Ashurst competition law newsletter

June 2018

Contents

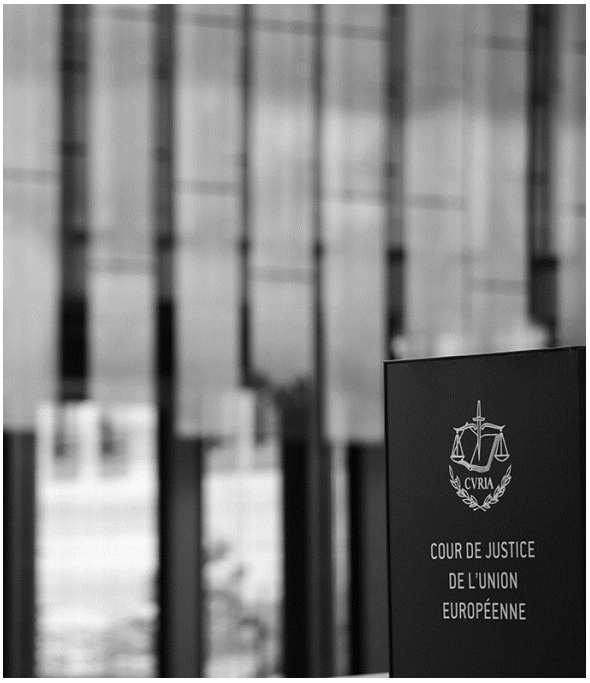
From the Editor

The June issue of Ashurst's competition law newsletter is now out, featuring a round-up of a number of developments that have caught our eye. This edition includes the European Court's landmark EY gun-jumping judgment, the annulment of the UK CMA's abuse of dominance finding in Pfizer/Flynn, the long awaited Supreme Court tobacco judgment in the UK, the German Federal Supreme Court's judgment likely to magnify cartel damages claims, and the coming into force of new UK merger control thresholds, as well other topics.

EY did not "jump the gun" – landmark case on EUMR standstill obligation

EU (MERGERS)

On 31 May 2018, the European Court of Justice ("ECJ") handed down a much anticipated judgment on the preliminary ruling request brought by the Danish Maritime and Commercial court in relation to the standstill obligation under Article 7(1) of the EU Merger Regulation ("EUMR"). The ECJ ruled that Ernst & Young ("EY") did not breach the EUMR's standstill obligation regarding its takeover of KPMG's Danish unit as a result of the termination of a cooperation agreement between KPMG DK and KPMG's international network.



What you need to know – key takeaways

- Gun-jumping (i.e. failure to notify a transaction or implementation a transaction in breach of the standstill obligation) can take many forms, but requires a change of control of the target company.
- Ancillary or preparatory transactions that do not present a direct functional link with implementation of a concentration do not, in principle, fall under the scope of gun jumping prohibition.
- Parties to a merger/takeover should carefully consider these principles before taking any pre-clearance steps which may be viewed as exercising control over the target.
- Gun-jumping can result in a fine up to 10% of aggregate worldwide turnover.

The Danish Competition Council's view

This case (Case C-633/16 Ernst & Young P/S v Koncurrencerådet) relates to a decision of 17 December 2014 by the Danish Competition Council ("DCC") which declared that EY and KPMG DK, a member of the KPMG International network at the time, had breached the standstill obligation under the Danish law by KPMG DK giving notice to terminate its cooperation agreement with KPMG International before the DCC had approved the

merger between KPMG DK and EY. The merger was notified to the Danish competition authority on 13 December 2013, and was approved by the DCC on 28 May 2014, subject to commitments.

However, immediately after the signing of the merger agreement on 18 November 2013, and prior to the approval by the DCC, KPMG DK announced that, in accordance with the merger agreement, they were withdrawing from the KPMG International network from 30 September 2014 at the latest. The DCC considered this a breach of the Danish standstill obligation on the basis that the termination of the cooperation agreement was, *inter alia*, merger-specific, irreversible and likely to have market effects in the period between the notice of termination itself and the approval of the merger.

EY appealed the DCC's decision before the Danish Commercial Court, which, in turn, referred the matter to the ECJ for a preliminary ruling on the approach under the EUMR (on the basis that Danish merger control law is based on the EU regime).

The ECJ's view

The ECJ took a more purposive approach by taking into account of the objective and general scheme of the EUMR, and interpreted the scope of the standstill obligation by referring to the definition of the concept of concentration as set out in Article 3 of the EUMR.

The ECJ held that:

- the standstill obligation under Article 7(1) of the EUMR prohibits the implementation of any transaction which, in whole or in part, in fact or in law, contributes to the change of control of the target company;
- transactions that are not necessary to achieve a change of control, although they may be ancillary or preparatory to it, do not fall within the scope of Article 7(1). This is the case even if the transaction may have effects on the market; and
- even though KPMG DK's termination of a cooperation agreement was conditional on completion of, and was likely to be ancillary and preparatory in nature to, the overall concentration, it did not contribute to a change of control of the target undertaking. In other words, EY had not acquired the possibility of exercising any influence on KPMG DK as a result of the termination of the cooperation agreement, and thus did not breach the standstill obligation under the EUMR.

The ECJ's EY judgment provides helpful clarification on the scope of the EUMR's standstill obligations, and provides welcome guidance on what companies can and should not do prior to clearance by competition authorities which follow the principles of the EUMR.

The latest in a number of EUMR gun-jumping cases

In the past few years, there have been a number of cases/decisions relating to the EU merger procedural rules, including standstill obligation. For example:

- a €125 million fine imposed on a Dutch telecom company, Altice in May 2018;
- in July 2014, the ECJ upheld a €20 million fine on Electrabel for failing to notify to the Commission its acquisition of a minority shareholding and completing the deal without prior clearance from the Commission (C-84/13 P Electrabel v Commission);
- an ongoing European Commission investigations into the allegations that Merck and SigmaAldrich, General Electric and Canon provided incorrect or misleading information to the Commission as part of the EUMR review process or implemented a merger before notification to and clearance by the Commission; and
- in October 2017, the General Court has handed down its judgment to reject an appeal by Marine Harvest against fine for gun-jumping (Case T-704/14 Marine Harvest ASA v Commission).

Commission accepts Gazprom commitments to end gas markets investigation

EU (ANTI-TRUST – ABUSE OF DOMINANCE)

On 24 May 2018, the European Commission ("Commission") imposed legally binding obligations on Gazprom after the latter had offered several commitments to address the Commission's concerns that it had abused its dominant position contrary to Article 102 of the EU Treaty by restricting the free flow of gas and imposing unfairly high prices in Central and Eastern European ("CEE") gas markets. By adopting a commitments decision pursuant to Article 9 of Regulation 1/2003, the Commission terminated its investigation without finding an infringement or imposing a fine.

What you need to know – key takeaways

- Commitments decisions are adopted in lieu of finding an infringement and/or imposing a fine and have been used frequently by the Commission in Article 102 cases in recent years.
- Fines of up to 10 per cent of worldwide turnover may be imposed on a company that breaches its commitment obligations, without the need to establish an infringement of competition law.
- Amongst other things, the commitments require Gazprom to: (a) Remove all contractual barriers to cross-border gas flows; (b) offer customers in five CEE countries the right to a price review every two years; and (c) offer customers with delivery points in seven CEE countries the right to swap for delivery in one of the other countries.

The Commission opened formal proceedings against Gazprom in September 2012 and issued a Statement of Objections in April 2015.

The Commission alleged that Gazprom had abused its dominant position on the wholesale gas supply markets in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia by imposing territorial restrictions in its supply agreements and by making gas supplies (in Bulgaria and Poland) conditional upon customers investing in unrelated transport infrastructure. The Commission also accused Gazprom of pursuing an unfair pricing policy in Bulgaria, Estonia, Latvia, Lithuania and Poland. In addition, the Commission had concerns that Gazprom had leveraged its dominant market position on the gas supply market to obtain advantages with regard to the access to or control of gas infrastructure.

Following initial commitments offered by Gazprom, the Commission opened a market test in March 2017 (see our earlier article), which prompted a number of negative reactions. In October 2017, the Commission sought a revised commitments proposal from Gazprom in order to address its outstanding competition concerns.

The final commitments, which will be legally binding for a period of 8 years, can be summarised as follows:

- Gazprom must remove all contractual barriers to the free flow of gas, including indirect restrictions incentivising customers not to re-sell or re-export (this may include profit-splitting provisions, which require customers to share the proceeds of re-sale with Gazprom).
- Gazprom must amend provisions in its contracts concerning the metering and monitoring of gas in Bulgaria so that the control of these activities is transferred from Gazprom to the Bulgarian operator of the gas transmission infrastructure.
- Gazprom must take active steps to integrate gas markets in the Baltic states (Estonia, Latvia and Lithuania) and Bulgaria with other CEE countries reflecting their lack of interconnection. In particular, Gazprom must allow customers that bought gas originally for delivery to these countries, or to Hungary, Poland or Slovakia (where the remaining contract duration exceeds 18 months), to instead have gas delivered to the other countries under swap transactions.

Gazprom can only refuse to perform the swap if no transmission capacity is available.

- Gazprom will also offer (existing and new) customers in Bulgaria, Estonia, Latvia, Lithuania and Poland with a contract with at least three years to run the right to ask for revised prices every two years, with an additional "joker" every five years, if its gas prices diverge from competitive Western European price benchmarks. If this right is activated, prices should in principle be adjusted to be in line with price levels in competitive Western European gas markets. If Gazprom and its customer do not agree on a new price within 120 days, the dispute can be referred to an arbitrator.
- Gazprom must not benefit from advantages that it has obtained by leveraging its market position as regards gas infrastructure and, in particular, will not seek damages from its Bulgarian partners regarding the termination of the South Stream project, a large-scale pipeline project, which was abandoned in 2014.

Many of the final commitments are similar to those consulted on in March 2017, although additional obligations have been added.

A monitoring trustee will be appointed to oversee Gazprom's compliance with the commitments. If Gazprom fails to comply with any of its obligations, the Commission can impose a fine of up to 10 per cent of the company's worldwide turnover, without the need to prove a competition law infringement.

Commissioner Vestager said the Commission imposed commitments instead of fining Gazprom because it believes legally-binding obligations are the "*best way to remove obstacles to competition and allow customers to enjoy competitive prices and the free flow of gas in the region*".

Netflix lacks standing to challenge Commission's decision on German firm levy

EU (STATE AID)

On 16 May 2018, the European General Court ("General Court") handed down its judgment in an action brought by Netflix against a European Commission ("Commission") decision declaring an amendment to a German aid scheme compatible with EU state aid law. The General Court dismissed the action as inadmissible, noting that Netflix has no legal standing to challenge the decision.

What you need to know – key takeaways

- Direct access to EU courts is restricted for individuals who are not (a) the addressee of an EU act or (b) directly and individually concerned by an act.
- However, proceedings can be brought against a regulatory act which involves no implementing measures if direct concern can be shown.
- Tax notices and national decisions granting aid are implementing measures within the meaning of Article 263, paragraph 4 of the Treaty on the Functioning of the EU ("TFEU")
- It is not sufficient for establishing "individual" concern that the act specifically targets the applicant, nor that he participated in the formal investigation procedure.

In 2014, Germany notified an amendment to an aid scheme aimed at supporting the local film industry. That amendment extended both the liability to pay a levy for the benefit of the local film industry and the eligibility to obtain aid. In September 2016, the Commission declared the amendment compatible with the EU's internal market rules and therefore authorised its implementation. Netflix brought an appeal against the decision since, following the Commission's decision, foreign video-on-demand services providers became subject to the obligation to pay the levy. The General Court handed down its judgment on 16 May 2018.

As regards individuals who are not the addressees of a decision, an action is admissible under Article 263, paragraph 4 of the TFEU, only if they are:

- directly concerned by the contested decision and the decision is a regulatory act which does not entail implementing measures; or
- directly and individually concerned by the contested decision.

The General Court considered that neither of these conditions were fulfilled.

First, it held that the contested decision comprised an implementing measure as its specific and actual consequences in respect of Netflix must be given material form by subsequent national acts. More specifically, tax notices and decisions granting aid - no matter how mechanistic – constitute implementing measures that can be challenged before national courts.

Second, Netflix failed to demonstrate that it was individually concerned, namely that it enjoys a special status on the basis that its market position was substantially affected by the contested decision. In particular, the fact that Netflix was specifically targeted by the amendment to the aid scheme was not sufficient to demonstrate that the contested decision substantially affects its market position. The General Court also found that being an active participant in the formal investigation procedure is not enough to establish individual concern.

The *Netflix* judgment is a reminder that there is a high hurdle to overcome in order to bring admissible direct actions against EU regulatory acts that are not specifically addressed to them. In particular, it is not enough to rely on the fact that a regulatory act is targeted specifically at the applicant.

Commission failed to properly consider airline's merger commitments waiver request

EU (MERGERS)

On 16 May 2018, the European General Court ("General Court ") handed down its judgment on an action brought by Lufthansa challenging a European Commission ("Commission") decision refusing to waive certain commitments given by Lufthansa in 2005 as a condition of the approval of its acquisition of Swiss International Air Limited ("Swiss International"). The General Court partially annulled the Commission's rejection decision on grounds that the Commission had made a manifest error of assessment and that the matters it relied on in reaching that decision were not capable of justifying its refusal to grant the request for a waiver.

What you need to know – key takeaways

- Where companies have previously agreed commitments with the Commission as a condition for merger clearance under the EU Merger Regulation ("EUMR"), they can apply to the Commission for those commitments to be waived, regardless of whether the commitments included a review clause.
- When making such applications, companies should aim to provide robust evidence to demonstrate that the commitments should be waived, for example because the relevant market circumstances have changed.
- It is then for the Commission to consider the evidence and request further input if required. The Commission cannot simply reject the evidence without further analysis.

Background

In 2005, the Commission granted the acquisition by Lufthansa of Swiss International conditional clearance under the EUMR. This was on the basis that the Commission had identified two affected routes which raised competition concerns, namely the Zurich-Stockholm and the Zurich-Warsaw routes, as only Swiss International and airlines with which Lufthansa had alliance partnerships operated on these routes.

To address the competition concerns, the parties offered commitments in relation to the fares applied to these routes. The commitments with the Commissions also contained a review clause which provided that, at the request of the parties, "the commitments may be reviewed, waived or modified by the Commission based on long-term market evolution".

In November 2013, Lufthansa requested a waiver from these commitments on the basis that:

- it had terminated its joint venture agreement with the alliance partner operating the Zurich-Stockholm route (the "Alliance Partner Agreement");
- the Commission has changed its policy with respect to the treatment of alliance partners in the context of its Lufthansa/Brussels Airlines merger review decision (COMP/M.5335); and
- there now existed competition between Swiss International and other operators on the affected routes.

In July 2016, the Commission rejected the waiver request on a number of bases and Lufthansa brought an action before the General Court for annulment of the contested decision.

General Court's judgment

As part of its first plea, Lufthansa pleaded that the Commission had breached its duty to carefully examine its waiver request, to conduct, if necessary, an investigation and to base its conclusions on all the relevant information.

The General Court made a number of preliminary observations in this regard. In particular, it noted that:

- although the current case relied on the application of a review clause, commitments may be amended or waived even in the absence of such a clause, if they become obsolete or disproportionate owing to subsequent exceptional developments;
- the EUMR grants the Commission certain discretion, especially with regard to assessments of an economic nature. This discretion extends to the need for commitments; and
- the burden is on the parties bound by the commitments to adduce sufficient evidence to demonstrate that the conditions for waiving the commitments are met. Where such evidence is provided, the burden of proof shifts on to the Commission if it wishes argue that the evidence is insufficient or unreliable.

Contractual changes

In this context, the General Court examined Lufthansa's plea that the Commission had erred by concluding the termination of the Alliance Partner Agreement regarding the Zurich - Stockholm route was not sufficient for the fare commitment to be waived:

- The Alliance Partner Agreement: The General Court found that the Commission had failed properly to examine the impact of the termination of the Alliance Partner Agreement. In particular, the Commission failed to analyse the opinion of the monitoring trustee, appointed under the commitments, which concluded that the termination was a "substantial market change". Whilst the Commission is not bound by a trustee's opinion, it is nevertheless required to take it into account.
- The pre-Alliance Partner Agreement: Furthermore, in the contested decision, the Commission based its rejection, not only on an evaluation of the Alliance Partner Agreement, but also due to the fact that a prior co-operation agreement dating back to 1995 had not been terminated and was still in place; thus the contractual relationship between the parties had not changed in a material respect so as to remove the Commission's concerns. However, in the course of the request for a waiver, Lufthansa had offered to terminate the 1995 agreement if it allowed the Commission to grant the waiver request. In light of Lufthansa's actions, the GENERAL COURT held that the Commission could not legitimately rely on the existence of the 1995 agreement as the basis for its conclusion that contractual relationships had not changed in any material respect. It was for the Commission, should it have considered it necessary, to ask Lufthansa during the waiver request process, to give a concrete expression to that commitment. As a result, the Commission did not take into account all the relevant elements for the assessment of the waiver request.

The Lufthansa/Brussels Airlines Decision

Similarly, the General Court examined Lufthansa's plea that the Commission had ignored its own analysis carried out in the *Lufthansa/Brussels Airlines* decision, in which it changed its policy as regards the treatment of alliance partners, which were no longer taken into consideration in the determination of affected markets.

In this regard, the General Court found that:

- the Commission had failed sufficiently to address Lufthansa's argument concerning the Lufthansa/Brussels Airline decision, and that omission was particularly significant given that it related to one of the main grounds for the waiver request;
- other subsequent merger decisions had taken the same approach as Lufthansa/Brussels Airlines; and
- Lufthansa was therefore not precluded from bringing this ground of appeal on the basis that courts are not bound by previous findings of facts or economic assessment, as

Lufthansa was not alleging a mere difference in fact, but a change in the Commission's policy.

Competition existed between Swiss International and the operators on the affected routes

Lastly, the General Court examined whether the Commission had failed to consider whether evidence of continued competition between Swiss International and the alliance partner established a "long-term market evolution", which would have triggered a re-evaluation of the commitments under the review clause. Whilst Lufthansa submitted evidence to the Commission in support of its view that the market had sufficiently evolved to trigger the review clause, the Commission questioned the reliability of that evidence.

In contrast, the General Court held that:

- whilst it is for the parties requesting a waiver to provide evidence, the Commission has investigation powers and tools of its own, and if it considered that the evidence put forward by the parties was not sufficiently reliable, it was the Commission's responsibility to request more specific information, or carry out an investigation;
- the Commission cannot limit itself to demanding compelling evidence, without specifying what that evidence should consist of;
- the Commission had failed to fulfil its duty to examine all the relevant information, to make enquiries or to conduct the necessary investigations to determine whether there was competition between Swiss International and the alliance partner.

On this basis, the General Court held that the contested decision must be annulled in so far as its related to the Zurich-Stockholm route.

It should be noted that the General Court did not find the failings of the Commission in respect of the Zurich- Warsaw route to be sufficient to cause the contested decision to be annulled in respect of that route.

The judgment provides useful insight into the Commission's approach to considering requests for waivers from commitments and provides a stark reminder to the Commission to ensure that it takes into account all revenant information provided by parties seeking such a request.

Cartelist to face larger damages claims following German Federal Supreme Court ruling

GERMANY (PRIVATE ACTIONS)

On 12 June 2018, the German Federal Supreme Court ("Supreme Court") ruled that claimant-friendly legislation of 2005 suspending the statute of limitations for follow-on cartel damage claims applies retroactively to cartel infringements that occurred before the law entered into force, provided that the claim was not otherwise time-barred. The judgment is likely to result in larger damages claims (spanning longer periods), further boosting Germany's position as one of the most attractive forums for cartel damage claimants.

What you need to know – key takeaways

- On 1 July 2005, a new German competition legislation entered into force that suspended the limitation period of a cartel damages claim from running during the course of a European Commission ("Commission") or an EU member state competition authority investigation.
- The Supreme Court confirmed that this principle also applies retroactively, i.e. to damages claims which are based on cartel infringements which occurred before 1 July 2005 and which were not already timed-barred at that time.
- This means that companies which have been found to have engaged in collusive conduct in breach of competition law may face significantly larger damages claims as potential claimants can now seek damages in relation to longer periods.

In 2003, the German Federal Cartel Office ("FCO") imposed a fine on several cement makers for a price-fixing and market-allocation cartel that operated between the 1990s and 2002. In 2013, after several appeals, the penalty was upheld by the Supreme Court. In 2015, a tool manufacturer sued a cement manufacturer for damages flowing from the excessive prices it had to pay for cement as a result of the cartel.

The limitation period in Germany for bringing a claim for damages in relation to breaches of competition law is three years from the time the claimant became aware of the illegal conduct. On 1 July 2005, new legislation ("2005 Law") came into force providing that this limitation period:

- is suspended on the commencement of an investigation by either the Commission or an EU member state competition authority; and
- restarts six months after the relevant authority issues a legally binding infringement decision.

Until the Supreme Court's judgment, the question of whether the suspension of the limitation period as set forth in the 2005 Law also applied to cartel conduct which occurred before the 2005 Law was enacted was unclear and subject to several deviating court decisions.

The Supreme Court has now ruled that the suspension provision also applies to cartel damages claims which are based on cartel infringements which occurred before 1 July 2005 and which were not previously time-barred. The Supreme Court underpins its judgment with the general legal principle that

as from the date on which changes of provisions concerning limitation periods of claims come into force, they also apply to claims which accrued already before and which have not yet become time-barred. The Supreme Court has stated that it will release a decision explaining its reasoning soon.

The Supreme Court's ruling will give potential cartel litigants many years of additional time to prepare for making any such claims, as the competition authorities' investigations regularly take several years. Accordingly, the Supreme Court explicitly noted that its judgment will affect not only the cement cartel but also other cartels such as trucks, train-tracks and sugar, as the German courts will need to consider suspending the limitation period also in the respective on-going proceedings. For example, in relation to the Commission's trucks cartel decision, a suspension of the limitation period may be expected to extend the time period for which a claim could be made by over 50%. However, because the ruling has retroactive effect, it will also impact even older cartel decisions, such as the Commission's bathroom fitting cartel or the cathode ray tube investigation.

On the one hand, the claimant-friendly ruling provides legal certainty and further compensates victims of long-lasting cartels. On the other hand, the ruling may reduce the incentive for cartelist to apply for leniency, as their risk of facing larger damages claims increases.

Germany and Austria issue draft guideline on transaction value merger control thresholds

GERMANY (MERGERS)

On 14 May 2018, the German Federal Cartel Office ("FCO") and the Austrian Federal Competition Authority ("AFCA") published joint draft guidelines on the new transaction value thresholds which were introduced in Germany and Austria in 2017. Even if the traditional turnover-based thresholds are not met, in certain circumstances a transaction may be notifiable if (a) the consideration exceeds €400 million in Germany or €200 million in Austria and (b) the target has significant current activities in Germany or Austria respectively. The draft guidelines aim, inter alia, to clarify the scope of the new transaction value thresholds. This article mainly focuses on the transaction value test in Germany.

What you need to know – key takeaways

- Since 2017, certain mergers have qualified for competition review based on the value of the transaction in circumstances in which the traditional turnover thresholds have not been met.
- In Germany, the primary purpose of introducing a transaction value test was to provide the FCO with the ability to investigate mergers concerning target companies with modest turnover, but which may nevertheless have a significant impact on competition which is in particular the case in certain digital and other innovative sectors..
- The draft guidance clarifies that the transaction value test is only applicable in Germany in cases where: (a) the target's German turnover is below €5 million; and, (b) the target has substantial current activities in Germany.
- The target will not be considered to have substantial current activities in Germany in circumstances in which its turnover in Germany to date reflects its market position and competitive potential in Germany.

In view of the interconnectedness of Austria's and Germany's economies and similarities in their merger notification tests, the FCO and AFCA have decided to publish joint draft guidance on the new transaction value tests applied in their respective jurisdictions since 2017.

In each of Germany and Austria, there are two limbs to the transaction value test. First, the transaction value must exceed a prescribed threshold: €400 million in Germany and €200 million in Austria. Second, the target company must have substantial domestic activities.

However, following the introduction of this new test in each of Germany and Austria, there has been a lack of clarity in respect of the application of that test.

Determination of the transaction value

For the purposes of the tests, relevant consideration comprises all assets and other monetary benefits that the seller will receive from the buyer in connection with the transaction, including all cash payments, voting rights, securities and tangible and intangible assets. It also covers any future payments, such as earn-out-clauses or payments which are conditional upon reaching certain turnover or profit targets (including outside Germany), payments for non-competition obligations by the seller, as well as assumed liabilities of the target or the seller (limited to interest bearing parts thereof).

Current substantial domestic activities

In Germany, not all transactions that exceed the transaction value threshold must be notified. In particular, the notification obligation will only arise where: (a) the transaction value threshold is exceeded; (b) the target did not achieve a turnover of more than €5 million in Germany; and (c) the target has substantial current activities in Germany.

The meaning of the concept of "substantial domestic activities" has been a significant source of debate. However, the draft guidance clarifies that the new transaction value threshold should not be interpreted extensively such that the notification obligation would arise in all cases where the relevant consideration threshold is exceeded and the target's turnover in Germany is below €5 million. The crucial question is whether the turnover generated by the target to date in Germany reflects its economic and competitive potential in Germany.

According to the draft guidelines, as a rule of thumb, if the target has generated insignificant domestic turnover (i.e. under €5 million) for a sustained period, it is less likely that its turnover does not adequately reflect its economic and competitive potential in Germany. The situation is, however, different when the target's turnover is not an adequate indicator, for instance, because the company is active on a market that is not characterised by turnover or because its product has only recently come onto market such that the inconsiderable turnover that it has generated to date does not reflect its real economic and competitive potential. In such cases, other indicators of the extent of the target's current domestic activities may be relevant, with those indicators depending on the particular sector in which the target is active (e.g. number of "monthly active users" or the number of "unique visitors" to a website).

The draft guidelines have been created in light of the FCO's and the AFCA's initial experience of dealing with notification made pursuant to the new thresholds and have been developed following discussions with practitioners. The FCO and the AFCA have emphasised that, in the absence of sufficient case practice, it cannot yet model every possible scenario where the obligation to notify a transaction pursuant to the transaction value threshold would arise and that the guidelines that are formally published should be regarded as preliminary. The FCO and AFCA have asked for comments on the draft guidelines to be submitted by 8 June 2018.

There are sound reasons for the new transaction value threshold not being interpreted too extensively by the FCO. In particular, we note that the German Act against Restraints of Competition already provides that the transaction value test is not applicable in cases where the target achieved a turnover of more than €5 million in Germany in the last business year.

Spanish cartel in the advertising sector

SPAIN (ANTI-TRUST – CARTELS)

On 7 May 2018, the Spanish competition authority ("CNMC") announced that it has fined 5 companies and 3 managers a total of €7.23 million and €109,000, respectively, for exchanging information with the aim of distributing contracts among themselves in the context of a Framework Agreement signed with the General Government Administration for its advertising campaigns.

What you need to know – key takeaways

- The CNMC is closely scrutinising tender procedures in Spain to identify possible anticompetitive behaviour.
- The existence of a vertical relationship between a facilitator and one of the companies involved in the anticompetitive conduct does not exclude its responsibility.
- The exchange of information through private e-mail accounts could be interpreted as an indicator of the awareness of the unlawful nature of those exchanges..

Following a consultation with the *General Government Administration*, the CNMC opened a formal investigation and considered that the companies under investigation were involved in, among other things, the following conduct:

- Exchanges of commercially sensitive information relating to specific tenders, such as the economic terms of their offers;
- Exchanges of commercially sensitive information relating to the Framework Agreement in general, such as, information regarding its management, documents and certificates that should be provided to the contracting authority;
- Reaching agreements not to submit bids following a call for tenders under the Framework Agreement in circumstances in which the relevant companies were obliged to submit tenders; and
- Knowingly submitting non-compliant bids that would be excluded.

According to the CNMC, the above practices amounted to a single overall agreement that lasted a year and a half and qualified as a cartel that restricted competition by object.

In this regard, a key fact that the CNMC took into consideration to qualify the conduct as a cartel infringement was that the relevant bid managers were using their private e-mail accounts instead of their company accounts to exchange information, which was considered as evidence of their awareness of the unlawful nature of their conduct by the CNMC.

Lastly, one of the companies was fined as a cartel facilitator, as it was in charge of coordinating the exchanges among the companies, and the CNMC considered that its vertical relationship with one of the other cartel participants did not preclude it from being separately responsible for the anticompetitive conduct.

This case shows, once more, the increasing interest of the CNMC in prosecuting collusion in public tenders. In particular, there have been several recent decisions in which the CNMC has sought to address anticompetitive behaviour in connection with the submission of public tenders.

CMA's finding of abuse in Pfizer/Flynn unfair pricing decision annulled

UK (ANTI-TRUST – ABUSE OF DOMINANCE)

The UK Competition Appeal Tribunal ("CAT") has overturned the UK Competition and Markets Authority's ("CMA") decision to impose a record £89.7 million fine against Pfizer and Flynn Pharma ("Flynn") for charging unfair and excessive prices for phenytoin sodium capsules, contrary to Article 102 TFEU and the Chapter II provision. The CAT has indicated that it is minded to send the case back to the CMA for further consideration, however it has invited written submissions from the parties before doing so.

What you need to know – key takeaways

- The CAT has identified deficiencies in the CMA's methodology for assessing when high prices are abusive; in particular, the CMA was wrong to confine its methodology to a "Cost-Plus" return on sales test, without also considering the prices of comparable products – in this case, phenytoin sodium tablets, which were sold at a higher price than capsules.
- However, the judgment is far from the end of the story. Assuming the matter is remitted to the CMA, the CMA will have an opportunity to rectify the issues that the CAT has identified and – if the relevant legal standard is satisfied using a revised methodology – issue a fresh decision, which could then be subject to a further appeal to the CAT.
- The CAT is also careful to emphasise that it is "not saying that no finding of abuse could be made in this case".

The CMA's decision

In December 2016, the CMA imposed an £84.2 million fine on Pfizer and a £5.2 million fine on its distributor Flynn after finding that both companies had abused their respective dominant positions by charging excessive prices in the UK for phenytoin sodium capsules, a legacy anti-epilepsy drug.

Pfizer had sold the rights to distribute the drug to Flynn, which subsequently made the drug an unbranded generic, meaning that it was no longer subject to the PPRS price regulation scheme.

The price that the NHS was charged for packs of the drug increased materially; overall NHS expenditure increased from around £2 million in 2012 to around £50 million in 2013.

The CMA found that:

- Pfizer and Flynn each held dominant positions in the relevant markets, namely for manufacture (Pfizer) and distribution (Flynn) of phenytoin sodium capsules.
- Pfizer had abused its dominant position by charging Flynn unfairly high selling prices, and Flynn had abuse its dominant position by charging its customers (wholesalers and pharmacies) unfairly high selling prices.
- Separate abuses were incurred in relation to each of the different strengths of phenytoin sodium capsules.

The CAT's judgment

The CAT upheld the CMA's findings that Pfizer and Flynn each occupied a dominant position in the relevant markets.

However, the CAT struck down the CMA's findings on abuse. The appeals focused in particular on the CMA's methodology for assessing when high prices will be abusive.

The key legal precedent relied upon by the CMA is *United Brands*, in which the Court of Justice set out a two-limb test:

- The price must be excessive, which could be determined by reference to the difference between the cost of production and the selling price (Excessive Limb)
- The price must be "unfair" either in itself (Test 1) or when compared to competing products (Test 2) (Unfair Limb)

There have been relatively few excessive pricing cases in the 40 years since the United Brands judgment. This has often been explained by the challenges in determining what should be considered to be benchmark price which would have existed for the relevant products under conditions of normal and effective competition. In this regard, two aspects of the CMA's application of the *United Brands* test were unusual:

- The adoption by the CMA of a 6% "Cost Plus" standard. This allowed each of Pfizer and Flynn a specified return on sales (ROS) based on their direct costs and a proportion of their indirect costs. For each of Pfizer and Flynn, a ROS of no more than 6% was considered reasonable, on the basis that this is the permissible price increase under the PPRS scheme. But the PPRS scheme applies across a portfolio of products, rather than to the individual products.
- The CMA's unwillingness to have regard to the price of phenytoin sodium tablets (as distinct from capsules), which were more expensive than capsules on the basis that: (1) Pfizer's and Flynn's prices were unfair in themselves as they bore no reasonable relation to the economic value of the capsules, i.e. Test 1 of the Unfair Limb was satisfied; and (2) in any event, they were not comparable products, as capsules do not compete with tablets.

In its judgment the CAT held that the CMA was wrong in law to confine its methodology for determining whether the drug prices were excessive by reference only to its "Cost Plus" test.

The judgment summarises the eight steps the CAT considers that the CMA should have followed in order to determine whether Pfizer and Flynn's prices were abusive.

These steps included identifying a benchmark price or price range for phenytoin sodium capsules which would have applied in conditions of "normal and sufficiently effective competition".

In determining that benchmark price, the CMA should have given proper consideration to whether, amongst other things, phenytoin sodium tablets – the prices of which were higher than the prices for capsules – served as a meaningful price comparator.

The CMA also erred in law in failing to have any regard to the benefit to patients of phenytoin capsules in determining their economic value.

The CAT did not limit its criticism to the CMA's methodology for assessing when prices may be abusive. The CAT also expressed concerns about the CMA's decision to impose a 400% uplift on Pfizer's fine for the purposes of deterrence. The CAT concluded that it would "likely have regarded the very substantial uplift for deterrence applied to Pfizer as, on its face, difficult to justify and not required by the CMA's own penalty guidance … If we had needed to come to a decision on the level of penalties to be applied to Pfizer in this case, we would have given the appropriate uplift for deterrence close scrutiny …"

Next steps

The judgment does not mark the end of the story. The CAT has indicated that it is minded to remit the case back to the CMA for further consideration of abuse (and any consequential findings, including penalties). The CMA has stated that it is disappointed that the CAT has not reached its own judgment, and that it is actively considering an appeal.

The CAT's judgment will inevitably have implications for the CMA's on-going pharmaceutical investigations where those cases involve allegations of abuse of dominance. At least two of those investigations have reached the statement of objections (SO) stage: an SO was issued in relation to hydrocortisone tablets in December 2016, and in relation to liothyronine in November 2017. Both of these investigations concern alleged unfair and excessive pricing.

Two wrongs don't make a right, says Supreme Court tobacco penalty judgment

UK (PROCEDURE)

On 16 May 2018, the UK Supreme Court held that the UK's Office of Fair Trading (the "OFT") was entitled to refuse to repay financial penalties imposed on Gallaher and Somerfield (the "Respondents"), who had entered into early resolution agreements ("ERAs") with the OFT in respect of its tobacco investigation, in circumstances where it had repaid a penalty to another party that had settled, following the successful appeal of the OFT's decision by other parties. The decision not to repay the penalties imposed on the Respondents was not vitiated by the OFT having respected an assurance mistakenly given a different party to an ERA that it would repay the penalty in the event of a successful appeal.

What you need to know – key takeaways

- Whilst there is a general duty of equal treatment and fairness upon regulators in the conduct of investigations, there may be circumstances in which departure from those principles is objectively justifiable and rational.
- Parties entering into settlement agreements with regulators do so with their eyes open, and should be prepared to accept the consequences of any subsequent infringement decision, even if that decision is successfully appealed by another party.

Background

In April 2008, the OFT (predecessor to the Competition and Markets Authority) issued Statements of Objections to 13 parties alleging indirect retail price maintenance in the supply of tobacco products. In June 2008, the Respondents entered into ERAs with the OFT. The ERAs provided for substantial reductions in anticipated penalties in exchange for the Respondents' admission of involvement in the infringements and procedural cooperation.

TM Retail ("TMR") had also entered into an ERA. However, TMR received an assurance from the OFT that, in the event of a successful appeal of an infringement decision by other parties, TMR would receive the benefit of the appeal. The OFT did not offer the same assurance to the Respondents.

Following the OFT's infringement decision in April 2010 (the "Decision"), six parties – Imperial Tobacco and a number of leading retailers - successfully appealed to the Competition Appeal Tribunal (the "CAT"). The Respondents and TMR did not appeal. In 2012, the OFT repaid TMR its penalty "*in light of the particular assurances provided*", but refused to do so to the Respondents. The Respondents issued claims for judicial review of the OFT's decision not to repay their fines.

The lower courts

The High Court rejected the claims finding that, although the OFT owed the Respondents duties of equal treatment and fairness, the assurance was given to TMR in error. The OFT was objectively justified in not repeating that same error by refusing to repay the Respondents (especially with the use of public funds).

The Court of Appeal, however, found in favour of the Respondents. It took the view that a mistake was not a "*trump card*" and that due regard must be given to all of the circumstances. It noted that the OFT had the opportunity to withdraw the assurance it gave TMR, but chose to act on that assurance instead. Ultimately, the Court of Appeal held that "*the breach of the principle of fair and equal treatment was not objectively justified on the facts of this case.*"

The Supreme Court's judgment

On 16 May 2018, the Supreme Court overturned the Court of Appeal's judgment. It found that, even if there was a breach of a legitimate expectation of equal treatment in the OFT's failure to give the Respondents the same

assurances given to TMR in 2008, that would not in itself provide a basis for reversal of the financial penalties imposed on the Respondents. The assurance to TMR was not made at the Respondents' expense; there was no "*zero sum game*". The Respondents had accepted the risk that they would not benefit from a successful appeal in order to obtain the benefit of the discount in the amount of the penalty: "*they knew what they were doing and accepted it with their eyes open*".

The Supreme Court found that the reality of the OFT's position in 2012 was that TMR would have had a strong case to appeal the Decision out of time if the OFT had not honoured its assurance. The same could not be said for the Respondents, who did not receive the same assurance. Therefore, in circumstances where the OFT's "*unpalatable alternatives*" were to repay penalties to the Respondents using public money, or to risk a likely successful appeal by TMR to the CAT, the OFT had a sufficient basis to justify its approach, notwithstanding that it was discriminatory and breached the general duty of equal treatment. This amounted, in the language of Lord Briggs, to "*a powerful objective justification for unequal treatment*".

The Supreme Court's judgment is an important contribution to the concepts of equal treatment and fairness under English law. It also illustrates the potential strategic and legal ramifications of entering into ERAs. The Respondents in *Gallaher* were, ultimately, unable to free-ride off the parties who successfully appealed the OFT's original infringement Decision, or to benefit from assurances given to third parties. The Respondents had also made a parallel application to appeal the OFT's Decision out of time, which reached the Court of Appeal in 2014, but this was also rejected (see our June 2014 newsletter).

New UK national security merger thresholds comes into force

UK (MERGERS)

On 11 June 2018 changes to UK merger control entered into effect. The changes are relatively narrow in scope in the sense that they only relate to target companies active in the following sectors: military and dual-use goods; computer processing units; and quantum technology. As a result, the scope of the UK Government's ability to intervene in deals in those sectors on national security grounds has been extended.

What you need to know – key takeaways

- The new rules only relate to targets active in the following sectors: military and dual-use goods; computer processing units; and quantum technology. Targets active in other sectors are unaffected.
- The Government has previously indicated that it expects to intervene on national security grounds in an additional 1 to 6 transactions per year as a result of the new provisions.
- Many deals in the relevant sectors will in principle be captured by the new regime, even if they have no obvious connection to national security.
- The changes are not expected to bring about a material change in the CMA's approach to the assessment of mergers on competition grounds.
- These changes are a pre-cursor to a more wide-ranging foreign investment review on which a White Paper is due in the coming months.

In the relevant sectors, the Secretary of State would be able to intervene (and potentially prohibit the merger; although, in practice, remedies are usually agreed) on national security grounds if:

- the UK turnover of the target exceeds £1 million (reduced from the normal £70 million); or
- the target has an existing UK share of supply of 25 per cent or more (this would remove the need for an increase in market share); or
- the transaction would create or enhance a UK share of supply of 25 per cent or more (i.e. the existing "share of supply test").

For deals involving targets in the relevant sectors, it should be noted that many deals will in principle be captured by the new regime, even if they have no obvious connection to national security. It is a matter for the Secretary of State's discretion as to whether he or she actually does intervene on national security grounds.

Additional details on the changes, and on the background to their introduction, is set out in our newsletter article of 9 April 2018.

The changes, while made for national security-related reasons, also technically amend the thresholds that allow the independent Competition and Markets Authority ("CMA") to scrutinise mergers for competition concerns. However, neither the government nor the CMA expect that the changes will bring about a material change in the CMA's approach to the assessment of mergers on competition grounds.

On 11 June, the CMA and Government also published their technical guidance in relation to these changes. There have been a limited

number of changes since the draft guidance was published in March 2018, including:

- The Government contacts have been amended from a single point of contact to separate Government contacts depending on whether the area covered is military or dual-use (Ministry of Defence), computing hardware (Department for Business, Energy & Industrial Strategy (BEIS)), or quantum technologies (Department for Digital, Culture, Media & Sport (DCMS)). This underscores the need for affected businesses to have a carefully thought through strategy for engagement with the Government as it may be necessary to engage with multiple Government bodies.
- The CMA guidance has been amended to make clear that the amendments have prospective effect only.

Electro Rent/Microlease merger subject to divestment and no-compliance fine

UK (MERGERS)

On 17 May 2018, the CMA published the Final Report of its Phase 2 Investigation into the completed acquisition by Electro Rent Corporation ("Electro Rent") of Microlease, Inc. and Test Equipment Asset Management Limited ("Microlease"), (together, the "Parties"). The UK Competition and Markets Authority ("CMA") found that the transaction may lead to a substantial lessening of competition ("SLC") in the supply of testing and measurement equipment ("TME") rental services in the UK. The Parties are therefore required to divest Electro Rent's UK business to a suitable purchaser approved by the CMA. A few weeks later, on 11 June, the CMA also announced that it has imposed a penalty on Electro Rent for a failure to comply with a CMA interim order.

What you need to know – key takeaways

Regarding the merger/divestment decision:

- The merger decision highlights the considerable weight the CMA is likely to place on internal documents and customer views when assessing transactions. The CMA has recently published draft guidance relating to internal documents in merger investigations.
- In terms of remedies, the CMA will be unlikely to take into account the cost of any divestments to the merging parties, as it considers this to be an avoidable cost/risk parties take when completing prior to obtaining CMA approval.
- Whilst the CMA generally prefers the divestment of a stand-alone business, it is willing to consider the divestment of a collection of assets, although this may result in the imposition of stricter suitability criteria on potential purchasers.

Regarding the penalty for breach of the interim order:

- The CMA has sent out a clear message - it will be actively enforcing its interim orders.
- The onus is on the addressee of an interim order to seek the consent of the CMA if it requires a waiver - a monitoring trustee has no authority to give consent on behalf of the CMA.
- Parties can be fined up to 5 per cent of their combined global turnover for breaching a CMA interim order.

The divestment remedy

As explained in the CMA's Final Report, Electro Rent and Microlease both supply TME, which is used to test and measure electronic devices in order to validate their performance. The Parties operate globally in the supply of TME for purchase, leasing and rental, across sectors such as telecommunications, aerospace and defence, industrial, and IT.

The CMA found that Microlease is the leading supplier of TME rental in the UK and Electro

Rent, which is based in the US and is substantially smaller than Microlease in the UK, is nevertheless its closest competitor. This was supported by the Parties' internal documents and evidence received from third parties. Therefore, the CMA found that the transaction would lead to the removal of each Party's closest rental competitor in the UK and a substantial reduction in the alternatives available to a significant proportion of the Parties' rental customers. A high proportion of customers also expressed concerns about the transaction.

The CMA considered a number of possible remedies, and concluded that divestment of the assets that Electro Rent was using to serve UK customers (Electro Rent UK) would be an effective and proportionate remedy and the least onerous of the possible options. This includes, for example, the lease for Electro Rent's premises in the UK, existing supplier contracts, staff, and a pool of TME stock/inventory. The sale must be to a suitable purchaser, subject to very strict criteria (i.e. going beyond those usually specified by the CMA), and, along with specific transitional arrangements, must be approved by the CMA.

It is notable that Electro Rent offered to sell its UK business at Phase 1, in order to address the CMA's concerns and avoid a Phase 2 reference and an "up front buyer" requirement being imposed by the CMA. However, the proposed purchaser withdrew from the deal, leading to the reference decision. While the ultimate divestment package set out in the Final Report is slightly different, this highlights the strategic importance of considering potential remedies, and engaging with the CMA on these, early on in the Phase 1 process, as well as the risks of an up-front buyer requirement.

Penalty for a failure to comply with interim order

The CMA has discretionary powers to impose an initial enforcement (or "hold separate") order to suspend all integration of merging businesses from the outset of a Phase 1 investigation, as well as powers to reverse any integration steps which have already taken place. The CMA can utilise these powers in respect of both anticipated and completed mergers.

In this case, the CMA imposed an interim order on Electro Rent on 7 November 2017 (which replaced the initial enforcement order made by the CMA on 1 February 2017 at Phase 1). However, the CMA has found that Electro Rent breached the interim order by giving notice to terminate the lease over the only premises Electro Rent had in the UK (and which formed part of a potential remedy package on which Electro Rent had made representations) without first seeking the consent of the CMA, as required by the interim order. The CMA's Penalty Notice states that Electro Rent terminated the lease without reasonable excuse, in particular:

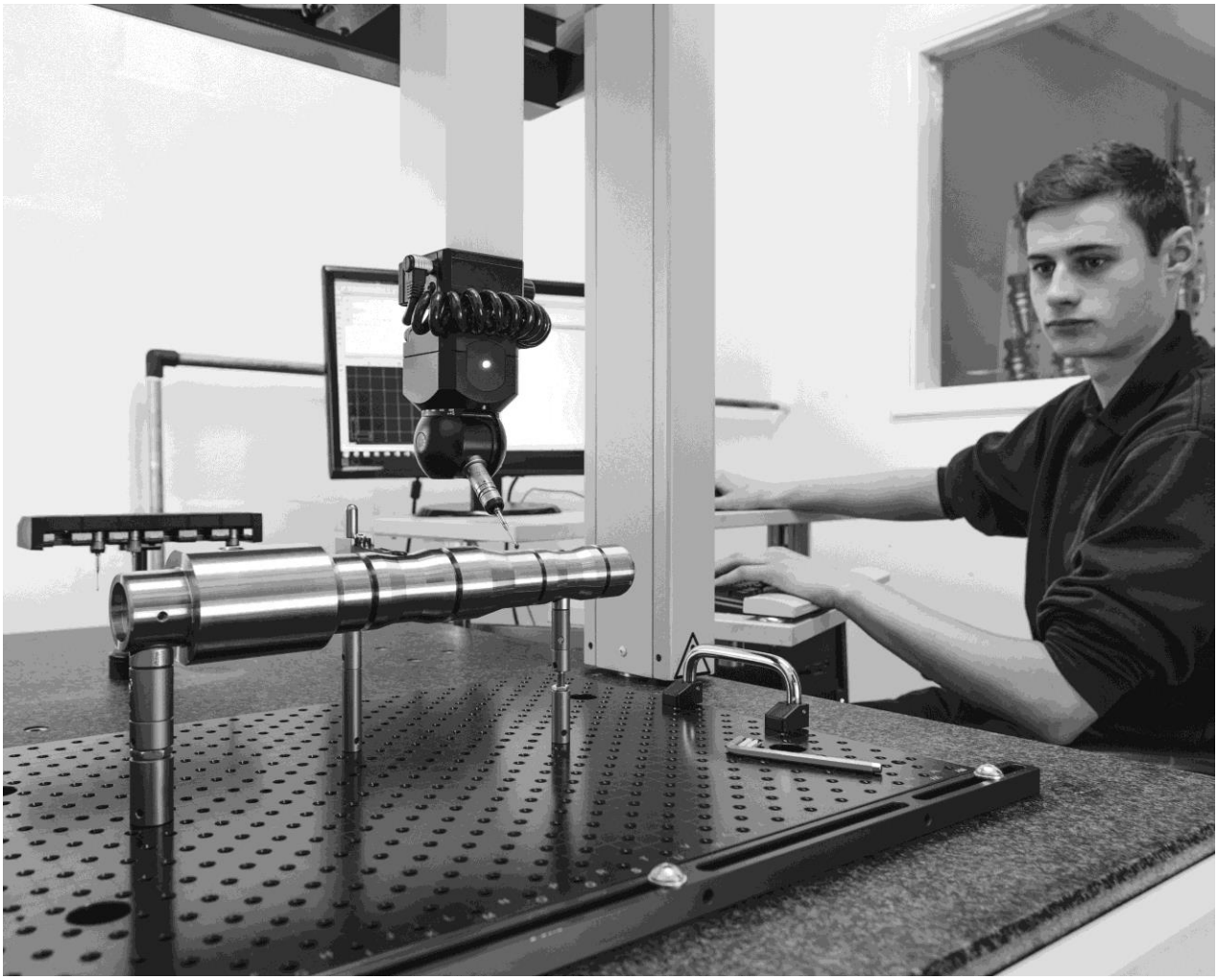
- it is not sufficient that it had informed the monitoring trustee appointed to monitor compliance with the interim order. The CMA has stated that the onus is on the addressee of the interim order to seek the consent of the CMA;
- the monitoring trustee has no authority, delegated or implied, from the CMA to give consent on behalf of the CMA;
- the reasons given by Electro Rent for terminating the lease relate to the decision to terminate the lease, and do not amount to a reasonable excuse for failing to comply with the interim order;
- whilst the monitoring trustee had not indicated that Electro Rent's action would be in breach of the interim order, this did not amount to a reasonable excuse for failing to comply with the order, but has been taken into account in determining the level of penalty (indicating that the penalty would have been higher without the monitoring trustee's involvement).

The CMA also noted the following factors which contributed to setting the level of the penalty:

- whilst Electro Rent had taken steps to remedy the breach by entering into a new lease, this is on worse terms than the previous lease;
- this was a "flagrant breach" and was committed in large part by the senior management of Electro Rent;
- the actions of the monitoring trustee was a significant factor in substantially reducing the level of the penalty;
- whilst Electro Rent had not brought the breach to the CMA's attention, there was no indication of any attempt by Electro Rent to conceal the failure to comply; and

- Electro Rent gained no advantage from the failure to comply.

Whilst the penalty relates to Electro Rent's breach of the interim order, it is also intended as a deterrent to other merging parties, who should ensure they have processes in place to comply with CMA hold separate orders. It should be noted that parties can be fined up to 5 per cent of their combined global turnover for breaching a CMA interim order. The £100,000 penalty imposed in this case was considerably below that, reflecting the mitigating factors of the case.



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