e. patent protection held by Lundbeck). However, the GC found the fact that the generic companies had

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4 Case C-67/13 P, Groupeamment des cartes bancaires v European Commission, Judgment Of The Court (Third Chamber) of September 11, 2014, paras 58 and 78.

5 T-470/13 Merck KGaA v Commission “It has already been held that a position adopted by United States law cannot take precedence over that adopted by EU law and that an infringement of United States law does not constitute as such a defect resulting in the illegality of a decision adopted under EU law (see, to that effect, Judgment of September 30, 2003 in Atlantic Container Line and Others v Commission, T 191/98 and T 212/98 to T 214/98, ECR, IIU2003:245, paragraph 1407).”
possibilities for entering the market, including by launching ‘at risk’ of infringing Lundbeck’s patent, and that this was sufficient for them to be regarded as potential competitors.

In reaching the conclusion that launching ‘at risk’ was an expression of potential competition, the GC relied on three factors:

- Lundbeck’s compound patent had expired.
- There were other processes available to produce citalopram that were non-infringing.
- The generics had taken steps and made investments to enter the market in competition with Lundbeck, including obtaining the active pharmaceutical ingredient (API), applying for a Marketing Authorisation (MA), and actively seeking customers for their generic products.

There is an uncomfortable contradiction in this analysis which necessarily assumes that Lundbeck’s patent would have been invalidated upon challenge, despite the GC also acknowledging that patents should be presumed valid once they have been granted. This goes to the heart of the concern patent holders will have that competition authorities might be willing to assume their patents are invalid on the basis of commercial decisions taken in the face of litigation, rather than through any objective analysis of the patent validity itself.

Indeed, in addition to the ‘blocking position’ created by Lundbeck’s patent, the generic companies in Lundbeck explained that there were a number of other reasons why they had not entered the market to compete with Lundbeck, including other regulatory and commercial barriers. For example, some of the generics had not obtained a MA. The GC did not give much weight to these arguments, noting that the very fact that Lundbeck had entered into settlement agreements with the generic companies indicated that it perceived those undertakings as a potential threat.

Another criticism of the GC’s approach in Lundbeck is with regard to the time period required for entry by a potential competitor. The traditional test for a potential competitor requires entry within a short period of time – however, the GC in Lundbeck indicated that competition could occur several years before expiry of the compound patent when generic producers that want to launch a generic product begin developments leading to a product that meets regulatory requirements. Effectively, this means a generic which is up to eight years from market entry could be considered a potential competitor – far longer than is typically considered for a company to be considered a ‘potential competitor’, and also at a point when there is little certainty as to the likelihood of successful entry.

There is a strong argument that potential competition cannot exist where market entry depends on infringement of an IP right – in these circumstances the generic company does not have the ability to enter the market. The fact that the right in question may be declared invalid at a later stage should not be a relevant consideration, because this is true for all patents.

It is no coincidence that the patents in question in Lundbeck, and also in Servier (the second reverse payment patent settlement case brought by the Commission) are process patents. The Commission has been clear in its view that once the compound patent for a molecule has expired, the market is in principle open to generic companies. It therefore appears relevant to the Commission’s analysis of patent settlement agreements whether the patent protects a new molecule rather than a new process. However, the implication of a hierarchy of patents is artificial and sets a potentially dangerous precedent for competition authorities.

The Commission’s view appears to be that medicines should be entitled to the standard period of patent protection, but that this should not be extended by means of process, secondary or formulation patents. However, this ignores the fact that medicines are often legally entitled to more than the standard period of patent protection. Patents can be extended by supplementary protection certificates (SPCs) (to compensate for the lengthy period of time which it takes to obtain a MA) and also pediatric extensions. Exclusivity can also be extended by various other means including regulatory and marketing protection, and market exclusivity for orphan medicinal products. These rights have been granted as an acknowledgement of the particular characteristics of the pharmaceutical sector, but the Commission’s approach to patents cannot be reconciled with this.

**Transfer of value**

A further aspect of the Lundbeck decision which is of interest is the treatment of the ‘value transfer’ – which was a critical element of the infringement finding. The generic companies had entered into a variety of agreements with Lundbeck. Some involved cash payments by Lundbeck, some involved the purchase and/or destruction of generic stocks, and others involved a distribution element (i.e. rights for the generics to distribute...
Lundbeck products). All of these were considered ‘value transfers’ by the GC.

In particular, the GC took issue with the size of the payments made by Lundbeck to the generics, concluding that the size of the payments were disproportionate and that this ‘induced’ the generic companies to enter into the settlement agreements, rather than pressing ahead with the patent litigation which could have led to their competitive entry.

However, this assessment discounts the commercial logic that can justify a ‘value transfer’ in a patent settlement agreement. In a patent dispute, views on validity and infringement may differ within organizations and over time. Patent cases are complex, even for patent judges, and there is an asymmetry of risk between the originator and generic given the huge investment associated with a patent protected medicine that has to be recouped over the patent period, as against the position of the generic which will have made minimal investment in reaching the stage of patent litigation. In other words, where the outcome of the litigation is uncertain (which will often be the case given the complexities involved), the originator has more at stake than the generic, and so has an incentive to settle at some cost, rather than risk the loss of the ability to recoup its investment in the patented product.

The consequence is that it can sometimes make sense to settle (in fact English procedural rules encourage parties to settle), and payments often bridge the gap due to the asymmetry of risk between the parties. Generic entry will lead to an almost immediate and irreversible downward spiral in the reimbursement price of the originator medicine, whereas the loss to the generic if the patent is upheld is relatively minor. In such circumstances it is not uncommon for the transfer of value to flow in reverse – i.e. from originator to generic.

While the GC appeared to accept that an ‘asymmetry of risk’ exists between the parties and that this can partly explain why the originator may make a payment to a generic in the context of a patent settlement, the GC ultimately rejects the argument that the value transfer might be justified on such grounds. The GC merely confirms the Commission’s reasoning that, there was significant uncertainty at the time the agreements were concluded, and that that uncertainty was eliminated and replaced by the certainty that the generic undertakings would not enter the market during the term of the settlement agreements, and that this had the effect of excluding generic competition. It does not acknowledge that this would be exactly the same position as if the patent were upheld in litigation.

Concluding comments

The GC’s judgment in Lundbeck has created more questions than answers and it is inevitable that the parties in Lundbeck will appeal. In the meantime, the GC is likely to rule on the Commission’s second reverse patent settlement decision in the Servier case. It will be interesting to see whether the facts in Servier make any difference to the GC’s approach to reverse payment patent settlement agreements. For example, one of the key differences between the cases is that in Lundbeck, unlike in Servier, the settlement agreements did not finally resolve the litigation (Lundbeck’s agreements merely suspending the litigation).

The Lundbeck decision will, however, be welcomed by the UK’s Competition and Markets Authority (CMA) who in February of this year adopted a decision against GSK and a number of generic companies for entering into reverse payment patent settlement agreements. No doubt the CMA will rely on the GC’s decision in the pending appeal before the UK Competition Appeal Tribunal (CAT) which is due to be heard in February 2017. The CMA’s decision is evidence of a continued focus by competition authorities of these types of agreements.

Due to the inevitable appeals in both Lundbeck and Servier, it will be several years until pharmaceutical companies and their advisors can obtain any certainty on the legality of reverse payment patent settlement agreements. Indeed, the reality is that their assessment will be fact specific. However, in the meantime, there are some conclusions that can be drawn from the GC’s judgment.

• There are three basic criteria for the finding of a ‘by-object’ infringement of competition law
  — Significant ‘value transfer’ from originator to generic company
  — Restrictions on the generic company’s entry on the market
  — The generic and originator company being actual or potential competitors.

• The size of the ‘value transfer’ matters. While a payment can be linked to the costs of litigation, if it is linked to the generic company’s anticipated profits post-entry, it is likely to be considered anti-competitive.
• The very attempt to conclude an agreement or to engage in discussions with a generic undertaking not yet present on the market provides a strong indication that that generic undertaking is a potential competitor (irrespective of any commercial, legal, and regulatory barriers to entry).

• There is a likelihood that once the compound patent has expired, the competition authorities may treat the market as in principle open to generic companies. Therefore a generic is more likely to be a potential competitor if the relevant patent is a process patent. The implication is that settling a patent dispute on a compound patent is much less likely to cause concern, but that care should be taken when settling a dispute on a process patent.

• The generic’s internal documents can be used to support the notion that the particular generic was a potential competitor. This would be the case, for example, where the generic company’s internal documents indicate that the generic would be prepared to enter ‘at risk’ and that it is taking steps to enter the market. On the other hand, any documents which indicate that the generic company considers the patent valid could be useful in proving the absence of potential competition.6

• Settlement agreements that are only temporary in nature and do not finally resolve the litigation will be looked at suspiciously.

Ultimately, the legality of any patent settlement agreement under competition law will need to be judged on its own facts. However, the points above can help provide a framework for the approach of both originators and generics who wish to best protect their position in the context of what is likely to be ongoing scrutiny of the sector by competition regulators in Europe, the US and beyond.

6 These might refer to the fact that the generic would not be prepared to enter the market without a court declaration of non-infringement or success in opposition proceedings before the EPO.

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Advocate General opines against European Commission ahead of long-awaited Intel judgment on whether anticompetitive effects are necessary for a finding of a breach of competition rules.

On Thursday October 20, Advocate General Wahl (AG Wahl) issued his long-awaited opinion in the Intel case. This is the case that in 2009 led to fines of over €1 billion being imposed on Intel in respect of rebates and other ‘naked restrictions’ which the European Commission found had been intended to exclude competition by Intel’s rival, AMD, in manufacture of a particular type of computer microprocessor (x86 CPUs).

The Intel decision – good law but bad policy?

The Intel decision by the Commission was controversial because the Commission appeared to follow a highly form-based line of reasoning, finding anticompetitive conduct on the basis of the legal parameters of previous cases, without seeking to justify its decision by considering in detail the existence of any actual anticompetitive effects arising from Intel’s conduct. In Intel’s first appeal of the Commission’s decision in 2014, the Commission’s approach was endorsed by the EU General Court. AG Wahl’s opinion comes as part of the subsequent appeal to the EU Court of Justice – and, while not binding on the Court, the Court typically follows the AG’s opinion in its subsequent judgment. AG Wahl’s opinion is striking in that it finds the Commission and the General Court were wrong on five of the six grounds of appeal raised by Intel. Significantly, the AG’s opinion looks again at the case law on which the Commission and General Court had relied, but the AG interprets that case law differently and finds that there was indeed a requirement that the case against Intel should consider more closely whether the practices in question were ‘capable’ of restricting competition, when considering ‘all the circumstances’, the ‘legal and economic context’, and whether agreements had any ‘immediate, substantial and foreseeable anticompetitive effect in the EEA’. This approach would raise the evidential bar for the Commission in future cases.

From a competition policy perspective, it would seem uncontroversial that companies should not face sanction – and certainly not €1 billion in penalties – for conduct where no anticompetitive effect has been demonstrated. The Commission had also appeared to recognise the need for a more ‘effects-based’ approach to enforcement of its abuse of dominance rules in its 2009 Enforcement Priorities guidance, which made the Intel decision more surprising for many commentators.

However, and as has also been seen in cartel case law, there has been an inclination on the part of the European Commission to follow the path of least resistance in framing its cases, relying on interpretations of legal precedent to allow it to avoid protracted consideration of the anticompetitive effects of the arrangements in question. There are of course circumstances where anticompetitive effects will be obvious and such an approach is justified. In such situations, for example obvious cartels involving price-fixing, it is not in the public interest for the Commission to have to address detailed economic submissions from the parties seeking to establish (against the relevant counterfactual) that there were no anticompetitive effects from such obvious practices. However, the AG’s opinion suggests a different threshold should apply in abuse of dominance cases such as Intel.

What is the correct legal standard for illegal behavior?

In the Intel case, Intel had a market share for x86 CPUs in excess of 70 per cent for the period considered by the Commission. This was sufficient to establish that Intel held a dominant position, and therefore had a ‘special responsibility’ as regards its market conduct not to unfairly exclude competitors. The conduct at the heart of the case involved two practices

- Rebates, which were conditional on major Intel customers buying all or the vast majority of their x86 CPUs from Intel.
Payments made to certain customers conditional on them postponing or cancelling launch of products based on CPUs produced by Intel's rival, AMD.

The Commission's case had sought to characterise Intel's rebates as 'exclusivity rebates', a category of rebates which, if employed by a dominant undertaking, according to the Commission's decision "render it unnecessary to verify whether they are capable of restricting competition in a specific case". The AG disagreed with this approach, and suggested the Commission and General Court had wrongly identified three possible categories of rebates (broadly: (i) exclusivity rebates, which are presumptively illegal; (ii) volume-based rebates, which are presumptively legal; and (iii) rebates having a loyalty-inducing effect, which may be illegal, but only when judged against 'all the circumstances'). The AG said in fact the illegality of all rebates – including so-called 'exclusivity rebates' – needed to be judged in the circumstances in which they exist. The Commission's failure to provide evidence on anticompetitive effects therefore meant its decision was legally incorrect. The AG also found the Commission and General Court to have erred in suggesting Intel's behavior was illegal even during periods where the proportion of the market covered by the restrictive practices was limited (in two years of the alleged infringement as little as 14 per cent of the market was effected by Intel's restrictive clauses). The AG did not conclude whether 14 per cent market coverage was sufficient to lead to an abuse. His point was that the Commission's failure to consider this issue was legally incorrect, and could not be replaced with an assessment of whether the conduct had persisted over a longer period of time (the notion of a 'single and continuous infringement'). Again, this can be seen as a criticism of the Commission's failure to consider the effects that the conduct actually had on the markets in question.

The AG made further criticisms of the Commission's decision: (i) it artificially segmented the market in order to characterise rebates as 'exclusivity' rebates for specific products, even though customers could still buy a significant proportion – or majority – of their overall x86 CPUs from AMD; (ii) the Commission made procedural errors in not recording third party interviews which it relied on in its decision; and (iii) the Commission failed to establish any impact in the EU (or EEA) of Intel's agreements with Lenovo (which related primarily to the Chinese market). An effect on trade in the EU/EEA is a pre-requisite for the Commission to have jurisdiction to rule in competition cases. The first and third of these criticisms can again both be linked to the Commission's failure to consider the effects of Intel's conduct: if customers could actually still buy most of their CPUs from AMD without restriction, where was the harm in Intel's rebate schemes for certain products? And if Intel entered an agreement with a Chinese computer company which foreclosed AMD's ability to supply in China, but not in the EU, why was the Commission seeking to sanction this?

What happens next?

Although the AG's opinion is not binding on the Court of Justice, it is to be expected that – on at least some of these grounds – the Commission will be defeated. In such circumstances the Court of Justice's only option will be to remit the case to the General Court, and the General Court may then revisit the facts and – by finding evidence of anticompetitive effects – reformulate the case against Intel to justify the original finding and impose a (likely reduced) penalty.

That said, the AG's opinion delivers a sharp rebuke to the Commission and General Court in having made and supported a decision which did not look sufficiently closely at the effects of the conduct which was being sanctioned. This is a positive message for business, and for competition policy more broadly, but it remains to be seen whether the AG’s opinion is followed, and how the interpretation of the relevant legal standards set out by the AG will be applied in future cases by the Commission.

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The United Kingdom’s June 23, 2016 vote to leave the European Union, known as Brexit, triggered a political and economic earthquake. Some immediate consequences were dramatic, including the replacement of the Conservative Prime Minister, leadership struggles in the Labour party, a sharp drop in the value of the pound against other major currencies, and fluctuations in the UK and global stock markets. The new Prime Minister, Theresa May, has committed to triggering the Article 50 process to start Brexit negotiations by March 2017, with indications that she will seek a “hard Brexit” – involving a clean break from the European Union and loss of access to the single market. However, the backlash to this approach is gathering steam and EU leaders are suggesting they will not grant the United Kingdom any advantageous deal involving the benefits of EU membership without the related obligations. In reality, the long-term consequences of Brexit will not become clear for many years, and certainly not before the process of negotiating the United Kingdom’s exit from the EU and the post-exit relationship between the United Kingdom and the European Union begins.

While the detailed terms of the new relationship will take time, some of Brexit’s main implications for competition law are already reasonably clear. For example, the United Kingdom’s rules on restrictive agreements and abuses of dominant positions, which are based on EU law, are unlikely to change in the short term. Likewise, in areas where the United Kingdom’s antitrust laws already diverge from the laws in other EU Member States or the European Union as a whole, like the United Kingdom’s regime for private antitrust enforcement and criminal sanctions for individuals in cartel cases, those divergences will likely remain post-Brexit.

One area in which Brexit can be expected to have significant implications for EU and UK authorities and for companies operating in Europe is merger control. Many observers have noted that, after Brexit, the ‘one-stop-shop’ of the European Union’s Regulation 139/2004 on the control of concentrations among undertakings (EUMR)1 will probably cease to apply to the United Kingdom. This will likely result in more UK merger notifications, a significant increase in the Competition and Markets Authority’s (CMA’s) workload, and increased burdens for companies engaged in mergers or acquisitions who may have to make parallel filings in Brussels and London. Under the current system, jurisdiction of the Commission precludes the need to file in the United Kingdom.

In this article, we explore the merger control implications of Brexit in more detail and offer some preliminary suggestions of ways to mitigate the burden on competition authorities and business.

Brexit background

The basic mechanism for an EU Member State to leave the European Union is set out in Article 50 of the Treaty on the European Union (TEU), but the language of this article is very general.2 The Article 50 process is triggered by a notice from the leaving Member State to the European Council. Article 50 TEU does not define the conditions or procedure for giving such a notice, which depend on Member State law. Even in the United Kingdom, there is some uncertainty about this, and a number of lawsuits are ongoing to test whether the Government can trigger Article 50 without support of the UK Parliament (with a large majority of Parliamentarians having opposed Brexit), and questions as to whether devolved assemblies in Scotland or Northern Ireland could frustrate the Brexit process.

Once the Article 50 notice is given, the leaving Member State and the European Union have two years to negotiate an exit agreement (unless an extension is mutually agreed), failing which the Member State’s exit becomes effective two years after the notice date. After much posturing on whether and if so when the United Kingdom would deliver the Article 50 TEU notice, Prime Minister Theresa May has confirmed she plans to deliver

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the Article 50 notice before the end of March 2017, and in the meantime is seeking informal discussions on the new agreement. EU officials, in contrast, are refusing to enter any discussions ahead of Article 50 being triggered. Because there is no way for the European Union to start the process, refusing to negotiate until the United Kingdom gives notice under Article 50 TEU is seen as the only leverage the European Union has to accelerate the process, and perhaps to push the United Kingdom into a more conciliatory approach.

Once the Article 50 TEU notice has been given, the complexity of the issues involved makes it highly unlikely that an agreement can be reached in less than two years. Therefore, the earliest effective date for the United Kingdom’s exit from the European Union will be sometime in early 2019.

The substantive terms of the future relationship between the United Kingdom and the European Union will not be clear for years. On the one hand, it seems unlikely that the United Kingdom will agree to any arrangement in which it must abide by EU law, like the members of the European Economic Area (the EEA – consisting of Norway, Iceland, and Liechtenstein), given the sovereignty-related concerns motivating the UK vote. Specifically, to accept the EUMR in a post-Brexit world would mean the United Kingdom ceding jurisdiction to Brussels with respect to large transactions with potentially significant impacts on UK markets. This would be at odds both with the desire for sovereignty (‘taking back control’), which was a major theme of the ‘leave’ campaign, and also with Prime Minister Theresa May’s stated intention to pursue a ‘proper industrial strategy.’ Moreover, the recent comments regarding the United Kingdom favoring a ‘hard Brexit’ suggest such an approach is unlikely. For purposes of this article, therefore, we assume that EU law, including the EUMR, will cease to apply in the United Kingdom after Brexit.

On the other hand, it also seems unlikely that the United Kingdom will immediately change its existing competition laws, given (among other things) the huge amount of work required to review and update UK legislation to reflect Brexit and the need to negotiate new trade agreements with other countries to replace the EU agreements that currently cover the United Kingdom. In particular, it seems reasonable to assume that wholesale change to the existing UK merger control regime will not be a high priority.

EUMR vs. UK Review

Before discussing merger control in the post-Brexit world, it is worth summarizing the main similarities and differences between the European Commission’s and the UK CMA’s merger review processes.

In many ways, the Commission’s and the CMA’s approaches to merger control are similar. Both are sophisticated authorities, and they apply similar substantive tests. While the Commission blocks or remedies mergers that would lead to a ‘significant impediment to effective competition,’ and the CMA looks for a ‘substantial lessening of competition,’ the theories of harm and underlying economic theory are essentially identical (although do not necessarily lead to identical outcomes). The CMA’s and the Commission’s notification requirements are similar, requiring detailed information and supporting documents. Both apply similar tests for establishing the relevant market (which the Commission refers to as its ‘small but significant and non-transitory increase in price’ test (SSNIP), and the CMA as its ‘hypothetical monopolist’ test), and understand that market definition is not completely distinct from the assessment of competitive effects. Both are more concerned with horizontal than with vertical or conglomerate mergers, and both look at possible unilateral and coordinated effects. Both use a two-phase process, where more problematic mergers are subjected to a more in-depth assessment, commonly referred to as ‘Phase 2.’

The key difference between the EU and UK systems lies in which mergers are caught in the first place. The UK system captures ‘relevant merger situations’ where the target has turnover above £70 million or the combined market share of the parties on any plausible market definition is 25 percent or more. In those situations, because notification is voluntary, parties can decide whether or not to notify the CMA. In practice, however, parties that meet the test are well-advised to inform the CMA, even if by an informal letter explaining why the parties do not intend to notify formally. The CMA can, wherever a relevant merger situation occurs, call in a merger for review (subject to a 4-month deadline for opening...


See, for example, the outcome of the SeaFrance case, infra note 17.
an in-depth investigation from the time the deal completes or becomes public). By contrast, if a deal meets the EU notification thresholds – which are entirely turnover-based – an EU notification is mandatory. Moreover, the parties cannot close a deal until EU clearance has been obtained: in the United Kingdom, it is legal to close a deal qualifying as a relevant merger situation, although the CMA will likely require the parties in a case that the CMA is investigating to hold their businesses separate until a decision has been reached.

The differences between the thresholds affect the types of mergers reviewed by each authority. For example, the Commission reviews a large number of ‘full function joint ventures,’ where a new joint venture has been set up by large multinational firms. Though the joint venture itself may be small scale and have minimal – or no – market presence in the European Union (sometimes in markets in which the parents themselves are not active), the deal will still fall to be reviewed by the Commission if the joint venture partners meet the turnover tests. For example, a deal struck by Maersk, a Danish shipping company, and Statoil, a Norwegian energy company, to buy a tug-boat operator in the Bahamas was notifiable in Brussels. Cases of this nature are not caught under the UK rules where cases involving no substantive competitive overlap are not typically notified to the CMA.

These structural differences are reflected in the outcomes of cases reviewed under the UK and EU systems. The CMA’s long-term average of cases that are subjected to an in-depth investigation is currently 36 per cent.9 The Commission has gone to Phase 2 just 242 times out of 6239 cases – approximately four per cent of cases.10 This reflects the fact that the CMA’s caseload includes a larger number of difficult cases, with routine cases typically not notified under the CMA’s voluntary system. Similarly, a far larger proportion of CMA decisions require remedies or commitments to resolve competition concerns than is the case in Brussels, again reflecting the fact that the CMA’s caseload is made up of a higher proportion of more challenging transactions. Because the CMA’s cases are more difficult, on the whole, the CMA has a number of different processes from the Commission

- The CMA can fast-track cases straight to the in-depth Phase 2 review when it is clear that the deal could not be cleared in Phase 1.11
- The CMA has no ‘short form’ notification procedure. At the EU level, parties to deals that on their face raise no concerns can use the less onerous ‘Short Form CO,’ an abbreviated version of the full Form CO used for notifying transactions under the EUMR. Indeed, the Commission even exempts notifying parties from complying with all aspects of the Short Form CO in the most straightforward cases. (The CMA might expect no notification or a simple informal letter in such ‘no issues’ deals.)

Finally, the Commission does not have any discretion to apply non-competition factors in its assessment of notified transactions. The United Kingdom retains an (admittedly narrow) role for public interest factors, such as national security, plurality of the media, and preserving stability of financial markets. It is possible that Theresa May’s renewed focus on ‘industrial strategy’ will lead to more interventions on such grounds – or potentially a relaxation of rules on ‘industrial strategy’ will lead to more interventions on such grounds – or potentially a relaxation of rules to support consolidation creating ‘national champions’ – but, by contrast, the EU regime carves out public interest factors as an issue for Member States and so there is, at least in theory, no scope for policy issues to intrude on EUMR reviews.

11 This fast-track process was first used in Thomas Cook/Co-op/Midlands Co-operative Society Merger Inquiry (CC Aug. 16, 2011, https://www.gov.uk/cma-cases/thomas-cook-co-op-midlands-co-op.
Commission/CMA Staff

The Commission’s competition team (DG Comp) has more than 700 members, including more than 450 higher level officials who ‘play a key role’ in the Commission’s activities. Unlike cartels merger reviews than at present, the CMA likely has the scope and resources to market investigations of particular sectors – notably banking and energy – but the individuals involved in those investigations could be redeployed to deal with a greater volume of merger notifications. Thus, the CMA likely has the scope and resources to take on a higher volume of merger reviews than at present.

Brexit consequences for Merger Control

Having set out some of the key similarities and differences in the existing regimes, we now turn to focus on the future.

Increased number of UK filings and greater burden on business

As noted, the most immediate consequence of Brexit from a merger control perspective is that merger filings to the European Commission under the EUMR will no longer cover the United Kingdom. This change can be expected to lead to a significant increase in the number of UK filings post-Brexit and possibly to a much more modest reduction in the number of EU filings, in particular as UK turnover will no longer count towards EU turnover.

As regards UK filings, many transactions that meet the EU thresholds are also likely to meet the UK thresholds. Following Brexit, therefore, many transactions currently notifiable to the Commission will likely also qualify for review before the CMA (although transactions clearly raising no competition issues, like many private equity transactions, will probably not need to be notified in the United Kingdom). Moreover, some transactions having a ‘Union dimension’ under the EUMR may not meet the UK test. For instance, joint ventures that meet the EU turnover thresholds by virtue of the parents’ turnover are unlikely to be captured under the UK rules. In addition, many deals that meet the EU thresholds will not trigger the UK thresholds because the target does not have more than £70 million in UK turnover and the transaction does not involve the creation or increase of a 25 percent share of supply in the United Kingdom.

In short, while not all transactions notifiable under the EUMR will also have to be notified in the United Kingdom, it seems likely that many horizontal and even vertical combinations will need to be notified in both jurisdictions. This duplication will lead to a significant increase in the CMA’s workload. As discussed above, however, the CMA is likely to have sufficient staff to deal with such an increase – and this increased workload may even have the positive benefit of streamlining the UK review process and reducing the currently onerous focus the CMA places on smaller transactions. From the business perspective, though, the requirement of an additional UK notification will increase the cost of obtaining required antitrust approvals and the complexity of managing the approval process.

Reduction in the number of EU filings

Conversely, Brexit may lead to a reduction in the number of EU filings. Many companies derive a significant portion of their EU turnover in the United Kingdom (as the EU’s second largest economy). Some transactions that would currently be notifiable under the EUMR will therefore likely not meet the turnover thresholds for mandatory filing when the United Kingdom is excluded.

Post-Brexit, the impact on the number of EU filings made pursuant to a voluntary referral request could also be affected. Under the EUMR, parties acquiring control in transactions that

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16 A concentration will alternatively have a ‘Union dimension’ where: (i) the combined aggregate worldwide turnover of all undertakings concerned is more than €2.5 billion; (ii) the aggregate EU-wide turnover of each of at least two of the undertakings concerned is more than €100 million; (iii) the combined aggregate turnover of all undertakings concerned is more than €250 million; (iv) in each of at least three of these Member States, the aggregate turnover of each of at least two of the undertakings concerned is more than €7.5 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover within one and the same Member State. EUMR, arts. 1(2) & (3).
would otherwise be notifiable in three or more Member States can request that the transaction be referred to the Commission for review. The United Kingdom’s jurisdictional thresholds are broad, and it is not uncommon for the United Kingdom to count as one of the jurisdictions that can be used to trigger a referral request. The parties to transactions that would be subject to review in only three EU Member States, one of which is the United Kingdom, would no longer be able to take advantage of the referral process. Overall, while it is not possible to predict with any accuracy the likely effect on the number of EU merger filings based on data published by the Commission, it seems likely that Brexit will result in a small but noticeable drop in the number of filings to Brussels.

Divergent outcomes and resulting burden on businesses

One theoretical possibility that would raise material concerns for business is the increased prospect of concurrent reviews in London and Brussels leading to divergent outcomes (i.e., one authority clearing a merger and the other blocking it) and/or of differing, inconsistent remedies. A recent example of such divergent outcomes involved Eurotunnel’s acquisition of the bankrupt SeaFrance ferry operation, which was approved by the French authorities but blocked by the United Kingdom.17

Currently, Section 60 of the UK Competition Act 1998 contains a ‘convergence clause’ to ensure the compatibility of UK competition law with EU competition law. Post-Brexit, there will be no legal need for such a clause, and it might be removed from EU law. Removal of the convergence clause would increase the likelihood of the CMA’s approach diverging from the Commission’s in specific cases, although both authorities will presumably strive to avoid such divergent outcomes. Moreover, the UK Government has indicated it will favor a ‘grandfathering’ approach to Brexit,18 which would mean existing EU law remains in force in the United Kingdom until specifically repealed. This should help ensure consistency of approach, at least in the medium term.

Exit from the European Competition Network

Another significant consequence of Brexit for competition policy within the European Union would be the removal of the CMA from the European Competition Network (ECN), which includes the Commission and EU Member State competition authorities. Two notable advantages of the ECN are (1) close cooperation and consistency among national competition authorities such as the CMA and (2) a flexible and informal case allocation system. Leaving the ECN will mean this close cooperation and consistency will be lost, with, importantly, both the CMA and the other national authorities losing out. The outgoing head of the CMA, Alex Chisholm, who has been vocal in warning that Brexit would be an ‘unfavorable outcome’ for the United Kingdom, commented in The Financial Times on January 18, 2016, that “from a competition regime perspective, we’re very interconnected through the ECN. So there’s a high level of consistency in the way in which competition law is enforced in every one of the 27 countries.” The United Kingdom will need to seek some alternative method to cooperate with the Commission and EU national authorities, but whatever is agreed will be less effective than the integrated ECN framework.

Many would also argue that the loss of the CMA’s voice from the ECN and from consultations with the Commission could lead to adverse outcomes for business. The CMA was influential (along with the German authority), for instance, in leading the European Commission to shelve, at least for the time being, its proposal to expand the EUMR mandatory notification regime to include minority investments in which the acquirer does not enjoy veto rights conferring ‘joint control.’ The Commission currently lacks power to review such transactions but, although the CMA has a power to review transactions where a company acquires ‘material influence’ – a lower threshold than control – this has rarely been used. This lower control threshold has been effective on occasion – for example, it allowed the CMA to intervene to block Ryanair’s minority stake in its rival Aer Lingus,19 which ultimately led to the acquisition of Aer Lingus by British Airways’ parent company, IAG.20 The Commission proposed to broaden its jurisdiction to cover certain non-controlling minority shareholdings, but with a mandatory notification regime instead of the United Kingdom’s voluntary one. The CMA argued that the burden on business of having to notify acquisitions of minority shareholdings on a mandatory basis was disproportionate and highlighted how seldom it had in fact used its powers to investigate cases involving levels of control below ‘joint control.’ In summary, Brexit may somewhat reduce the number of EU filings and thereby alleviate the burden on the Commission staff, but Brexit will likely lead to a significant increase in the number of UK notifications. This increase may

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strain the CMA’s resources, although as noted the CMA probably has flexibility to deal with a higher case load. The duplication of work and the risk of divergent timetables and (potentially) outcomes will impose significant additional costs on businesses and (in some cases) increase legal uncertainty for business.

**Mitigating the ‘Brexit Tax’ in Merger Review**

There are some concrete steps that could be taken to mitigate these negative consequences. Some of these steps are discussed below.

One key step that the Commission and the CMA can and, in our view, should take is to create an ad hoc framework for cooperation in merger cases. This framework should provide for close cooperation between the Commission and the CMA in cases notified to both jurisdictions, beginning well before the Commission’s existing procedures for consulting EU Member State authorities on proposed merger decisions. To reduce the duplication of effort for themselves and for businesses, for example, the Commission and the CMA could consult on the information to be included in a complete notification. The CMA could also agree that it would accept EU notifications (with some supplemental UK-specific information) for UK purposes. The Swiss competition authority already follows such an approach with respect to transactions that have also been filed in Brussels.

Similarly, the Commission and the CMA could cooperate in the collection of evidence with the approach governed through a formal cooperation agreement. For instance, they could prepare common questionnaires, cooperate in interviews with customers and competitors, and conduct site visits and state-of-play meetings jointly. The US and Canadian authorities embrace such practices to facilitate their parallel merger reviews. Parties would be encouraged to grant waivers to allow the CMA and EU agencies to exchange evidence from their respective files to support collaborative approaches—much as currently occurs between the EU and US agencies. In each of these cases, the parties’ rights of defense would need to be protected, but merging parties would benefit from close cooperation in many if not most cases.

In the relatively small percentage of cases raising substantive issues, cooperation may be more challenging, but may offer even greater potential for efficiencies. If the recipients of an EU statement of objections wished to exercise their right to an oral hearing, for example, the hearing could be coordinated with the CMA—or, perhaps more realistically, the CMA could consult closely with the Commission and adjust its review timelines to allow the EU and UK processes to move forward in parallel and align key decision points. As noted, the current UK process is 40 working days in Phase 1 in comparison to 25 working days in Brussels, which will mean the Commission may have had to conclude whether to open a Phase 2 investigation before the CMA has reached the same point. It would be in the interest of all parties if such decision making could be better coordinated—including synchronizing the end of pre-notification periods to allow formal review periods to be aligned (a concern which already exists with respect to the larger global transactions facing divergent merger review timelines between the United States, European Union, China, and elsewhere).

Where the parties wish or are required to submit remedies to obtain merger clearance, the Commission and the CMA could agree to accept remedy proposals in the same format, if and to the extent the issues are the same. The Commission and the CMA could also agree to cooperate in the market testing of proposed remedies. Similarly, in remedy implementation the Commission and the CMA could agree to accept the same forms and otherwise avoid duplication. For example, in many cases only one monitoring or divestiture trustee should be required for both the EU and UK processes.21

In many cases, we anticipate that it would make sense for the CMA to rely on the Commission’s existing precedents and procedures. A useful model might be the existing arrangements under which the Canadian Competition Bureau sometimes relies on remedies negotiated by the US agencies based on a side letter, without the need for a complete separate remedy process in Canada.22 The United Kingdom’s proposed ‘grandfathering’ approach should be helpful in this respect.

Procedural cooperation and convergence between the United Kingdom and the European Union are clearly desirable post-Brexit, but it remains to be seen how far the CMA will be prepared to accept the Commission as the ‘lead authority’ on European competition matters. The CMA may be less willing to allow another agency to take a leading role than the Swiss and Canadian authorities have been. If that turns out to be the case, a looser structure in which the Commission and the CMA could agree on a case-by-case basis which authority is best placed to take

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the leading role may be preferable – and it is to be hoped that this would not result in political stalemate, duplication, and an increased burden on the notifying parties. The level of cooperation in the transitional period as Brexit takes effect may be a useful indicator for the future: will the CMA allow the Commission to assert jurisdiction on deals notified just before Brexit takes effect? Will any transitional rules be agreed?

In summary, Brexit will likely lead to parallel EU and UK notifications in many transactions that meet the EUMR thresholds. The additional notification requirements may put a strain on the CMA’s resources and will very likely lead to increased costs and complexity for business. With creativity and good will, however, the Commission and the CMA could do much to mitigate these burdens. In many cases, the Commission and the CMA could potentially make significant improvements through bilateral agreements without the need for new legislation. Although the structure and contents of the broader Brexit negotiations are likely to be unclear for some time, we encourage the Commission and the CMA to consider potential steps and to set up working groups to discuss these initiatives in parallel with or potentially even before the commencement of the broader negotiations.

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Acquisition of Darty by Fnac

The competition watchdog modernizes its view to define a market by including in-store and online retail channels

On July 27, 2016, the French Competition Authority (the ‘FCA’) approved the acquisition of Darty by Fnac and has for the first time in France and Europe considered the market for the retail distribution of certain domestic electronic products to include both online and in-store sales. Due to the FCA’s decision, the tie-up – equating to approximately one billion with the aim to create a new entity consisting of about 400 stores – received approval subject to the divestiture of merely six of them.

The product market definition

The electronic products at stake were the so-called ‘brown’ and ‘grey’ products. Brown products included items such as TV’s, cameras and audio sets, for instance MP3, DVD and Blu-ray players etc. Grey products referred to communication and multimedia merchandise such as tablets, laptops, smartphones, etc. The FCA confirmed and clarified its position on video game related products (i.e., software, consoles and video game accessories), considering that they constitute a separate market.

The convergence of the distribution channels and the integration of online sales

The most interesting issue of the decision concerns the segmentation by distribution channels, which the FCA had already analyzed in previous decisions. In its 2011 decision, the FCA estimated that in-store and online retail channels were not substitutable due to four main differences:

- Opposite consumer experiences: consumers can look in-store products up and get advice; the products displayed are most of the time immediately available. In contrast, online products can be bought at any time, from anywhere.
- The quality of the services offered, which were superior in shops.
- Click and mortar shops must ensure a commercial strategy consistency between their stores and their websites, something pure players do not need to do.
- The pure players’ pricing policies are more aggressive than in-store retailers’.

Yet, in its 2012 e-commerce market enquiry, the FCA envisaged a convergence of the two channels in the near future, given the increase of households with internet access along with the rise of online purchases.

It is therefore only four years later that the competition watchdog has acknowledged this evolution and decided that, with respect to the retail of brown and grey products, the differences between the two channels narrowed enough – although the substitutability is not perfect – to consider that they constitute one single market.

Another interesting feature of this decision is the use of market surveys to analyze distribution channels. The parties ordered a survey but the FCA deemed it useful to perform an additional one, based on a wider population sample (over 20,000 for the FCA instead of about 1,500 for the parties). Given the time constraint of a merger control case, this shows the FCA’s desire to fit its market definition to real consumer habits. The FCA’s findings are the following:

- In terms of products and services, the product lines sold in-store and online are becoming increasingly similar. As for the parties to the transaction, common products between Fnac/Darty and online stores represent around 70 per cent to 90 per cent of the parties’ turnovers. In parallel, online channels services have improved by providing real-time advice through chats, easier and better delivery times and methods, as well as return policies.
• In terms of pricing, the FCA analysis reveals that within the last three years, shops decreased their prices toward pure players prices (mainly Amazon and Cdiscount) aiming to adapt their pricing policies. Although there is not yet full price harmonization, it is indeed spreading among the overall range of electronic products.

• The analysis also brings to light how consumption patterns are evolving toward a more prominent role of the internet. Prior online research regarding price and product characteristics is a key step in the purchasing process, consequently, it is not viable for stores to act independently from the internet channel. Consumers look products up on both distribution channels before buying from one or the other. The survey confirms the preponderance of ‘ROPO’ (Research Online, Purchase Offline) and ‘showrooming’ (looking products up in-store before buying them online) patterns. In reaction to that, in-store sales business models are becoming more and more omnichannel.

• It is therefore not surprising that the online sales of brown and grey products in France account for between 20 per cent to 30 per cent of the total market. The potential shift in purchases from in-store to the main pure players in the event of price increase is estimated between 20 per cent to 45 per cent.

**The local dimension of the transaction**

Taking into account online sales could have impacted the geographic definition of the market, making it national rather than local and Fnac’s position in that respect was that competition conditions between in-store and online retail are similar on the French territory. However, the FCA considered that a local analysis was also required, given that more than seven out of ten French consumers still prefer in-store purchases. In addition, it also noted that one specific characteristic of the retail market is the retailers’ ability to locally adjust their pricing strategy. Consequently, the analysis of the takeover’s effects was conducted both nationally and locally. The parties could therefore not avoid the traditional and burdensome ‘shop catchment areas’ analysis.

**The new market shares calculation method**

Another change brought by this decision is the market share estimate method. Traditionally, market shares were based on a comparison of the retail floorspace dedicated to sell the products concerned in each competitor’s store. However, the FCA noted – that in relation to the specific market for the retail of brown and grey products – such method is no longer viable. It leads to underestimating the parties’ market power because Fnac and Darty generate higher turnover than their competitors on equivalent surface areas. Above all, as a result of the inclusion of both in-store and online retail channels to the market definition, using the floorspace method to calculate market shares is not suitable.

One of the difficulties the FCA faced was the lack of public data necessary to reconstruct online sale shares for each catchment area. The FCA concluded that online sales pressure is homogeneous on the French territory as a result of the general coverage of internet and 3G in France, which facilitates consumers access to online sales from anywhere. Moreover, it appears that the FCA was unable to obtain relevant data in relation to the geographical distribution of online sales, from the main pure players. Amazon, for example, declared that they do not monitor geographical distribution as such data is irrelevant to their business activity. This seems quite surprising given that consumers have the products delivered to the address they indicated and also the widespread use of ‘big data’ in marketing, logistics and business strategies.

The FCA estimated the local market shares, with online sales included, by taking into account the local in-store market shares (when relevant), the national market shares of the parties on the online channel and the national penetration rate of online sales. In the analysis of each catchment area, the competitive pressure exerted by competitors was reported using a weighted score system, in particular, based on the diversity of choice within the catchment area and the geographical proximity of the competitors.

**The results of the competition analysis**

Concerning the competition effects of the transaction, the FCA assessed the potential unilateral and conglomerate effects. The FCA concludes that competition issues exist in Paris and in the south-western region of Paris where the post-merger alternatives will not be sufficient. In the end, Fnac had to commit to divest, within a period of eleven months from September 2016, five Darty stores and one Fnac store to obtain merger approval. The stores must be sold to one or more retailer(s) already well-established in the same economic sector of activity, with the ability to exert competitive pressure. This process will be subject to the control of an independent trustee.
A brief assessment of efficiency gains

The Fnac/Darty merger creates a giant in the retail distribution of certain electronic domestic products. Yet, the decision only provides for a brief assessment of the potential efficiency gains, probably due to the lack of sufficient verifiable and quantifiable evidence. It would have been interesting to have further developments concerning the synergies that will likely result from the transaction, for example in terms of logistics or after-sales services, which are key in the concerned markets.

Conclusion

By looking at the physical and online distribution channels as one, the FCA has shown its ability to innovate and adapt to emerging consumption habits and marketing strategies. This precedent changes the market analysis, immediately reducing the in-store market shares of retailers. It also brings a diverse range of new issues, such as the geographic definition of the market, the difficulty to reconstruct data, the intensity of the competitive pressure of the online sales, and the market shares calculation methodology. Yet, an in-depth competition assessment of the concrete impact of online sales on each catchment area would have been welcome and useful to fully measure the implications of a single market definition. As the percentage of online sales is predicted to keep increasing, a more detailed analysis will probably be developed for future decisions.

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Increased focus on public interest considerations in South African merger control

The competition authorities in South Africa are well-known for imposing diverse and interventionist conditions on merger transactions which have an impact on the public interest in South Africa.

The competition authorities in South Africa are specifically mandated in terms of the South African Competition Act to consider the effect that the merger will have on a particular industrial sector or region, employment, the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive and the ability of national industries to compete in international markets.

What do the trends show?

The trends over the years in South Africa show an increase in the number of merger transactions over which the South African competition authorities have imposed conditions to address public interest considerations. Only four public interest conditions were imposed in the 2010/2011 year which increased to 22 and 28 in 2011/2012 and 2012/2013 respectively. There was a slight dip in 2013/2014 with only ten transactions being approved subject to public interest conditions, but this number increased substantially to 39 for the 12 months ending March 31, 2015. Whilst the number decreased again to 28 for the 12 months ending March 31, 2016, this number equates to public interest conditions being placed on more than 20 per cent of all mergers adjudicated in this year.

In South Africa, the conditions imposed in mergers began with a principal focus on ensuring that any proposed transaction did not result in significant retrenchments. This focus has evolved over the years and has developed into extensive conditions that are becoming onerous and costly for merging parties, and in particular, on international investors.

Public interest interventions in practice

The most publicized merger at the time was the Walmart-Massmart merger (filed on November 3, 2010). This transaction became notorious for the interventionist conditions that were imposed following trade union and ministerial intervention and included: a moratorium on retrenchments (redundancies) for two years, reinstatement of 503 employees who were retrenched prior to the merger, honouring of labour agreements and the establishment of a R200 million fund to be created for the development of small businesses possibly affected by the transaction to be spent over a five year period.

Over the years, the extent of the South African competition authorities’ far reaching powers has been demonstrated through the remedies that have been imposed on merging parties aimed at protecting local industry and job security. Arguably, however, none are as onerous as those that were imposed in 2016 on SABMiller and Coca Cola and SABMiller and AB Inbev in their respective mergers.

SABMiller, in the Coca Cola merger which was filed in March 2015 (and approved in May 2016) will require Coca Cola Beverages Africa to invest R800 million to support enterprise development. The conditions further require Coca Cola Beverages Africa to increase its broad-based empowerment ownership from 11 per cent to 20 per cent and sell a 20 per cent shareholding in its subsidiary, Appletiser South Africa to appropriate black shareholders. The merging parties have also committed to localization of supply-chains. This is the first merger in South Africa in which the competition authorities have specified what shareholding in a company must be black-owned and, as such, demonstrates the competition authorities’ commitment to ensure that local Black Economic Empowerment (BEE) requirements are met.
In the AB Inbev merger that was filed on December 14, 2015, the Competition Commission identified a large number of competition and public interest issues during its investigation. Ultimately, the conditions imposed by the Competition Tribunal on June 30, 2016 require AB Inbev, amongst others, to make an amount of R1 billion available over the next five years for investment into various programmes aimed at local agricultural, enterprise and societal development. The conditions are exceptionally precise because they specify the types of programmes in which funding should be directed and the amounts towards each form of development. The conditions go as far as requiring AB Inbev to fund 40 scholarships for South African engineering and agronomy students. In relation to local production, AB Inbev is required to maximize local production of beer and ciders, support the participation of small craft-beer producers in domestic markets and provide access for small brewers to fridges and cooler space. The South African competition authorities also imposed a BEE condition in this transaction. It is noteworthy that the South African competition authorities did not specify the extent of black ownership but merely required the merging parties to submit its empowerment plan within two years of the transactions closing, setting out how the merged entity intends to maintain BEE participation, including equity. A number of other conditions were also imposed but these aim to address competition considerations rather than public interest concerns.

Whilst the prevention of retrenchments has always been at the forefront of conditional approval in South Africa, the moratorium on retrenchments is far wider in this case than it has ever been. In particular, the Competition Commission has imposed a condition whereby AB Inbev will not retrench any employee and this condition will endure in perpetuity. The caveat being that any retrenchment made within a period of five years after the closing date will be presumed to be as a result of the merger, unless the merged entity can demonstrate otherwise. Similarly, after five years of the closing date, any retrenchments will be presumed not to be as a result of the merger, unless the
employee concerned can demonstrate otherwise. The absence of a fixed time period is unusual for the Competition Commission but the condition does relate only to retrenchments as a result of the merger.

**Implications for transacting parties**

The interventionist approach adopted by the South African competition authorities has had a significant impact on the cost associated with implementing a transaction in the South African market. One only needs to look at the SABMiller and AB Inbev transaction to see that the implementation of mergers in South Africa can have significant, unforeseeable cost implications.

These mergers also demonstrate the competition authorities’ continuous focus to ensure that local markets are protected and, if mergers may adversely affect these markets, conditions are likely to be imposed.

**Guidance on the authorities’ approach to public interest issues**

In order to assist both the Competition Commission and merging parties to address public interest considerations upfront, the Competition Commission issued its final guidelines on the considerations to be taken into account in considering the impact on the public interest on June 2, 2016. These, however, are simply guidelines and not binding but they do provide useful guidance on the approach the competition authorities will take in evaluating public interest in mergers.

Notably, the public interest guidelines state that the merging parties must declare all potential retrenchments that are being considered irrespective of whether they are due to the merger or are due solely to operational reasons.

**A growing trend?**

Whilst the South African authorities are more progressive than their African counterparts in their interventionist approach to merger control, there are a number of competition authorities in Africa who have started considering similar public interest factors when approving transactions. Botswana, Kenya, Namibia, Zambia and Zimbabwe are some of the courtiers which have started moving towards this way of thinking. In particular, the Competition and Consumer Protection Commission in Zambia almost always impose conditions that encourage local procurement.

Whilst there have been diverging views on the impact of these interventionist conditions on mergers, the South African competition authorities will almost certainly continue their interventionist approach to merger control. Consequently, it will be up to the merging parties in the market to adapt, innovate and evolve to meet these additional challenges.

The increased focus on public interest conditions must be taken into account when transactions are structured and timelines are put together.

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Hong Kong Competition Commission releases proposed liner shipping block exemption

Introduction

On September 14, 2016, the Hong Kong Competition Commission released a proposed block exemption order for public consultation. The Commission proposes to confirm that vessel sharing agreements among shipping lines are excluded from the application of the first conduct rule under the Hong Kong Competition Ordinance (Cap 619), subject to a number of conditions, including: (i) that the parties do not collectively have a share of more than 40 per cent in the relevant market; and (ii) that the agreements do not include any pricing coordination. The Commission also published a Statement of Preliminary Views outlining its rationale for the proposed order based on information collected to date. In the same document, the Commission explains why it does not propose to include voluntary discussion agreements among shipping lines within the scope of the proposed order.

Interested parties are invited to submit comments before December 14, 2016, following which a final decision on the issuance of a block exemption order will be made. If adopted, the order would be valid for a period of five years.

A partial success for shipping lines

The Commission’s proposal follows an application made by the Hong Kong Liner Shipping Association on behalf of the shipping industry shortly after the Ordinance entered into force last year. The shipping lines sought a formal order from the Commission that would confirm that two categories of cooperation arrangements do not infringe the Ordinance’s first conduct rule on account of the economic efficiencies they produce. The first category relates to vessel sharing agreements, by which shipping lines agree to exchange space on their respective vessels and to coordinate sailing schedules, capacity and other operational matters. The second category relates to so-called ‘voluntary discussion agreements’ pursuant to which shipping lines discuss certain commercial matters relating to particular shipping routes, including pricing.

The Commission’s provisional views are that vessel sharing agreements, while potentially restrictive of competition, produce sufficient benefits to justify their exclusion from the prohibition on restrictive agreements under the first conduct rule if certain conditions are met. However, based on information so far received, the Commission cannot find sufficient benefits arising from voluntary discussion agreements that would justify their exclusion, particularly in view of the very significant competition restrictions which can arise as a result of pricing discussions among competitors.

Relevance of the Commission’s proposal beyond the shipping sector

The public consultation offers an opportunity for shipping lines and their customers and suppliers to provide views to the Commission on the text of the proposed block exemption order. The Commission’s very detailed statement of reasons supporting its proposal should help these stakeholders frame their representations. It also signals to parties from other sectors of the economy that any application for similar orders will likely lead to a protracted, in-depth engagement with the Commission that would include an intensive public consultation process. Depending on the results of the public consultation, it appears unlikely that any order in the liner shipping case would be adopted before the first quarter of 2017.

The Statement of Preliminary Views is the most detailed substantive analysis released by the Commission since the adoption of its guidelines on the enforcement of the Ordinance last year. It provides insight into the authority’s interpretation of the law and into its enforcement policy.

Restriction of competition

The Statement only briefly discusses whether the relevant agreements would lead to restriction of competition caught by the first conduct rule. This brief discussion however provides some
useful insights, particularly as regards vessel sharing agreements.

- The Commission indicates that, in general, vessel sharing agreements are unlikely to result in significant harm to competition in spite of possible diminished service variety and an increase in the commonality of costs between contracting parties. The only real concern appears to be the ability for parties to control capacity in the market through their joint provision of shipping services, a concern which would only arise where parties have some degree of market power. The Commission does not provide an indicative market share threshold above which market power concerns would arise in this context. It is however noteworthy that, in its subsequent analysis of economic efficiencies, the Commission considers that ‘effective competition’ exists if contracting parties have a combined market share of below 40 per cent.

- The Statement’s analysis of the restrictive effects of voluntary discussion agreements is equally succinct and does not add to the interpretation already reflected in the Commission’s Guideline on the first conduct rule. The Commission points out that these agreements may give rise to significant competition concerns, where they involve recommended pricing guidelines and information exchanges on pricing and certain other customer terms.

Overall economic efficiency analysis
Where agreements and practices have the object or effect of restricting competition, an infringement of the first conduct rule can nonetheless be avoided if efficiency benefits outweigh the competition restrictions. The bulk of the analysis in the Statement of Preliminary Views is devoted to the conditions for the overall economic efficiency exclusion, being the main purpose of the proposed block exemption order.

- Consistent with the methodology outlined in its Guideline on the first conduct rule, the Commission is prepared to consider qualitative and quantitative efficiencies. The larger number of destinations offered, the availability of higher frequencies, the ability to contract with a single provider and the overall greater volume of services are all recognized as qualitative improvements which would potentially fall within the overall economic efficiency exclusion. As regards quantitative benefits, the Commission proposes to take account of reduced operational costs as a result of economies of scale and lower costs of expansion. The Commission is however very sceptical that price stability could be regarded as an economic benefit of the type eligible under the overall economic efficiency exclusion. It is also reluctant to consider non-economic benefits, such as those relating to the environment, to employment and to the wider Hong Kong economy to fall within the scope of the exclusion.

- In its review of the evidence adduced by the applicant, the Commission applies a proportionality test. Whereas the Guideline on the first conduct rule explains that ‘convincing’ evidence should be adduced, the Statement usefully explains that the more significant the harm to competition, the greater the efficiencies must be, and the more ‘compelling’ the evidence must be in this respect. This explains why the Commission rejects most of the applicant’s arguments in respect of claimed benefits that would outweigh the significant competition restrictions that arise from pricing discussions.

- The Statement of Preliminary Views expands on the Commission’s prior guidance in respect of another aspect of the overall economic efficiency test. Among other conditions, once benefits have been established, parties must also show that a fair share of these benefits accrue to consumers. The Commission considers that parties will have an incentive to pass cost savings on to consumers in the form of lower prices if they are subject to ‘effective competition’. The Commission proposes a market share limit of 40 per cent as an indicative measure relevant to its assessment of whether effective competition exists. While the Statement does not explain the reasons for this choice, it is the same threshold above which the Commission expects competition concerns to arise in the context of horizontal mergers under its Guideline on the merger rule.

Other matters of broad relevance
Other matters which may be of relevance beyond the shipping sector include the following.

- The proposed block exemption order demonstrates a flexible approach by the Commission. The order is not very prescriptive in respect of the types of covenants and other provisions to be contained in the relevant agreements, and – contrary to what is required in Malaysia and Singapore – there is no obligation for parties to file copies of their agreements with the authority.

- While in its prior guidance the Commission signalled that it would only be prepared to issue sector-specific block exemption orders as an ‘exceptional measure’, it is convinced that the specific features of the shipping industry call for a greater need for cooperation warranting the adoption of an order.
• On the difficult question of enforcing the Competition Ordinance in a manner that is consistent with other relevant statutory provisions, the Commission proposes to resolve the apparent conflict with the Merchant Shipping (Liner Conferences) Ordinance (Cap 482), which provides that ‘restrictions in respect of the provision of international liner services’ shall not be ‘unenforceable by virtue of any rule of law about unreasonable restraint of trade’, by considering that this Ordinance has no bearing on the Commission’s ability to seek the imposition of fines for contravention of the Competition Ordinance.

Consequences of the proposed order for the shipping industry

Vessel sharing agreements
If the order is adopted in its current form, parties to such agreements will be able to continue operating provided that they meet certain conditions. The Commission recognizes that vessel sharing agreements may differ in scope. Accordingly it lists a certain number of activities which would benefit from the exclusion. All of these activities would be excluded if certain conditions are met.

• The main condition is that their combined market share remains below 40 per cent on the relevant market. This threshold should be calculated by reference to volumes carried or to capacity on the market, and allows for short-term fluctuations up to 45 per cent over a two-year period. Global shipping lines will already be familiar with this market share approach, which is broadly consistent with the methodology adopted in the European Union (where a 30 per market share threshold applies) and Singapore (where a 50 per cent market share threshold applies). While it is the parties’ responsibility to define the relevant markets in each case, the Commission signals in its Statement of Preliminary Views that it would be prepared to consider very broad markets for long-distance trades (such as between the ‘Far East and the Mediterranean’) and possibly country-wide markets (it cites ‘Hong Kong to the Philippines’ as an example) for shorter routes. More specifically, the Commission recognizes accessibility to inland transport and transhipment opportunities as a factor contributing to broader geographic markets.

• In addition to activities essential to the purpose of typical vessel sharing agreements, such as coordination on sailing schedules and destinations and capacity or vessel pooling, other ancillary activities will also benefit from the exclusion. These largely correspond to those listed under the EU block exemption for shipping lines and include the pooling or joint use of office premises, port facilities and container equipment, the joint operation or use of port terminal and related services, as well as any other activities which are considered necessary to the implementation of the agreement. Whilst the pooling of resources and the joint procurement of third-party services clearly fall within the scope of the exclusion, the test of ‘necessity’ leaves some uncertainty as to which other types of ancillary activities might also benefit. In any event, cooperation within the scope of one vessel sharing agreement may well need to remain distinct from that envisaged as part of another, even where they share one or more of the same contracting parties.

• Amongst other conditions, parties cannot discuss or fix prices, limit sales, or introduce capacity limitations other than in the form of adjustments inherent to the operation of the vessel sharing agreement. Parties should also be free to withdraw from the coordination arrangements without the risk of facing onerous consequences. As with the list of excluded activities, these conditions are again broadly consistent with those found in similar block exemption decisions made in the EU and Singapore.

Where the conditions set out in the proposed order are not met, parties have a choice among several options, some of which are outlined below.

• They can make changes to fulfil the conditions, for example, by reducing the number of participants to bring the combined market share below the threshold. This would allow them to benefit from the legal certainty offered by the block exemption order. Note that the relevant market share refers to that of each party to the agreement, irrespective of how many vessels it contributes under the agreement. Accordingly, withdrawing vessels operating within the scope of the agreement while keeping them on the route is not an option that would enable the agreement to bring their collective market share within the safe harbour threshold.

• Another option would be for the parties to assess by themselves whether a particular vessel sharing agreement complies with the Ordinance despite not fulfilling the conditions of the order. For example, where they have a market share higher than 40 per cent on a new or thinly serviced route, they may still be able to show that no restriction of competition arises, or that specific market circumstances enable them to meet the conditions for exclusion.

• Finally, although this may be difficult to achieve operationally, parties could revise the vessel sharing agreement to exclude
sailings to Hong Kong from its scope, and seek to exclude the application of the Ordinance on this basis.

**Voluntary discussion agreements**

As mentioned, the Commission is so far unconvinced that this type of agreement should benefit from a block exemption. While the Commission does not expressly rule out the possibility, the analysis contained in the Statement of Preliminary Views suggests that the Commission will be unlikely to find room to apply the economic efficiency exclusion to any agreement or practice that contemplates pricing recommendations or discussions on prices and commercial terms among independent operators. The Commission’s approach to voluntary discussion agreements differs from that adopted in Singapore, but reflects the same view as those held by competition authorities in the EU and Malaysia.

With little prospect of convincing the Commission that discussions of prices and commercial terms among independent operators would not fall foul of the Competition Ordinance, parties have few options other than to cease their involvement in such discussions, at least to the extent they have the object or effect of restricting competition in Hong Kong markets.

- The Commission proposes to offer a grace period of six months after its final decision on the application for a block exemption order, but thereafter, could well investigate pricing discussions. By then parties will need to have formally withdrawn from pricing discussions that have the object or effect of restricting competition in Hong Kong markets. Going forward, shipping lines will be mindful of recent commitments provided to the European Commission in relation to forward-looking price announcements, as these may well inform the views of the Hong Kong Competition Commission when assessing how prices are communicated to the Hong Kong market.

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