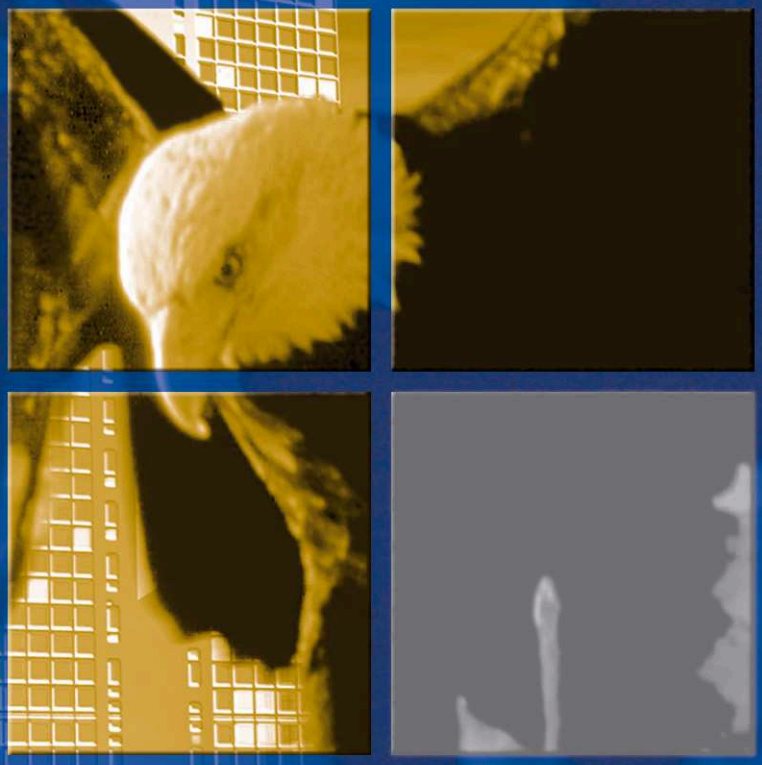
C/M/S/ Cameron McKenna

Competition



Survival Pack

Fourth edition

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Introduction

All businessmen and women and their advisers need to know about EU and UK competition law. Our **Competition Survival Pack** provides an overview of the essentials and explains the impact of new legislative developments on your business. It is relevant to in-house counsel, company directors and those responsible for competition compliance.

Beyond "modernisation"

This fourth edition of the Competition Survival Pack is updated to 1 January 2007. Whilst there have been fewer major changes in legislation since the third edition in 2004, the practice of competition law develops apace. The UK has witnessed the first challenges to Office of Fair Trading (OFT) merger decisions under the Enterprise Act 2002 and the impact they have had on how the OFT conducts its merger review process. We are experiencing a higher likelihood of referral to the Competition Commission and increased volume of data requested from merging parties. The first actions at the Competition Appeal Tribunal (CAT) for damages for breach of competition law have been lodged. While the first two claims settled without getting as far as a judgment, at least one competition damages claim is progressing at the CAT. The effects of some aspects of the Enterprise Act 2002 have not yet been seen clearly, for example the OFT has not secured any convictions for the UK criminal cartel offence at the time of writing.

The European Commission has published a green paper on private enforcement of competition law, as well as a public discussion paper on Article 82. It has also opened sector investigations into the financial services industry (specifically retail banking and business insurance) and into the gas and electricity industries. At the time of writing, the final conclusion in the sector investigations into downstream energy markets and into retail banking, as well as the interim report into business insurance are anticipated in January 2007. The Commission's preliminary findings suggest legislative changes are on their way.

Central and Eastern Europe

The ten 2004 accession countries now have well established competition authorities becoming more active in enforcement. In Bulgaria and Romania, which joined the EU on 1 January 2007, the building blocks are in place, though awareness and enforcement still have to develop.

What does this mean for business?

The EU's new "self-help" competition culture cannot be ignored. Companies now have to take full responsibility for their competition compliance. The evolution of leniency programmes and private enforcement of competition law can only make this more important. It is therefore crucial to understand the importance of competition law compliance when doing business in the EU, including the UK.

Versions of this Survival Pack

The Survival Pack has been sent to you in pdf format. Updated versions of the Survival Pack and additional chapters will be loaded onto our website at www.law-now.com. E-mail alerts will signal the arrival of new or updated pages.

About us

CMS Cameron McKenna

CMS Cameron McKenna is an award-winning international commercial law firm with over 130 partners and more than 900 fee earners in Europe (including Central and Eastern European countries and Russia), Hong Kong and China.

CMS Cameron McKenna's competition practice includes 3 partners and a team of other fee earners in the UK and Europe. The team based in London advises on UK competition law and merger control in the Competition Act 1998 and Enterprise Act 2002, as well as on EU competition law in Articles 81, 82, 86, EU merger control notifications, and state aid submissions. We have broad experience of dealing with the UK and EU authorities including the European Court of Justice and UK Competition Appeal Tribunal. We have a very strong practice in Central Europe, with specialist competition lawyers in Bucharest, Budapest, Moscow, Prague, Sofia and Warsaw advising on EU and domestic competition law and merger clearance. All of the partners and several of the associates have worked in our Brussels office. The team liaises with commercial lawyers in other offices on the application of competition law to their clients' activities, both across European borders and in those jurisdictions where competition law is still developing.

Within the wider association of the transnational legal services organisation, CMS, we have some 80 competition law specialists available to provide advice on domestic merger and competition law. Overall, CMS has more than 2000 legal and tax advisers in 47 cities.

Competition specialists

David Marks has an established reputation as a competition and procurement lawyer in the field of electricity regulation and other infrastructure project work, and is an acknowledged leader in the application of the competition rules in the life sciences industry. He is regularly involved in the competition aspects of mergers and strategic alliances and major energy and infrastructure projects. He has handled European Commission investigations and competition law enforcement proceedings and has appeared at European Commission and European Court of Justice hearings. David has spent six years of his career in Brussels.

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Susan Hankey has a broad range of experience in EU and UK competition law and merger control and in dealing with the Office of Fair Trading and the European Commission. For three years she was a senior lawyer in our Brussels office. Susan has represented clients in UK and EU investigations, before the Competition Commission, at the Competition Appeal Tribunal and at the European Commission. She is known in particular to the oil and gas industry for competition and procurement advice. Susan advises both public sector and utility clients (purchasers and contractors) on procurement strategy. She acts for governments and for beneficiaries in state aid cases. Susan is responsible for our Central Europe competition practice and has extensive experience of the application of the competition and state aid regimes to the EU 2004 and 2007 accession countries.

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Nick Paul is best known for his work in the financial services sector. He advises a large number of financial institutions on regulatory issues, including financial sector mergers, competition compliance and investigations. He has represented clients before the Competition Commission and the European Commission. He was a resident Brussels partner between 1990 and 1992.

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Our Central Europe practice

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How can we help?

There are a number of ways in which we can help you review your agreements and business practices generally to ensure compliance with competition law. Possibilities include:

- a competition audit to flush out inappropriate behaviour and to formulate best practice
- creation of a tailored in-house checklist of do's and don'ts
- reviewing with you your compliance procedures, for example, developing compliance strategies and monitoring systems
- coaching your management in competition law compliance
- holding a short focus session with your legal and/or contract teams to create a methodology for reviewing existing arrangements and documents
- helping tailor a competition compliant marketing strategy to your own company's particular needs
- providing one of our competition lawyers for a few hours (or as long as you want) to review your standard documents or procedures
- holding an in-house workshop with your legal and/or contract teams to examine the impact of competition law in various scenarios and how you should respond.
- tailored on-line competition compliance training ('e-learning').

And in an emergency you can always call our Dawn Raid Hotline on +44 20 7367 3499.

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1 January 2007

Competition law in the EU and UK - basic principles

"And while the law [of competition] may be sometimes hard for the individual, it is best for the race, because it ensures the survival of the fittest in every department." *Andrew Carnegie*

This section provides a brief overview of the central legal texts and institutions which form the pillars of the UK and EU competition law regimes.

EU competition law

The Treaty of Rome

The Treaty of Rome of 1957 (often called the "EC Treaty") established the European Community. In 1993, the European Community (EC) became the European Union (EU), following adoption of the Treaty of Maastricht.

The EC Treaty (as variously amended, by the Maastricht Treaty and more recently by the Amsterdam Treaty of 1997) consists of 314 Articles. It is primarily concerned with:

- eliminating obstacles to the free movement of goods, services, persons and capital within the EU
- the progressive co-ordination of the economies of the EU Member States so as to create an economic and monetary union; and
- other social objectives.

Because competition law was included in the Treaty of Rome, it is correctly called "EC competition law". But, in general parlance, it is often called "EU competition law". They are the same thing.

In this Survival Pack, for ease of reference we use"EU competition law" throughout.

The EC Treaty is divided into parts and chapters. EU competition law is contained in Chapter 1 of Part III, but must be interpreted in the context of the general aims of the EC Treaty and the contents of the other Articles.

Competition law in the Treaty of Rome

Chapter 1 of Part III of the Treaty of Rome consists of Articles 81 to 89.

Article 81 prohibits agreements, decisions by associations of undertakings and concerted practices that are restrictive of competition (e.g. price fixing or market sharing agreements).

Article 82 prohibits the abuse by an undertaking or undertakings of a dominant position (e.g. predatory pricing or tying).

Article 86 is concerned with the application of competition law in the public sector of the economy.

Articles 87 to 89 prohibit state aids to undertakings by EU Member States which might distort competition in the common market.

This Survival Pack is principally concerned with Article 81 EC Treaty and Article 82 EC Treaty (Article 81 and Article 82 respectively).

EU merger control

The Treaty does not contain any specific provisions on mergers. The regime for the scrutiny of mergers of undertakings active in the Community was established in 1989. The current rules are set out in the EC Merger Regulation (Regulation (EC) 139/2004). There are also implementing rules, notification forms and guidance. See the section of this Survival Pack entitled "EU merger control".

The internal market

One of the principal aims of the EC Treaty is to ensure effective integration of the internal market. The application of Articles 81 and 82 therefore has two policy objectives: promotion of the single market and the conventional protection of competition. EU competition law must be understood in this context. Any agreement or conduct which hinders single market integration is closely scrutinised and may be severely punished.

The institutions of the EU

The European Council

The European Council is composed of the heads of state or government of each EU Member State plus the President of the European Commission. The European Council takes basic policy decisions and issues instructions and guidelines.

The European Parliament

The European Parliament is made up of representatives of the peoples of the EU Member States (MEPs). It has a role in the development of competition policy. It can be influential in the legislative process or in persuading the European Commission to take action in a particular case.

The European Commission

The European Commission is a separate institution, independent of the Council of Ministers of the European Union. It is of central importance to EU competition law, as it is responsible for investigating and taking action against infringements of EU law. It is divided into departments known as Directorates. The Directorate-General for Competition (DG COMP) is the Directorate responsible for enforcing competition law. It learns about cases from its own investigations and complaints by third parties.

The Council of Ministers of the European Union

This is a different body from the European Council. The Council of Ministers of the European Union is made up of representatives of the governments of EU Member States. Its function is to lay down and implement legislation. It is also responsible for ensuring co-ordination of the economic policies of EU Member States.

The Courts

There are two levels to the judicial decision-making process in the EU: the Court of First Instance (CFI) and the European Court of Justice (ECJ).

The CFI deals with applications:

- to annul European Commission decisions on the application of the competition rules
- to review the European Commission's decisions on fines

  and
- to seek the application of the competition rules where the European Commission has failed to act.

The ECJ hears appeals against decisions of the CFI.

The UK courts can also make references to the ECJ for rulings on the interpretation of EU competition law.

UK competition law

The Competition Act 1998

The Competition Act 1998 (CA) introduced prohibitions of anti-competitive agreements (the Chapter I prohibition) and of abuse of a dominant position (the Chapter II prohibition) into UK law with effect from 1 March 2000. The principal aim of the CA was to align UK competition law with EU competition law. The Chapter I prohibition mirrors Article 81 EC Treaty while the Chapter II prohibition mirrors Article 82 EC Treaty.

The Enterprise Act 2002

The Enterprise Act 2002 (EA) represented a further major shake up of the UK competition law regime. Some of the changes attracting the most publicity were the introduction of criminal penalties for persons involved in hardcore cartels and the ability to disqualify directors involved in breaches of competition law.

In addition, the EA gives strengthened powers to consumer bodies.

Particularly important changes to the merger regime introduced by the EA included amending the thresholds which trigger UK merger control, altering the substantive test and removing ministerial influence from the merger control process. The EA also abolished the position of Director General of Fair Trading and created the Office of Fair Trading as an independent statutory body. Mergers involving a target which achieves turnover in the UK exceeding £70 million or involving parties with at least a combined 25% share in the supply of particular goods or services within the UK or a substantial part of it may be investigated under the EA. See the section of this Survival Pack entitled "National merger control in the UK and other countries".

The EA also provides for the carrying out of market investigations by the Competition Commission. See the section of this Survival Pack entitled "Dealing with the authorities – market investigations".

The Fair Trading Act 1973

The EA replaced most of the Fair Trading Act 1973, the old law on mergers and monopolies. The newspaper merger control regime continued to be dealt with by the FTA until 29 December 2003, and is now covered by the EA in conjunction with certain public interest considerations set out in the Communications Act 2003.

UK institutions

The Secretary of State

The Secretary of State for Trade and Industry (Secretary of State) has responsibility within the Government for competition policy. The Secretary of State appoints:

- the members of the OFT board in consultation with the Chairman of the OFT;
- the members of the Competition Commission; and
- the ordinary members of the Competition Appeal Tribunal.

His/her powers in the competition area have been substantially diminished by the EA. The Secretary of State now has only limited powers to intervene in merger and market investigations, mainly on public interest grounds.

The Competition Appeal Tribunal

The EA abolished the Competition Commission Appeal Tribunals (CCAT) and created the Competition Appeal Tribunal (CAT). The CAT has different functions from those previously held by the CCAT.

The CAT hears:

- appeals against OFT decisions regarding the Chapter I and II prohibitions (by the parties involved and third parties with "sufficient interest");
- appeals against directions made by the OFT designed to bring to an end infringements of the Chapter I and II prohibitions;
- appeals regarding the amount of penalties imposed by the OFT;
- appeals against OFT, Competition Commission [and Secretary of State] decisions on mergers;
- appeals against OFT, Competition Commission [and Secretary of State] decisions on market investigations;
- claims for damages where a decision has already been made that Chapter I or II or Article 81 or 82 have been infringed;
- certain other cases.

The Office of Fair Trading

The Office of Fair Trading (OFT) is an independent statutory body governed by a board. The current OFT Chairman is Philip Collins and the current OFT Chief Executive is John Fingleton.

The OFT has the principal role in enforcing the Chapter I and Chapter II prohibitions and also enforces Article 81 and 82 in the UK. The Competition Act 1998 affords the OFT significant powers to obtain information, enter premises to conduct investigations, make decisions on infringements of EU and UK competition law and impose potentially heavy financial penalties. In addition, under the EA, the OFT and the Serious Fraud Office are responsible for investigating directors who are suspected of being involved in hardcore cartels (the cartel offence). The OFT's powers of investigation relating to the cartel offence are wide ranging and include the ability to compel a person under investigation to answer questions.

The OFT also plays a major role under the merger provisions of the EA, investigating mergers and referring to the Competition Commission for further investigation transactions which may cause or have caused a substantial lessening of competition.

The OFT can also refer for investigation particular features of a market or markets or of business conduct in the UK. This investigation is carried out by the Competition Commission.

UK institutions

The Courts

The High Court may hear cases involving competition law issues and has the power under the EA to transfer the competition law aspects of such cases to the CAT.

The Court of Appeal hears further appeals on the amount of penalties, the award of damages and appeals on points of law from decisions of the CAT. Appeal from the Court of Appeal lies to the House of Lords.

The UK courts can also make references to the ECJ for rulings on the interpretation of EU competition law. References can be made either in cases where the UK courts are applying Articles 81 or 82, or in a case involving the application of the Competition Act 1998 for which the interpretation of EU competition law is relevant.

The Competition Commission

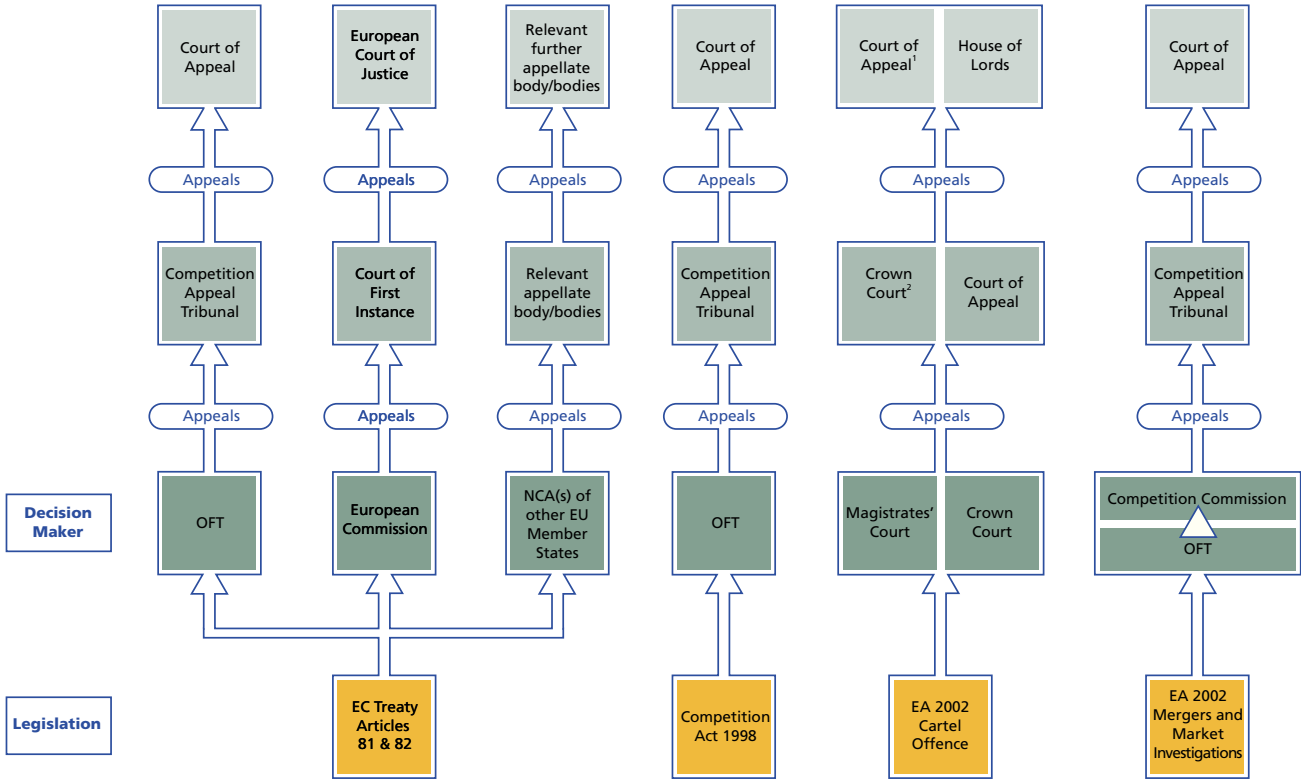
The Competition Commission (which replaced the Monopolies and Mergers Commission in April 1999) carries out investigations under the merger and market investigation provisions of the EA.

(As mentioned above, the Competition Commission Appeal Tribunals have been abolished and replaced by the Competition Appeal Tribunal).

The Sectoral Regulators

The sectoral regulators for rail, water, gas and electricity and communications, as well as the Civil Aviation Authority, have concurrent power with the OFT to enforce Article 81 and Article 82 in the UK as well as the Chapter I and Chapter II prohibitions of the Competition Act 1998. The sectoral regulators also have powers under the EA to make market investigation references to the Competition Commission.

Summary of EU and UK competition decisions and appeals



1 Further appeal from the Court of Appeal is to the House of Lords, provided leave to appeal is granted and the case raises a point of law of public importance.

2 It is also possible to appeal from the Magistrates' Court to the High Court. However, such appeals are not appeals as of right. Grounds for appeals to the High Court are that the magistrates' decision is wrong in law or in excess of jurisdiction. Any further appeal from the High Court is made to the House of Lords and must be on a point of law of public importance.

CMS Cameron McKenna

Does UK or EU law apply?

When will a merger, a course of conduct or an agreement be covered by UK competition law and when will EU competition law apply?

Mergers

For mergers, the answer to this question is usually relatively straightforward. In order for a merger to fall under the EC Merger Regulation, it must pass one of two tests which address the turnover of the parties concerned. If the EC Merger Regulation applies, then UK merger control under the Enterprise Act 2002 does not apply. Newspaper mergers attract certain public interest considerations set out in the Communications Act 2003. Mergers between two water companies are dealt with by the Water Industry Act 1991. Mergers between one water company and one non-water company are dealt with by the normal EA merger regime.

Agreements and conduct

For other agreements and conduct, EU competition law will only apply where there is (or may be) an appreciable effect on trade between EU Member States. Otherwise, UK competition law will apply.

Over the years, the European Commission and the EU courts have taken a liberal interpretation of when an agreement or conduct may have an appreciable effect on inter-state trade. The result has been a widening of the scope of EU competition law.

The European Commission has published guidelines giving more detail on the concept of effect on trade between EU Member States.

Often it will be clear whether an agreement has an effect on inter-state trade. However, where the situation is not clear, or even where it appears the effect of the agreement or conduct is limited to the UK, the EU guidelines should be borne in mind. The following points are useful reminders when assessing whether EU law will apply:

- For agreements, it is not necessary for each individual part of the agreement to affect trade for the effect on trade criteria to be met. It is sufficient if the agreement taken as a whole is capable of affecting trade between EU Member States.
- It is not necessary for there to be an actual effect on inter-state trade. If the agreement or conduct has a potential effect on inter-state trade, EU law will apply.
- The indirect as well as the direct effect of the agreement or conduct on inter-state trade should be examined.
- Article 81 or 82 requires there to be an influence on the pattern of trade between EU Member States.
- The fact that the parties to an agreement are both in the UK or that the agreement relates only to business carried out within the UK does not mean there can be no effect on trade between EU Member States. Such agreements might still be found to have repercussions on patterns of inter-state trade.

- Agreements which cover the whole of an EU Member State and which make it more difficult for an undertaking from other EU Member State(s) to enter a national market are likely to have an effect on inter-state trade.
- The effect on inter-state trade must be "appreciable". There is a rebuttable presumption that agreements are generally not capable of appreciably affecting inter-state trade where the parties do not exceed certain market share and turnover thresholds.
- Agreements between SMEs (as defined in the Annex to Commission Recommendation 96/280/EC) are normally not capable of affecting inter-state trade.

The relationship between EU and UK competition law

If EU law applies, then it will take precedence over the application of UK law. If UK law applies, the analysis of the agreement or conduct concerned will in any event usually be substantially the same as that carried out under EU law. This is because:

- The Chapter I and Chapter II prohibitions are modelled on Articles 81 and 82.
- Under section 60 of the Competition Act 1998, the UK authorities and UK courts must deal with matters arising under the CA in a manner so far as possible consistent with the approach taken at EU level in relation to Article 81 and Article 82.
- If an agreement would be exempt from EU competition law under Article 81(3) (or would be but for the issue of jurisdiction), that agreement will benefit from an automatic exemption under the Competition Act 1998 (section 10).
- EU Member States may not apply national competition law which is stricter than EU competition rules when dealing with agreements. By contrast, EU Member States can have stricter rules on conduct of dominant entities than those in Article 82. EU Member States can also apply domestic rules on unfair contract terms and related matters.

Since the entry into force of Council Regulation (EC) 1/2003 on 1 May 2004, the application and enforcement of UK competition law has come into even greater alignment with EU competition law. The Office of Fair Trading (OFT) is obliged to apply EU competition law where there is an effect on trade between EU Member States. The OFT may also carry out investigations under EU competition law on behalf of the European Commission or on behalf of the national competition authorities of other EU Member States. Certain other aspects of the UK regime are harmonised with those of the EU e.g. penalties for breach of UK competition law are in line with those for breach of EU competition law.

1 January 2007

Restrictive agreements

The prohibition against anti-competitive agreements: UK and EU

Both UK and EU competition law prohibit anti-competitive agreements. The UK prohibition in Chapter I of the Competition Act 1998 (CA) is modelled on Article 81 EC Treaty (Article 81). The two prohibitions are therefore very similar.

The UK authorities and courts are obliged to apply the Chapter I prohibition in a manner that is consistent with Article 81. Thus, the law in relation to Article 81 is of direct relevance when considering the application of the Chapter I prohibition.

Fines

Contravention of Article 81 or Chapter I can have serious consequences for a company. Firms engaged in activities which breach these prohibitions could face fines of up to 10% of group worldwide turnover. In addition, breach of the Chapter I prohibition can lead to disqualification of directors (see "Disqualification of directors" below) and/or criminal charges on directors carrying the risk of unlimited fines on individuals and/or up to 5 years' imprisonment (see "The cartel offence" below). Firms in breach of either of Article 81 or the Chapter I prohibition also leave themselves open to challenge in domestic courts by customers and competitors.

Disqualification of directors

The Enterprise Act 2002 (EA) also gives the OFT the power to apply to the courts for a Competition Disqualification Order (CDO) where there has been a breach of competition law. The court must grant a CDO to disqualify a person where the person is a director of an undertaking which commits a breach of any of the prohibitions set out in Chapter I or Article 81 and where the court considers that as a result of his or her conduct the person concerned is unfit to be a director. The maximum period for disqualification under a CDO is 15 years.

The OFT may also, instead of applying for a CDO, accept Competition Disqualification Undertakings, which have the same binding effect as a CDO but are given voluntarily by the person concerned rather than imposed by the court.

The cartel offence

The EA introduced a criminal offence for individuals who dishonestly engage in "hardcore" cartel agreements. "Hardcore" cartels are those involving price-fixing, market-sharing, bid-rigging and limiting the production or the supply of goods and services. Individuals prosecuted under this offence may be liable to imprisonment of up to five years and/or the imposition of unlimited fines.

The law in relation to Article 81 is far more developed than that in relation to Chapter I. For this reason, this section on restrictive agreements considers Article 81 before looking at Chapter I.

EU competition law – Article 81

Article 81 regulates business agreements and arrangements which may be anticompetitive and affect trade at EU level.

The prohibition

Article 81 contains a blanket prohibition on:

- agreements, arrangements, concerted practices
- between undertakings
- which may affect trade between EU Member States, and
- which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular where they:
  - directly or indirectly fix purchase or selling prices or any other trading conditions
  - limit or control production, markets, technical development or investment
  - share markets or sources of supply
  - apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
  - make the conclusion of contracts subject to tie-in of supplementary obligations unconnected with the subject matter of the contract.

The text of Article 81 is at Annex 1.

Article 81(2) states that any agreement prohibited pursuant to 81(1) is automatically void.

Article 81(2) has both prospective and retroactive effect. It is clear, however, that it is not the whole agreement which is automatically void, but only those clauses which infringe Article 81(1). The whole agreement becomes void only if the offending clauses cannot be separated from the contract. The question of severability is determined by the national court dealing with the dispute by reference to the law applicable to the contract. This will usually be the law chosen by the parties and in, the absence of express choice, the judge will look at the Rome Convention on the law applicable to contractual obligations.

However, an agreement which is prohibited by Article 81(1) may be "justified" and thus capable of being "cleared" if Article 81(3) applies. Article 81(3) can clear agreements which:

- improve production/distribution or promote technical/economic progress, and
- give consumers a fair share, and
- contain only indispensable restrictions, and
- do not lead to substantial elimination of competition.

Agreements which may not be prohibited

Automatic clearance is available if an agreement complies with a block exemption.

Parties must analyse potentially anticompetitive agreements which fall outside block exemptions to see whether they benefit from a legal exception because they comply with the exemption criteria in Article 81(3). It is no longer possible to apply to the European Commission (or to the Office of Fair Trading) for an exemption decision or comfort letter.

Some agreements which are caught by the prohibitions in Article 81(1) may in fact be assumed to be harmless because the parties and their market shares are simply too small to have any real effect on trade between EU Member States and on competition. Such agreements may be of "minor importance" - see below.

Article 81

Article 81(1) prohibits agreements:

- which may affect trade between EU Member States, and
- which prevent, restrict or distort competition within the common market

Article 81(2) makes such agreements void.

Article 81(3) can clear agreements which:

- improve production/distribution or promote technical/economic progress; and
- give consumers a fair share; and
- contain only indispensable restrictions; and
- do not lead to substantial elimination of competition.

Does the agreement distort, restrict or prevent competition?

An agreement may be caught by Article 81 if either its effect or object (or both) result in a change to the market.

There is no need to show intent. Actual or potential effect is considered. It is not necessary to offer proof that an agreement has in fact affected trade; it is sufficient to show that the concerted action is capable of having a restrictive effect.

Practices which can lead to trouble under Article 81(1)

- Price fixing
- Bid rigging
- Market sharing
- Limitation on control of production
- Information exchanges
- Cover bidding/cover pricing
- "English clauses"
- Technical development limitations
- Joint selling/joint purchasing
- Boycotts
- Resale price maintenance
- Tie-ins
- Requirements contracts

The practices listed above are discussed in more detail below. The list is a guide to some of those commercial arrangements which may raise competition concerns. Such arrangements may take the form of horizontal and/or vertical agreements.

Horizontal agreements are generally regarded by the European Commission as potentially more anti-competitive than vertical agreements because they are entered into between undertakings which operate at the same level of trade, i.e. between competitors. Horizontal agreements and the block exemptions regarding research and development agreements and specialisation agreements are discussed at the section of this Survival Pack entitled "Horizontal agreements".

Parties to vertical agreements (i.e. agreements between undertakings operating at different levels of the production or distribution chain) are reminded that they can benefit from the Block Exemption on Vertical Agreements. In broad terms, the purpose of this block exemption is to exempt most vertical agreements from the application of Article 81(1) where the supplier has a market share of less than 30%. The Block Exemption on Vertical Agreements lists a number of "hardcore" restrictions including, for example, resale price maintenance, which cannot be exempted. The Block Exemption on Vertical Agreements is discussed in more detail below and at a separate section of this Survival Pack entitled "Vertical agreements".

The following descriptions are therefore useful to give a broad understanding of when competition concerns may arise.

Price fixing

Article 81 expressly forbids agreements which directly or indirectly fix purchase or selling prices or any other trading conditions.

The following would therefore be caught:

- a straightforward agreement between suppliers to set prices
- simultaneous and uniform price increases made by competing suppliers
- agreements on particular elements of a pricing strategy, for example rebates, discounts, margins
- agreements on recommended prices (although the individual recommending of a price by a supplier to his own distributors is not caught by Article 81, unless the supplier uses duress to ensure the distributors stick to that recommendation)
- agreement on prices set by a trade association
- price agreements on imports into or exports out of the EU, insofar as they affect trade within the common market
- collective resale price maintenance.

The concepts relevant to price fixing are also relevant to the fixing of any other trading conditions, such as the terms on which goods are supplied or the types of customers to whom they may be sold.

Bid rigging

Agreements or schemes to allocate successful bids among competitors, for example by agreements to refrain from bidding for particular contracts so that a competitor will get "his turn", would amount to the sharing out or control of markets or sources of supply.

Market sharing

Article 81 explicitly forbids agreements which would allocate business among competitors on either a geographical or a customer basis, through distribution or licensing or other arrangements. Markets can be divided by (inter alia):

- class of customer
- geographical region
- manipulation of intellectual property rights for territorial reasons
- quota setting

Such divisions need not be between inter-brand competitors, but may also result from vertical arrangements.

Limitation or control of production

Agreements which:

- limit total output
- restrict investment levels
- set production or sales quotas
- prevent some parties from manufacturing certain products

will often form part of a more complex arrangement which has as its aim or effect the sharing of markets or fixing of prices.

Exchange of information

Companies should be careful about swapping price or other commercially sensitive information since this can lead to co-ordination of pricing policies contrary to Article 81(1). The European Commission has clearly stated that "it is contrary to the provisions of Article 81(1) … for a producer to communicate to its competitors the essential element of his pricing policy, such as price lists, the discounts and terms of trade he applies, the rates and dates of any change to them and the special exceptions he grants to specific customers".

Cover bidding / cover pricing

A number of breaches of competition law have involved cover bidding (also known as cover pricing). This occurs when a supplier submits a price for a contract that is not intended to win the contract. Instead it is a price that has been decided upon after consultation with another supplier that wishes to win the contract. Cover bidding aims to give the impression of competitive bidding, but in reality suppliers agree to token bids that are usually too high. It is a clear breach of competition law.

English clauses

Another aspect which causes difficulties in this area is the "English clause". This is where the supplier says that if the purchaser can show that he has been offered better terms by a third party, then the supplier will meet those terms, failing which the purchaser is free to go and get his supplies elsewhere. The European Commission's view is that this is an objectionable practice, not because of its effect on exclusivity, but because it allows competitors access to others' pricing policy information and other commercial terms. So, price fixing / market sharing might result.

Technical development limitations

Agreements between potential competitors to use only a particular type of technology or technical standards may, in some circumstances, benefit the end user in that he has a greater choice of compatible products, but generally this will be overridden by the fact that no competing technologies can develop.

The use of only agreed standards will also be restrictive of competition if it prevents imports reaching a market or divides the market geographically or by customer.

Joint selling/joint purchasing

Agreements between groups of suppliers to deal exclusively through certain approved dealers, agreements on prices or methods of purchase to be observed by groups of competitors, and operating a joint sales subsidiary or agency through which all sales in a particular jurisdiction are carried out, may each be contrary to Article 81. The underlying question would be whether the ability of each competitor or potential competitor to act independently vis-à-vis third parties had been removed.

Boycotts

Collective use of blacklisting, refusal to sell to particular customers or to buy from particular suppliers can be a serious offence. There is not much reported EU case law on this point, but the European Commission has found a boycott organised by a trade association under an agreement between competing suppliers to be "a particularly severe violation of the rules of competition, since its aim was to eliminate a troublesome competitor".

Resale prices

Collective and individual resale price maintenance agreements are generally contrary to the competition rules. If a supplier introduces minimum resale prices into his distribution agreement, the reseller may regard these as an indication of what the supplier would like (recommended resale prices), but can in fact ignore them. Distributors must be free to set their own prices according to their own reading of the market. Attempts by the supplier to enforce his r.r.p. will be contrary to Article 81. Setting by a manufacturer of his retailers' maximum resale price is, however, usually allowed.

Tying-in

An arrangement where the supply of one type of goods is "tied" to the supply of another, which is not in a related field, will generally get you into trouble. Withholding supplies or refusing to enter into an agreement unless the customer takes additional goods of a different genre restricts that customer's freedom to obtain what he wants where he wants. This may be contrary to Article 81, but it will be especially vilified if the supplier is in a dominant position in his market.

Requirements contracts

The European Commission has often objected to long term industrial supply agreements where the purchaser must agree to take the whole of his requirements from one source. Again, this can be especially difficult where the purchaser or supplier (or both) is/are in position of strength on their market. An alternative may be to set fixed quantity requirements, but not if these are agreed so as effectively to equal all or a very high proportion of the purchaser's requirements over the period. The European Commission takes the view that a long term all-requirements contract freezes the relationship with potential suppliers and the role of offer and demand is eliminated to the disadvantage of new competitors who cannot get near this customer, and of old competitors who, in the meantime, may have become more competitive than the actual supplier.

Analysing the application of Article 81(1)

There are three distinct elements in analysing the application of Article 81(1).

- Does the agreement have an anti-competitive effect?

  First, one has to consider whether the agreement will have, or is intended to have, an anti-competitive effect. This will depend on whether it affects competition between the parties or restricts their freedom of action in dealing with customers or suppliers. This can involve market collusion, as well as expressly restrictive agreements, such as standardised contract terms, and exchanges of market information.

- Will the arrangements affect trade between EU Member States?

  Second, there is the question of whether the agreement is capable of having a direct or indirect effect on trade between EU Member States. If not, EU competition law will not apply.

  The question here is whether the arrangement will cause the pattern of trade within the EU to change. Both the European Commission and the European Court of Justice have given increasingly wide definitions to the concept of what constitutes an effect on trade between EU Member States. It does not have to be a prejudicial effect. It may be actual or potential, direct or indirect. The European Commission has published a notice which gives more detail on its understanding of the concept of effect on trade between EU Member States.

Article 81 can apply to an agreement between parties in the same EU Member State which only concerns business in that State. For instance, exclusive distribution agreements may make it more difficult for undertakings in other EU Member States to find an outlet for their products, or one of the parties may be a branch or subsidiary of a company in another EU Member State whose position may be affected by the agreement.

Partitioning the market through distribution arrangements which give the distributor complete territorial insulation is an obvious culprit. But what about a joint venture between three companies to design and develop new apparatus? This might affect trade because, if they had not entered into the agreement, the companies might each have developed new apparatus independently and marketed it across the EU. The consumer would have had three choices instead of one. So one has to look beyond the terms of the agreement and ask what the consequences might be. What competition is there now and what will there be after this agreement is implemented.

- Is the effect appreciable?

Finally, the effect on competition and inter-state trade must be "appreciable".

There is a "Notice on Agreements of Minor Importance" which sets out some guidelines on what is meant by "appreciable effect". This Notice is not binding on the courts and the thresholds are only a guide.

The Notice states that the European Commission holds the view that agreements between undertakings which affect trade between EU Member States do not appreciably restrict competition if:

- the aggregate market share of the parties to an agreement between actual or potential competitors does not exceed 10%, or
- the market share held by each of the parties to an agreement between non-competitors does not exceed 15%

provided that they do not contain any "hardcore" restrictions of competition, such as price-fixing, market sharing or limitation of output or sales.

Block exemptions

Where an agreement complies with the requirements set out in a block exemption, that agreement is exempted from Article 81(1), such that the agreement will be "cleared" under competition law. This does not mean that the agreement falls outside Article 81(1); rather, the agreement falls within Article 81(1), but is exempt for the reasons in Article 81(3). The agreement's validity therefore cannot be challenged on competition grounds. The only exception to this occurs if the European Commission or the national competition authority of an EU Member State (NCA) decides to withdraw the benefit of a block exemption in respect of a particular agreement (see below).

Block exemptions have been granted for agreements which satisfy the detailed requirements of the relevant regulation. There are block exemptions relating, for example, to:

- vertical agreements
- motor vehicle distribution agreements
- specialisation agreements
- research and development agreements
- technology transfer
- certain types of insurance agreement.

It is always helpful to draft agreements as close as possible to block exemption requirements.

Where it is anticipated that only UK competition law would apply to an arrangement the block exemptions are also useful as they are effectively replicated in UK law. There are no separate UK regulations but parties can rely on "parallel" exemption using the EU texts.

The UK vertical agreements exclusion no longer exists. Parties must instead look to whether their agreement is in line with the provisions set out in the EU model.

The UK exclusion in relation to land agreements remains in force.

The block exemption on vertical agreements

Vertical agreements are agreements between companies which for the purposes of a particular arrangement operate at different levels of the production or distribution chain and which relate to the conditions under which businesses may purchase, sell or resell goods or services.

Points to note

- the safe harbour

  There is a presumption that no breach of Article 81 occurs in agreements for the sale of goods and services concluded by companies having less than 30% market share, unless they contain "hardcore" restrictions such as minimum or fixed retail prices.

- the "hardcore" restrictions

  The block exemption will not apply and parties are unlikely to be able to assume that their agreement is otherwise "cleared" by Article 81(3) if the agreement contains:

  - price fixing (although recommended prices may be included)
  - restrictions on resale (except in limited circumstances in relation to exclusive and selective distribution arrangements)
  - restrictions on active or passive resale by members of a selective distribution system
  - restriction of cross-supplies between distributors within a selective distribution system
  - certain restrictions on sales of spare parts.

- Non-compete obligations must be limited to a period of five years if the agreement is to obtain the benefit of the block exemption.

- While the European Commission has always retained the power to withdraw the benefit of a block exemption, the block exemption on vertical agreements also grants the right to NCAs to withdraw the exemption where an agreement ceases to satisfy Article 81(3) in relation to a particular EU Member State. The benefits of the block exemption on vertical agreements can be withdrawn if the agreement has the effect of restricting parallel imports, or where the distributor refuses to supply certain categories of customer without good reason, or if the prices charged by him are excessive. (Since 1 May 2004, NCAs have the right to withdraw the benefit of any EU block exemption in their respective territories in respect of particular cases where certain conditions are met.)

Individual exemptibility

Many commercial agreements contain restrictions on the parties, which will, to a greater or lesser extent, affect competition. Some of these agreements will be acceptable, indeed desirable, from the overall economic point of view, but not of the sort which fall easily into block exemption formats.

Where no block exemption covers an agreement, that agreement will be "clear" under competition law provided it fulfils the criteria of Article 81(3).

The criteria of Article 81(3)

These are, broadly, that:

- the agreement contributes to improving the production or distribution of goods or promoting technical or economic progress; and
- the end consumer is allowed a fair share of the resulting benefits; and
- the restrictions on the parties are the minimum necessary to achieve these objectives; and
- competition is not eliminated in respect of a substantial part of the products covered by the agreement.

The directly applicable exception system

In the past, it was possible to notify an agreement to the European Commission for a decision whether it would grant an individual exemption from Article 81(1). The European Commission (and the European Courts on appeal) were the only bodies capable of granting an individual exemption under Article 81(3).

However, Council Regulation (EC) 1/2003 abolished the notification system. In its place is a directly applicable exception system. This provides that any agreement which is caught by Article 81(1) but which meets the conditions of Article 81(3) will automatically benefit from an exception from Article 81(1) and will be legally enforceable without requiring any prior approval.

The European Commission no longer grant individual exemptions or gives "comfort letters" to companies.

National competition authorities (such as the OFT) and national courts now have the power not only to apply Article 81(1) but also Article 81(3). There is no replacement notification system allowing notifications to domestic authorities. Parties need to make their own assessments.

There is a large body of EU competition case law and regulation which provides guidance to national competition authorities, national courts and parties to agreements, together with a number of EU and OFT guidance documents.

Gist of the directly applicable exception system

- Notification system abolished
- Instead, the Article 81(3) exemption is made directly applicable at EU and national levels without a prior decision by the European Commission, and undertakings are able to rely on Article 81(3) before national courts
- Article 81 as a whole is applied by the European Commission, national competition authorities and national courts
- The European Commission's role remains important in determining EU competition policy by adopting regulations and notices on the interpretation of Articles 81 and 82 and on continuing to adopt prohibition and "non-prohibition" decisions

Why change to a directly applicable system?

The European Commission recognised that the system of notifying an agreement to the European Commission for individual exemption was designed when the EU had just six members and was not suitable for an EU of 27 Member States (as of 1 January 2007). From the practical perspective of business, the European Commission's Competition Directorate General simply did not have the manpower to deal promptly with notified agreements and most parties had to be satisfied – often after many months of waiting – with a comfort letter which has persuasive effect, but was not legally binding. The directly applicable system has freed up Commission resources, allowing it to focus on more serious breaches of competition law such as cartels.

Effect on companies

The European Commission believes that legal certainty is maintained for business and in certain respects enhanced, as, for example, companies can obtain immediate enforcement of their contracts in national courts from the date of their conclusion if the Article 81(3) conditions are fulfiled.

Companies and their advisers need to carry out a detailed review of whether Article 81(1) is infringed and whether the Article 81(3) conditions are met, rather than relying on the old system where the European Commission could be invited to make a decision and some protection from fines was offered.

Companies may have to rely on or defend their conclusions in front of national courts or national competition authorities.

The role of the national courts

Article 81 has direct effect in all Member States. It grants rights to, and imposes obligations on, EU residents. The national courts are responsible for the application of Article 81 (and also Article 82 – see the section in this Survival Pack entitled "Abuse of a dominant market position") in the domestic forum. National courts can apply Article 81(3), (this was previously reserved to the European Commission).

Complaints

Those who believe they have been damaged due to another's breach of EU competition law may make a complaint to the European Commission. Complaints can be made formally or informally. Formal complaints may only be made by those undertakings which have a "legitimate interest". They may request the European Commission to initiate a procedure to establish the existence of an infringement of Article 81 (or 82) (and/or relevant parallel Articles of the European Economic Area Agreement). Formal complaints must be made on Form C. This form requires details of the alleged infringement and the ground on which the complainant claims his interest, together with documentary evidence and names of persons, especially those affected by the alleged infringement, able to testify to the facts. Informal complaints do not require the complainant to have a "legitimate interest" or to use Form C. However, the complainant has less opportunity to participate in the European Commission's investigation of the complaint where it makes its complaint informally.

The European Commission is keen to root out and punish cartels and abuses of dominance. This is part of the rationale behind the Regulation, which aims to free resources for the pursuit of cartels and other serious abuses. Therefore, complaints about serious breaches of Article 81 involving business across a wide area of the EU should generally be made to the European Commission. National competition authorities are also able to deal with complaints of breach of Article 81. In deciding whether to complain to the European Commission or, for example, the OFT, companies should have regard to the seriousness of the alleged infringement and whether its effects are widely felt throughout the EU. They may complain to any relevant EU Member State competition authority. However, national competition authorities will not hesitate to contact the European Commission where they believe a complaint would be better handled in Brussels.

Complain or use the courts?

Complaints to the European Commission or national competition authorities can be less costly than using the courts, as litigation fees and associated costs are avoided. Complainants will not obtain from national competition authorities damages for losses they have suffered due to breaches of competition law. The national competition authority may, however, impose fines on the party against whom the complaint is made where the complaint is upheld. Complainants may then "enforce" the decision in national domestic courts by bringing a claim in damages.

Using national courts has the advantage of often achieving a speedier resolution, and damages are available. However, this approach may be costly. The national courts are not as experienced in the application of competition law as national competition authorities. In the UK this has changed to some degree now that the Enterprise Act has given courts the ability to refer competition matters to the Competition Appeal Tribunal (CAT) and also introduced a right to bring certain damages claims in the UK directly before the CAT. National courts can also adopt interim measures and end infringements by using their powers such as injunctions.

Transactions outside Europe

Companies outside the EU can be caught by the competition rules. Parent companies located outside the EU have been held responsible for the anti-competitive conduct of their subsidiaries located inside the EU. This is sometimes called the "economic unity theory" and can involve the whole of a group in violation and fines. Companies which have no permanent EU presence at all can also be caught; the decisive factor is where their agreements are implemented or have their effect, rather than the place where they are made.

Thus, if third country undertakings agree to apply a common pricing policy within the single market of the EU, whether they have subsidiaries or branch offices within the EU is irrelevant. Their actions have an effect on supplies of goods in the EU. Nor does it matter where the contract is signed.

Analysing the risk of competition compatibility

- De minimis?
- Available block exemption?
- Effect on competition in the market
  - parties are competitors?
  - economic analysis – market and market shares/dominance?
  - effects of collaboration – on existing/potential competition?
  - co-ordination of policies?
  - foreclosure?
  - spillover?
- Attitude of competitors
- Big players, high profile, substantial effect on market?
- Risks
  - Important provisions may be vulnerable
  - Investment may depend on these provisions
  - Disgruntled third parties may complain
  - Court actions

Checklist of information required to determine whether a transaction is caught by Article 81

What your lawyer will ask you
Questions related to the undertakings involved in the arrangements

- Do the undertakings form part of groups of companies?
- List main parent companies and subsidiaries, giving place of registration and main type of business.
- Provide copies of latest Report and Accounts together with relevant company publications such as catalogues.

Questions related to the products or services involved in the arrangements

- What exactly are the products or services involved?
- Are they new, where are they already marketed, do they involve a great deal of research and development…?
- What products are generally considered interchangeable with the products which are the subject of the arrangements?

Defining the arrangement

- What is the object of the arrangement?
- What is or will be its effect (actual or potential) on the market?
- What is the impact of the arrangement:
  - on the parties involved
  - as regards third parties (competitors, consumers)?

The market related to these products or services

- What is its geographical extent?
- How competitive is it:
  - identify the main existing competitors to the client - their size (turnover, market shares, their location…).
  - how difficult is it for new suppliers to enter the market ("barriers to entry": start up costs; financial and technological lead of the parties over their competitors)?
- Who are the consumers (individuals, corporations, wholesalers…) and where are they located?

Market shares

- What is the share of the product or service market affected by the arrangement:
  - of the undertakings involved and their groups
  - nationally
  - in the EU

    and
  - worldwide?

The Chapter I prohibition

The Chapter I prohibition outlaws agreements and arrangements between companies which have, or may have, an anti-competitive effect. It is based on Article 81(1). The Chapter I prohibition applies only to anti-competitive activities which are intended to be carried out in the UK.

As is the case with Article 81, the prohibition applies to agreements and to concerted and collusive arrangements between two or more companies or other economic entities. Decisions of trade associations may also be caught by the prohibition. The prohibition applies to all and any activities of a company whether formalised in a legally binding agreement or merely the subject of an oral understanding. In this section of the Survival Pack these various types of arrangement are referred to as "agreements".

There is clearly a significant amount of overlap between the application of Chapter I and Article 81. The examples provided above on "Practices which may lead to trouble under Article 81(1)" are also useful with regard to agreements which have an effect in the UK.

The fundamental difference between the two provisions is that Chapter I applies where an agreement has an effect on trade in the UK as opposed to trade between EU Member States.

An effect on UK trade

An agreement will affect UK trade where it has an actual or potential, direct or indirect, effect on a UK market for goods or services. It is clear that an agreement relating to the supply of goods between two UK-based companies will affect UK trade. An agreement relating to the shipment of goods between the USA and the UK, however, could have an indirect effect on trade within the UK, and so would also be likely to fall within the scope of the prohibition.

The UK market

An agreement may affect the whole or any part of the UK. Even if its effects are only felt within one town in the UK, the Chapter I prohibition can still apply.

A restriction on competition

An agreement will be caught by the Chapter I prohibition if it restricts, distorts or prevents competition, or is intended to do so. The structure or form of an agreement will not be relevant. Examples of the types of agreements that may be caught by the Chapter I prohibition are set out below.

Examples of agreements likely to breach the Chapter I prohibition

- market sharing agreements - e.g. Company X based in Birmingham agrees with Manchester based Company Y that it will not operate in the North West if Company Y does not operate in the Midlands
- price fixing agreements - e.g. agreements between competitors not to lower or raise prices for their goods or services
- resale price maintenance - e.g. imposing the price for onward sales of goods
- information exchange between competitors - e.g. meetings to exchange market information relating to pricing, customers or suppliers
- collusive tendering - e.g. competitors agreeing not to bid against each other for certain contracts
- cover bidding / cover pricing arrangements - e.g. suppliers obtain from competitors a price at which they know their bid will not be successful, while still giving the impression of a competitive bid
- limiting sources of supply - e.g. a group of competitors agreeing not to supply certain companies or preventing access to the market
- non-compete provisions - e.g. agreements relating to the types of products or forms of business in which a company may or may not be involved

An agreement must have an "appreciable effect" on competition in the UK. In the past, the OFT had viewed an agreement as having no appreciable effect in the UK where the parties' combined market shares did not exceed 25%. This meant that agreements with 25% market share or less were unlikely to be caught by the Chapter I prohibition unless they included a "hardcore" restriction of competition, such as price fixing, market sharing or imposition of minimum resale prices. By contrast, the European Commission sets the thresholds for appreciability at 10% (agreements between competitors) or 15% (agreements between non-competitors). This approach is set out in the Notice on Agreements of Minor Importance.

The OFT has indicated that "as a matter of practice [it] is likely to consider an agreement, will not fall within either Article 81 or the Chapter I prohibition when it is covered by the Notice on Agreements of Minor Importance"[1]. It goes on to state that even where these 10% or 15% thresholds are exceeded this "does **not** mean that the effect of an agreement **is** appreciable. Other factors will be considered in determining whether the agreement has an appreciable effect. Relevant factors may include for example, the content of the agreement and the structure of the market or markets affected by the agreement, such as entry conditions or the characteristics of buyers and the structure of the buyers' side of the market"[2]. In addition, the OFT notes that "where [it] considers that undertakings have in good faith relied on the terms of the Notice on Agreements of Minor Importance [it] will not impose financial penalties for an infringement of Article 81 and/or the Chapter I Prohibition"[3].

It therefore appears that the OFT wishes to be flexible in dealing with appreciability, but this approach, if adopted, will require parties to agreements to give more thought to this issue. Also, whilst the parties' market shares give some indication of the economic importance of an agreement, they do not tell the whole story of its effect on competition. It is, therefore, not sensible to rely solely on the market shares of the parties, without considering the overall effect of the agreement.

1 OFT competition law guideline on agreements and concerted practices, paragraph 2.19

2 OFT competition law guideline on agreements and concerted practices, paragraph 2.20

3 OFT competition law guideline on agreements and concerted practices, paragraph 2.19

Exclusions from the Chapter I prohibition

The CA excludes certain types of agreements from the Chapter I prohibition. The main categories of such excluded agreements include those:

- which result in a merger falling under the Enterprise Act 2002 or the EC Merger Regulation
- made by undertakings entrusted with the operation of "services of general economic interest" or a "revenue producing monopoly"
- which are covered by the separate competition regime in the Financial Services Act 1986.

Agreements which have received clearance under the Restrictive Trade Practices Act 1976 (section 21(2) directions) will benefit from a transitional period lasting until 1 May 2007, after which they will fall within the scope of the Chapter I prohibition.

The Secretary of State has the power to add, amend or remove exclusions in certain circumstances.

Previously, agreements which constitute the rules regulating specified professional bodies were excluded from the Chapter I prohibition. This exclusion was repealed by the Enterprise Act 2002 as no rules were ever designated under it. Therefore, these rules are subject to the Chapter I prohibition in the same way as all other agreements and decisions of associations.

Vertical and land agreements

Both the UK and EU rules are based on the assumption that vertical agreements are generally not as restrictive of competition as horizontal agreements.

Until 1 May 2004 there was a UK statutory instrument which excluded from the Chapter I prohibition vertical agreements (that is, between companies at different economic levels such as manufacturer and distributor) and agreements relating to land, except where price fixing was concerned. This was more generous than the EU regime.

However, the UK exclusion was repealed from 1 May 2004. The reason for this repeal was a UK government decision that vertical agreements should be dealt with by relying on the parallel effect in the UK of the EU block exemption on vertical agreements (see "Parallel exemption" below).

The UK exclusion for land agreements remains (under a new statutory instrument).

Exemption

There are two ways in which an agreement may be exempted from the Chapter I prohibition:

- under the terms of a specific UK "block exemption"

or

- under the terms of a "parallel exemption" – a parallel with the EU rules.

An exemption, either block or parallel, does not mean that the agreement falls outside the Chapter I prohibition. Rather, the agreement falls within the Chapter I prohibition but is exempt because it complies with the requirements of section 9 of the Competition Act 1998 (see "Individual exemptibility" below for the section 9 criteria).

UK block exemptions

The OFT can, if appropriate, recommend that the Secretary of State make UK block exemptions. To date, only one block exemption has been made under the Competition Act 1998. The Public Transport Ticketing Schemes Block Exemption Order came into force on 1 March 2001. It provides that certain types of public transport ticketing schemes receive the benefit of the block exemption as long as they meet certain conditions set down in the block exemption Order. This block exemption was reviewed by the OFT between 2003 and 2005. The OFT recommended to the Secretary of State in November 2005 that the block exemption be extended to last until 2011, but that the requirement for operators to sell their own tickets concurrently with individual multi-operator tickets should be removed. In addition, the OFT recommended that any method of revenue distribution should be permitted provided it does not incentivise operators to set their own fares at higher levels than in the absence of multi-operator travelcard schemes and provided it does not significantly reduce the incentive for each of the operators to compete for passengers. The amended block exemption came into force on 23 January 2006.

Parallel exemption

Agreements will be exempt from the Chapter I prohibition, if they are exempt from Article 81 EC Treaty (parallel exemption). Such agreements are those which:

- are covered by an EU "block exemption" (regulations exempting common types of agreement)

or

- have been granted an individual exemption by the European Commission under the EU's notification system and, from 1 May 2004, those which are exempt automatically under Article 81(3).

Individual exemptibility

Following the abolition of the UK notification system, any agreements which meet the above criteria will automatically be "cleared" under the Chapter I Prohibition without any need for prior approval. Parties must make their own assessments. Section 9 of the Competition Act 1998 set out criteria which must be met for an individual exemption to be possible. These are in parallel with the exemption criteria in Article 81(3) i.e. that the agreement:

- must contribute to:
  - improving production or distribution

  or
  - promoting technical or economic progress
- but must not:
  - impose restrictions which are not indispensable to the achievement of the above objectives

  or
  - give the companies involved the opportunity of eliminating competition in respect of a substantial part of the products in question.

Consequences of breaching the Chapter I prohibition

Entering into agreements or engaging in practices which breach the Chapter I prohibition can have serious consequences for a business:

- The OFT can impose fines of up to 10% of worldwide turnover for intentional or negligent infringements.
- Offending provisions in an agreement cannot be relied on or enforced, or the entire agreement could in some cases be invalid.
- The infringement may give third parties a right of action for damages or injunction in the UK courts.
- The OFT has strong powers to investigate suspected infringements and a company could be put at risk of an unannounced "dawn raid".
- The OFT has the power to take interim measures to suspend or modify an agreement pending completion of its investigation.
- Those individuals found to be dishonestly participating in a hardcore cartel could be liable to criminal sanctions (unlimited fines and/or up to 5 years imprisonment) (see section in this Survival Pack entitled "The cartel offence").
- The OFT can apply to the court to disqualify a director where that person is a director of an undertaking that has breached competition rules and the court considers the person is unfit to be a director.

There is an immunity from fines on companies (but not from invalidity or third party actions) in respect of small agreements which have been defined, broadly speaking, as agreements between companies having a combined turnover of not more than £20 million.

What should businesses do?

The Chapter I prohibition (and also Article 81 EC Treaty (see above)) needs to be considered every time a business enters into a new agreement, whether formal or informal. Businesses should implement a compliance programme (or update an existing programme) in order to raise awareness of the Chapter I prohibition and the consequences of infringement. Further details of compliance programmes can be found in the relevant sections of this Survival Pack.

1 January 2007

Annex 1

Article 81

(1) The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

(2) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

(3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

any agreement or category of agreements between undertakings

any decision or category of decisions by associations of undertakings

any concerted practice or category of concerted practices

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Annex 2

The Chapter I prohibition

(1) Subject to section 3 [types of excluded agreements], agreements between undertakings, decisions by associations of undertakings or concerted practices which –

(a) may affect trade within the United Kingdom, and

(b) have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom

are prohibited unless they are exempt in accordance with the provisions of this Part.

(2) Subsection (1) applies, in particular to agreements, decisions or practices which –

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which by their nature or according to commercial usage, have no connection with the subject of such contracts.

(3) Subsection (1) applies only if the agreement, decision or practice is, or is intended to be, implemented in the United Kingdom.

(4) Any agreement or decision which is prohibited by subsection (1) is void.

Vertical agreements

Introduction

A "vertical agreement" is an agreement between companies operating at different levels of the production or supply chain. Examples include agreements for the supply of raw materials, wholesale supply and distribution and retailing agreements. An agreement between a wood supplier and a paper manufacturer for the supply of wood to make paper, or an agreement between a pharmaceuticals manufacturer and a distributor for the sale of certain drugs, are each examples of a vertical agreement.

Vertical agreements can cause competition concerns as they frequently contain restrictions on the commercial freedom of one or more parties. Typical of such restrictions, or "vertical restraints", is a clause requiring the retailer or distributor to deal exclusively with a single manufacturer or producer for a particular type of product. Others include:

- resale price maintenance - where the manufacturer specifies the resale price of the product
- tie-in sales and bundling - where the manufacturer makes the purchase of one product conditional on the purchase of a second product
- full line forcing - where the retailer or distributor is required to stock the full range of the manufacturer's products.

The treatment of vertical agreements under UK and EU law has been harmonised since 1 May 2004 when the UK repealed its more permissive exclusion for vertical agreements.

The EU position is represented by a block exemption found in Council Regulation (EC) 2790/1999 of 22 December 1999 (the Block Exemption). This Block Exemption covers all types of vertical agreement, but is subject to market share and other constraints.

The UK position is to exempt vertical agreements with UK effects but which do not have effects on EU trade if those agreements comply with all the other provisions of the EU's Block Exemption.

History of the EU regime

The European Commission has operated since the late 1960s a number of block exemptions to give automatic exemption from the prohibition of restrictive agreements in Article 81(1) EC Treaty (Article 81(1)) for specific types of agreement, including exclusive purchasing, exclusive distribution and franchising agreements. Provided that an agreement falls within the terms of a block exemption, the agreement is safe and is exempted from Article 81(1).

There was originally a notification system whereby parties to potentially restrictive agreements could notify them to the European Commission for a decision on their compatibility with EU law. The European Commission was flooded with "failsafe" and other notifications and the system fell into disrepute when exemption decisions took years to be reached, if they were reached at all. The European Commission's practice of issuing comfort letters giving a non-binding indication of its assessment of an agreement, after a lengthy wait by the parties, was also heavily criticised. The system was abolished from 1 May 2004.

Early block exemptions set out a list of fairly rigid rules of what was and was not permitted and also received much criticism. However, to benefit from legal certainty and to avoid the need to notify each agreement to the European Commission for clearance, parties drafted their agreements in accordance with the block exemptions. Consequently, companies were restricted in the terms they could include within their agreements, and commercial agreements became increasingly standardised. Another difficulty was that the block exemptions on exclusive distribution and exclusive purchasing only applied to goods which were to be resold, rather than to intermediate goods such as raw materials, and therefore only covered a limited range of vertical relationships.

The European Commission responded to this criticism by introducing a single block exemption relevant to all vertical arrangements with effect from mid-2000. It concentrates on the economic context in which the parties operate.

The EU Block Exemption

Vertical restraints with an effect on trade between EU Member States may in certain circumstances benefit from the Block Exemption. On 1 June 2000, the Block Exemption replaced the old block exemptions for exclusive distribution, exclusive purchasing and franchising. The replacement Block Exemption applies to all vertical agreements, whatever their commencement date. The Block Exemption's underlying purpose is to be economically realistic and to recognise that vertical agreements do not present serious competition concerns in the absence of market power.

The regime is therefore meant to be liberal and to make life easier for business. It is not, however, always an easy regime to understand. The wording of the Block Exemption is often complicated.

This summary seeks to answer the following questions:

- Which vertical agreements are covered?
- What is the market share threshold below which the parties can benefit from the Block Exemption?
- Which restrictions must a vertical agreement avoid at all costs?
- When are non-compete provisions still permissible?
- When can the Block Exemption be withdrawn or disapplied?
- What happens to agreements falling outside the Block Exemption?

As well as the Block Exemption itself, the European Commission has published extensive guidelines on the application of the Block Exemption. These guidelines both comment on the specific terms of the Block Exemption and provide an overriding framework of analysis for vertical agreements and the enforcement policy of the European Commission within and outside the scope of the Block Exemption.

Which agreements are caught?

The current regime, represented by the Block Exemption, covers a broader range of agreements than previous regimes. As a result, selective distribution and agency agreements (where Article 81(1) is triggered) benefit from a block exemption, which they did not before 1 June 2000.

The Block Exemption defines vertical agreements as agreements and concerted practices

"between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services".

Both goods and services, whether final or intermediate, are covered. Multi-party agreements, where each party operates at a different level of the production or distribution chain, enjoy the benefit of the Block Exemption. This goes beyond the two-party limit of the earlier regime.

Even vertical agreements between actual or potential competitors may enjoy the benefit of the Block Exemption, provided the agreement is non-reciprocal (i.e. only one of the parties is distributing the other's goods) and the buyer either has a total annual turnover not exceeding €100m or is the distributor and not also the manufacturer or provider of competing goods or services. Agreements between an association of undertakings (i.e. a trade association) and its suppliers may be covered, if all members are retailers of goods and no individual member, together with its connected undertakings, has a total turnover exceeding €50m.

Finally, the exemption can apply to the assignment of intellectual property rights when the assignment does not constitute the primary object of the agreement and is directly related to the use, sale or resale of goods or services by the buyer or its customer. A trade mark licence granted to a distributor could be covered, as could software supply agreements where the reseller, without acquiring licensed rights itself, acts as a channel for a licence to use between the supplier and the end user of the software, for example "shrink wrap" licences. This means that the application of the Block Exemption to franchising agreements may not always be clear, since a trade mark licence is usually a central feature of such arrangements. Care must therefore be exercised in deciding whether a franchise agreement is not in fact a pure transfer of intellectual property rights. Franchising is covered in a separate section below.

Market share rule

The main point of the Block Exemption is to focus the European Commission (and other competition authorities) on agreements where market power threatens inter-brand competition. Consequently, the principal feature of the Block Exemption is a single market share cap of 30%, below which vertical agreements are presumed not to involve market power and are therefore block exempted.

For exclusive supply obligations, the market share to consider is that held on the relevant market by the purchaser and connected undertakings. For other obligations, the market share cap applies to the share held by the supplier and connected undertakings. This means that the market share to consider is the share of the company imposing the obligation.

Which restrictions must a vertical agreement avoid at all costs?

The other principal feature of the Block Exemption (other than the market share threshold) is that there is no longer (as there was under former regimes) a "white list", but only a "black list". Any vertical agreement complying with the Block Exemption's market share and other general criteria will be covered, provided that the agreement does not contain any of the "blacklisted" or "hardcore" provisions.

The Block Exemption contains five blacklisted provisions:

- any element of price fixing or minimum resale price maintenance
- any restriction upon the territory into which, or upon the customers to whom, the buyer may sell the contract goods or services
- any restriction on sales to end users by retail-level dealers in a selective distribution system
- any restriction on cross-supplies between any distributors (at whatever level) in a selective distribution system
- any restriction on sales of spare parts by the supplier to end users/repairers who are not the buyer's own repairers.

Of these five, the first two blacklisted provisions have the most general application.

The first blacklisted provision is readily understood. Price terms and resale price maintenance are not permitted. Maximum or recommended resale pricing is, however, permissible.

There are four instances where the second blacklisted restriction will not apply. The most significant of these exceptions (and perhaps the most complex) is a restriction on active sales into an exclusive territory and/or to an exclusive customer group reserved to another distributor or to the supplier (see also "Customer allocation and exclusive distribution" below). Thus, it is possible to prohibit a distributor from seeking custom outside its own territory and/or customer group (i.e. active selling), but not possible to prohibit a response to requests which originate from the customer (i.e. passive selling). It can be difficult to draw a clear distinction between "active" and "passive" sales in vertical agreements containing an element of exclusivity. The main source of potential complexity for the active/passive distinction comes from the status of Internet sales and these are covered in a separate section below.

The other three exceptions to the blacklisted restriction on sales to other territories or customer groups are: restrictions on sales to end users by a buyer operating at the wholesale level of trade; restrictions placed on unauthorised distributors by the members of a selective distribution system; and restrictions on selling components for incorporation where the customers would use them to manufacture the same type of goods as those produced by the supplier.

When are non-compete provisions still permissible?

Although not in the hardcore of blacklisted restrictions, many types of non-compete obligation are effectively blacklisted. A non-compete obligation, as defined in the Block Exemption itself, can take either of two forms:

- a direct or indirect obligation imposed on the purchaser not to deal in competing goods or services whether through manufacture, purchase or sale; or
- an obligation imposed on the purchaser to purchase more than 80% of the contract goods or services or their substitutes from the supplier or an undertaking designated by the supplier.

A non-compete obligation is blacklisted where it is of indefinite duration or its duration exceeds five years. This means that a non-compete provision or exclusive purchasing clause which is tacitly renewable beyond a period of five years is not covered by the Block Exemption. If such provisions are not expressly limited, and if the contract itself is renewable on a "rolling" basis, the provisions will not be block exempted.

This cap placed on the duration of non-compete obligations has proved to be one of the more controversial elements of the Block Exemption regime and, in fact, represents a less liberal approach than the previous exclusive distribution regime. In its guidelines accompanying the Block Exemption, the European Commission has slightly softened this approach. It may be possible for the non-compete provision to be covered by the Block Exemption where renewal beyond five years is possible but requires the explicit consent of both parties and there is no obstacle placed upon the buyer effectively terminating the non-compete obligation at the end of a five-year period.

The 80% threshold below which an exclusive purchase requirement will be permissible may be of significance for many business arrangements. Many companies seeking exclusivity from their purchasers/distributors may, within a particular agreement's commercial context, find 75-80% to be a satisfactory level of exclusivity. Contracts which do not impose a purchase level of more than 80% may escape the need for a five-year cap.

Post-termination non-compete obligations are not permitted by the Block Exemption, except where they relate to franchise-style agreements to protect know-how transferred by the supplier and in circumstances where the obligation is limited to the premises and land from which the buyer has operated during the contract period. Such post-termination obligations must also be limited to a period of one year to enjoy the benefit of the Block Exemption.

Also, the supplier may not impose any indirect or direct obligation causing the members of a selective distribution system to refrain from selling the brands of particular competing suppliers.

There is one main difference between the hardcore of blacklisted restrictions (resale price maintenance etc.) and the types of non-compete obligations which are not permitted. The hardcore restrictions are not severable. This means that, where an agreement contains a hardcore restriction, the benefit of the Block Exemption is lost for the entire vertical agreement. This rule, however, does not apply to non-compete obligations. The benefit of the Block Exemption is only lost in relation to that part of the agreement which does not comply with the criteria for non-compete provisions. Severance is discussed further at the end of this summary.

When can the Block Exemption be withdrawn or disapplied?

Withdrawal

Both the European Commission and national competition authorities (NCAs) of EU Member States have a right to withdraw the benefit of the Block Exemption in respect of a particular agreement. NCAs may withdraw this benefit only in respect of their own territory e.g. the Office of Fair Trading (OFT) may only withdraw the benefit of the Block Exemption in respect of the UK.

The conditions for withdrawal by the European Commission are that it must believe that an agreement does not satisfy the conditions of exemption from Article 81(1).

An interesting feature of the general development of the European Commission's thinking on vertical agreements (as represented above all by the guidelines) is the weight it attaches to the cumulative effect of exclusivity arrangements entered into by all competitors on a relevant market. The European Commission has a right to withdraw the benefit of the Block Exemption in a given case,

"in particular where access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar vertical restraints implemented by competing suppliers or buyers".

The conditions for withdrawal of the Block Exemption by the OFT in the UK (or a part of it) in respect of a particular agreement are that the UK (or part of it) has all the characteristics of a distinct geographic market and the agreement in question has effects that are incompatible with the conditions of exemption from Article 81(1) in the UK (or part of it).

Disapplication

The European Commission has a similar (but different) right to disapply the Block Exemption. In situations where parallel networks with similar vertical restraints cover more than 50% of the relevant market, the European Commission may adopt a further regulation disapplying the Block Exemption for vertical agreements which contain restraints relating specifically to that market.

The difference between "disapplication" and "withdrawal" is that disapplication, which removes the benefit of the Block Exemption from a whole market, still leaves the door open to exemption for individual agreements where the criteria of Article 81(3) are met. In contrast, withdrawal relates to an individual case and therefore subsequent exemption is very unlikely.

In addition to all the other various thresholds under this regime and in competition law generally, companies therefore have a threshold of 50% for overall market foreclosure to remember. It is clear not only from the disapplication provisions of the Block Exemption, but also from the guidelines, that the European Commission regards industries in which for example more than 50% of the market is covered by selective distribution arrangements as far more likely to suffer anti-competitive effects.

What happens to agreements falling outside the Block Exemption?

Agreements which fall outside the Block Exemption – normally because the supplier's market share is over the 30% market share threshold – are not automatically prohibited. They may still be exemptible. Parties to such agreements will not however be able to benefit from the automatic comfort afforded by compliance with the terms of the Block Exemption. Parties to agreements containing restrictive provisions (such as exclusivity) not covered by the Block Exemption must determine themselves whether their agreements conform to the exemption criteria in Article 81(3).

The possible exemptibility of an agreement which falls outside the Block Exemption will depend on an economic assessment of whether the potential negative effects of the parties' market power will in the relevant market context outweigh any arguable pro-competitive effects of the restrictive agreement. The higher the market shares of the parties and the lower the market shares of their competitors, the less chance the agreement would have of being exemptible. The Block Exemption guidelines contain detailed guidance on the main assessment factors to be applied to a number of types of agreement not covered by the Block Exemption.

Implications of the Block Exemption for common types of commercial agreement

The principal implications of the Block Exemption for commercial agreements are:

- parties have great freedom in which to draft their agreements - provided they avoid blacklisted provisions;
- the exemption applies to a wide range of vertical agreements - exemption will automatically be given to agreements concerning selective distribution, supply of intermediate products, some agency agreements and non-exclusive as well as exclusive distribution and purchasing agreements, provided that the 30% market share threshold is not exceeded;
- suppliers with a significant market share must analyse carefully the operation of their vertical agreements within the context of their relevant market - such agreements may not receive automatic exemption.

Agency agreements

Under an agency agreement, a legal or physical person (the agent) is granted authority to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the purchase or sale of goods or services.

If they operate what the guidelines call a "true agency", commercial agents are generally considered to fall outside the competition rules, since they are usually treated as a single economic unit with the principal. Provided that the agent does not bear any risk or bears only insignificant risks in relation to the contract he concludes for his principal, Article 81(1) will not apply to the agreement. The issue of whether a block exemption is needed therefore does not arise.

However, if the agent is not integrated fully into the principal's distribution system, but operates independently, accepts financial risks on his own account (such as taking title in the goods bought or sold) or undertakes personal liability to perform contracts, the agency agreement may be caught by Article 81(1), but may be able to take advantage of the Block Exemption. Exemption will therefore be applicable up to the 30% market share threshold and will extend to exclusivity provisions, but will not be applicable if restrictions confer absolute territorial protection or impede parallel trade.

Exclusive purchasing and distribution agreements

Under an exclusive purchasing agreement, a supplier appoints a reseller of its products, on condition that the reseller will not obtain supplies from any other supplier. Unlike an exclusive distribution agreement, it does not involve the allocation of a territory and the supplier remains free to sell to others in the reseller's sales area.

Provided the supplier's market share does not exceed 30%, exclusive purchasing is permitted under the Block Exemption. Above 30%, the guidelines indicate that the higher the market share of the supplier, the shorter the permitted duration of exclusivity.

Under the previous regime, the duration of exclusive purchase agreements was capped at five years. This aspect remains unchanged.

An exclusive distribution agreement is where a supplier agrees to sell its products for resale in a particular territory only to one distributor. The distributor is usually restricted from actively selling into territories exclusively allocated to another distributor and from engaging in the manufacture or sale of competing products.

The Block Exemption is at once restrictive and flexible. The main limitation to the generosity of the 30% threshold is the five-year cap for non-compete restrictions. On the more flexible side is the ability of the distributor to process the goods, something not possible under the earlier regimes.

Commonly, exclusive distribution and exclusive purchasing obligations are combined. The European Commission has indicated that an agreement which combines these restraints is unlikely to be individually exemptible where the supplier has a market share in excess of 30%.

Franchising agreements

Franchise agreements are agreements whereby one company, the franchisor, grants to the other, the franchisee, a package of intellectual property rights relating to trade marks, signs and know-how for the sale and distribution of goods or services, usually in return for a fee or a royalty.

Generally, franchising agreements contain a combination of vertical restraints such as selective distribution and/or non-compete and/or exclusive distribution, on both the franchisee and the franchisor. The guidance on other types of commercial agreements is therefore relevant.

The Block Exemption will cover the necessary intellectual property provisions contained in the franchising agreement, such as trade-mark licences, provided that such provisions do not constitute the primary object of the agreement, but are directly related to the use, sale or resale of the relevant goods or services.

It will not always be clear whether the Block Exemption applies to agreements which the parties themselves consider to be "franchises". In some cases, it will be difficult to determine whether the transfer of intellectual property rights is the "primary object" of the contract.

The licensing of trade marks and know-how is often the main part of a franchise or master franchise agreement, but is still ancillary to the provision of the contract goods or services. The intellectual property rights assist the franchisee in reselling the relevant product. For instance, the provision of the product may require a level of technical knowledge which the franchisor alone possesses.

A franchising agreement, even with an extensive transfer of intellectual property rights, is likely to come within the scope of the Block Exemption, unless it can be demonstrated that the rights could be used for other irrelevant products or services, or that they exceed what would be required for the provision of the relevant products and/or services.

Selective distribution

A selective distribution system is a distribution system where the supplier undertakes to sell certain goods or services only to distributors selected on the basis of specified criteria. Both distributors and retailers could be appointed within the same system.

Under general principles, certain "simple" selective distribution systems do not infringe Article 81(1) at all. The European Commission guidelines identify three conditions for determining whether a system is purely qualitative and escapes the application of Article 81(1):

- selective distribution is appropriate for the product in question
- retailers must be chosen on the basis of objective, relevant and technical criteria that are applied uniformly to all potential retailers

and

- the criteria must not go beyond what is necessary.

No block exemption is needed for systems which satisfy these conditions.

It is only the more onerous or "complex" systems, which involve e.g. minimum purchase obligations or where the selection of outlets is on a quantitative basis, which might be caught by Article 81(1). These will be assisted by the Block Exemption.

The Block Exemption lists a number of provisions which are not to be included within selective distribution agreements, irrespective of the market share of the supplier. These are:

- the distributor cannot be restricted from supplying other distributors within the same selective distribution system. Thus, appointed wholesalers cannot be restricted from supplying other appointed wholesalers nor from supplying appointed retailers.

- retailers within a selective distribution system cannot be restricted in the customers to whom they may sell, nor can they generally be prohibited from advertising or selling via the Internet (unless there is an exceptional objective justification, for instance, on the grounds of product quality or safety)
- distributors or retailers within a selective distribution system cannot be restricted in selling the brands of particular competing suppliers – thus, an obligation requiring dealers not to resell competing brands in general will be permitted, whereas making the non-compete obligation specific to certain competitors will fall outside the exemption.

Restrictions on the retailer's ability to decide the location of its business premises are, however, permitted.

The Block Exemption does not prevent distributors from being chosen on the basis of a combination of quantitative (i.e. the number of outlets) and qualitative (i.e. the standard of the outlet and related services) criteria up to the 30% market share threshold.

The availability of exemption for quantitative selection criteria through the Block Exemption represents a new and more liberal approach by the European Commission than the approach sometimes found in older case-law.

If it is considered that the nature of the product does not justify a selective distribution system, the exemption may be withdrawn, even if the 30% market threshold is not exceeded.

For suppliers with over 30% market share, the European Commission has indicated that individual exemption is less likely where the majority of the market is covered by selective distribution or where there are few other competitors within the market, although the anti-competitive effects of a selective distribution agreement in such a market will be reduced where other suppliers are able to use the same distributors.

Supply agreements

The Block Exemption grants exemption to agreements concerning the supply of intermediate products such as raw materials. These agreements are sometimes better known as "industrial supply agreements".

Many of the common provisions contained in such agreements, such as requirements to purchase minimum quantities, long-term purchase obligations, tying provisions and non-compete obligations, are permitted under the Block Exemption, provided that the market share of the supplier does not exceed 30% and the non-compete obligations are for no longer than five years.

Above 30%, the Block Exemption does not apply and the position of the supplier on the relevant market will affect the competition authorities' or court's thinking on the permitted length of the contract and any non-compete provisions and the level of minimum volumes of goods to be supplied. In general, the higher the former, the shorter the latter. Suppliers with significant market power must also take care to ensure that any such provisions are not viewed as an abuse of dominance under Article 82 EC Treaty/Chapter II prohibition.

The Block Exemption covers the most extreme form of limited distribution, exclusive supply, whereby an agreement will specify that there is only one buyer inside the EU to which the supplier may sell a particular good or service. However, unlike non-exclusive supply agreements, the relevant market share to consider when applying the Block Exemption to exclusive supply agreements is that of the buyer and not that of the supplier.

Single-branding and tying arrangements

The European Commission's guidelines also assess the potential anti-competitive effects of any obligation placed upon the purchaser to concentrate its purchases with one supplier. Such an obligation may relate to one type of product and is often described as "single-branding" or "quantity-forcing". As a non-compete obligation, such a restriction is exempted by the Block Exemption, subject both to the 30% market share and to the five-year cap on duration of the exclusivity. The obligation may relate to more than one product. The purchase of one product may be conditional on the purchase of another, which is usually called a "tie", or the obligation may even be to purchase a whole range of products, called "full line forcing". Tying arrangements are block exempted up to the market share threshold.

For agreements where the supplier's share is above the 30% threshold, an agreement may be individually exemptible. For both types of restrictions (which are analogous to exclusive purchasing), the competition authorities' or court's assessment of a notified agreement will cover not only the supplier's market power, but also the market power of its competitors and the potential for new competitors to enter the market, and the cumulative effect of similar single-branding or tying arrangements over the whole market.

A single-branding arrangement where the supplier's market share is above 30% in a given market is less likely to meet the criteria of Article 81(3) and therefore benefit from an exception to Article 81 if the cumulative level of the same market covered by single-branding arrangements also exceeds 30%. Tying arrangements where the supplier's market share exceeds the 30% threshold are unlikely to be exempted in the absence of clear efficiencies based on joint production or distribution which are passed on to the consumer.

Issues to watch

What about sales on the Internet?

Like most areas of law, competition law has not yet come to terms with the explosive growth of e-commerce. There is as yet no new legislation or significant case-law which is specifically aimed at competition aspects of Internet sales. Business must therefore fall back on established principles and see how they apply in this new context.

The European Commission has informally confirmed that, where possible, it intends not to be interventionist concerning the Internet. However, there are perhaps three issues with an impact upon vertical relationships where the European Commission may still choose to intervene:

- Can a supplier prohibit a distributor from using the Internet to sell into exclusive territories or to exclusive customer groups?
- Can a supplier ever refuse to supply to a distributor who uses the Internet?
- Can a supplier recommend a differential retail pricing system for sales over the Internet?

Active/passive sales and the Internet

It is possible to prohibit a distributor from active selling into exclusive territories and/or to exclusive customer groups (see "Customer allocation and exclusive distribution" below). The question of whether a supplier would be allowed to prohibit a distributor from using the Internet to sell to other territories or customers depends on whether Internet sales should properly be considered to be active or passive.

The only assistance comes from a short section of the European Commission's guidelines on the Block Exemption. The use of the Internet to advertise or sell products is considered to be a passive sale, i.e. a supplier generally cannot stop distributors from using the Internet to advertise or sell products. Inevitably, therefore, the Internet will erode the value of exclusive distribution to many suppliers. The European Commission's general view of the Internet is that it is, by its very nature, an open territory. The fact that it may have effects outside a given territory (or outside a given customer group) is a natural result of the easy access provided by the technology itself.

However, the European Commission does not exclude the possibility that a website may be primarily targeted at customers in a territory or customer group exclusively allocated to another distributor or reserved for the supplier. The only example of possible active sales given by the European Commission is "the use of banners or links in pages of providers specifically available to these exclusively allocated customers". The uncertainty arises from imagining circumstances in which such "banners or links" may be active selling. The European Commission itself has said that the use of a specific language does not mean that the selling is active, which would permit distributors to use multi-language or multi-currency sites.

Finally, unsolicited e-mail sent to individual customers is definitely considered as active selling and can therefore be prohibited.

Can you refuse to supply to Internet distributors?

The guidelines state as a general principle that refusal to supply a distributor only because the distributor uses the Internet is not permissible. It may, exceptionally, be permissible where it is "objectively justified". A selective distribution system might be argued to be one example of objective justification. A prohibition on selling on the Internet for members of a selective distribution system may be considered analogous to a prohibition placed on the same members using mail order. The product in question may, for instance, require personal service or a particular style of presentation. However, in its first application of the Block Exemption to a selective distribution system, the European Commission affirmed that a ban on Internet sales, even in a selective distribution system, is a restraint on sales to consumers which could not be covered by the Block Exemption. Increasing sophistication in websites may mean that back-up services can be presented on the website itself and the justification for excluding websites would become impossible.

So, in this area too, it will be difficult for suppliers to control Internet sales.

Differential price systems

A supplier's distribution system may involve the provision of recommended resale prices. Insofar as the recommended resale prices are genuine recommendations, for many products it is not uncommon to have different prices in different countries. There should be no discrimination by reason of nationality or location in the treatment of those who access the website. Companies in a dominant position should be especially careful about objectively unjustifiable price discrimination.

Assuming, however, that differential pricing is permissible, the question is whether it remains permissible on the Internet, which obviously involves no physical distribution and where there may be a single website for the whole of Europe or indeed the world. The same website may contain a range of different prices depending upon the country of origin of the purchaser. This point is not covered in the guidelines, but the European Commission has informally indicated that it may adopt a favourable approach to Internet-based differential pricing, if there is no demonstrable strategy of discrimination and if there is no effect upon inter-state trade. It is likely that the same principles will apply to a system which differentiates between prices charged on the Internet and prices charged in a traditional context.

Customer allocation and exclusive distribution

In many distribution agreements, suppliers seek to impose a restriction on the distributor which prohibits both active selling into other territories and active selling to customer groups other than those specifically allocated to it. In other words, the restriction is a double restriction according to which the distributor can only sell to defined customers within a defined territory. It is not clear on the face of the Block Exemption regulation (or in the guidelines) whether it is possible to include such a double restriction in a distribution agreement. The relevant wording in the Block Exemption is that "the exemption… shall not apply to vertical agreements which… have as their object… the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except… the restriction of active sales into the exclusive territory or to an exclusive customer group".

The European Commission's informal view is that such a double restriction is permissible and the word "or" within the exception for restrictions of active sales means "and/or". If this is so, it should therefore be possible to have an agreement where the exclusivity is limited to distribution to certain customers within a certain territory.

Severance

A final note of caution on the subject of severability. The difference between the hardcore of blacklisted restrictions and the (more or less black-listed) non-compete obligations has been described above. The former are not severable - any agreement with any of the hardcore restrictions loses the benefit of the Block Exemption in its entirety. On the other hand, the rules of severability apply to the blacklisted non-compete obligations. The benefit of the Block Exemption is only lost in relation to the part of the agreement not complying with these restrictions.

The uncertainty here arises from which law of severance to apply. Under the general principles of EU law, the domestic law on severability of the relevant country applies, i.e. there is no EU-wide approach to severance. It may be that the Block Exemption introduces such a pan-European principle and offending non-compete obligations in distribution agreements should simply be removed, leaving the rest of the agreement valid in all cases. Nonetheless, there is a principle in English law (and possibly in other jurisdictions) according to which it must be possible for the contract to survive as essentially the same contract. In the case of many contracts, an exclusivity provision might go to the root of the contract. It is not therefore entirely clear whether a contract with exclusivity as an essential term would survive the Block Exemption's rules on severability.

Conclusion – good points and bad points of the Block Exemption regime

Experience of the regime has been mixed, but perhaps there is more good than bad.

Advantages:

- the Block Exemption applies to a wide range of types of agreement
- a permissive regime for companies with market share below 30%
- drafting contracts should be flexible - there is only a "black list" of provisions to avoid.

Disadvantages:

- the Block Exemption and the accompanying guidelines are often difficult to understand, especially the blacklisted provisions
- identifying the relevant market and calculating the market share of the parties concerned and their competitors can be difficult
- the cap on duration for non-compete provisions (five years) is too strict
- many agreements will be above the market share threshold of 30%.

1 January 2007

Glossary of terms

Active sales Where a retailer or a distributor sells goods or services by seeking out or soliciting customers.	**Quantity forcing** Where the distributor or retailer is required to purchase a minimum quantity of a certain product.
Foreclosure Conduct by a combination of companies or by a single company with market power which hinders or prevents other companies from accessing or competing fairly in the relevant market.	**Resale price maintenance** Where the manufacturer specifies the resale price of the product, commonly only a minimum or a maximum price, or indirectly enforces a recommended resale price.
Full-line forcing An extreme form of tie-in sale under which the retailer must stock the full range of the manufacturer's product range. It may be an absolute requirement, or the manufacturer may charge higher prices if only part of the range is stocked.	**Selective distribution** A distribution system where goods and services are sold via distributors who are selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors.
Passive sales Where a retailer or a distributor sells goods or services in response to an unsolicited request or approach from a customer.	**Tie-in sales/bundling** Where the manufacturer makes the purchase of one product conditional on the purchase of a second (tied) product. A set of tied products is sometimes referred to as a bundle. Alternatively, customers might receive a discount conditional on purchasing a tied product.

Horizontal agreements

Introduction

A "horizontal agreement" is an agreement between companies operating at the same level of the production or supply chain in a particular market. Horizontal agreements are likely to constitute agreements between competitors. They are therefore particularly sensitive in the eyes of the competition authorities.

Some types of horizontal co-operation by their nature restrict or distort competition and will be prohibited under competition law, such as market sharing agreements, price fixing and exchange of confidential information.

However, many forms of horizontal co-operation have economic benefits without necessarily damaging competition. An example would be an agreement between two pharmaceutical companies, with market shares of below 10%, to pool R&D efforts concerning an improved product and then independently to exploit the result of that R&D. Another example would be the creation between companies having relatively small market shares of a joint purchasing group to enhance their buyer power and reduce costs.

This section looks at the types of horizontal co-operation, which can, because of the positive benefits produced, be permitted under UK and EU competition law.

Horizontal co-operation is assessed in EU law under Article 81 EC Treaty (Article 81) and for the purposes of UK law under Chapter I of the Competition Act 1998. The provisions of Chapter I mirror those of Article 81. The framework for the analysis of horizontal co-operation under Chapter I also mirrors the framework used under Article 81. So the framework provided under EU law is valid for both EU and domestic agreements. This chapter therefore concentrates on the EU law framework, but the comments apply equally to UK law.

The aim of the present EU law framework is to concentrate on the economic context of horizontal agreements. The framework is established by three instruments, operative since 2001:

- block exemption on specialisation agreements (Commission Regulation (EC) 2658/2000 – expires on 31 December 2010);
- block exemption on research and development agreements (Commission Regulation (EC) 2659/2000 – expires on 31 December 2010); and
- guidelines on the applicability of Article 81 to horizontal agreements (the Guidelines).

These block exemptions replaced earlier block exemption regulations on specialisation agreements (Commission Regulation (EC) 417/85) and on research and development agreements (Commission Regulation (EC) 418/85). The Guidelines replaced two previous notices which provided guidance in respect of certain types of co-operation agreements falling outside Article 81 and the assessment of co-operative joint ventures. The Guidelines also cover a wider range of the most common types of horizontal agreements, and complement the block exemptions.

Overall the 2001 regime is helpful but is short on specifics. Only the two block exemptions provide direct legal certainty. There will be a large body of co-operative arrangements which are not covered by the block exemptions and here the parties can only look for comfort from the Guidelines. The legal certainty for horizontals is therefore much narrower than, say, in the case of the verticals regime, where the types of commercial arrangement are typically more homogeneous.

One of the European Commission's objectives in this regime has been to provide commerce with more flexible block exemptions and, where they are not applicable, with more explicit "safe harbours". The Guidelines help to explain the European Commission's thinking, but the way in which the guidance is heavily qualified may not always inspire the confidence companies need.

The block exemptions

The block exemptions exempt all R&D and specialisation agreements from Article 81, subject to certain conditions and the exclusion of hardcore restrictions. They thus follow the model set by the block exemption on vertical agreements (see the section in this Survival Pack entitled "Vertical agreements").

The block exemptions incorporate "black lists" of clauses which constitute hardcore restrictions of competition and therefore prevent the block exemption from applying. There are no corresponding "white lists" of acceptable clauses so the parties have a great deal of freedom in drafting of contracts.

If an agreement is outside the block exemptions, it will not be presumed to be anti-competitive, but must be analysed in detail using the framework provided by the Guidelines.

The R&D block exemption

Scope

The R&D block exemption covers agreements between two or more undertakings regarding:

- joint research and development and joint exploitation of results (including distribution of products)
- joint exploitation of results (of a joint research and development pursuant to a prior agreement between the same parties) only
- joint research and development only.

Conditions for exemption

The block exemption is only available if the following conditions are met:

- all parties must have access to the results for the purposes of exploitation and research
- joint exploitation must relate to results protected by IP rights or (secret) know-how
- undertakings charged with manufacture must fulfil orders for supply from all parties (except where the R&D agreement also provides for joint distribution).

If the R&D agreement provides only for joint research and development and nothing further, then each party must be free to exploit independently the results and pre-existing know-how necessary for such exploitation (in cases of non-competing undertakings, limitation to technical fields of application is possible).

Co-operation permitted by the exemption

For non-competing undertakings:

- joint research and development is permitted for the duration of the research and development; and
- joint exploitation of results is permitted for seven years from the time the products are first put on the market.

For competing undertakings, the same time limits apply, provided that the combined market share of the parties (at the time the R&D agreement is entered into) does not exceed 25%.

Following the expiry of the seven-year period, the block exemption continues, provided the 25% threshold is not exceeded. If it rises above 25%, then the block exemption lasts for a further period as follows:

25%-30% - 2 years more

over 30% - 1 year more.

The "black list"

The "black list" distinguishes between "hardcore" restrictions which are prohibited in any event and restrictions which are only prohibited after expiry of the seven-year period, completion of the research and development, or expiry of the R&D agreement.

Hardcore restrictions:

- limitation of output or sales
- fixing of prices
- prohibition on passive sales to territories reserved for other parties
- prohibition on granting licences to third parties, if the exploitation of the results is not provided for or does not take place
- requirement to refuse to meet demand from users or resellers in their respective territories who would market the products in other territories
- requirement to make it difficult for users or resellers to obtain products from other resellers (in particular by exercising IP rights)
- restriction on freedom to carry out research and development in a field unconnected with the R&D agreement.

Restrictions prohibited after the end of the seven-year period:

- restrictions on the purchasers to which a company may sell
- prohibition on putting products on the market or on pursuing active sales in territories reserved for other parties.

Restrictions prohibited after completion of the research and development:

- restriction on freedom to carry out research and development in a field to which the R&D agreement relates or in a connected field
- prohibition on challenging IP rights relevant to the research and development.

Restrictions prohibited after expiry of the R&D agreement:

- prohibition on challenging IP rights which protect the results of the research and development.

The specialisation block exemption

Scope

Agreements between two or more undertakings regarding:

- unilateral specialisation (A and B agree that B produces certain products and A refrains from producing these products, but purchases the products from B)
- reciprocal specialisation (A and B agree that A produces product X and B produces product Y. A refrains from producing Y, but purchases this product from B, and B refrains from producing X, but purchases this product from A)
- joint production agreement (A and B agree to produce certain products jointly).

Market share thresholds

The block exemption can only apply where the combined market share of the parties does not exceed 20%. Transitional provisions apply where the market share of the parties later exceeds 20%.

"Black list"

In contrast to the R&D block exemption, the specialisation block exemption only prohibits certain "hardcore" restrictions:

- limitation of output or sales (not prohibited: provisions on the agreed amount of products in case of a unilateral or reciprocal specialisation agreement/setting of the capacity and production volume and setting of sales targets in case of a production joint venture)
- fixing of prices (not prohibited: fixing of prices charged by a production joint venture to its immediate customers)
- allocation of markets or customers.

The Guidelines

The aim of the framework is to focus on the economic context of horizontal agreements. The intention is to allow for co-operation where it contributes to overall economic welfare without creating a risk for competition. This mirrors the approach taken by the block exemption on vertical agreements.

The Guidelines cover all common types of co-operation which are intended to create efficiency gains (including R&D and specialisation agreements which fall outside the new block exemptions). The Guidelines describe the general approach which should be followed when assessing whether horizontal co-operation agreements are permissible under Article 81. Because the nature of co-operation can vary so greatly, the Guidelines are understandably short on specifics, but do provide a helpful range of hypothetical examples. The following types of agreements are addressed:

- Research and development
- Production - specialisation, joint production and subcontracting
- Purchasing - joint buying
- Commercialisation - co-operation in selling, distribution and promotion
- Standardisation - agreements on technical or quality standards
- Environmental agreements - agreements on pollution abatement or other environmental objectives.

The "centre of gravity" of the co-operation will determine which section of the Guidelines is relevant to the agreement.

A common analytical structure is used for all sections of the Guidelines. It consists of three principal steps:

- the nature of the agreement
- the economic context
- criteria for exemption under Article 81(3).

The nature of the agreement

Some types of agreement will, by their nature, not affect competition and therefore not fall under Article 81(1). This is normally the case for co-operation which does not imply a co-ordination of competitive behaviour, such as:

- co-operation between non-competitors
- co-operation between competing companies that cannot independently carry out the project or activity covered by the co-operation
- co-operation concerning an activity which does not affect the parameters of competition.

Other types of agreement will, by their nature, be restrictive of competition and therefore fall under Article 81(1) (e.g. market sharing, price fixing and output limitation).

For agreements which lie between these two extremes it will be necessary to conduct a more detailed examination of the economic context of the agreement to assess its impact on the market and determine its treatment under Article 81.

The economic context

An understanding of the economic context of an agreement requires an assessment of the relevant product and geographical markets and the position of the parties within those markets. What is the extent of the parties' market power? For a general discussion of these issues, see the "Market definition and market power" section of this Survival Pack.

If the parties together have a low combined market share, a restrictive effect of the co-operation is unlikely. In addition to the market position of the parties themselves, other factors will be relevant to the assessment of the economic impact of the agreement, e.g.:

- market concentration – the position and number of competitors
- stability of market shares over time
- entry barriers
- buyer power
- nature of the products concerned (e.g. homogeneity).

Criteria for compatibility with Article 81(3)

If the assessment of the economic context of the agreement indicates that it is restrictive of competition (and therefore Article 81(1) applies), do the provisions of Article 81(3) provide exemption?

In order to qualify for exemption, it must be shown that the agreement:

- contributes to improving the production or distribution of products or to promoting technical or economic progress
- allows consumers a fair share of the benefit and does not
- impose restrictions which are not indispensable to the attainment of the above objectives
- afford the possibility of eliminating competition in respect of a substantial part of the products in question.

The Guidelines and specific types of agreement

This part looks at particular themes in the treatment of four of the more common types of agreement considered in the Guidelines:

- R&D agreements
- Production agreements (including specialisation agreements)
- Purchasing - joint buying
- Commercialisation - co-operation in selling, distribution and promotion.

R&D agreements

R&D agreements present particular difficulties of market definition, whether or not in the context of the R&D block exemption.

Defining the relevant market in the case of R&D agreements can often be difficult because the type of products covered by the agreement may not yet exist and may not fit readily into an existing market. The Guidelines contain an indication of how to approach this problem by distinguishing between existing markets and competition in innovation. In practice, it may be necessary to look both at existing markets and at the impact on innovation.

Existing markets

The first step is to identify whether the product (or technology) concerned will compete in an existing product (or technology) market. This will be the case where the innovation concerned is directed at improvements or variations to existing products. The relevant market will therefore be that for the existing products and their close substitutes.

Where rights to intellectual property are marketed separately from the products to which they relate, the relevant market for the technology has to be defined as well. Technology markets consist of the intellectual property that is licensed and its close substitutes, i.e. other technologies which companies could use as a substitute.

Innovation markets

In some cases (such as the pharmaceutical industry), the process of innovation is conducted in a sufficiently structured way for it to be possible to identify particular R&D "poles". An individual "pole" represents the R&D efforts directed towards a particular product or technology and the close substitutes for that product or technology. In these cases, the market impact of the agreement can be assessed by looking at the impact on the various R&D poles.

If innovation is not conducted in a sufficiently structured way for R&D poles to be identified, then the impact of the co-operation will generally be assessed by the impact on existing and related product (or technology) markets.

Market power

It has been seen that R&D agreements are exempted, provided that the parties' combined market share does not exceed 25% and that the other conditions of the R&D block exemption are satisfied. Where that threshold is exceeded, the agreement may not necessarily restrict competition – however, it cannot be block exempted automatically. The greater the combined market share, the more persuasive the market justification will need to be.

Production agreements (including specialisation agreements)

These can take a number of forms such as joint production (whether on a unilateral or reciprocal basis), specialisation or sub-contracting arrangements.

Sub-contracting

Sub-contracting agreements are not always horizontal agreements. If they are not made between competitors, then they will be vertical agreements and need to be considered under the verticals regime. If they are between actual or potential competitors, then the Guidelines are relevant. The Guidelines do not, however, replace existing guidance (dating from 1979) for the assessment of sub-contracting agreements between non-competitors involving the transfer of know-how to the sub-contractor.

Market power

The specialisation block exemption applies both to specialisation and to joint production arrangements, where a combined market share of 20% is not exceeded and the other conditions of the block exemption are satisfied. Where the block exemption does not apply, the Guidelines consider that where the parties have a combined market share of 20% or less, there is unlikely to be sufficient market power for Article 81(1) to apply. Above the 20% level, the justification will need to be explored in greater detail, particularly if the market is highly concentrated.

Purchasing – joint buying

Two markets can be affected by joint buying: the purchasing market to which the co-operation relates and the selling market downstream of the joint purchasers. Each of these markets, as well as their interaction, need to be considered.

The Guidelines do not set an absolute threshold at which a buying co-operation creates some degree of market power to trigger the application of Article 81(1). However, in most cases, it is thought that a combined market share of below 15% on the purchasing market and a combined market share of below 15% in the selling market is likely either to fall outside Article 81(1) altogether or to fulfil the conditions of exemption under Article 81(3).

Joint purchasing arrangements where the participants have market shares above 15% do not necessarily have a negative market effect, but the parties are likely to need to demonstrate that the benefits outweigh the detriments.

Commercialisation agreements

Consideration needs to be given to whether the parties are actual or potential competitors. If not, their agreement should be considered under the rules applicable to vertical agreements (see the section in this Survival Pack entitled "Vertical agreements").

Generally, the Guidelines consider that commercialisation agreements between competitors which do not involve price fixing are only subject to Article 81(1) if the parties have some market power. This is unlikely to be the case where the combined market share is below 15% and even if it were, the conditions for exemption under Article 81(3) are likely to be present. Combined market shares above 15% will again involve a closer assessment of the market context.

1 January 2007

The cartel offence

Introduction

One of the major reforms of competition law in the UK introduced by the Enterprise Act 2002 was the "cartel offence", which criminalised dishonest participation in cartels in the UK. The cartel offence applies to individuals, rather than to companies, and is an extraditable offence. Those who commit the cartel offence face terms of imprisonment of up to 5 years and the possibility of unlimited fines.

The cartel offence operates alongside the Competition Act 1998 regime, so that a company could be found to have breached the Competition Act while a director or directors could in addition or alternatively be tried in relation to the cartel offence.

The OFT hopes that the criminal penalty on individuals for breach of competition law will have a significant deterrent effect on companies and their directors by making directors take more of a personal interest in the company's policies or risk harsh personal sanctions including jail terms.

The elements of the offence

An individual is guilty of the cartel offence where he or she dishonestly agrees with one or more other persons that undertakings will engage in one or more of the prohibited hardcore cartel activities. These are:

- Price-fixing
- Limitation of supply or production
- Market sharing; and/or
- Bid-rigging

It does not matter whether the agreement was ever put into effect. Nor does it matter if an individual who agreed to the cartel behaviour did not have authority to act on behalf of his or her undertaking. The fact that a dishonest cartel agreement has been made is enough for the offence to be committed.

If the agreement is made outside the UK, proceedings may only be brought where the agreement has been implemented in the UK.

Types of arrangement

The cartel offence is limited to agreements to fix prices, limit supply or production, share markets or rig bids (in all cases within the UK) as these are regarded by the OFT as among the most serious breaches of competition law.

The offence is only committed where agreements are between undertakings at the same level in the supply chain (horizontal agreements) such as agreements between retailers. Agreements between undertakings at different levels of the supply chain (vertical agreements) such as agreements between a manufacturer and a wholesaler do not fall within the scope of the cartel offence.

Dishonesty

The cartel offence requires the individual dishonestly to agree to cartel activities.

Dishonesty is a concept arising from criminal law and requires a jury to decide:

- whether according to the standards of reasonable and honest people what was done was dishonest (an objective test); and
- whether the accused must have realised that what he was doing was dishonest by the standards of reasonable and honest people (a subjective test).

Generally, if the actions by ordinary standards are obviously dishonest, it will be taken that the accused knew that he was acting dishonestly.

Penalties

The cartel offence can be tried in the crown court or a magistrates' court. Where the trial is in the crown court, the maximum penalty is five years' imprisonment or a fine (no upper limit) or both. Trials in the magistrates' court attract a maximum penalty of a six month jail sentence or a fine (limited to the statutory maximum) or both.

Proceedings can be instituted by the Serious Fraud Office (SFO) or by or with the consent of the OFT. In practice, it is likely that the SFO, which has experience of criminal trials, for example for fraud offences, will take the lead in instituting proceedings for the cartel offence, at least in the short to medium term, to allow the OFT to build up its expertise in criminal prosecution work.

At the time of writing, no individuals have yet been tried in relation to the cartel offence, although it is understood that the OFT/SFO are pursuing certain cartel offence investigations.

OFT powers of investigation for the cartel offence

Where there are reasonable ground for suspecting that the cartel offence has been committed, the OFT may use special powers of investigation where "there is good reason to exercise them for the purpose of investigating the affairs of any person".

These special powers of investigation include the power to require persons to:

- answer questions
- provide information
- to produce documents
- to explain documents which they produce to the OFT.

In addition, the OFT may obtain a judicial warrant to:

- enter premises
- search premises
- take documents from premises
- require persons to explain documents
- require electronic information to be provided to the OFT in a format that can be taken away.

The OFT may also use intrusive surveillance which is surveillance carried out in relation to anything taking place on any residential premises or in any private vehicle. This permits the planting of "bugs". The consent of the Chairman of the OFT, or in cases of urgency, a designated OFT officer, together with the consent of the Office of Surveillance Commissioners is required for the OFT to use intrusive surveillance. The use of intrusive surveillance must be proportionate to the circumstances of the case.

Since 5 January 2004 the OFT has had even greater investigatory powers available to it. These include:

- allowing OFT officers access to communications data such as telephone records (although the OFT will not be able to listen in to telephone conversations)
- allowing OFT officers to monitor people's movements e.g. by following them
- allowing the use of Covert Human Intelligence Sources i.e. informants. These could for example be cartel members who have already "blown the whistle" on the cartel to the OFT in confidence but who have been requested to continue attending cartel meetings so that they may help the OFT to gain more evidence against other cartel members.

Before these powers may be used, consent to their use and the surveillance method must be obtained from the OFT's Director of Cartel Investigations. The use of these powers and the particular power chosen must be proportionate to the circumstances of the case. In cases where monitoring people's movements or the use of informants are concerned, where there is an urgent need to use the power and it is not reasonably practicable to consult the OFT Director of Cartel Investigations, consent may be given by the Principal Investigating Officer in the OFT's cartel branch.

Extradition

The cartel offence is an extraditable offence, as is a conspiracy or attempt to commit the cartel offence. However, a person cannot be extradited unless the offence also carries criminal sanctions in the other country involved. For example, cartel behaviour carries criminal penalties in the USA, so extradition to the USA should be possible in relation to cartel members located in the UK, and vice versa.

Possible conflicts

Where the OFT is investigating a possible breach of the Competition Act 1998, it may decide that the case is also suitable for prosecution of an individual (likely to be a director) for the cartel offence.

This may cause a conflict of the interests of the company which may want to confess all and try to obtain leniency from the OFT, with those of the individual, who may prefer not to volunteer information to OFT officers for fear of self-incrimination. Separate legal representation for the company under investigation under the Competition Act 1998 and the individual under investigation for the cartel offence is therefore likely to be necessary in these circumstances.

No-action letters

The OFT considers that "it is in the best interests of the economic well-being of the United Kingdom to grant immunity from prosecution to individuals who inform competition authorities of cartels and who then cooperate fully"[1] with the OFT while it, for example, pursues its investigation under the Competition Act.

This immunity from prosecution takes the form of a letter from the OFT stating that intends to take no action against the individual in relation to the cartel offence, except in certain circumstances.

The OFT may issue a no-action letter where the relevant individual:

- admits participation in the criminal offence
- provides the OFT with all information available to them regarding the existence and activities of the cartel
- maintains continuous and complete cooperation throughout the investigation and until the conclusion of any criminal proceedings arising as a result of the investigation
- has not taken steps to coerce another undertaking to take part in the cartel, and
- refrains from further participation in the cartel from the time of its disclosure to the OFT (except as may be directed by the investigating authority).

However, the OFT is under no duty to grant a no-action letter in the above circumstances. If, for example, the OFT believes it already has, or is in the course of gathering, sufficient information to bring a successful prosecution for the cartel offence, it will not issue a no-action letter to the individual concerned.

Related offences

Under the Enterprise Act there are a number of criminal offences related to the cartel offence:

- failing to answer questions/produce documents/give an explanation of a document/give a hard-copy of information which investigators can take away from the premises investigated – punishable by up to six months in prison or a fine or both;
- intentionally or recklessly making a false or misleading statement – punishable by up to two years in prison or a fine or both;
- where the person knows or suspects that an investigation relating to the cartel offence is happening or will happen, the destruction, hiding or falsifying of documents relevant to the investigation is an offence punishable by up to five years in prison or a fine or both;
- intentionally obstructing an officer with a warrant investigating the cartel offence is punishable by up two years in prison or a fine or both.

Aiding, abetting, counselling or procuring the commission of the cartel offence is also a criminal offence.

It is therefore important that businesses are aware that cartel behaviour is at the top of the OFT's hit-list and ensure that they do not become involved in cartels in any way. In addition, businesses need to be familiar with the OFT's/SFO's powers of investigation and have document retention policies in place which will not cause an offence to be committed inadvertently if an investigation takes place.

1 January 2007

1 OFT guidance on the issue of no-action letters for individuals.

Trade associations

Trade associations bring businesses in the same sector together to discuss and regulate their behaviour amongst themselves and towards others. Because of this, such associations are a natural focus for the attention of the competition authorities. Trade associations should review their ongoing activities in the market, as well as all decision-making processes and association rules. Members should be careful to ensure that their participation in association activities is not anti-competitive. The same considerations apply to the activities of self-regulating bodies, unless they benefit from an exclusion under UK or EU law.

EU and UK competition law

Over the years, the anti-competitive activities of trade associations have become a feature of EU competition law cases under Article 81 EC Treaty (Article 81).

Article 81 prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between EU Member States and which have as their object or effect the prevention, restriction or distortion of competition. The Chapter I prohibition of the Competition Act 1988 applies the same principles in relation to UK trade.

The Office of Fair Trading implements the Competition Act 1998 in accordance with the European Commission's approach and also implements Article 81 and 82 EC Treaty in the UK. The general approach to trade associations is to ensure that they are not used as a means of organising or effecting anti-competitive behaviour. For instance, the OFT has indicated that the key consideration is whether the effect of a decision of a trade association, whatever form it takes, is to limit the freedom of action of the members in some commercial manner. The OFT has also confirmed that recommendations issued by trade associations can infringe the Competition Act 1998, even if the recommendations are not expressed to be binding on members.

Trade associations and their members also need to be aware of the potential for criminal prosecution in relation to the cartel offence introduced by the Enterprise Act 2002 (see the section of this Survival Pack entitled "The cartel offence").

What does competition law catch ?

Competition law has the potential to impact on virtually every area of trade association life. Any trade association or any other body formed to represent the commercial interests of its members, whether or not formally constituted, is likely (to use the jargon) to be an "association of undertakings" to which the prohibitions against anti-competitive behaviour apply.

As a general rule, the law will treat trade associations and their members in the same way as it deals with any group of co-operating competitors. The fact that the work of a trade association is aimed at benefiting an industry as a whole does not change the analysis. The law will not allow companies to escape the application of the competition rules simply by acting through the intermediary of a trade association.

So trade associations and individual members have to be very careful in how they establish membership criteria, how they set up their association rules and regulations, how they run their committees and what those committees do, what activities they carry out, and what recommendations they make to their members. Individual members should keep competition issues in mind when monitoring the actions of their association.

Sanctions

It is important to remember that underlying the rules is the ability of the authorities to impose hefty sanctions for infringements of the law.

If companies are found to breach EU competition rules, the highest fine the European Commission can impose is 10% of worldwide group turnover.

The UK rules on penalties for breach of competition law are harmonised with the EU rules. This harmonisation was prompted by Council Regulation (EC) 1/2003, which devolves power to apply Article 81 in its entirety to national competition authorities. The result is that the maximum fine for breach of EU or UK competition law which the OFT may impose is 10% of worldwide turnover for the previous business year.

Since they are subject to the competition rules, trade associations themselves may be fined, in addition to their members being fined on an individual basis.

It is also worth noting that breach of competition law opens companies up to the possibility of disgruntled third parties bringing actions in the domestic courts.

Membership, rules, activities, recommendations

The prohibitions catch agreements, decisions and concerted practices, which may be written or oral, formal or informal.

The terms are broadly defined. They could include:

- membership criteria
- the rules or constitution of the association
- an association code of conduct
- any committee or executive resolution
- any association activity
- the exchange of information between members at a meeting
- a resolution of the full membership in general meeting
- a non-binding recommendation by the executive to the members of an association.

When is a member liable for anti-competitive activities undertaken by the association?

An agreement for the purposes of competition law need not be written down. The same is true of the decision of an association of undertakings. A verbal information exchange or agreement to exclude a competitor can be an infringement, even if it is merely an informal "gentlemen's agreement". Individual members need not actively support an agreement. They can be guilty of an infringement simply by being members of an infringing association. This is particularly the case where the association rules provide that its decisions shall be binding on members. In such a case, a member may be liable, even though it did not specifically agree to follow such decisions, where it does in fact comply with those decisions.

Members, when attending any association meetings, should remember that as soon as they become aware of a potential infringement, they should express their disagreement and ensure that a record is kept of their disagreement. In addition, if a member is absent from an association meeting, he should check the minutes of that meeting upon receipt for any potential infringement. Reference should be made to the guidelines at the end of this note.

Further, a company should question its own membership of a trade association if it does not actively participate in the association's activities, since the company would not easily be able to disassociate itself and its employees if the association's behaviour became questionable. Clearly, if the association's activities no longer relate to the company's or member's interests, or the company member(s) no longer participate, there is little point continuing as a member.

Membership criteria

Who may join the association? The following are some points to bear in mind in establishing application criteria or when considering joining a trade association.

- Membership of the association should be voluntary. Companies who are not members of the association should not be compelled to join in order to be able to enter the market, to access suppliers or dealers, or to sell to final customers. The ability to do business in a particular market must not depend on membership of an association.
- A clear set of admission rules should therefore be based on reasonable, objective standards, and not, for instance, on nationality or geographical base.
- The membership of any governing committees should be based on a fair reflection of the differing interests within the market.
- The association should have an appeals procedure for use by any companies who are initially refused admission.
- Entry into the association should not be made conditional on the vote of the existing membership.
- The association should prepare a set of rules to deal with expulsion. Where a member is expelled, the association should provide written reasons for the expulsion and allow the undertaking an opportunity to appeal against the decision.

- The association should consider whether the relevant industry involves essential services (e.g. trade shows, use of product standards, quality labels), which should be open to members and non-members alike. It could be anti-competitive to deny access to such services.
- The association and its members should also remember that any other form of restriction placed on the conduct of members may be anti-competitive.

Industry standards

The work of trade associations often consists in the promotion of industry standards, codes of practice or standard terms and conditions. Competition law problems may arise in these areas because they can work to increase barriers to entry to the market or to discriminate against particular groups of companies. Areas to note include the following matters:

- It is accepted that standardisation measures can be beneficial where they are aimed at improving the quality of the association members' products or services.
- Standardisation measures should not be used to raise artificial barriers to entry to the market. Such measures should be non-discriminatory: all interested parties and not merely association members should be given an opportunity to participate in the development and use of the standards and the standards should not be linked to obligations regarding production, marketing or price formation.
- Members should not be required to sell only those products and/or services which comply with the association's standards.
- The award of certificates or seals of approval to those members whose products or services meet objective criteria is encouraged as long as such schemes are available to all companies in the industry.
- Sets of standard terms and conditions for contracts may be helpful for the industry, but the use of standard forms must not be made compulsory, and should not cover terms which are likely to be relevant to a customer in choosing between competing suppliers e.g. by indirectly affecting prices charged.

Rules, codes of practice and recommendations: things to avoid

Membership of a trade association implies acceptance of its rules. So those rules must not directly or indirectly induce anti-competitive behaviour. Common examples of rules which should be avoided are:

- The development by a trade association of an industry code of conduct to promote "best practice". This will be unproblematic, as long as care is taken to ensure that the code does not limit the way in which participants are able to compete. Rules restricting the members' commercial freedom to negotiate contract terms with their customers.
- Rules of "fair trade" designed to stop, for example, a competitor undercutting the prices of other members.
- Rules providing for the imposition of fines or other sanctions to enforce conduct on members.
- Rules or practices which lead to the boycotting of particular customers or suppliers.

- Rules which require members to deal only with recognised or approved third parties. Such rules may be valid where the third parties are approved because they have met a set of reasonable, objective criteria.
- Rules restricting the amount, nature or form of members' advertising will tend to restrict competition. Rules aimed at implementing a set of advertising standards are less likely to be anti-competitive.

Co-ordination of trading arrangements and other trade association activities

Trading activities conducted by any group of collaborating companies, including members of trade associations, may seem to them to be innocuous and time-honoured standard practice, but, at the same time, they may infringe the competition laws. Associations should be aware that they may be implicated if their members indulge in anti-competitive conduct, for example, where the discussions which lead to the conduct take place at trade association meetings or the idea can be traced to an association recommendation. The following are some pointers:

- Marketing arrangements which lead to the sharing or dividing up of customers on the basis of product, customer size or geographical location, are likely to be anti-competitive.
- For instance, joint buying schemes promoted by the association are generally regarded as being restrictive of competition, as they can limit the freedom of the participants to source their requirements and can distort the structure of demand in the market. The need for such schemes is also doubted if they include participants which are economically powerful enough to obtain, on an individual basis, favourable buying terms from suppliers. If an association is proposing such a scheme, members should ensure that they are not obliged to participate in the scheme, are free to purchase the majority of their requirements from other suppliers of their choice, that the scheme does not set maximum prices at which the products or services are to be purchased and that participation is not conditional upon the acceptance by the member of ancillary provisions, such as restrictions on the use of products or market sharing provisions.
- Also, joint selling is unlikely to be permitted where the participants sell exclusively through the scheme, where they agree to sell their competing products at uniform prices and conditions, and where they agree to equalise profits and losses on sales made through the joint arrangement or implement any form of market sharing practices.
- In any form of joint marketing arrangements, associations should pay particular attention to any recommendations on prices and charges, since price-fixing is regarded as the most serious form of anti-competitive activity.

- Trade associations often co-ordinate joint research and development programmes carried out by some or all of their members. Whilst such activities may in some circumstances be essential to innovation, and are sometimes indispensable for smaller members who may not be able to undertake them individually, such programmes can give rise to competition problems to the extent that they involve close co-operation between competitors. For co-ordinated research and development programmes, associations should ensure that, where possible, results are made freely available to all members (and perhaps more widely) to avoid the appearance of distorting competition.
- Within bench-marking exercises, or in any other context, any information exchanged (whether in simple discussions between members or on industry-wide databases) should avoid information about price, terms of trade and quantities of production, unless this is historical and aggregated. The information should be anonymous and (ideally) collated, aggregated and disseminated by an independent body. Members should not be able to work out particular competitors' prices and conditions of trade from association materials.
- It is not unlawful for members of an association to conduct lobbying to seek legislative changes or to participate in other activities which involve working with government or other regulatory bodies to review the effectiveness of existing legislation. Members may also meet to discuss industry reaction to proposed legislation or regulation and present these reactions to government bodies. However, members should avoid disclosing any confidential competitive information when gathering information to present to government bodies and regulators. Members should also avoid entering into any agreements regarding the commercial conduct which individual members will or will not follow in response to proposed or new legislation.
- Members should avoid collective boycotts – i.e. any activities or decisions of the trade association which have the effect of requiring members to deal only with recognised or approved third parties and to refuse to deal with others. This type of activity will always be found to be unlawful. Even if no formal agreement has been reached between members, if they have been in contact on the subject and then all cease dealing with that third party, then an illegal collective boycott arrangement can easily be inferred.

Trade associations and the prohibition on abuse of a dominant position

If the competition authorities were unable to establish that collective action on the part of association members was the result of a decision, agreement or concerted practice, they might still be able to establish abuse of a collective dominant position. Article 82 and Chapter II refer to "one or more undertakings".

Joint dominance arises where one or more undertakings are connected in any structural or economic fashion and where they together hold a dominant position on a given market. If the presence on a particular market of its members means that it has a position of joint dominance, and if its actions are allowing its members a collective unfair market advantage, then the actions of a trade association could be seen as an abuse of that dominant position and therefore an infringement of this prohibition. There is no possibility of exemption from this prohibition.

Guidelines for participation in association meetings

Meeting agenda

- Ensure that all meetings, including those of committees and sub-committees, have a specific written agenda clearly describing the topics of the meeting.
- Avoid open-ended items such as "Miscellaneous".
- It is advisable to request your legal department to review the agenda prior to attending the meeting.
- If the agenda lists any questionable topics, the member should either request that this topic be withdrawn from the agenda and not discussed or otherwise not attend the meeting.

Attending a meeting

- Ensure that minutes are being kept of the meeting which should then be distributed to all participants.
- If no minutes are taken of the meeting, the attendee himself should keep a written record of the subjects that were discussed.
- Discussions in, or outside, the meeting room should be limited to agenda items or legitimate subject matters such as lobbying, health and safety etc.
- Avoid any discussions, both during and outside the meeting, about any matters concerning pricing, marketing strategy, discounts, profit margins, distribution practices, sales territories, production matters, cost structures, the identity of customers or suppliers and plans concerning the development, production, distribution or marketing of particular products etc.
- Object clearly if any other member raises an improper or questionable subject during a meeting. It is advisable to leave the meeting if the discussion continues, and to ask that your withdrawal be noted in the minutes.

1 January 2007

Market definition and market power

One of the principal aims of competition law is to prevent companies unfairly exploiting market power. The competition authorities will therefore usually look at the extent of a company's market power in assessing whether its behaviour constitutes a breach of the law. Such a breach may be by unilateral behaviour, where a dominant company exploits its position to the detriment of its competitors, suppliers and/or customers. Or companies may jointly exploit their combined market position through cartel activities.

An understanding of the concept of market power is therefore central to a company's understanding of its competition law risks. This note provides a brief guide to the concepts involved.

What is market power?

Market power is an economic concept which lies at the heart of any economic assessment of competition in a market. It is not the same as measuring market share. A company (or group of companies) has market power when it is able to raise prices above the level that would exist under normal competitive conditions and enjoy increased profits as a result. Essentially, this implies a situation where a company's strengths enable it to ignore, to a certain extent, the constraints on behaviour usually caused by the need to compete with other companies in the market. Classically this might occur if a company felt able to increase its prices without too much fear that it would lose significant amounts of business to competitors. It is important here to note that the power concerned is to be able to raise prices above the competitive level, rather than the existing level (the two may not be identical).

Measuring market power

There is no magic formula for measuring a company's market power. A wide variety of economic analyses are available and the particular characteristics of the market in which the company operates will determine which are the correct ones to use. However, as a brief starting point, a company should consider:

- what is the relevant market
- its own market share and the market shares of competitors
- how easy it would be for a new company to enter (and exit) the market
- other factors particularly relevant to competition in that market.

Defining the relevant market

Defining the relevant market is usually the first step in a competition law investigation. Defining the market for the products or services concerned allows the calculation of market shares and also clarifies for the competition authority the characteristics of the market under investigation.

The process of defining the market can be very technical and often leads to disputes between the authority and the company being investigated. The European Commission and the Office of Fair Trading have published similar sets of guidelines which indicate how they go about defining the market.

A market definition will always consist of two parts: the product market and the geographic market. In order to reach the correct market definition, a competition authority will start with a narrow product range and geographical area and expand these until it finds what it believes constitutes a distinct market.

Product market

The product market is defined by reference to the attitudes of consumers and of other suppliers. To understand which products should be included in the market definition, the competition authority will look at what products consumers regard as substitutable for the products under investigation. The method often used to test this substitutability is to imagine that the products under investigation are subject to a small, industry-wide price rise. If the reaction of a significant number of consumers to the price rise would be to switch to other products, then the market definition is widened to include those products. The process is repeated until a set of products is reached for which such a price increase would allow for a stable industry-wide increase in profits.

The effect of this imaginary price rise on other suppliers is also taken into account. The price rise may be enough to encourage those companies able to switch their production at short notice to start selling the products under investigation and therefore wipe out any gains for the existing suppliers. If this is the case, the definition of the market is widened to include those products from which the potential competitors would switch production.

Geographic market

In a similar way, the price increase is used to assess the geographic extent of the market. The competition authority will start with a fairly narrow geographical region. If the imaginary price increase by all the companies in that region would not be profitable because many consumers would respond by sourcing supplies from a neighbouring region, then the neighbouring region should also form part of the market definition.

Similarly, on the supply side, if companies in another region would enter the market as a result of the price increase (and therefore negate any profit gain), their region should also be part of the market definition.

Market shares

A company is more likely to have market power if it has a consistently high market share (e.g. over 30%). Market share is therefore often used as a shorthand way of looking at market power (see box). Having defined the relevant market, it is then necessary to measure market share using a relevant source of data (e.g. sales data by value and volume).

It should be noted that market share is not dependent solely on a company's size. It is vital to understand the likely definition of the market. A company with a small turnover can have a large market share if the market itself is found to be small in scope.

Once the market has been defined, it is possible to look at the structure of the market by comparing the market shares of participating companies. The structure of the market may have a bearing on the existence of market power. For example, a company's market share may not be very large in absolute terms (e.g. 25%), but if all the other companies in the market have very small market shares (e.g. 3%), that company is more likely to have market power. Conversely, a market share of 25% is unlikely to indicate market power if there is another company in the market with a share of 50%.

Market entry/exit

Calculating market shares is only the beginning of the process. The ease with which companies can enter and exit the market will also affect the assessment of market power. A company might have a market share of 50%, but not have market power, where there are no significant barriers impeding entry into that market. In such a situation, the threat that a price rise could eventually attract new entrants into the market might be real enough to discourage the company from increasing its prices. Put the other way round, the more difficult it is to enter a market, the more confident the incumbents will feel about the positive effects of raising prices.

The assessment of the height of the barriers to entry to a market is therefore also crucial to an understanding of market power. Barriers to entry are items which would constitute a cost that a new entrant would have to face which is not already faced by existing companies in the market. Barriers to entry would include, for example:

- a cost to the new entrant in making capital investment which is higher than that of the incumbent
- strict regulatory requirements or existing intellectual property rights which make entry difficult
- a market where it is difficult for a new entrant to get access to customers because of the foreclosure effects of existing agreements between purchasers and suppliers.

Other factors affecting the assessment of market power

Any assessment of market power must also take into account the particular characteristics of the market in which a company operates. Other factors which commonly affect market power include:

- buyer power - where the buyer or buyers of the products in question are able to exert a substantial influence on price and on other contract terms of the seller, as a result of their position in the downstream market(s)
- regulation - the behaviour of some companies is affected by the economic regulation of their activities
- product differentiation and substitutes - in most markets products are not homogeneous, but are differentiated from one another, for example, where companies offer different levels of quality or different brand images. Such differentiation may prevent consumers switching readily to alternative supplies and may therefore increase market power. Similarly, where there are very few other products which could conceivably be used as a substitute for the product in question, market power may be higher.

Competition authorities' attitudes to market share

The market share of a company is often used by the UK and EU competition authorities as a shorthand way of indicating its potential market power. Here are some examples of the use of market shares by the competition authorities:

UK law

- Dominance is presumed if a company has a market share consistently over 50%.
- Under the Chapter II prohibition, the OFT considers it unlikely that a company with a market share below 40% could be individually dominant.
- Under the Chapter I prohibition, the OFT follows the EU model of when agreements will generally have no appreciable effect on competition i.e agreements have no appreciable effect if the parties are not actual or potential competitors and each of their market shares is below 15% and agreements have no appreciable effect if the parties are actual or potential competitors and their combined market shares are below 10% provided, in both cases, that the agreement does not contain any hardcore restrictions of competition. However the OFT will not be bound by the EU model and may take the view that there is no appreciable effect even if these thresholds are exceeded.

EU law

- Dominance is presumed if a company has a market share consistently over 50%.
- Under Article 82, a market share of below 40% is unlikely to lead to a finding of individual dominance.
- The block exemption for vertical agreements is not available to suppliers holding more than 30% of the relevant market.
- Agreements between parties which are not actual or potential competitors will usually not fall under Article 81(1) if each of the parties' market shares is below 15%.
- Agreements between parties which are actual or potential competitors will not usually fall under Article 81(1) if the parties' combined market shares are below 10%.

Abusing market power

The competition authorities are more likely to rule that a restrictive element of an agreement is in breach of the law, if one or more of the companies involved possesses market power. A company with market power must therefore be aware of the increased danger of falling foul of the Chapter I prohibition of the Competition Act 1998 and of Article 81 EC Treaty.

A company with a substantial level of market power might also be regarded as being in a dominant position on the market. Chapter II of the Competition Act 1998 and Article 82 EC Treaty prohibit abusive conduct by an undertaking in a dominant position. Issues of dominance and abuse are explored elsewhere in this Survival Pack.

What should business do?

A company which has market power must be particularly careful to ensure it is aware of the types of conduct which might constitute a breach of the law. A company which possesses a significant degree of market power should conduct a compliance audit and institute a competition law compliance programme.

1 January 2007

Abuse of a dominant market position

Both EU and UK competition law prohibit abusive conduct by an undertaking enjoying a dominant market position. The UK prohibition in Chapter II of the Competition Act 1998 (Chapter II prohibition) is modelled on the Article 82 prohibition of the EC Treaty (Article 82). The two prohibitions are therefore similar. The Chapter II prohibition is applied in a manner consistent with the application of Article 82. Thus, the EU's experience of applying Article 82 is of direct relevance when considering the application of the UK prohibition. In addition, the OFT has responsibility for enforcing Articles 81 and 82 in the UK under Council Regulation (EC) 1/2003.

Contravention of Article 82 or the Chapter II prohibition can have serious consequences for a company. Firms engaged in activities which breach Article 82 or the Chapter II prohibition could face fines of up to 10% of group worldwide turnover. Firms infringing either of the prohibitions also open themselves up to challenge in the UK (and possibly other) courts by customers and competitors.

This section describes each of the prohibitions in turn and the key differences between them. It then indicates when each prohibition will apply to you.

EU competition law - Article 82

Article 82 governs the abuse by an undertaking of a possible dominant position in the market and is therefore concerned both with monopolies and oligopolies (the control of a market by a small number of suppliers/dealers etc.).

Article 82 applies where:

- one (or more) undertakings which
- have a dominant position
- on a relevant product and geographical market
- abuse that dominant position

  and
- the abuse may affect trade between EU Member States.

Article 82 concerns the unilateral conduct of undertakings in their dealings with third parties.

As with Article 81, the European Commission, national competition authorities such as the OFT and national courts will be concerned with Article 82 abuse where it may affect trade between EU Member States. The second paragraph of Article 82 gives examples of the kind of behaviour which will be considered to be abusive. The list of examples given in Article 82 is not exhaustive; the authorities reserve the right to consider a far broader range of activities than those exemplified. It can be seen that the examples given closely correspond to the examples of offensive agreements discussed in Article 81(1).

Dominant position

The concept of a dominant position, although not defined in Article 82, is usually taken to mean a degree of market control which enables an undertaking to behave to an appreciable extent independently of its competitors and customers. First, you have to establish what products constitute the relevant market and what its geographical boundaries are. Substitutability and the definition of the relevant geographical area are considered separately below.

The question of market dominance should be considered when a company has a substantial market share. There is no precise threshold above which dominance is presumed and the level will vary from market to market depending on its particular characteristics. As a very rough guide, a 40% market share is sometimes taken as a benchmark above which it may be difficult to dispute dominance, although in some circumstances it is possible also to have a dominant position below that level. The European Court of Justice has stated, broadly, that dominance can be presumed if a firm has a market share above 50%.

A company does not necessarily have to be big in terms of turnover to be dominant. One important question is what sort of competition there is in a particular product market - how many players and on what do they compete? The more fragmented the competition, the lower the percentage share which may enable the market leader to dominate the sector.

The ease with which new competitors can enter the market and existing players get out - the barriers to entry and exit in terms of cost, regulation, availability of raw materials, attitude of other players and so forth - are also important.

None of these characteristics is enough on its own to prove or negate the existence of market power. When the European Commission (or for that matter the relevant national authorities) comes to investigate the existence of dominance and its possible abuse, it will undertake research and put together detailed evidence of what the market is really like.

Article 82

Article 82 prohibits conduct

- by one (or more) undertakings
- in a dominant position, which
- abuses that dominance, and
- the conduct may affect trade between EU Member States

Dominance

- in a product and geographical market
- can act independently of competitors and customers

No exemption available

Joint dominance

The European Court of Justice has confirmed that Article 82 can be infringed by a collective dominant position.

The Court said that collective dominance can arise where two or more independent entities are united by such economic links in a specific market that together they hold a dominant position vis-à-vis other operators. They do not need to be members of the same group of companies. This may occur, for example, where such undertakings jointly have, through agreements or licences, a technological lead over their competitors. Parallel behaviour, structural links, organisational links, common methods of dealing, may all be indicators of collectivity. The Court has confirmed that a finding of collective dominance requires three conditions to be met:

- The market must be transparent, so that each member of the oligopoly must know how the other members are behaving in order to be able to adopt the same policy.
- There must be a punishment mechanism, so that members of the oligopoly are deterred over time from departing from the policy adopted (the punishment mechanism need not have been used – it is sufficient if effective deterrent mechanisms exist, even if not yet used).
- The policy adopted must be able to withstand challenge by other competitors, potential competitors or customers.

If collective dominance is established, then behaviour which seeks to exclude a competitor, for example by boycott, by refusal to deal, by putting him at a competitive disadvantage through the application of trading terms not applied to other customers, by tie-in arrangements aimed only at that competitor, by other predatory actions, would be contrary to Article 82.

Definition of the market

One of the most difficult, and yet one of the most critical, questions will be the definition of the relevant market. This is true for both Article 82 and the Chapter II prohibition. Whether a dominant position may exist will often depend on how the market is defined. For this reason, those under investigation often argue for the largest possible definition of the market thereby reducing their market share and the effect of their allegedly anti-competitive practices. On the other hand, those complaining will frequently argue the reverse. In one sense, the arguments can be often circular because if there is actual evidence that, for instance, a practice has had an anti-competitive effect this will tend to show that the firm concerned must have had sufficient market power within its markets.

The market where the undertaking may have a dominant position must be defined by product and by geographical area.

The relevant product market

It is first necessary to identify the relevant products (or services) concerned by the dominant position. A product market will include:

- the products directly concerned

  and

- substitutable products (see below).

There may be separate markets for:

- products having specific uses
- raw materials
- spare parts
- groups of products within a potentially very large market.

When the product market has been identified, it is necessary also to look at the conditions for competition prevailing on that market.

Substitutability

In one case, it was suggested that a particular firm had a large market share in relation to the supply of bananas. The firm argued that the relevant market was not the one for bananas, but the whole of the fruit market, on which basis they enjoyed a relatively small market share. This argument was based on the proposition that one fruit was an effective substitute for another (that a customer who found bananas to be too expensive would be satisfied with buying another type of fruit as a substitute).

It may well be the case that some fruits are "substitutable" or "interchangeable" in this way and therefore form part of a larger market. However, in this case, it was decided that bananas constituted a separate and distinct market because of the particular qualities of a banana which were not found in other fruits, namely their appeal to the elderly and the young as an easily digestible food.

This question can also be of particular importance in relation to spare parts. For instance, the manufacturer of a photocopier may have a very small market share in the photocopier market as a whole. However, if he is able to maintain a monopoly or near monopoly on the supply of compatible spare parts, there may be a separate market in spare parts for his type of photocopier.

In assessing competition, one may also need to consider the ease with which manufacturers or suppliers can switch from one product market to another.

Geographical markets

The other aspect is the question of the geographical size of the market to be considered. This may, according to the wording of Article 82, be the EU as a whole or a "substantial part of it". The relevant geographical area must be one in which the "objective conditions of competition applying to the product in question must be the same for all traders" and where the dominant undertaking "may be able to engage in abuses which hinder effective competition". This will be a question of fact in each case. In some sectors, an undertaking may not have a large market share across the EU but may nonetheless be dominant in one region or Member State.

The abuse of a dominant position

The mere existence of a dominant position is not a breach of Article 82. There must be an abuse.

Abuse is always a question of fact:

- is the conduct obviously unfair or restricting competition?
- is the conduct obviously different from normal industry practice?
- does the dominant undertaking intend to act in an exclusionary manner or is it legitimately responding to competition?
- what is the effect of the conduct on competitors and customers?

A dominant undertaking can operate on a market without being restrained by effective competition. The unilateral conduct of such companies is therefore subject to control under Article 82.

Undertakings may abuse their strength by altering the normal conditions of competition which should apply in their market.

Abusive behaviour

The following are examples of abuse of dominance:

Excessive pricing

A dominant company must take care in setting the prices of its products. In certain circumstances, setting a price which has no reasonable relation to the economic value of the product can amount to an abuse.

Discriminatory pricing

A dominant company must also be careful about its pricing policy towards resellers based in different EU Member States to ensure that this does not lead to partitioning of markets.

Predatory pricing

If you are dominant on your market and you set up any arrangements by which you trade at unprofitable prices (selling below cost price or at a barely profitable level), or you address price cuts selectively with a view to "encouraging" a competitor out of the market, or if, because of your position on the market, you can offer special discriminatory prices to your competitors' customers, but keep higher prices for your own equivalent customers, you will be abusing the competition rules.

It is sometimes difficult to establish the dividing line between keen, but legitimate, competition and real predatory or abusive action.

Refusal to supply

An objectively unjustifiable refusal to supply by an undertaking which has a dominant position on a market will always be contrary to Article 82. The same problem is encountered when a dominant company makes the supply of its products conditional on its having control of the further processing or marketing of those products. How to prove an "objective justification" will always be a difficult question.

An agreement or understanding with your competitors about behaviour towards a particular customer could also lead to a "collective dominant position". This may be because of structural or organisational links, or because of common methods of dealing, or parallel behaviour within a market. This might, in other terms, be called "concerted exclusionary conduct".

Fidelity/loyalty rebate schemes

Rebates based on quantities purchased should be applied objectively to all comers. You cannot offer rebates - or other inducements - on the basis that your customer will take all or a large percentage of his supplies from you. The European Commission will regard this as another way of trying to gain exclusivity and prevent the customer having a free choice elsewhere, without actually imposing a total requirements obligation.

Tying in

Article 82 prohibits a company in a dominant position making the conclusion of contracts subject to the acceptance by the other parties of supplementary obligations which have no commercial connection with the product or service in question. The sale of product A must not be conditional upon the purchaser's also agreeing to pay for unrelated service B.

The European Commission's discussion paper on Article 82

Following some general feelings of unease about the application of Article 82, in December 2006 the European Commission published a staff "Discussion Paper on the application of Article 82 to exclusionary abuses" and requested public comments. The European Commission noted that the Discussion Paper was "designed to promote a debate as to how EU markets are best protected from dominant companies' exclusionary conduct … The paper suggests a framework for the continued rigorous enforcement of Article 82, building on the economic analysis carried out in recent cases, and setting out one possible methodology for the assessment of some of the most common abusive practices, such as tying, and rebates and discounts."

While the Discussion Paper does not commit the European Commission to producing guidelines on the application of Article 82, this has been discussed. However, the European Commission has not committed to producing guidelines.

It is understood that the Commission wishes to announce its further steps in this review of Article 82 early in 2007.

Abusive behaviour – EU case studies

Example A

Company A specialising in equipment for the packaging of liquid and semi-liquid food products in cartons:

- enforced standard clauses requiring only A's own cartons to be used on the machines A manufactured
- demanded that supplies of cartons be obtained only from A, with the intention of making customers totally dependent on A for the life of the machine
- sold at prices below average variable costs in certain countries (predatory pricing).

The ECJ said that A's behaviour formed part of a deliberate and coherent group strategy seeking to eliminate competitors.

Fine €75 million (approx. 2.2% of group turnover)

Example B

Company B applied a system of loyalty rebates and discounts to its major customers by reference to marginal tonnage. It also required its customers to enter into long term contracts aimed at ensuring effective exclusivity of supply for Company B, including "evergreen" contracts terminable on 24 months' notice.

- The European Commission said that Company B's activities were designed to exclude competitors from the market.
- Fine: €20 million

Example C

Company C, a computer manufacturer dominant in the market for the supply of certain key products:

- refused to supply central processing units without main memory (memory bundling)
- refused to supply central processing units without software included in the price (software bundling)
- refused to supply certain software installation services to users of non-Company C central processing units (discrimination between users)
- failed to give other manufacturers timely information needed to permit them to make competitive products (interface information)

Company C did not admit either the existence of a dominant position or abuse, but, after a European Commission investigation, it undertook to amend its practices.

UK competition law – the Chapter II prohibition

Chapter II prohibits abusive conduct by an undertaking enjoying a dominant position within the UK which affects trade within the UK. As described above, the prohibition is modelled on Article 82 EC Treaty.

The Chapter II prohibition concerns the unilateral unfair conduct of a powerful undertaking (or group of undertakings). It contrasts with Chapter I which is concerned with restrictive agreements between different companies of any size.

There is no exemption from the prohibition in Chapter II.

To assess whether Chapter II applies, four questions have to be answered:

- does the conduct affect trade in the UK?
- what is the market?
- is the relevant company dominant?
- is the company abusing its dominant position?

An effect on UK trade

This is the key difference between the Chapter II prohibition and Article 82. For there to be a breach of Chapter II, there must be an effect on UK trade. This contrasts with Article 82, which, as described above, requires an effect on trade between EU Member States.

Conduct will affect UK trade where it has an actual or potential, direct or indirect effect on a UK market for goods or services. It is clear that conduct relating to the supply of goods between two UK based companies will affect UK trade. In addition, an activity relating to the shipment of goods between the USA and the UK could have an indirect effect on trade within the UK, so would also be likely to fall within the scope of the prohibition.

Is a company dominant?

A company must assess whether it possesses a significant level of market power. Although the relevant geographic market could be wider than the UK (some markets are worldwide), the Chapter II prohibition is only concerned with dominance in the UK. Dominance is not just a measurement of size. An undertaking can be small and dominate, just as it can be big and fail to dominate. The essence of dominance is whether businesses can behave independently (for example by charging higher prices or attaching conditions to purchases) without regard to pressure from competitors, customers and ultimately consumers.

Although market share is not determinative of dominance, it is the best starting place. The Competition Act 1998 requires the UK competition authorities to follow relevant EU case law. As described above, the European Court of Justice has stated, broadly, that dominance can be presumed if a firm has a market share above 50%. The OFT has indicated that it is unlikely to consider a firm to be individually dominant if its market share is below 40%. The overall structure of the market is relevant and must be considered. If a company has a high market share, but competitors are large or powerful, the company will be less likely to be dominant. On the other hand, a company with a 40% share in a market where all the other competitors have small market shares, could more easily be dominant.

In assessing dominance, companies should also consider potential competitors and entry barriers - there is more chance that a company (or companies) will be dominant if it is difficult for new competitors to enter the market. "Entry barriers" would include regulatory requirements or start-up costs or the reputation of existing companies.

A business should finally determine whether there are other constraints on its behaviour in the market. For example, does it face strong buyer power from its customers? A large customer, such as a retail chain, could exert pressure on a large supplier in such a way that the supplier would not be able to act without taking that customer's requirements into account.

In short, if a business has a large market share (above 40%), if the market has entry barriers and there are no further constraints on its commercial activity, then the chances that it can behave independently and therefore enjoy a dominant position are high.

Definition of the market

As indicated, a dominant position is identified by reference to a company's position on a relevant market. It is therefore necessary to define the relevant market, taking into account the goods or services involved (the product market) and the geographic extent of the market (the geographic market).

As with Article 82, in defining the product market, a first step is to consider whether there are goods or services which could be used as substitutes for the goods or services in question. If customers could easily change to an alternative product in the event of a price increase, then the alternative product should be included in the definition of the relevant product market.

The relevant geographic market could be wider than the UK, the whole of the UK or a part of it (which could be as small as a single town). There is no need for a dominant position to be in a substantial part of the UK. A small part of the UK would constitute a relevant geographic market. Firms can therefore breach the Chapter II prohibition where, due to lack of interstate trade, they have little chance of infringing Article 82.

The relevant geographic market is assessed on the basis of the area supplied by the relevant company and the availability and accessibility of similar products from suppliers in other areas on reasonable terms.

Joint dominance

Like Article 82, Chapter II prohibits abusive conduct on the part of "one or more dominant undertakings". As described in the context of Article 82, several undertakings may together hold a dominant position because they are united by some form of economic link. Parallel behaviour, structural links or organisational links may all be economic links sufficient to show collective dominance, provided the three conditions to establish a finding of collective dominance are met (i.e. a transparent market, an effective punishment mechanism, and a policy that is capable of withstanding challenge by other competitors, potential competitors or customers).

Is there abuse?

It is the abuse of a dominant position which is prohibited, not dominance itself. It is quite acceptable to have market power. There is no legal test to establish the existence of abusive conduct, which is a matter of fact in each case.

Broadly, the following considerations should help decide whether an action is abusive:

- is the conduct obviously unfair or restricting competition?
- is the conduct obviously different from normal industry practice?
- does the dominant undertaking intend to act in an exclusionary manner or is it legitimately responding to competition?
- what is the effect of the conduct on competitors and customers?

The UK competition authorities will take into account cases at EU level which have considered whether particular conduct is abusive.

Examples of conduct which is likely to amount to an abuse of a dominant position is described in relation to Article 82 above. They are also typical of conduct which is likely to breach the Chapter II prohibition.

Examples of conduct likely to breach the Chapter II prohibition

- excessively high prices – e.g. setting a price above the economic value of the product in the relevant circumstances
- discriminatory prices, terms or conditions – e.g. charging different prices to different customers where the differences do not reflect quantity or quality of product supplied
- predatory pricing – pricing products below average variable costs to drive out competitors.
- refusal to supply – e.g. refusing to supply or reducing supplies to a customer without an objective justification such as unavailability of supplies or the poor creditworthiness of a customer
- fidelity/loyalty rebate schemes – e.g. rebates which are offered only on the basis that a customer will take all or a large percentage of its supplies from a dominant supplier
- tying arrangements – e.g. making the sale of product A conditional upon the purchaser also agreeing to take unrelated product B.

Abusive behaviour – UK case studies

Example A

Company A, the publisher of a weekly free local newspaper engaged in predatory pricing by:

- selling advertising space in the paper at an abnormally low price
- deliberately incurring losses when selling advertising space to protect its position vis-à-vis a new market entrant

The OFT imposed a fine of £1.328 million, subsequently reduced on appeal to £1 million.

Example B

Company B, a drug manufacturer was found to have abused its dominant position by:

- bundling three different services into the price of a drug to ensure that only it could provide those services
- precluding competition by charging independent service providers a price that allowed them no possible margin

The OFT found that Company B's actions were preventing existing competitors from operating viably; ensuring that no new competition could enter the market; and depriving customers of choice of service provider.

Fine: £6.8 million, subsequently reduced on appeal to £3 million.

Exclusions from the Chapter II prohibition

Although there are no exemptions from the Chapter II prohibition, certain kinds of conduct are excluded from the scope of Chapter II altogether.

The main exclusions are in respect of:

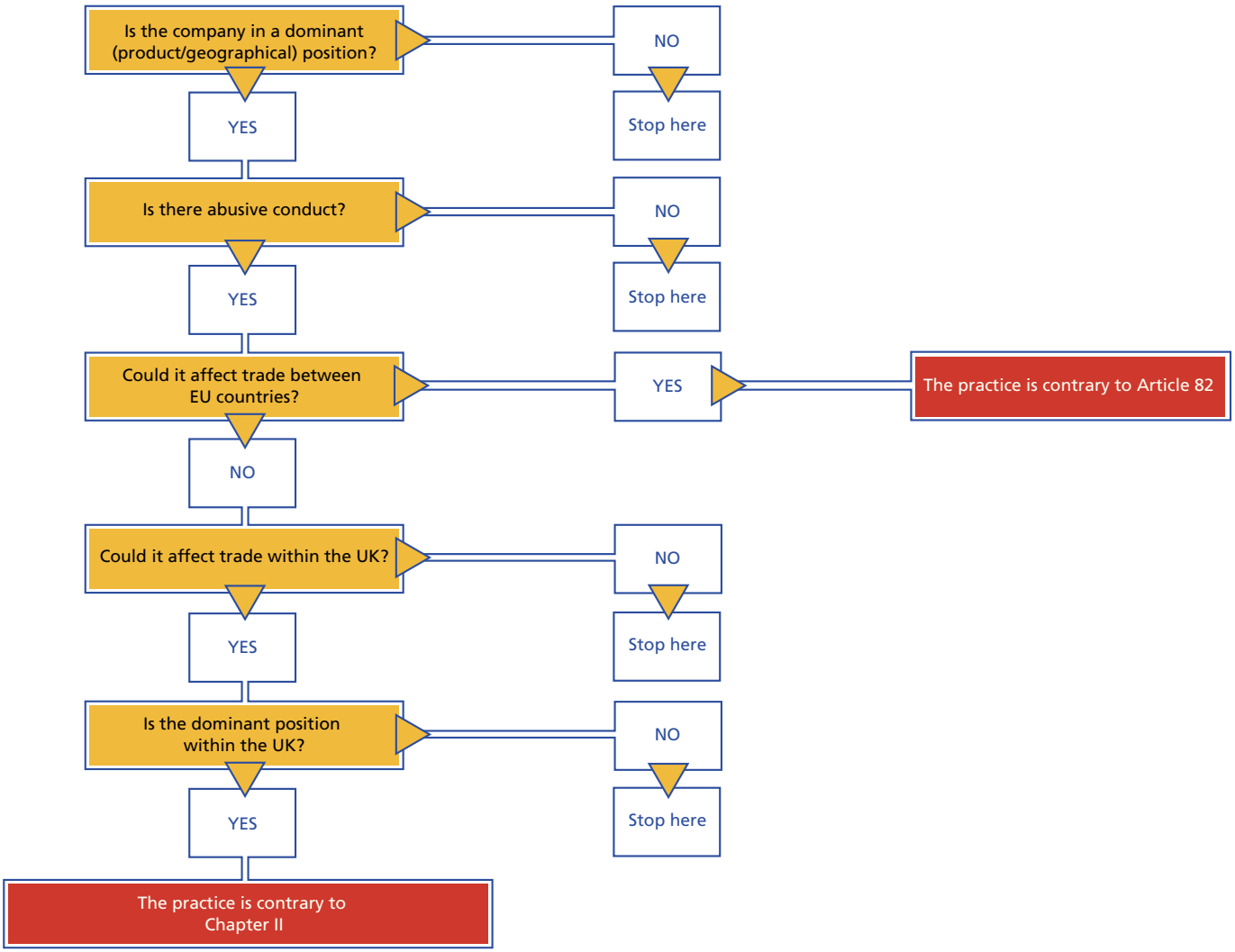
- conduct which results in a merger falling under the Fair Trading Act 1973 (now replaced by the Enterprise Act 2002) or the EC Merger Regulation
- undertakings entrusted with the operation of "services of general economic interest" or a "revenue-producing monopoly".

The Secretary of State has the power to add, amend or remove exclusions in certain circumstances.

Article 82 and Chapter II – what should business do?

As described, Chapter II and Article 82 are strict prohibitions on the abuse of market power which are supported by potentially severe penalties. The first step for businesses is to assess whether they may be dominant (taking a 40% market share as a starting point) in any market in which they operate. If there is possible dominance, businesses should conduct an audit of all pricing, marketing and sales conduct to check that these are not abusive. It is also advisable to establish a compliance programme (or update an existing programme) to raise awareness of the prohibitions and of the competition regime in general (see the section of this Survival Pack entitled "Compliance programmes").

Article 82 or Chapter II: which prohibition applies to you?



Annex

Article 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

b) limiting production, markets or technical development to the prejudice of consumers;

c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The Chapter II prohibition

18 (1) … Any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.

(2) Conduct may, in particular, constitute such an abuse if it consists in –

a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

b) limiting production, markets or technical development to the prejudice of consumers;

c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to their commercial usage, have no connection with the subject of the contracts.

(3) In this section:

a) "dominant position" means a dominant position within the United Kingdom; and

b) "the United Kingdom" means the United Kingdom or any part of it.

(4) The prohibition imposed by subsection (1) is referred to in this Act as "the Chapter II prohibition".

1 January 2007

Pricing issues

The main purpose of competition law is perhaps to ensure fair prices. Infringements relating to price have led to the highest fines at EU level and have also been the subject of substantial fines under the Competition Act 1998. Companies (and especially companies with large market shares) should keep under close and regular review the prices they charge to their customers and their pricing policies. This section explains when pricing policies are likely to infringe the prohibitions.

When do you have to worry about pricing issues?

Not only do you have to take care that your own pricing policies are not illegal, you should also monitor those of your competitors to see if they give grounds for complaint.

There are two basic prohibitions under EU and UK competition law and pricing policies can be caught by either or both:

- Under the prohibition on anti-competitive agreements (Article 81 EC Treaty (Article 81) or Chapter I of the Competition Act 1998), if a company enters into an agreement which has, or may have, any price-fixing element, the arrangement is likely to infringe, whatever your market share.
- The prohibition of conduct which constitutes abuse of a dominant market position (Article 82 EC Treaty (Article 82) or Chapter II of the Competition Act 1998) catches a wider range of price-related activity than the prohibition on anti-competitive agreements.

For EU competition law to apply, there must be an effect on trade between EU Member States. The need for an effect on EU trade has been interpreted widely and will be satisfied even if there is only an indirect or potential effect. Therefore, pricing policies, whether agreements or unilateral conduct, will in many cases affect both UK and EU trade. References to either EU or UK law in this section should be treated as references to both.

The prohibition on anti-competitive agreements

When do non-dominant companies need to worry about their pricing policy?

A company which is not dominant is free to set its own prices. Even companies with small market shares, however, must beware of the competition rules since there are a number of ways in which they could impact upon their pricing policies.

Price-fixing agreements

A basic tenet of both UK and EU competition law is that an agreement to fix a price or to fix any price-related terms is anti-competitive. You must not agree to fix prices whatever your market share and whatever the nature of the agreement. This is an inescapable prohibition - there is no de minimis or appreciability test - and could include any of the following:

- a straightforward agreement between suppliers to set prices
- agreements on particular elements of a pricing strategy, for example rebates, discounts, margins

- an agreement to set a range of prices or to set a minimum price
- acceptance of prices set within a trade association
- price agreements on imports into or exports out of the EU insofar as they affect trade within the common market of the EU
- any form of resale price maintenance - e.g. a manufacturer wishing to impose a particular resale price on its distributors either expressly or by making it known that price-cutters will not be supplied.

Concerted pricing practices

There are circumstances where the authorities may feel that price-related conduct is anti-competitive, but may be unable to demonstrate that the company or companies instigating the conduct are dominant. The authorities may instead seek to prove the existence of an agreement so that the anti-competitive conduct can be assessed as a price-fixing agreement. There may, for instance, be evidence of a concerted practice between a supplier and its distributors leading to price uniformity. A concerted practice stops short of a clear agreement but involves any form of conscious co-ordinated conduct such as raising your prices at the same time as your competitors. A concerted practice is caught by Article 81 or Chapter I.

In addition to avoiding price-fixing agreements and resale price maintenance, it is always advisable to have an answer to charges of conscious co-ordination of pricing policies. For instance, if all suppliers have similar discount policies, the authorities may decide that their pricing strategies follow a similar pattern and that they represent an agreement or concerted practice in breach of the prohibition on anti-competitive agreements. This can happen even where no individual company is dominant. It will also be assumed where a purchaser receives discounts according to its purchases from a number of companies who are not part of the same corporate group.

Finally, you should beware of exchanging sensitive price-related information with your competitors. In some circumstances, the exchange of commercially sensitive information on prices can be a breach of the prohibition on restrictive agreements even where there is no agreement actually to set any element of the price.

The prohibition on abusive conduct

General principles of pricing for dominant companies – when are pricing policies abusive conduct?

There is nothing wrong with a dominant market share (40%+) but having a dominant position does impose special responsibilities. A dominant company must not profit from its dominance to the detriment of consumers or competing companies with smaller market shares. Abusive conduct is not linked to an agreement or concerted practice, but simply consists of the unilateral action of the dominant company.

To avoid accusations of abusive conduct, dominant companies should observe the following overriding principles in framing and implementing their pricing policies:

- Any price structure should be applied uniformly to all customers
- Discounts, rebates and reductions should be applied consistently and on an objective basis
- Any differentiation in treatment should also be based on objective criteria
- Prices should not be excessive or predatory
- Prices should be
  - Fair
  - Uniform
  - Non-exclusionary.

If you do not feel your company's pricing policies are FUN, you may be risking accusations of abuse. If you feel your competitors' pricing policies are not FUN you may be able to complain to the competition authorities.

Can you still charge different prices?

A company may have various forms of differential pricing structure - e.g. charging lower prices to its national distributors, offering favourable terms to long-standing customers or generally favouring one customer or customer type over others.

Discriminatory prices, including any differential element in price-related terms, can be an abuse of a dominant position.

Differentiation in pricing terms is permissible where there is an objective justification. This could be in terms of cost savings for lower prices, e.g. for bulk or for levels of transport cost. It may reflect the quality differential between products supplied.

To avoid accusations of abusive discriminatory pricing, a supplier should treat its customers on an equal basis where those customers are in an equal position.

The authorities can be expected to treat evidence of excessive price differentials or exclusionary behaviour as strongly indicative of abusive discrimination.

When is a price excessive?

An excessive price is defined as one which bears no reasonable relation to the economic value of the products supplied or of the service provided. Economic harm suffered by the purchaser would be a strong indicator.

It is, however, difficult to decide on economic value and the authorities have never issued guidance. The value would probably be indicated by a cost/price analysis. Comparison may be made to competitors' prices.

The Office of Fair Trading has stated its opinion that it would regard a price as an abuse where it is persistently excessive without stimulating new entry or innovation.

There is a lack of legal certainty here for the dominant company. In other words, there is no numerical formula to answer the question of when a price is excessive. To feel secure, such a company should, if it wishes to set prices at higher levels than its competitors, only do so where it is sure that this is reflected in some element of quality and/or cost.

When can a dominant company lower prices?

It may seem strange to prohibit a low price, but there may be circumstances where a dominant company is using a low price to drive out its non-dominant competitors. This may be similar to loss-leading, where the dominant company accepts losses from one part of its product range which it can recoup through its pricing for the rest of the range. Or it may be that the dominant company can use a lower price to attract customers to its products and then raise the prices of the same products again once it has secured their custom. In either case, the non-dominant competitor may not have the ability to match this behaviour.

Although the setting of low prices is in many circumstances a legitimate commercial strategy, strategies which are aimed at eliminating competition are prohibited as the abuse of a dominant position. There is a defined legal test to establish when a price is "predatory". It is assumed that a price is predatory when it is below average variable costs. If, in other words, it goes so low that you cannot possibly be in a position to make a profit, the price can only be predatory and the authorities don't need any evidence to prove it. On the other hand, if it is above average variable costs but below average total cost, they do need evidence. They need to prove that the dominant company intended to exclude competition.

This test is, however, not set in stone. In one case even where a price was set at above total cost, the opinion was expressed that it may in the circumstances be part of a selective price-cutting strategy intended to damage competitors.

One possible defence to an accusation of predatory pricing is to argue that you are reducing a price only to meet a low price charged by a competitor. This should be acceptable provided you do not undercut your competitor's price and also provided it is not a selective price cutting scheme across all your customers. Of course, in order to be meeting a competitor's price, your price movement should not pre-empt the competitor's price movement – it should come in response to it.

It is not easy to prove the intention required to justify accusations of predatory pricing. It is nonetheless easy to allege predatory pricing and a company with a strong market position should beware of laying itself open to such accusations. Whenever it reduces a price significantly, it should have an objective and preferably cost-based commercial justification.

Are discounts allowed?

There are many possible forms of discount scheme, but the basic competition principles are relatively simple. A discount scheme should result in a fair price charged which does not exclude competitors or make it difficult for customers to access the products of other suppliers. There are fundamentally three types of discount: discounts based on volume, discounts based on targets and so-called fidelity or loyalty discounts.

Of these three, volume discounts, i.e. discounts based on quantity, are the least likely to infringe the prohibition on abuse of a dominant position. Provided the rebate is given to the purchaser because of the objectively justifiable (i.e. quantifiable) amount the purchaser buys from the particular supplier, it is less likely to have an exclusionary effect and is unlikely to be condemned. At the other extreme, a fidelity/loyalty rebate is a reward for exclusivity and will often oblige the purchaser to take all or most of its purchases from one source. The commercial justification for the customer doing so is unlikely to be objective and cost-based.

Discounts given to purchasers as a reward for reaching defined targets may also be an abuse. Companies with large market shares should ask themselves how such discounts are calculated, what the reference period is, how transparent are the criteria and who they apply to. The more transparent the criteria, and the shorter the reference period, the greater chance a target discount system has of being allowed. Nonetheless, the authorities have taken a firm line against target discount systems. It has indicated that it will not be easy for a dominant firm to prove that a target discount system does not put its customers under a degree of pressure incompatible with their commercial freedom.

In the context of discounts, a dominant company should also never make a low price conditional upon a customer taking more than one product or a full range of products. In other words, product ties or full-line forcing can be abuses of dominance. Cost-related savings due to bulk buying, whether of one product or across a product range, is perfectly acceptable commercial behaviour, but tying the purchase of different products together can easily be viewed as an attempt to boost market share to the detriment of your competitors. So-called English clauses, in which the purchaser must inform the contract supplier of better prices or better terms set by another supplier and the contract supplier is given the opportunity to match the other supplier's terms, may also be an infringement of Article 82 or of Chapter II if the contract supplier is in a dominant position. Such a clause would make it harder for rival suppliers to win market share.

Related markets/collective dominance

A final note of caution on the prohibition on abuse of a dominant position - even if you are not dominant on a particular product market, there are still two circumstances in which Article 82 or Chapter II could be relevant to your pricing policies:

- If you are dominant upon a market related to the market on which you are pricing, the authorities might be able to link the abusive conduct on the non-dominant market to your dominance on the associated market.
- You may be part of a group of two or more companies together enjoying a collective dominant position if you have some form of structural link with the other companies or even if you are merely pursuing identical forms of conduct.

1 January 2007

Test your competition law knowledge

Market position

Failure to comply with competition law poses a number of risks for companies, not least of which are the competition authorities' strong powers to punish offenders and the possibility that agreements entered into by the company may be invalid.

Developing a knowledge of how the law works and how it affects your business is therefore essential. This questionnaire is designed to allow you to conduct a brief survey of your company's awareness of the main issues and to assess the risk that your company may fall foul of UK and EU competition law. It is not necessary to answer all of the questions in order to complete the analysis, as not every question will be relevant to the activities of your company.

The first set of questions establishes your company's market position to indicate the extent to which the nature and size of your business may interest the competition authorities. The remaining sets of questions test your knowledge of the competition rules. Score 1 for each correct answer. Some questions have more than one correct answer (e.g. of options (a) to (e), (a), (c) and (d) might be correct). Answers are at the end of each set of questions – no peeping, please – together with some suggestions for further study (should you need them).

Question 1 – What do you estimate is your company's market share?

	Score	Comment
Less than 10%	1	With a market share of less than 10% your company's activities will not usually attract the attention of the competition authorities. The principal competition risks are cartel activities and resale price maintenance.
Between 10% and 20%	2	With this level of market share the competition authorities will not usually regard your company as having market power – which could be used to distort competition in the market. The principal competition risks are cartel activities and resale price maintenance.
Between 20% and 40%	3	With this level of market share the competition authorities may regard your company as having market power – and therefore the potential to distort competition in the market. A competition compliance programme should be in place to ensure the company's activities do not infringe the law.
Over 40%	4	With this level of market share the competition authorities will assume the company is in a dominant position in the market. More stringent rules apply. It is essential that the company has a competition compliance programme in place to ensure its conduct does not infringe the law.
Don't know	2	Understanding your company's market and its position within it is the first step in any assessment of competition law risk.

Question 2 – How many competitors (holding more than 5% of the market) do you consider your company has?

	Score	Comment
More than 8	0	The competition authorities are likely to operate on the assumption that your market is operating competitively – there is therefore less competition law risk for your company.
Between 4 and 8	1	The competition authorities may consider the low number of competitors means there is more likelihood of competition issues arising in the market – perhaps as a result of collusion between competitors.
3 or under	2	The market is likely to be treated as an oligopolistic one and is therefore likely to be the subject of careful scrutiny by the competition authorities.

Question 3 – How easy would it be for a new company to enter your market?

	Score	Comment
Straightforward - there are no major obstacles.	0	One of the main issues addressed by the competition authorities in analysing a market is the ease of entry for new competitors. With low entry barriers the authorities are less likely to consider that competition law issues arise in this market as price rises are likely to encourage new entrants.
Fairly difficult - it would require fairly sizeable investment in fixed costs and there would be some regulatory/know how hurdles.	1	One of the main issues addressed by the competition authorities in analysing a market is the ease of entry for new competitors. With significant entry barriers the authorities are are more likely to consider that competition law issues arise in this market as there is less likelihood that price rises will encourage new entrants.
Very difficult - it would require a major investment in fixed costs and regulatory/know how barriers would be hard to overcome.	2	One of the main issues addressed by the competition authorities in analysing a market is the ease of entry for new competitors. With major entry barriers the authorities are likely to consider that competition law issues will arise in this market as price rises alone are unlikely to encourage new entrants.

Market position – score result

1 to 3 – The market and your company's position in it do not automatically raise competition law concerns.
4 or 5 – The market and your company's position in it are likely to attract the attention of the competition authorities.
6 to 8 – The market and your company's position in it are certain to attract the attention of the competition authorities.

Understanding competition law

Question 1 – At a meeting of a UK trade association with broad industry membership the existing members vote on whether to accept the membership application of a company based in Spain. The Spanish company meets the association's membership criteria as regards type of business it carries on. You voice some reservations but the decision is eventually taken to refuse admission because the company does not do much business in the UK. Which of the following statements is the most accurate competition law analysis?

(a)	It is up to the trade association to decide who is admitted so there is no breach of competition law.
(b)	This is a potential breach of competition law by all the members (including your company) and the trade association itself.
(c)	This is a potential breach of competition law and all those who opposed admission are at risk of being fined.

Question 2 – A colleague is attending a meeting of the same trade association. It is proposed that a study be done by a committee of the association on market trends in the industry using market data supplied by association members. What would be the best advice to give to your colleague?

(a)	Participate on the basis that the information provided is historical in nature and is collated by an independently appointed body.
(b)	Participate but only on the basis of ensuring that the information gathered is up to date and that your company has access to everything produced.
(c)	Refuse to participate in the study and ensure that the refusal is minuted.

Question 3 – Your company is thinking of entering into a joint venture with a French competitor. The JV would be limited in scope to speculative R&D on a completely new product. The results of the R&D would be available for use by both parties as they saw fit. You are aware of a number of other competitors who are engaged in R&D in the same field. Which of the following descriptions represents the best competition law analysis of the situation?

(a)	The agreement is unlikely to be in breach of competition law.
(b)	The JV agreement should be notified for clearance to the appropriate merger authority.
(c)	The JV should be notified to the European Commission as it is likely to be in breach of Article 81.

Question 4 – Your company has a distributor in Italy. The distributor has been charging prices which you think are too high. You consider trying to put a cap on the maximum price at which the distributor resells. Is this permissible under competition law?

(a)	No, this would be a form of resale price maintenance and as such would be a breach of EU competition law.
(b)	No, this would be a form of resale price maintenance and as such would be a breach of UK competition law.
(c)	Yes

Question 5 – Assume the company you work for has a 55% market share. One of your salesmen has just negotiated a deal with your largest customer with a price guaranteed to be 10% lower than that offered to any other customer. Does this raise a competition law risk?

(a)	Yes, if the price charged cannot be justified by reference to production cost savings brought about by the customer's purchase volumes.
(b)	No, the company is free to determine what prices it offers.
(c)	Maybe, it will depend on whether other customers complain.

Question 6 – Your Italian distributor has started making supplies to Spanish customers in contravention of its distribution agreement - which limits its territory to Italy. Can you enforce a requirement on the distributor not to sell into Spain?

(a)	It may be possible to prevent the distributor actively selling into Spain; this will depend on your company's market share and on whether sales to Spain have been reserved – either to an exclusive distributor for Spain or to your company itself.
(b)	It is possible to prevent the distributor selling into Spain, depending on the quantity of sales concerned.
(c)	No, such restrictions on a distributor are not enforceable under EU competition law.

Question 7 – You sell spare parts to construction companies. One of your lines is spare parts for pneumatic drills for digging up roads. Your supplier is the leading market player with around 50% of sales of pneumatic drills in the UK. Your supplier informs you that it will soon stop selling spare parts to you as it is setting up its own spare parts distribution business. What should you do?

(a)	Contact other spare part suppliers to see if they are receiving the same treatment and discuss the possibility of boycotting the supplier's products by way of retaliation.
(b)	Threaten to report the supplier to the competition authorities for an abuse of its dominant position
(c)	Nothing; it is up to the manufacturer to decide to whom it sells.

Score one point for each correct answer

Question 1 answer – (b)

Admission to a trade association should be based on objective criteria and should not be dependent on the vote of existing members. Here refusal to admit is essentially on the grounds of nationality and is therefore likely to be a breach of competition law. The trade association itself is subject to competition law and therefore might be pursued. Each of the members are also likely to be in breach, including your company unless you can point to a record of your support for admission.

Question 2 answer – (a)

Exchange of information between competitors is clearly a very sensitive area from a competition law perspective. However, the competition authorities recognise that there can sometimes be benefits for the market – as is potentially the case in this instance. Where such exchanges do take place the safest course of action is to ensure that information supplied by each company is historical in nature and is collated by an independent person or body with responsibility for ensuring that no confidential information is shared.

Question 3 answer – (a)

The creation of JVs can sometimes require clearance under the jurisdiction of the relevant merger authority. However a JV such as this, which has no life outside that of supplying R&D results to its parents, will not be subject to merger control.

In this case the agreement is unlikely to be in breach of competition law because (i) it is confined to R&D efforts – which the European Commission recognises can lead to market benefits and (ii) there are other companies active in the same area of innovation. No notification under Article 81 would be possible so the parties must come to a view on the competition law compatibility (or otherwise) of the agreement.

Question 4, answer – (c)

Setting a maximum resale price for a distributor is permitted under competition law – it is the setting of minimum prices levels which is not permitted. Therefore provided the maximum stated is not in reality being used to implement a minimum resale price policy there is no difficulty with this under either UK or EU competition law.

Question 5, answer – (a)

With a 55% market share it can be assumed that your company is in a dominant position. Pricing by dominant companies is a sensitive area which will attract the attention of the competition authorities. In particular, if there is discrimination between different customers on price in a manner which cannot be justified by reference to production costs and volumes purchased this may constitute an abuse of a dominant position contrary to Chapter II of the Competition Act 1998 and/or Article 82 EC Treaty.

Question 6, answer – (a)

This is certainly an instance where the market share of your company will be relevant. If its market share is below 30% the agreement could potentially fall within the EU's block exemption for vertical agreements. If your company has a market share over 30% the block exemption will not be available and there is a greater risk that the enforcement of this requirement will not be enforceable as it is in breach of EU competition law.

The block exemption for vertical agreements does allow for restrictions on active sales by a distributor into a territory which has been reserved for another exclusive distributor or for the supplier itself. However passive sales (i.e. simply responding to sales enquiries) to another territory cannot be prevented.

Question 7, answer – (b)

With a market share of over 50% it can be assumed here that the manufacturer is in a dominant position in the market for the sale of pneumatic drills. It can be an abuse for a manufacturer in a dominant position to refuse to supply an existing distributor of spare parts for its product. Threatening to inform the competition authorities of this conduct may be the best way to head off the problem. If the manufacturer still refuses to supply in addition to potential action by the competition authorities for breach of a dominant position, it may be possible to bring an action in court for damages.

It would not be wise to try and co-ordinate action with other distributors as this may in itself be regarded as an anti-competitive agreement between competitors.

Understanding competition law – score result

0 to 2 – Your knowledge of competition law principles is a bit sketchy – why not take a look through the rest of the Competition Survival Pack?
3 to 5 – Your knowledge of competition law principles is pretty good but you need to expand your understanding – refer to the rest of the Competition Survival Pack to increase your knowledge
6 or 7 – You are either a lucky guesser or you already have a very good understanding of competition law principles. Check the Competition Survival Pack if you have a query or why not speak to a member of the CMS Cameron McKenna competition team?

Competition law enforcement

Question 1 – At 9 o'clock one Monday morning a team of officials from the Office of Fair Trading arrives at your offices and announces that the officials are conducting an investigation of a cartel in which it is suspected your company has been involved. The officials produce an authorisation for the investigation, a document explaining the purpose of the investigation and some information on the penalties for failing to comply with the officials' requests. Your chief executive is unsure how to react and asks you what powers the officials have to conduct a search. Which of the following powers do they have?

(a)	They can ask for particular documents to be produced.
(b)	They can take copies of documents.
(c)	They can require staff members to state where particular documents can be found.
(d)	They can require explanations of particular documents.
(e)	They can use force to enter the premises if necessary.
(f)	They can conduct a search of the premises.
(g)	They can require information held on a hard drive to be copied onto a disk so they can take it away.

Question 2 – During this inspection one of your directors is asked to produce his record of a particular trade association meeting. The director finds the document but is concerned it may reveal evidence of a cartel and so quickly shreds it. What is the maximum penalty that might be imposed on the director?

(a)	A fine of £5,000
(b)	An unlimited fine
(c)	Imprisonment for up to two years and an unlimited fine

Question 3 – Your company is found to have participated in a cartel over the last five years. Assuming the worldwide turnover of the company has been around £10 million for each of the last 5 years what is the maximum fine which might be imposed under the Competition Act?

(a)	£100,000
(b)	£1 million
(c)	£3 million
(d)	£5 million

Question 4 – Your company has been fined by the Office of Fair Trading for participating in a price fixing cartel. You were not involved in the cartel, although were suspicious that it may have existed and were concerned about the competition law implications. Are there any penalties which you could face personally?

(a)	Yes, I could be disqualified from being a director in future.
(b)	No, as I was not an active participant in the cartel.
(c)	Yes, I could be fined.

Question 5 – It transpires that one of your fellow directors was involved in the price fixing cartel. She attended various meetings where price levels were discussed and followed the agreements reached but did not actively instigate the cartel. She asks for some advice on the likely consequences for her personally. Which of the following is most accurate?

(a)	It is possible the OFT will try to disqualify her as a director.
(b)	The company will be fined but no action can be taken against her personally as she did not instigate the cartel.
(c)	It is possible the OFT will try to disqualify her as a director and also possible that she will face criminal charges.

Question 6 – In these circumstances what would have been the potential benefits of contacting the OFT independently and providing information on the existence of the cartel?

(a)	Directors may have avoided the possibility of the OFT bringing applications for disqualification.
(b)	Those involved in the cartel may have avoided any possibility of criminal prosecution.
(c)	The company may have avoided some or all of its fine for breach of competition law.

Score one point for each correct answer

Question 1, answer – (a), (b), (c), (d) and (g)

Officials of the OFT only have power to use force to enter premises, or to conduct a search, if they have first obtained a court warrant. As a warrant has not been produced these powers are not available. However all the other powers can be used during the inspection. This illustrates the importance of understanding the authority under which a "dawn raid", or indeed any investigation, is conducted. As well as understanding the powers available to the inspectors, it is also essential to determine the precise scope of their inquiry as those powers should only be used in relation to that defined scope.

Question 2, answer – (c)

Destroying a document after having been asked to produce it under an inspection is an offence under the Competition Act. The maximum penalty is two years imprisonment and/or an unlimited fine on conviction on indictment.

Question 3, answer – (b)

£1 million - the maximum fine is 10% of annual worldwide turnover for the year preceding the date of the infringement decision.

Question 4, answer – (a)

Under the Enterprise Act the OFT has the power to bring an application to court for disqualification of directors following a finding of a competition law breach. The OFT has stated that it considers all directors of all companies may reasonably be expected to know that companies must comply with competition law. The OFT regards a situation where a director has suspicions of a breach but fails to take steps to halt the activity in question as a "serious case" – it would therefore be likely to apply for a disqualification order in these circumstances.

Question 5, answer – (c)

Under the Enterprise Act it is a criminal offence to be dishonestly engaged in a cartel involved in price fixing. Although this director is not the instigator of the cartel the OFT is likely to regard her involvement as satisfying the dishonesty requirement and could therefore bring a prosecution against her. The maximum penalty which can be imposed for the cartel offence is five years imprisonment and/or an unlimited fine.

Question 6, answer – (a), (b) and (c)

The OFT's strong enforcement powers are designed to encourage participants in anti-competitive activities to come forward voluntarily. By being the first to do this a company, its directors and other individuals involved can benefit from lenient treatment.

Competition law enforcement – score result

0 to 5 – Oh dear – you really need to develop your understanding of competition law risks. A competition law compliance programme will help with this.

6 to 8 – Not bad, however a competition law compliance programme would help you improve understanding of competition law risks.

9 to 12 – Well done! You have a good understanding of competition law enforcement. Have you thought about applying for a job at the Office of Fair Trading?

Compliance programmes

Introduction

Both EU and UK law prohibit undertakings from engaging in various anti-competitive activities, including restrictive agreements (such as cartels) and abuses of market power by undertakings in a dominant position. Chapter I of the UK's Competition Act 1998 and Article 81 EC Treaty (Article 81) prohibit anti-competitive agreements. Chapter II of the Competition Act 1998 and Article 82 EC Treaty (Article 82) prohibit abuse of a dominant position. Each of these prohibitions is covered in detail in relevant sections of this Survival Pack.

Firms engaged in anti-competitive activities in the UK or EU could face fines of up to 10% of worldwide turnover and open themselves up to challenge in court by customers and competitors. In addition, the UK has a criminal "cartel offence", which if committed can mean individuals facing up to 5 years imprisonment and/or a fine (no maximum amount). Company directors can also be disqualified for breach of competition law. For further information on penalties for infringement of the UK or EU competition rules, please refer to the relevant sections of this Survival Pack.

Compliance programmes

Both the European Commission and the Office of Fair Trading place great emphasis on the need for companies to be aware of how the competition rules affect their everyday course of business. They recommend that all businesses take steps to ensure they comply with the competition rules and implement compliance programmes.

This section explains why compliance is important, what compliance programmes should contain and how a company can go about organising its compliance effort. Companies should extend their compliance activities to cover all jurisdictions in which they carry on business.

Why have a compliance programme?

A compliance programme and audit of a firm's activities will help to:

Avoid criminal liability of individuals

In the UK, an individual who dishonestly agrees to fix prices, restrict output/supply, share markets or bid-rig may be guilty of the cartel offence. If convicted on indictment, he may be imprisoned for up to 5 years or fined, or both. If summarily convicted he may be imprisoned for up to 6 months or fined, or both.

Avoid disqualification of directors

In the UK, directors of a company may be disqualified for up to 15 years if the company of which he/she is a director breaches UK or EU competition law (Chapters I and II of the Competition Act 1998 or Articles 81 and 82) and if a court considers that his conduct contributed to the breach or he had reasonable grounds to suspect that the conduct of the undertaking constituted a breach or he did not know but ought to have known the conduct of the undertaking constituted a breach, thus rendering him unfit to manage the company.

Raise awareness of competition law to avoid agreements being void and unenforceable

Under Article 81/the Chapter I prohibition, an illegal agreement or particular illegal provisions of it will be void and unenforceable. By raising awareness within the company, in particular with managers and those making agreements or selling the products concerned, the company may reduce the likelihood of entering into strategic agreements which later prove to be unenforceable.

Avoid potential fines

Penalties imposed by the European Commission/OFT for breaching Article 81/the Chapter I and Article 82/the Chapter II prohibitions may be severe. Breach of EU or UK competition law may lead to fines of up to 10% of worldwide turnover.

Mitigate the consequences of any breach of Article 81/the Chapter I and Article 82/the Chapter II prohibitions

At UK level, penalties may only be imposed where the infringement has been committed intentionally or negligently. At EU level, the negligent or unintentional nature of an act will be a factor in reducing the level of any fine. The existence of a compliance programme may provide evidence in the company's favour to show that breach was not intentional or negligent. In assessing the amount of any penalty for infringement, the authorities have indicated that they may take the existence of a compliance programme into account as a mitigating circumstance reducing the amount of the penalty.

Avoid civil liability

Companies may be liable in the civil courts, including in certain circumstances the Competition Appeal Tribunal, to third parties who suffer harm as a result of those companies' breach of Article 81/the Chapter I and Article 82/the Chapter II prohibitions. Complying with the law will lessen the chance of third parties bringing damages actions.

Deal with an investigation

The European Commission/OFT have powers to request information and documents, and to send properly authorised inspectors to enter, search and where necessary seal premises. A compliance programme can prepare employees for what to expect during a "dawn raid" or an announced visit. Receptionists should know whom to contact. Employees should know to direct all questions to management who should be aware how to answer questions and which documents to produce in response to requests (some may be protected by legal privilege). The OFT also has powers to require individuals to answer questions, provide information, produce documents, explain documents and explain where documents are kept. Both European Commission and OFT officials may be entitled (with a warrant) to enter domestic premises to look for evidence. See the section entitled "What you need to know about dawn raids" in this Survival Pack.

Limit indirect costs

An investigation or other action arising from breaches of EU/UK competition law will take up senior management time and disrupt normal business. Avoiding such investigations (and the damage to the company's name which can result) is a key compliance programme aim.

Identify existing activities which may infringe

It may not be immediately obvious to a company to what extent it may be entangled in the competition rules. An audit and introduction of a compliance programme can never ensure complete compliance, but it does force the issues to be addressed and dealt with.

Public relations

A company found to be in breach of Article 81/Chapter I or Article 82/Chapter II prohibitions may well generate unwanted and adverse publicity.

Competitor tactics

A compliance programme helps companies understand and spot more easily the tactics of competitors and respond to business opportunities with minimal competition exposure. If a company knows the rules, then it will more easily be able to spot attempts by competitors to bend them.

Establishing a compliance programme

There are two main stages in setting up a compliance programme. First, the company needs to establish what it expects the programme to achieve, and, second, it must determine how the programme should be organised and who should have what responsibilities.

The OFT in the UK has described the minimum features of an effective compliance programme. These features can be used to provide the framework around which a compliance programme can be developed to suit the needs of a particular company. If they are all used, the existence of the compliance programme may be taken into account as a mitigating factor by the OFT when calculating the level of any financial penalty which might be imposed under Article 81 or 82 or in relation to the Chapter I or Chapter II prohibition of the Competition Act 1998. Such a compliance programme will also be useful if facing allegations of an infringement from the European Commission or the national authority of another EU Member State.

Support of senior management

Commitment to compliance must begin at the top so that it can filter down through the company. The commitment of senior management must be visible, active and regularly enforced.

Policies and procedures

Implementation of the compliance programme should be promoted through appropriate policies and procedures. A policy should include at least: an overarching commitment to comply with competition law; a duty on employees to observe this commitment; and a disciplinary system to deal with those who involve the firm in an infringement of competition prohibitions. Procedures should include a system which allows employees to seek advice on the application of competition law and to report activities they suspect may breach it.

Training

Employees should receive training and information on competition law and on the company's compliance programme. Training should begin when employees join the firm and should then be offered on a continuing basis.

Evaluation

The effectiveness of the compliance programme must be regularly evaluated in order to assess whether it is functioning correctly and also in order to identify any areas of risk which need to be addressed. Evaluation might take the form of interviews with employees or formal audits of particular areas of the business.

Tailoring compliance

Beyond the minimum elements for the programme indicated above, a company should establish which other goals should be pursued in order to tailor the rest of the programme to suit its particular circumstances. The more specific aims of a compliance programme will depend upon the sector of industry in which the company operates, its role and its market share within that sector.

Auditing existing business

One way of beginning the process is to conduct a compliance audit of the company's current arrangements in order to isolate any existing problems and to highlight areas of concern. The company will need to examine relevant areas such as licensing, dealings with commercial agents, joint purchasing and selling activities, pricing policies, and contact with competitors. A company health check will often involve putting together a questionnaire, or interviewing key members of staff, to establish how the company actually conducts its business (rather than how it should conduct its business).

This health check can then be used as a base from which a programme can be developed.

Organising the compliance programme

The role of management and the strategy for educating personnel through presentations, discussions and the preparation and circulation of compliance handbooks will be central to the programme.

The role of management

Management at all levels must be aware of the programme and committed to it. Authorisation, funding and technical resources will need to be available. Consideration should be given to which departments should be available and to the extent of external advice.

Mission or policy statement

It may be useful to have a central message to convey. Success depends on employees' clear understanding of the importance of the policy.

Compliance manuals

A brief and concise manual will be helpful and may be presented to relevant employees at seminars or discussion groups. Clarity and the giving of practical examples will be more useful than an overcomplicated approach.

Presentations

Presentations to employees should reinforce the practical points. The law and its consequences should be outlined, but detailed technicalities should be avoided. Illustrations are very effective. Decisions should be taken on the frequency of the training and who should attend in order to keep employees aware of the issues. Presentations can be made at yearly intervals to ensure compliance is maintained.

Reporting lines

It is important that everyone involved in competition compliance not only knows the rules, but knows to whom he or she goes if a potential problem is spotted or if there is some uncertainty about taking a particular course of action.

Legal advice

For day-to-day advice on compliance, somebody in the company's in-house legal team or other management department will have responsibility for responding to queries. The aim is to be able to recognise whether a problem can in fact be handled in-house, or whether a situation has arisen where outside advice may be required or appropriate.

Vetting agreements

Many companies find it useful, especially if an audit has revealed some discrepancies in the level of competition compliance in its documentation, to include in the compliance system guidelines on who has responsibility to sign off on various types of agreement.

Contact reports

Some companies in sensitive sectors set up and use a system of contact reports, which personnel are required to fill in every time they have a meeting with a competitor or a major supplier or purchaser. The main purpose of such reports is to avoid any unfortunate conversations. They can also be used to demonstrate the innocence of the meetings, should this ever be required.

Dawn raid response pack

When the investigators arrive at the company's door, it is unlikely to be the managing director who opens it. A compliance programme can thus usefully include a small file to be kept at the reception desk (and therefore available to the receptionist or security people) containing simple instructions on what sort of identification they can ask of the unwelcome visitors, which telephone calls to make immediately to company personnel and advisers, and what they can and cannot keep back from the investigators, pending the arrival of someone in a more senior position.

This will be supplemented by a more complete checklist for the managers or in-house lawyers who then take charge.

Checking up and compliance forms

A compliance programme will be less effective in maintaining compliance without a monitoring procedure. One useful tool is to require relevant personnel each year to sign a form declaring that they have not in the course of the previous twelve months to their knowledge been involved in any activities nor signed any agreements where competition problems might have arisen, without due reference to the legal department or other designated officer. This type of form can easily be included in the compliance manual.

Appraisals

The importance of the compliance programme could be stressed by including adherence to it as an objective in staff appraisals.

Disciplinary action

All relevant personnel must be made well aware of the consequences of disregarding the competition rules. A description of the effect on the career of the employee who involves the company in an infringement can be a very effective warning mechanism.

Compliance manuals

- statement of company policy
- brief description of the main legal concepts
  - anti-competitive agreements
  - abuse of a dominant position
- outline of prohibited behaviour
  - unauthorised discussions with competitors
  - price agreements
  - market rigging
  - cover bidding/cover pricing
  - bid rigging
  - fixing resale prices
- the consequences of infringing the rules
- lists of the company's standard agreements and guidelines and where to find them
- when and where to go for advice
  - manager? in-house/external legal advice?
- include forms for
  - contact reports of competitor meetings
  - annual acknowledgement of copy of manual/attendance at seminars/compliance with company rules and procedures

What should business do?

Businesses may already have compliance programmes covering the EU competition rules which have not been extended to cover the UK rules or which do not take into account the cartel offence and/or the ability to disqualify directors due to a breach of competition law. Any existing compliance programmes should be revised/extended to cover both UK and EU competition rules. Businesses that have no compliance strategy should put a programme in place.

1 January 2007

Competition authorities' powers of investigation

It is the duty of the competition authorities to detect and pursue infringements of the rules and to this end they have at their disposal extensive powers of investigation. Firms that infringe the prohibitions on anti-competitive agreements and on abuse of a dominant market position face fines of up to 10% of worldwide turnover. Company directors may be liable for up to 5 years' imprisonment and/or unlimited fines if they commit the "cartel offence" set out in the Enterprise Act 2002. A director may also be liable to disqualification from being a director for up to 15 years for breaches of competition law where it is felt his or her conduct makes him or her unfit to be a director. In addition, firms which breach competition law also face possible challenge in court by customers and competitors.

Impact of Council Regulation (EC) 1/2003

EU competition law prohibits anti-competitive agreements (Article 81 EC Treaty) and conduct (Article 82 EC Treaty). Its enforcement underwent important changes with the entry into force of Council Regulation (EC) 1/2003 (the Regulation) on 1 May 2004. The Regulation introduced a new framework for the application and enforcement of Articles 81 and 82. The European Commission continues to investigate and enforce Article 81 and Article 82 cases which it believes raise EU wide issues or otherwise merit its involvement, but under the Regulation, the OFT assumed an obligation to apply Articles 81 and 82 in the UK. In other EU Member States, the national competition authorities (NCAs) assumed obligations to apply Articles 81 and 82 in their national jurisdictions.

This means that while the European Commission continues to be able to conduct investigations under Articles 81 and 82, the OFT can also conduct investigations in the UK under Articles 81 and 82 as well as under the Chapter I and Chapter II prohibitions of the Competition Act 1998. In addition, the European Commission may request the OFT to carry out investigations in the UK under Articles 81 and 82 on its behalf. Furthermore, other NCAs investigating possible infringements of Articles 81 and 82 may request the OFT to carry out investigations or fact finding missions in the UK under Articles 81 and 82 on their behalf. The Regulation also introduced changes to the powers of investigation available in relation to Articles 81 and 82.

This section reviews the three main types of investigation under competition law powers which can take place in the UK. These are:

- investigations by the European Commission (Article 81, Article 82)
- investigations by the OFT (Article 81, Article 82, Chapter I prohibition, Chapter II prohibition)
- investigations by the OFT regarding the cartel offence

See the tables at the end of this section for summary information on powers of investigation.

Investigations by the European Commission

The European Commission continues to investigate infringements of Articles 81 and 82 throughout the EU. It is focusing on the most harmful cases of infringement, while allowing NCAs such as the OFT to apply Articles 81 and 82 in their territories. However, it should not be assumed that the European Commission will no longer carry out investigations such as "dawn raids" in Member States. This continues to be a part of its tasks and the Regulation granted it more powers, such as the power to seal premises and go into private homes.

The European Commission's powers of investigation consist essentially of the right to send a request for information and the right to carry out on-the-spot investigations.

Grounds for an investigation

The European Commission is required to have reason to suspect an infringement before it may use its investigative powers. In other words, it is not allowed to go on a "fishing expedition", looking for infringements and evidence at the same time. The European Commission may become aware of a restrictive agreement or practice as a result of its own investigation, through an investigation commenced by an NCA or due to a complaint by an aggrieved third party.

What powers does the European Commission have?

The European Commission has two main investigatory powers:

- the power to request information (Article 18 of the Regulation)

  and
- the power to carry out on-the-spot investigations including the power to search directors' homes in the EU (Articles 20 and 21 of the Regulation).

In addition, the European Commission may request an NCA to carry out an on-the-spot investigation on its behalf. The European Commission can request any information that is "necessary" for the enforcement of the competition rules and has a wide discretion in deciding when information is needed.

Requests for information

The European Commission's power to send written requests for information gives it two options:

- send a written simple request for information (Article 18 letter), stating the legal basis and purpose of the request, specifying the information required, the time limit for replying, and the penalties for supplying incorrect or misleading information. The firm may choose whether to respond, though the threat of formal decision (see below) in practice provides the incentive to reply. Care must be taken to ensure the information supplied is correct and not misleading (whether supplied intentionally or negligently), otherwise the European Commission may impose fines of up to 1% of total turnover in the preceeding business year;
- issue a formal binding decision to compel production of information, stating the legal basis and purpose of the request, specifying the information required, the time limit for supplying it and the

penalties for failing to supply it or for supplying incorrect or misleading information. Failure to comply can result in fines of up to 1% of total turnover in the preceding business year for supplying incorrect or misleading information and up to 5% of daily turnover for failure to supply complete and correct information for each day until the breach is remedied.

Both Article 18 requests and Article 18 formal decisions may be sent not only to the firm alleged to have committed an infringement, but also to its suppliers, customers or competitors.

The European Commission also has a new power to take statements from any person who consents for the purposes of gathering information relating to the investigation (Article 19 of the Regulation).

Investigation of business premises

The European Commission has the right to carry out on-the-spot "voluntary" inspections of business premises by way of European Commission authorisation - to which a firm is not obliged to submit or "mandatory" inspections by way of European Commission decision - to which a firm is required to submit. The European Commission might opt for mandatory inspection for a variety of reasons: the firm has already refused to submit to a "voluntary" inspection; the European Commission suspects the existence of particularly serious infringements and is concerned that documents or other evidence might disappear; the investigation involves a number of firms located in more than one EU Member State and the effectiveness of the European Commission's investigation would be hampered by the inability to conduct simultaneous inspections.

The procedure for a voluntary inspection of business premises requires an authorisation specifying the subject matter and purpose of the inspection, the penalties for producing incomplete or misleading documentation and the penalties for providing incorrect or misleading answers to questions asked by the European Commission officials when carrying out the investigation. A decision for a mandatory inspection must additionally specify a date for the investigation to be carried out, the penalties for failure to submit to the inspection and the firm's right to have the decision reviewed by the Court of First Instance.

Where a firm submits to a voluntary investigation, it must actively assist the European Commission inspectors, who will then have the same powers as if the inspection were "mandatory". The European Commission inspectors are usually accompanied by OFT officials. They may also have a High Court warrant allowing them to gain entry to premises and/or to seal premises or documents.

Investigation of other premises

The Regulation has given the European Commission the power to inspect any other premises, land and vehicles, including the homes of directors, managers and other staff where it reasonably suspects that relevant books or records are kept there. The European Commission may only exercise this power by way of a formal decision and must first consult the NCA of the EU Member State in which the inspection will be carried out and obtain prior authorisation from the courts of the EU Member State concerned. The decision must state the subject matter and purpose of the inspection, a date for it to

be carried out, the reasons which have led the European Commission to suspect that relevant information is kept there and the right to have the decision reviewed by the Court of First Instance.

The European Commission may not "seal" homes or ask for explanations of documents or facts relating to the inspection when inspecting domestic premises.

Your rights when inspectors arrive

Inspections will generally be carried out during office hours. When inspectors arrive at the premises, you should ask to see:

- their identification (European Commission / OFT staff ID cards for OFT officials assisting the European Commission or acting on its behalf), of which a note should be made;
- a document setting out the scope of their investigatory powers and the subject of the investigation; and
- where there is a warrant for the inspection, a copy of the warrant specifying the named officer in charge of the investigation.

Firms and individuals are entitled to contact their legal adviser, who may also attend the inspection. Inspectors will normally agree to wait a short time for the lawyer to arrive, provided they consider it reasonable to do so and this would not impede the investigation. European Commission inspectors are unlikely to wait over 30 minutes. In the meantime, they may take such measures as they feel necessary to ensure that other parties are not warned of the investigation, or that evidence is not removed or tampered with. This could include the suspension of external e-mail, sealing filing cabinets, waiting in selected offices or rooms and sealing premises and documents in the case of an investigation of business premises. No delay will be permitted where advance warning was given of the investigation, or there is an in-house legal adviser on the premises.

What happens in an inspection?

Inspectors normally arrive in a small group. European Commission inspectors are generally accompanied by a representative from the OFT.

On arrival at the premises, the inspectors will produce their authorisation, and will also show their European Commission/OFT staff cards in order to prove their identity.

During an inspection, total cooperation with the inspectors is required. Inspectors can:

- enter any premises, land and means of transport of the firm involved and also the homes of directors, management or other staff of the firms involved (homes by judicial warrant only);
- examine any book or business record (regardless of form);
- take copies or extracts;
- in the case of investigations of business premises, seal premises, books or records; and
- in the case of investigations of business premises, ask for oral explanations on the spot.

Where European Commission inspectors do not also have a UK judicial warrant, they may only ask for the production of documents and information. They will not carry out the search themselves. Unless the firm agrees otherwise, the employees of the firm must perform the search. However, in practice, a firm may allow the inspectors to look through documents themselves rather than allocate resources to the task of producing documents. Where the European Commission inspects and there is also a UK judicial warrant as OFT inspectors are accompanying the European Commission's inspectors, the UK warrant permits the inspectors to make an active search for documents. In the case of inspections of homes, a UK judicial warrant is required before the inspection can proceed. The warrant permits inspectors to make an active search for documents.

Safeguards and documents outside the scope of inspection

The inspectors may examine any document to determine whether it is relevant to their investigation, except for correspondence which is privileged because it is between the firm and its independent legal advisers established within the EU. Documents and letters emanating from both the lawyer and the client are covered. By contrast to the position under UK law, EU legal professional privilege does not extend to correspondence with the firm's in-house lawyer, unless that lawyer is simply reporting the statements of an independent lawyer. Where firms claim that documents are privileged, they must provide evidence that the documents qualify for such treatment.

Disclosure of information to the European Commission cannot be refused on the grounds that it would involve business secrets. There is however, protection from disclosure to competitors or third parties (Articles 27 and 28 of the Regulation).

Firms can protect their interests by drawing the attention of inspectors to particular documents relating to the inspection which are favourable to the firm and which the inspectors have not examined.

In addition, EU law recognises the right of privilege against self-incrimination. Thus, no member of staff (or individual in the case of a home inspection) is required to answer questions put to them by the European Commission where the answer might lead to an admission of an infringement of the competition rules which it is the European Commission's duty to prove.

Assistance in inspections by national authorities: warrants to enter and search

Where a firm refuses to submit to an investigation of its UK premises under a European Commission decision, the OFT may apply to the courts for a warrant conferring a right of entry on its inspectors and those of the European Commission. The right of entry allows the inspectors to use reasonable force to secure entry, and to search for books and records on the premises.

Penalties for non-compliance

A firm may refuse to submit to a voluntary inspection under an authorisation without fear of penalties being imposed in respect of this refusal.

Firms and individuals must submit to mandatory inspections under a decision and will face fines of up to 5% of daily turnover for failure to do so.

In addition, a warrant can be obtained by the OFT officials accompanying the European Commission inspectors. Individuals who intentionally obstruct the exercise of these powers may find themselves the subject of criminal sanctions.

The European Commission may also impose fixed fines up to 1% of total turnover in the preceding business year for supplying incorrect or misleading information (simple request and formal decision) or daily fines of up to 5% of daily turnover for failure to supply complete and correct information (formal decision only).

What should business do?

The European Commission has extensive powers of investigation under the EU competition rules. Companies should seek legal advice so that they know their rights in the event that they are the subject of an investigation. In particular, firms should ensure that they have procedures in place to deal with a dawn raid should inspectors turn up unannounced, and brief all relevant personnel accordingly.

Investigations by the OFT (Article 81, Article 82, Chapter I prohibition, Chapter II prohibition)

Following the entry into force of the Regulation on 1 May 2004, the OFT may carry out on its own behalf investigations into possible infringements of Article 81 and 82. It may also carry out investigations under Article 81 and 82 on behalf of the European Commission or on behalf of another NCA. The OFT may also conduct investigations under the Competition Act 1998 into possible infringements of the Chapter I prohibition (restrictive agreements) and Chapter II prohibition (abuse of dominance).

Powers of investigation

The OFT's powers are wide and include the ability to enter and search premises, using force where necessary, under the authority of a warrant, to require explanations of documents and seal premises. Below we set out the OFT's powers in the following situations:

- OFT investigates Article 81 or 82 and/or Chapter I or Chapter II on its own behalf
- OFT investigates Article 81 or 82 not on its own behalf

OFT investigates Article 81 or 82 and/or Chapter I or Chapter II on its own behalf

The OFT's powers of investigation when investigating under Article 81 or 82 on its own behalf are the same as the powers of investigation it has when investigating under the Chapter I or Chapter II prohibition.

The Competition Act 1998 (CA) prohibits anti-competitive agreements (the Chapter I prohibition) and conduct (the Chapter II prohibition). The CA is enforced by the Office of Fair Trading (OFT) and the sector regulators. In this section, the term "OFT" means the OFT and/or sector regulators, as appropriate.

Grounds for an investigation

The OFT can conduct an investigation where there are "reasonable grounds for suspecting" that the Article 81, Article 82, or the Chapter I or Chapter II prohibition has been infringed. Some examples of these grounds are given in the OFT's Guideline on Powers of Investigation. If a disgruntled cartel member were to give the OFT information about a secret agreement to share markets or fix prices, or if a complaint were to be made of some anti-competitive practice, these would be grounds for an investigation.

By launching an investigation and using its powers under the CA as amended to take into account the entry into force of the Regulation, the OFT can determine whether there has indeed been an infringement of the rules.

What powers does the OFT have?

The CA gives the OFT two main powers:

- to request information - the power to require the production of specified documents or specified information
- to inspect premises - the power to enter premises without a warrant, or to enter and search business premises with or without a warrant and domestic premises with a judicial warrant.

Requests for information

The OFT can of course make informal enquiries at any time to obtain information. While no sanctions attach to informal requests, companies should take them seriously. Simply ignoring an informal letter may create the wrong impression. Failure to respond could trigger further formal action. Once an investigation has been launched, the OFT has power under the CA formally to request specific documents and information, and failure to comply will be a criminal offence.

To make a formal request for information, the OFT has to serve a written notice setting out the subject and purpose of the investigation, the documents or information required and the possible offences for failing to comply. The notice may also specify the form in which the information is to be produced and/or a deadline for compliance, according to the quantity and complexity of the information requested, the resources available to the recipient of the request and the urgency of the case. Individuals, companies or trade associations may all be served with notices, whether they are suspected themselves of an infringement or have information which could assist the OFT's investigation.

The information which can be requested includes estimates, documents and computer records. The OFT can also require the compilation of information which is not already recorded at the time of the request, for example a chart showing market shares. It can take copies of information produced and can ask for explanations of material it contains both from the person providing it and from employees. If the required document cannot be produced, the OFT may ask where it can be found.

Investigations of business premises

Business premises include not only the centre of business operations, but also vehicles. An investigation may be by simple authorisation of the OFT, or with the additional powers of a judicial warrant.

In most cases where there is no warrant for the inspection (i.e. there is only an OFT authorisation), investigating officers may not enter premises, unless the occupier has been given written notice at least two working days in advance, specifying:

- the subject and purpose of the investigation, and
- the possible offences committed by failing to comply.

Broadly, a warrant can be granted where there is a reasonable suspicion that there are on the premises relevant documents which have not been produced on request, or which would be tampered with or concealed if they were requested. Alternatively, if the investigating officer has been unable to enter business premises and it is thought that relevant documents are kept there, a warrant can be granted to enable him to enter using force. Where there is a warrant for the inspection, no advance notice will be given and the investigating officers can use reasonable force to enter the premises, if necessary. They can, for example, use equipment to force locks. They may make an active search for documents, seize documents, require explanations of documents and require electronic information to be put into a format whereby it can be taken away by inspectors. However, where the premises are unoccupied, investigating officers have a duty to take reasonable steps to inform the occupier of the intended entry. Where this has not been possible, they must leave a copy of the warrant in a prominent place and leave the premises as effectively secured as when they entered them.

Investigations of domestic premises

The OFT may also enter domestic premises to carry out investigations. This power is only available to the OFT where it has first obtained a judicial warrant. Domestic premises are premises used as a dwelling and also used in connection with the affairs of a business or where documents relating to the business are kept.

A warrant for an investigation of domestic premises will be granted where there is a reasonable suspicion that there are on the premises relevant documents which have not been produced on request, or which would be tampered with or concealed if they were requested.

OFT inspects under Article 81 or 82 not on its own behalf

Where the OFT inspects under Article 81 or 82 on behalf of the European Commission or an NCA and where it assists European Commission inspectors in their Article 81 or 82 investigations, the OFT has the same powers as European Commission inspectors (see "Investigations by the European Commission" for more details on powers of European Commission inspectors). This gives the OFT an extra power in these cases to ask for facts regarding the subject matter or purpose of the investigation. This power to ask for

facts is not available where the OFT investigates under Article 81 or 82 on its own initiative or where it investigates under the Chapter I or Chapter II prohibition.

Your rights when inspectors arrive

Inspections will generally be carried out during office hours. When investigating officers arrive at the premises, businesses should ask to see:

- their identification
- a document setting out the scope of their investigatory powers and the subject of the investigation, and
- where there is a warrant for the inspection, a copy of the warrant specifying the named officer in charge of the investigation

Occupiers are entitled to contact their legal adviser, who may also attend the inspection. Investigating officers should agree to wait a short time for the lawyer to arrive, provided they consider it reasonable to do so and this would not impede the investigation. The OFT follows the European Commission's practice (so the delay would probably not exceed 30 minutes). In the meantime, the investigating officers may take such measures as they feel necessary to ensure that other parties are not warned of the investigation, or that evidence is not removed or tampered with. This could include the suspension of external e-mail, sealing filing cabinets, waiting in selected offices and the sealing of premises and documentation. No delay will be permitted where advance warning was given of the investigation, or there is an in-house legal adviser on the premises.

What happens in an inspection?

Investigating officers can bring with them any equipment they consider necessary for the inspection. This may include tape recorders and laptops. During the inspection, they can require any person on the premises to produce any document which they consider to be relevant to the investigation. They can also ask for explanations of the material. Where a document cannot be produced, the officers can demand to be told where it is. In addition, investigating officers can take copies or extracts from documents, and where information is held on computer, they can require it to be provided in a readable form in which it can be taken away. This applies not only to computers on the premises themselves, but also to information held on any computer accessible from the premises. In addition, investigating officers may take any measures they believe are necessary to preserve documents e.g. sealing offices for up to 72 hours.

Where there is a warrant for the inspection, investigating officers can actually search the premises and take possession of any relevant document where they consider this necessary to protect the material or prevent tampering or where they are not able immediately to decide whether a document is relevant to the investigation.

Documents outside the scope of inspection

There is some protection for business against these powers. Whether the OFT is investigating possible infringements of the Chapter I or Chapter II prohibitions or possible infringements of Article 81 or 82, no matter whether on its own initiative or on behalf of the European Commission or another NCA, it cannot require the production of documents which would be protected from disclosure in the UK courts on the grounds of legal professional privilege. This applies to communications between a professional legal adviser and his client, and to documents made in connection with or in contemplation of legal proceedings, for the purpose of those proceedings.

It is important therefore for companies to identify which documents can be protected from inspection. The scope of legal professional privilege is wider for these purposes than the equivalent protection under investigations carried out by the European Commission on its own behalf. It will cover not only advice from external lawyers in private practice, but also communications with in-house legal advisers.

There is also a defence against self-incrimination. The OFT cannot therefore compel anyone to provide answers which could contain the admission of an infringement which it is the OFT's duty to prove.

As far as confidential information is concerned, while this must be produced to the OFT, there are limits on the extent to which the OFT can publish or disclose the material. It is up to the OFT to determine whether information is in fact confidential in any given case, but, generally speaking, confidential information cannot be disclosed without the consent of the individual or business to which it relates. There are various exceptions to this, including where disclosure of the information is necessary to enable the OFT to fulfil one of its functions under the CA or the Enterprise Act 2002.

Co-operation with inspections

The CA provides that a warrant to enter and search premises may be obtained where a European Commission or OFT investigation has been or is likely to be obstructed. Criminal sanctions are available against individuals who intentionally obstruct the OFT in its exercise of its powers to investigate under Article 81 or 82 (whether on its own initiative, or on behalf of the European Commission or a NCA) or the Chapter I or Chapter II prohibition.

Refusal to co-operate with the terms of a UK warrant or authorisation is a criminal offence. Sanctions may be imposed on individuals, as well as on corporate undertakings, who intentionally obstruct the exercise of these new investigatory powers. Generally, the applicable penalty will be a fine. But some offences carry the possibility of imprisonment. These include intentionally obstructing an officer carrying out an inspection under a warrant, or intentionally or recklessly supplying false or misleading information or concealing relevant documents.

What type of inspection is it?

It is important to ascertain what sort of authorisation the inspectors have, because their powers vary accordingly. Without a warrant, investigating officers can enter premises, call for the production of documents, require explanations from individuals, require electronic information to be put into a form where it can be taken away and seal premises for up to 72 hours subject to limited exceptions. Only a warrant conveys the power actively to search premises, or if necessary to force entry and to seize documents and decide later whether they are relevant.

What should business do?

The powers of investigation contained in the CA for Article 81, 82, the Chapter I prohibition and the Chapter II prohibition are wide-reaching, and enable the OFT to take an active lead in their enforcement. Companies should ensure they have procedures in place to deal with a dawn raid, should investigating officers turn up unannounced, and brief all relevant personnel accordingly. The CMS Cameron McKenna Dawn Raid Response Pack provides further information and guidance on what to do in such situations.

Investigations by the OFT regarding the cartel offence

Under the Enterprise Act (EA) in force since 20 June 2003, it is a criminal offence for individuals to dishonestly agree to fix prices, limit/prevent supply or production or be involved in bid-rigging. This offence is known as the cartel offence. The cartel offence is enforced by the OFT (the Serious Fraud Office (SFO) may become involved in certain aspects) which has wide powers to investigate by notice in writing or by entering and searching premises, using force where necessary, under the authority of a warrant.

Grounds for an investigation

The OFT can conduct an investigation where there are "reasonable grounds for suspecting" that a cartel offence has been committed and it may exercise its powers of investigation where it has "good reason to exercise them for the purposes of investigating the affairs…of any person".

What powers does the OFT have?

The EA gives the OFT three main powers:

- to require the production of relevant information – the power to require the production of specified documents/information or to answer questions
- to inspect premises - the power to enter premises and search and seize documentation with a judicial warrant
- to carry out intrusive surveillance – the power, with authorisation, to conduct surveillance of an individual suspected of participating in a cartel for the purposes of preventing or detecting a cartel offence

The OFT may carry out these powers using its own officers or delegate certain of them to other "competent persons".

Requirement to provide information

The OFT has the power to require, by notice in writing, production of relevant documentation or information (in any form) at a specified place and either at a specified time or on-the-spot. Such requests must indicate the subject matter of the investigation and the further criminal offences which may be committed for failing to comply (see "penalties for non-compliance" below).

The OFT may take copies of any documents or require explanations of them from any person producing them. In the event that documents are not produced, the OFT may require the person required to produce them to state to the best of his knowledge where they are.

Investigation of premises

The OFT may, with a judicial warrant, enter premises using such force as it considers necessary where it is satisfied that there are reasonable grounds for believing that there are relevant documents on the premises and:

- a person has failed to comply with the requirement to produce documents; or
- it is not practicable to require the production of information; or
- to do so might seriously prejudice the investigation.

Having entered the premises, the OFT may search them and seize relevant documents or take necessary steps to preserve them. The OFT may also require a person to provide an explanation of a relevant document or to explain to the best of his knowledge its whereabouts and may require electronically stored information to be produced in a form which can be taken away and which is visible and legible or from which it can readily be produced in a visible and legible form (namely a print out or a disk).

A person may be guilty of additional criminal offences for failing to comply (see "penalties for non-compliance" below).

Your rights when inspectors arrive

You should ask to see:

- the visitors' identification
- a document setting out the scope of their investigatory powers and the subject of the investigation, and
- a copy of the warrant specifying the named officer in charge of the investigation, without which you are not required to comply with any of the above requirements

Documents outside the scope of inspection

There is some protection for individuals against these new powers. The OFT cannot require the production of documents which would be protected from disclosure in the courts on the grounds of legal professional privilege. This privilege works in the same way as described above under the CA.

A person may not be required to disclose any information/documentation in respect of which he owes an obligation of confidence by virtue of carrying on any banking business unless the person to whom he owes the obligation of confidence consents or the OFT has authorised the requirement for him to produce it.

There would appear to be only a limited defence against self-incrimination under the cartel offence since:

- a statement provided by any person during investigation of a cartel offence may be used in evidence against him on a prosecution of the offence of making false or misleading statements;
- it may also be used in connection with another offence where in giving evidence another statement is made inconsistent with that made in connection with the cartel offence; and
- a statement made by anyone during a CA investigation may be used in evidence against him on a prosecution of the cartel offence if when giving evidence in relation to the latter he makes a statement inconsistent with one made in connection with the CA investigation and evidence relating to that statement is adduced, or a question relating to it is asked, by him or on his behalf.

Although confidential information must be produced to the OFT during investigation of the cartel offence, the OFT may not disclose (except with consent) information whose disclosure it considers is contrary to the public interest or which relates to the private affairs of individuals and disclosure of which would significantly harm the individual's interests. Any disclosure the OFT deems necessary must also take into account the purpose for which the OFT is permitted to make the disclosure.

The OFT may disclose confidential information to the European Commission if this is required to fulfil an EU obligation and to any overseas public authority (including the European Commission but also other national regulators) to facilitate any investigation or civil proceedings or any criminal investigation.

Penalties for non-compliance

Failure to comply with the OFT's powers of investigation under the cartel offence may result in the following further offences which are punishable by a term of imprisonment, a fine or both:

- failure without reasonable excuse to comply with a requirement to produce information
- recklessly or knowingly making false or misleading statements
- knowing or suspecting that an investigation is likely to be carried out by the Serious Fraud Office or the OFT, to falsify, conceal, destroy, or otherwise dispose of (or allows the same) documents relevant to the investigation, and
- intentional obstruction of the OFT in exercise of its powers to investigate the cartel offence.

1 January 2007

Summary of EU and UK powers to fine and imprison

Investigation by European Commission

Infringement	Penalty
Refusal to reply to a "simple" request for information	No penalty but possibly unwise action
Failing to provide an adequate response to a formal request for information made by European Commission decision	Fixed fine up to 1% of total turnover in the preceding business year; periodic fine up to 5% of daily turnover until remedied
Refusal to submit to voluntary inspection under European Commission authorisation	No penalty. Mandatory inspection likely to follow
Refusal to submit to mandatory inspection under European Commission decision	Fixed fine up to 1% of total turnover in the preceding business year, periodic fine up to 5% of daily turnover until submit to inspection
Intentionally or negligently producing incomplete or misleading information	Fixed fine up to 1% of total turnover in the preceding business year
Non-compliance by firms where warrant held by UK inspectors accompanying European Commission (a UK power)	Fines and/or imprisonment

Investigation by OFT on own behalf of Article 81, 82, Chapter I or Chapter II prohibition or on behalf of another NCA

Offence	Sanction on summary conviction	Sanction on conviction on indictment
Failure to comply with a requirement imposed under the investigation powers	Fine up to the statutory maximum (currently £5000)	Unlimited fine
Intentionally obstruct an officer carrying out an on-the-spot investigation without a warrant	Fine up to the statutory maximum	Unlimited fine
Intentionally obstruct an officer carrying out an on-the-spot investigation with a warrant	Fine up to the statutory maximum	Unlimited fine and/or up to two years' imprisonment
Intentionally or recklessly destroy, dispose of, falsify or conceal document the production of which has been required or cause or permits its destruction etc.	Fine up to the statutory maximum	Unlimited fine and/or up to two years' imprisonment
Knowingly or recklessly provide information that is false or misleading in a material particular	Fine up to the statutory maximum	Unlimited fine and/or up to two years' imprisonment

Source: OFT's Guideline on Powers of Investigation

Investigation by OFT of business premises on behalf of European Commission; European Commission inspects business or domestic premises with OFT assistance

Offence	Sanction on summary conviction	Sanction on conviction on indictment
Intentionally obstruct an officer exercising powers under a warrant issued in connection with Article 81 or 82 investigation requested or ordered by European Commission	Fine up to statutory maximum	Unlimited fine and/or up to two years' imprisonment

Investigation into the cartel offence

Offence	Sanction on summary conviction	Sanction on conviction on indictment
Failure without reasonable excuse to comply with a requirement to produce information	Imprisonment up to 6 months or a fine up to level 5 on the standard scale or both	N/A
Recklessly or knowingly making false or misleading statements	Imprisonment up to 6 months, or a fine not exceeding the statutory maximum (currently £5,000), or both	Imprisonment up to 2 years, or an unlimited fine, or both
Knowing or suspecting that an investigation in relation to the cartel offence is likely to be carried out by the Serious Fraud Office or the OFT, falsifies, conceals, destroys, or otherwise disposes of (or allows the same) documents relevant to the investigation	Imprisonment up to 6 months or a fine up to the statutory maximum, or both	Imprisonment up to 5 years, or an unlimited fine, or both
Intentional obstruction of the OFT carrying out an on-the-spot investigation	A fine not exceeding the statutory maximum	Imprisonment up to 2 years, or an unlimited fine, or both

Main powers of competition law inspectors

	A81/82 investigation by EU inspectors		A81/82 investigation by EU inspectors with OFT inspectors' assistance		A81/82 investigation by OFT inspectors on behalf of EU		A81/82 investigation by OFT inspectors on behalf of other National Competition Authority (NCA)		A81/82 investigation by OFT inspectors on OFT behalf (possible to have EU inspectorsí assistance)		Chapter I/II investigation by OFT inspectors	
	AUTH	DECISION	AUTH	DECISION	AUTH	DECISION	AUTH	WARRANT	AUTH	WARRANT	AUTH	WARRANT
Grounds for investigation	Necessary to ascertain breach of A81/82	Necessary to ascertain breach of A81/82	Necessary to ascertain breach of A81/82	Necessary to ascertain breach of A81/82	Necessary to ascertain breach of A81/82	Necessary to ascertain breach of A81/82	Reasonable grounds to suspect breach A81/82	Reasonable grounds to suspect breach A81/82	Reasonable grounds to suspect breach A81/82	Reasonable grounds to suspect breach A81/82	Reasonable grounds to suspect breach Ch I/Ch II	Reasonable grounds to suspect breach Ch I/Ch II
Wait for company lawyer?	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour especially if in-house lawyer present	Unlikely wait over one hour. Will not wait if in-house lawyer present	Unlikely wait over one hour. Will not wait if in-house lawyer present	Unlikely wait over one hour. Will not wait if in-house lawyer present	Unlikely wait over one hour. Will not wait if in-house lawyer present
Enter business premises?	✓	✓	✓	✓	✓	✓	✓	✓	✓Written notice required in certain circumstances	✓	✓Written notice required in certain circumstances	✓
Enter domestic premises?	X	Only if have UK warrant	X	Only if have UK warrant	X	Only if have UK warrant	X	✓	X	✓	X	✓
Use force to enter?	X	X	X	Only if have UK warrant	X	Only if have UK warrant	X	✓	X	✓	X	✓
Active search?	X	X	X	Only if have UK warrant	X	Only if have UK warrant	X	✓	X	✓	X	✓
Require produce documents?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Require explanation of documents?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Require electronic info to be put into takeaway format?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Can take other necessary steps? e.g. seal	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Seize & sift?	X	X	X	X	X	X	X	✓	X	✓	X	✓
Take copies?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Legal privilege?	External lawyers' advice only	External lawyers' advice only	External lawyers' advice only	External lawyers' advice only	External & in-house lawyers' advice	External & in-house lawyers' advice	External & in-house lawyers' advice[1]	External & in-house lawyers' advice[1]	External & in-house lawyers' advice	External & in-house lawyers' advice	External & in-house lawyers' advice	External & in-house lawyers' advice
Ask for facts re subject matter/purpose of investigation?	✓	✓	✓	✓	✓	✓	X	X	X	X	X	X
Right to silence?	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but can't compel self-incrimination	No, but canít compel self-incrimination
Duty to comply?	X	✓	X	✓	X	✓	✓	✓	✓	✓	✓	✓
Penalties non-comply/obstruction	No, but likely European Commission will then get decision.[2]	Fines	No, but likely European Commission will then get decision.[2]	Fines	No, but likely European Commission will then get decision.[2]	Fine	Fine	Fine and/or prison	Fine	Fine and/or prison	Fine	Fine and/or prison

1 If OFT receives communications of in-house lawyers from another NCA in whose territory such communications are not privileged, the OFT may use the received documentation in its investigation.

2 No duty to comply with inspectors where they do not have EU decision, but if you nevertheless comply but provide incomplete books or records to inspectors, you can be fined 1% of your total turnover for preceding business year.

CMS Cameron McKenna

What you need to know about dawn raids

Dawn raids - unannounced investigations by competition authorities - get their name from the investigators' habit of turning up at the beginning of the business day, when companies are likely to be least prepared for the unexpected.

The European Commission has for many years had the power to carry out such raids to investigate alleged breaches of EU competition law. European Commission inspectors may be accompanied by Office of Fair Trading (OFT) officials. Indeed, the European Commission may request the OFT to carry out an inspection on its behalf. Where the European Commission requests the OFT to inspect on its behalf, it may nevertheless assist the OFT by sending European Commission officials to accompany the OFT officials carrying out the raid.

The OFT has had similar powers under the Competition Act 1998 together with, where relevant, the sector regulators. These powers of investigation allow their entry and search of premises, using force if necessary, to obtain evidence of unlawful agreements or conduct. Since 1 May 2004, the OFT has had the power to carry out dawn raids relating to possible breaches of EU law on behalf of the European Commission and on behalf of the national competition authorities (NCAs) of EU Member States.

The Enterprise Act 2002 has also conferred further powers on the OFT to investigate the criminal "cartel offence" under judicial warrant. See the section in this Survival Pack entitled "The cartel offence".

Investigations

In addition to carrying out dawn raids, of which businesses receive no warning, the authorities may also make announced investigations where you will be given notice of the time of their visit.

Offences

In the case of an unannounced investigation by the OFT on its own behalf or on behalf of another NCA under a court warrant, it is a criminal offence to fail to comply with any requirement which the investigators are authorised to impose in the course of investigation.

Failure to cooperate with officials investigating possible breaches of EU or UK competition law may result in fines where the officials carry authorisations, but no court warrant. In the case of an investigation by the OFT on its own behalf into possible breaches of EU or UK competition law where the OFT officials have no warrant, it is a criminal offence intentionally to obstruct an investigator in the exercise of his powers of investigation. The same applies when the OFT is investigating a possible breach of EU competition law on behalf of another NCA.

Obstruction and failure to comply with properly authorised requirements always carry the risk of fines. Criminal offences may result either in fines or imprisonment (or both).

Failure to comply with the OFT's powers of investigation of the cartel offence under the Enterprise Act 2002 carries further criminal penalties punishable by up to 5 years' imprisonment and/or unlimited fines depending on the offence (see the section in this Survival Pack entitled "Competition authorities' powers of investigation").

What type of inspection is it?

On arrival, the inspectors should produce a document setting out the type of inspection they are to carry out, the legal basis, the subject matter and the purpose of the investigation, and the nature of the offence or penalties applicable in the event of non-compliance.

European Commission inspectors will be armed with either an "authorisation" or a "decision". For inspectors from the OFT investigating possible breaches of EU or UK competition law, an inspection will be made under written authorisation of the OFT, with or without the additional powers of a warrant issued by the UK courts. Inspections under the Enterprise Act 2002 will be made with a judicial warrant only.

It is important to ascertain:

- whether an inspection is being carried out for the purposes of the EU competition rules, the UK competition rules, or the Enterprise Act 2002;
- on whose behalf the investigation is being carried out; and
- whether the officials possess a UK authorisation, an EU authorisation or an EU decision (and in each case whether they also have a UK court warrant or alternatively, a court warrant only)

as the powers of the officials vary accordingly.

The differences between the main powers of European Commission officials and of OFT officials carrying out inspections for the purposes of the EU competition rules, the UK competition rules and the Enterprise Act 2002 are set out in a comparative table (see the back of the section on "Competition authorities' powers of investigation") in this Survival Pack).

What should I do if my business is the subject of an investigation?

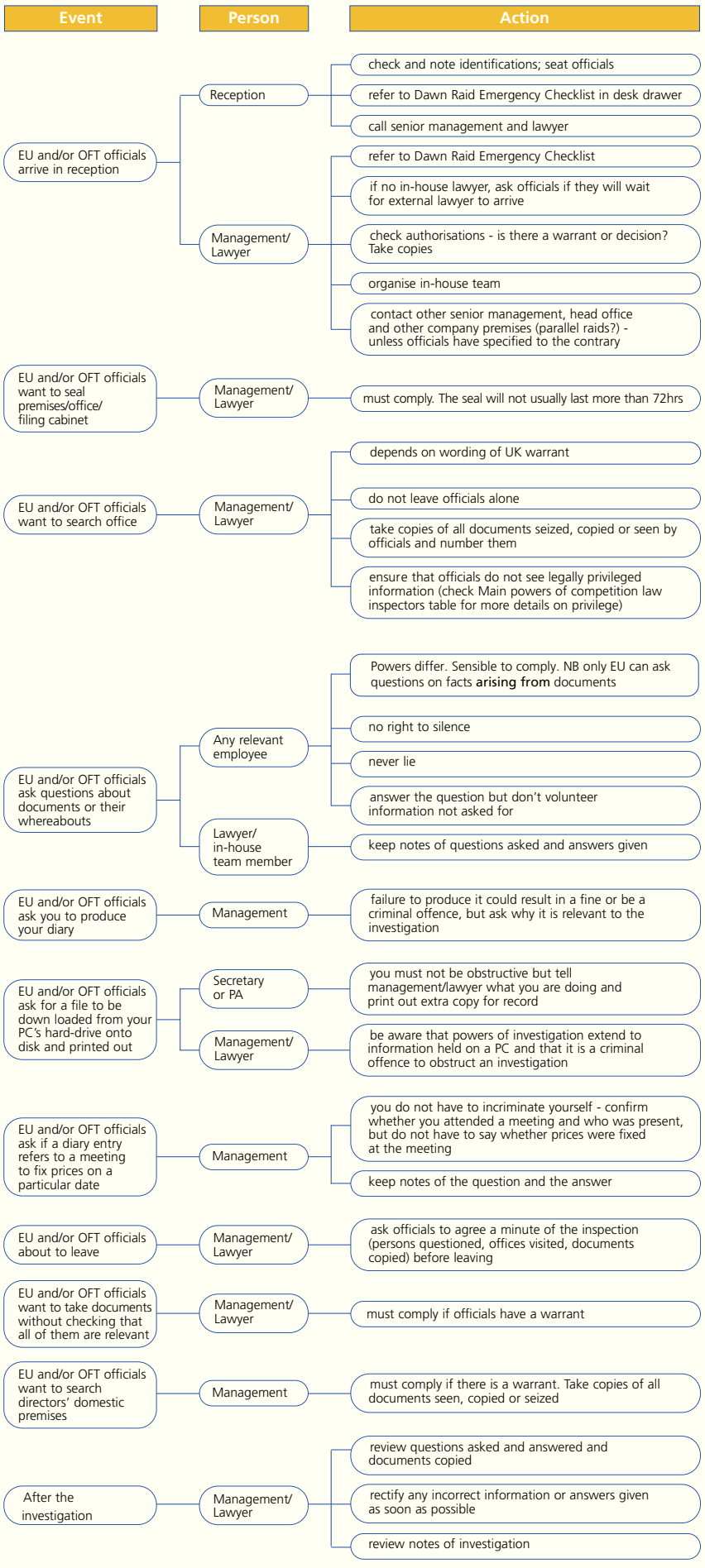
Being prepared is key. Ideally, your firm will already have in place a response plan to deal with the surprise circumstances of a dawn raid, so that if you are the subject of an investigation, the responsibilities of the members of your firm – from the receptionist to senior management – will already be clearly set out.

There are detailed provisions in UK and EU law, and in procedural rules and guidelines, setting out what the competition regulators and inspectors may do in the course of an investigation. Criminal sanctions can apply if the investigators are obstructed or if their requirements are not complied with. Having a dawn raid response plan in place ensures that relevant people within the organisation know what to do, thus minimising the risk of an unwitting breach of the rules.

If your business is the subject of an investigation by the competition authorities, immediate help is available by calling CMS Cameron McKenna's Dawn Raid Hotline number +44 20 7367 3499.

1 January 2007

Dealing with a Competition Dawn Raid



This is only a general guide - seek advice in particular cases

Dealing with the authorities

When is your business likely to deal with the competition authorities, and which is the relevant authority in each case? This section outlines the main events involving the competition authorities and explains whether the European Commission, the Office of Fair Trading or the UK Competition Commission will be the interested body.

The authority most often encountered in EU competition law issues is the Competition Directorate General of the European Commission.

The authorities relevant to UK competition law issues are the Office of Fair Trading (OFT) and the sector regulators exercising concurrent powers. The OFT and the sector regulators enforce the Chapter I prohibition, the Chapter II prohibition, Article 81 and Article 82 and the provisions of the Enterprise Act 2002. In this section, the term "OFT" means the OFT and/or sector regulators, as appropriate.

The chart at the end of this section summarises the main events and, for each of those, the relevant authorities, the legislation and the formalities involved. It also contains references to other sections of this Survival Pack which treat particular topics in more detail.

This section also includes two organigrammes showing the main divisions of the Office of Fair Trading and the European Commission's Competition Directorate General.

Mergers, acquisitions and joint ventures

Whether a business needs to notify a merger, acquisition or joint venture to one or more competition authorities depends on the structure, size and scope of the transaction.

A very large scale merger or acquisition where the turnover of the parties exceeds the turnover thresholds in the EC Merger Regulation (ECMR) must be notified to the European Commission. A transaction caught by these rules will be one which is "a concentration having a Community dimension". The deal must not be completed until the European Commission has decided whether to allow it to proceed, with or without imposing conditions. The European Commission can also prohibit the deal altogether.

Large scale "full function" joint ventures where the ECMR thresholds are exceeded are subject to the same rules. A typical full function joint venture would be where XCo and YCo pool their miniwidget divisions into a new JVCo which they jointly control. XCo and YCo transfer all their relevant technology and know-how into the joint venture, and set it up so as to be a fully functional, self standing entity, with its own staff and other resources so that it operates on a market separate from that of its parents.

Joint ventures which are looser in structure, and may, for example, be established for joint marketing or joint purchasing or research and development activities, are unlikely to be covered by the ECMR, but may be caught by Article 81 or by the Chapter I or Chapter II prohibition or by other domestic competition law in other jurisdictions.

A merger or acquisition which is too small to be covered by the ECMR may nonetheless be caught by domestic law. This may be in one or more jurisdictions.

In the UK, the OFT is empowered under the Enterprise Act 2002 to look into any transaction where two or more enterprises "cease to be distinct" and where either the turnover of the business taken over exceeds £70 million or the transaction has the effect of creating or enhancing a 25% market share. In contrast to the ECMR, there is no obligation in the UK to make a notification where a transaction is caught by these criteria. Parties therefore tend to notify if they foresee competition issues arising and wish to obtain the security of merger clearance. The clearance decision is provided by the OFT except that the Secretary of State for Trade and Industry may intervene in certain public interest (e.g. involving defence) cases. Transactions which may cause real competition difficulties may be referred by the OFT (or exceptionally the Secretary of State) for a full investigation to the Competition Commission, which is charged with assessing whether the transaction may be expected to result in a substantial lessening of competition. Parties which do not notify their deal run the risk of the transaction being referred to the Competition Commission in the 4 months following completion or the deal becoming public knowledge, whichever is the later. See the sections in this Survival Pack entitled "EU merger control and merger checklist" and "National merger control in the UK and other countries and UK merger checklist" for more information on merger and joint venture clearances.

Market investigations

The Enterprise Act 2002 allows the authorities to investigate markets where they believe competition may have been adversely affected, but where there has been no obvious infringement of the mainstream UK or EU competition rules. The anti-competitive effect may come from the overriding structure of a market or from the conduct of the participants on the market, such as the parties supplying goods or services on the market or from their customers. For instance, a market may predominantly consist of a few similar-sized firms which follow comparable or parallel forms of conduct, such as the use of similar distribution facilities or pricing policies, without any form of conscious agreement or concerted practice. In such circumstances, competition may become less rigorous, smaller existing firms may find it hard to compete, or new firms may be deterred from entering the market.

Market investigations are conducted by the Competition Commission, on reference from the OFT following a preliminary and less formal OFT investigation. The Competition Commission has a maximum of two years to make a report and to specify remedies to any adverse effects identified. Such remedies do not include fines. In exceptional public interest cases, the Secretary of State for Trade and Industry may make a reference or, during an investigation following reference by the OFT, serve an intervention notice. In such cases, it is for the Secretary of State to determine the final remedies.

The market investigation regime under the Enterprise Act 2002 replaced the old and similar monopoly investigation regime under the Fair Trading Act 1973.

Agreements which have an appreciable effect on UK or EU trade and competition

The OFT has always had responsibility for the implementation of the Chapter I prohibition and Chapter II prohibition of the Competition Act 1998. The Chapter I prohibition catches arrangements which may affect trade within the UK or a part of it and which have as their object or effect the prevention, restriction or distortion of competition within the UK. The Chapter II prohibition catches abuse of dominance which may affect trade in the UK or a part of it.

Since 1 May 2004, the OFT has also had responsibility for the implementation in the UK of Article 81 (prohibition of restrictive agreements with EU effects) and Article 82 (prohibition of abuse of dominance with EU effects).

The old exemption system whereby the European Commission granted exemption from the prohibition of anti-competitive agreements was abolished from 1 May 2004. Similarly, the UK abolished from 1 May 2004 its notification system in relation to the Chapter I and Chapter II prohibition. However, the European Commission has indicated that it will publish written guidance in particular cases which present novel or unresolved questions regarding the application of the law. Where a particular case gives rise to genuine uncertainty because it presents novel or unresolved questions regarding the application of the law, the OFT may publish guidance in the form of a written opinion. These opinions are not binding on the courts, the OFT or the European Commission, but they may be persuasive. This system results in a decentralisation of competition law enforcement. The European Commission is focusing on the investigation of serious cartel-like activity and of serious abuses of a dominant position. It is no longer the first port of call for simple, everyday compliance checks, so the OFT, in enforcing both UK and EU competition law, is now the front-line authority for UK business.

The OFT's Competition Enforcement Division is organised into five parts, each able to call on specialist legal and economics advice. The parts are:

- services
- goods
- infrastructure
- mergers
- cartels

as set out in the organigramme.

The OFT's powers under the Competition Act 1998 may also be exercised concurrently by the sector regulators in electricity and gas, water, rail, air traffic services and telecoms. All regulators may:

- give informal guidance on the application of the Chapter I prohibition, the Chapter II prohibition, Article 81 and Article 82
- consider complaints
- impose interim measures to prevent serious and irreparable damage
- carry out investigations
- impose fines
- give and enforce directions to end infringements
- issue general advice
- publish formal written guidance on the application of the Chapter I or Chapter II prohibition, or Article 81 or Article 82.

In addition, the sector regulators are able to make market investigation references under the Enterprise Act 2002.

Businesses under investigation or seeking informal guidance or a formal opinion may therefore need to deal with the relevant sector regulator.

Activities involving abuse of market power

Businesses which abuse their market power in the UK may fall foul of the prohibitions on abuse of a dominant position (Chapter II of the Competition Act 1998 or Article 82 EC Treaty). They may therefore expect to be investigated by the OFT, a sector regulator, by the European Commission or by a national competition authority (NCA) of another EU Member State. Conduct which is found to breach these prohibitions is not exemptible.

Making a complaint

Competition law should not be considered as solely a constraint on commercial enterprise, but also as a tool in asserting business rights. Of course the competition rules create obligations on business, but they impose those obligations equally on all commerce. So a business which finds itself in difficulties because of the anti-competitive conduct of others can ask the OFT, another NCA or the European Commission for help. It can complain.

Complaints to the European Commission can be made formally or informally. Formal complaints may only be made by those undertakings which have a "legitimate interest". Formal complaints must be made on Form C, which requires information about the complainant and the entity whose conduct is the subject of the complaint, as well as details of the alleged breach of competition law, the finding sought from the European Commission and the grounds on which the complainant asserts a legitimate interest in making the complaint. Informal complaints to the European Commission do not require the complainant to have a "legitimate interest" or to use Form C. However, the informal complainant has less opportunity to participate in the European Commission's investigation.

When making a complaint to the OFT no forms need to be filled in but for the complaint to be taken seriously by the OFT, the business needs to produce some detail and evidence about how its interests have been damaged. Where possible it should also provide relevant information about the market on which the alleged infringement is taking place. Officials are usually willing to discuss the situation before any formal complaint is made and to indicate what information they will need to be able to take the complaint forward.

The authorities are bound to consider complaints made to them in order to decide whether they reveal possible infringements of competition law which should be pursued.

Businesses which complain may be doing so as a last resort, having warned the allegedly offending parties that this is what they will do. Others are concerned about confidentiality. The European Commission must respect the confidentiality of informants and of the information and documentation they provide. The OFT recognises the importance of confidentiality and, as a general rule, will not disclose information without the consent of the complainant. But there are exceptions, including when disclosure is necessary to facilitate the performance of the authority's duties. So businesses making a complaint should make very clear to the relevant authority the extent of the confidentiality they seek, and should ensure that any confidential documentation is kept separate and clearly marked as such.

Whistle blowing

A business itself involved in a cartel may decide that the time has come to blow the whistle. Both UK and EU authorities recognise this phenomenon and make provision for it. A reduction in fines - or even an exemption from fines - may be available where undertakings cooperate in the uncovering of secret cartels aimed at fixing prices, production or sales quotas, sharing markets or banning imports or exports.

In addition, the OFT may in certain circumstances issue "no-action" letters in relation to the cartel offence. These letters indicate that the OFT intends to take no action to prosecute a named individual under the cartel offence. No action letters may only be granted where the individual meets certain criteria.

Investigations

All of the European Commission, the OFT and other NCAs have the ability to investigate suspected infringements of competition law.

Details of the authorities' respective powers are set out in two sections of this Survival Pack - "Competition authorities' powers of investigation" and "Dealing with a Dawn Raid". There are three main types of investigation:

- requests for information: formal and informal
- inspection of premises on notice
- inspection of premises without warning - "dawn raids".

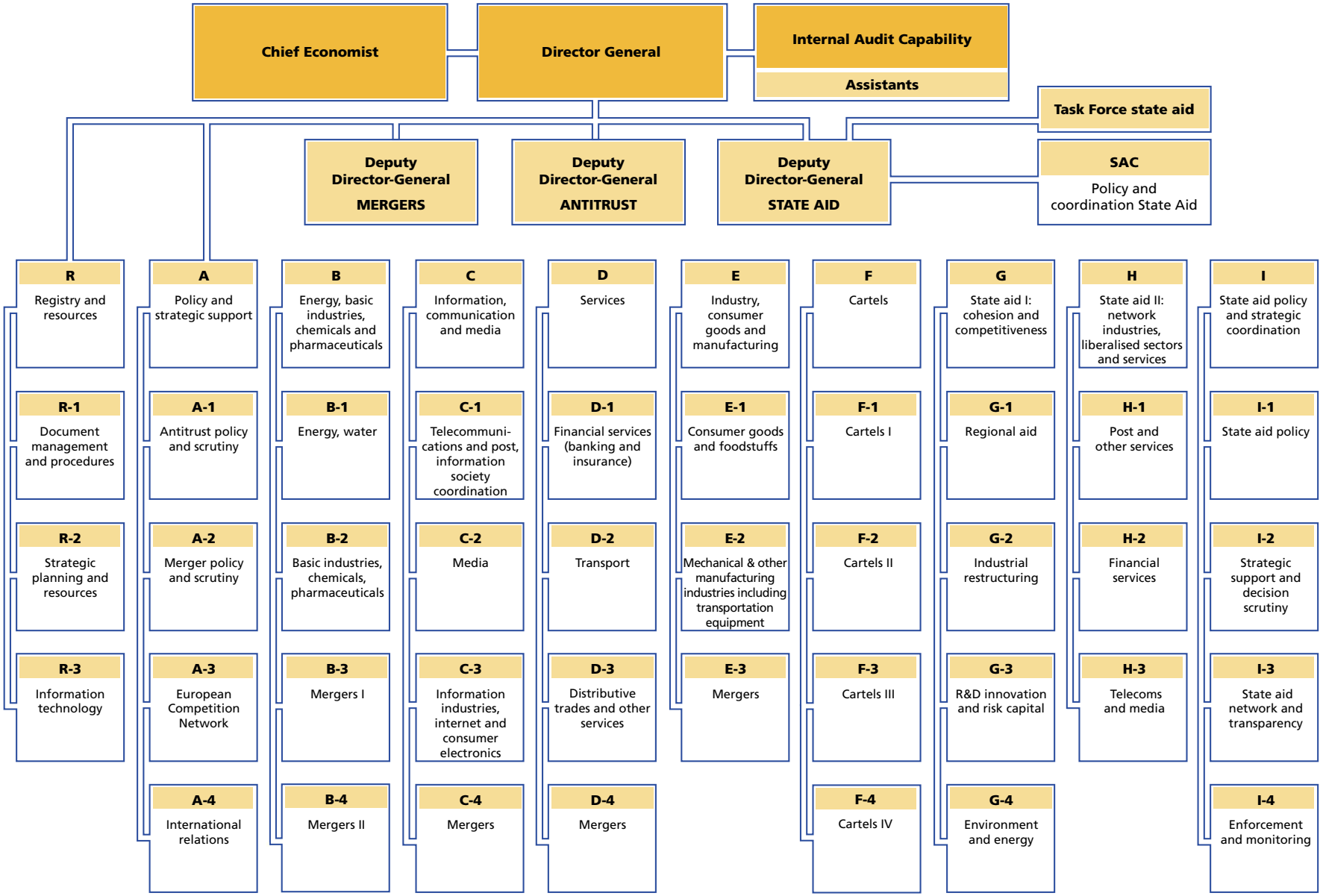
Every investigation should relate to specific matters. The powers of the inspectors vary according to what sort of authorisation they carry. Inspectors will wait a short time for legal advisers to arrive, but businesses should keep a plan of action to hand so that they know what powers their unwelcome visitors may have, and what are their own rights.

What event, which authority, what legislation?

Event	Authority	Legislation	Formalities	Competition Survival Pack
Large scale merger / acquisition / full function joint venture "a concentration having a Community dimension"	European Commission	EC Merger Regulation No. 139/2004	Obligatory waiting period	EU merger control and checklist
UK merger / acquisition of target with turnover over £70m or creating / enhancing 25% market share	Office of Fair Trading Competition Commission	Enterprise Act 2002	Voluntary notification (fees payable) to Office of Fair Trading (with possible reference to Competition Commission)	National merger control and UK checklist
Informal guidance / formal opinion on agreements affecting trade in the UK and in the EU	Office of Fair Trading and/or Sector Regulator	Competition Act 1998	Formal notification abolished. Request for guidance may be in any format. Opinion only if novel, unresolved questions involved	Dealing with the authorities
Making a complaint against a competitor / supplier/ purchaser participating in an anti-competitive arrangement or acting in abuse of a dominant position and which is damaging your business	European Commission, Office of Fair Trading, other NCA and / or Sector Regulator	Article 81, Article 82 EC Treaty, Chapter I prohibition, Chapter II prohibition of Competition Act 1998	Complaints to European Commission on Form C or in-formally. Complaints to OFT, other NCA, sector regulator. May be formal or informal, written or oral	Dealing with the authorities
Investigation - information request - inspection on notice - dawn raid	European Commission (appeals to Court of First Instance, then to European Court of Justice) Office of Fair Trading / Sector Regulator other NCA (appeals depend on national system)	Article 81, Article 82 EC Treaty, Chapter I prohibition, Chapter II prohibition of Competition Act 1998	Numerous - depends on type of investigation	Competition authorities' powers of investigation. What you need to know about dawn raids.

CMS Cameron McKenna

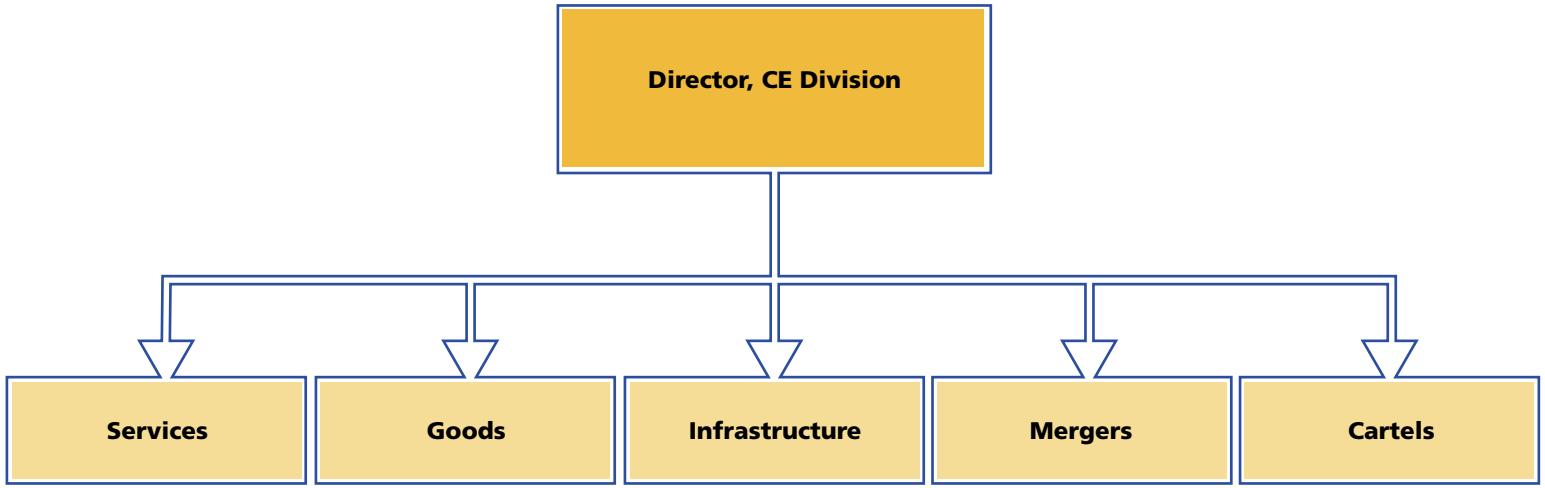
European Commission Directorate General for Competition



Source: DG Competition web-site, 16 February 2007

CMS Cameron McKenna

Office of Fair Trading Competition Enforcement division



Source: OFT

CMS Cameron McKenna

Concurrent powers of regulators in the UK

UK competition law and the concurrent jurisdiction of the OFT with sector regulators

Since 1 May 2004, Council Regulation (EC) 1/2003 (the Regulation) has given the Office of Fair Trading (OFT) extensive powers to investigate and to enforce not only the Chapter I and Chapter II prohibitions of UK competition law, but also Article 81 and 82 prohibitions of EU competition law. The Competition Act 1998 (CA) has been amended accordingly. Under the Enterprise Act 2002 (EA) the OFT has powers to investigate monopolies and carry out market investigations. Significantly, the OFT shares its powers in relation to the Chapter I and Chapter II prohibitions and its EA powers with sector regulators when the subject matter at issue relates to commercial activities in that regulator's sector.

Under the new enforcement system introduced by the Regulation, sector regulators are designated as "national competition authorities" (NCAs) with the power to apply Article 81 and 82 EC Treaty. To resolve potential institutional conflict caused by concurrency, matters relating to the Chapter I or Chapter II prohibition which fall within the regulator's sector should be handled by the regulator and not by the OFT. For matters regarding Article 81 or 82, similar considerations apply, but also, it is possible that another NCA in a different EU Member State may take over the case. See below "which of the OFT, the sector regulators or other NCAs will act?"

Which sector regulators have concurrent jurisdiction?

The sector regulators with concurrent jurisdiction are:

- the Office of Communications[1]
- the Gas and Electricity Markets Authority
- the Director General of Electricity Supply for Northern Ireland[2]
- the Director General of Gas for Northern Ireland[2]
- the Water Services Regulation Authority
- the Office of Rail Regulation
- the Civil Aviation Authority.[3]

When will sector regulators have concurrent powers?

The CA allows sector regulators to exercise powers concurrently with the OFT when agreements or conduct "relate to" commercial activities in that particular regulated sector. Additionally, a number of sectoral regulators have concurrent powers under Part 4 of the EA to make market investigation references in respect of markets which fall within their areas of responsibility. For example, the Gas and Electricity Markets Authority will have jurisdiction over agreements or conduct "which relate to commercial activities connected with the generation, transmission or supply of electricity". Generally, it should be relatively easy for sector regulators to establish jurisdiction, yet it is possible to envisage situations in which more than one sector regulator will have jurisdiction, e.g. an agreement to supply electricity to a railway network.

1 The Office of Communications was established by the Office of Communication Act 2002. It replaced OFTEL, the Radio Authority, the Radiocommunications Agency, the Broadcasting Standards Commission and the Independent Television Commission.

2 These appointments are held by the same person and the functions handled by one office (OFREG).

3 Since 1 February 2001, under the Transport Act 2000.

However, only the OFT has power to issue guidance on penalties and commitments and to make and amend the OFT's Rules which set out the procedures to be followed under the CA when applying Article 81, Article 82, the Chapter I prohibition or the Chapter II prohibition.

Regulators' sectoral duties

The general duties of regulators are contained in the statutes applicable to each sector. In general, regulators must ensure that there is sufficient provision of service throughout the UK, promote competition and protect the interests of customers and consumers.

Regulators may be faced with a choice of whether to apply sector-specific legislation, Article 81, 82 or the Chapter I or Chapter II prohibition to a particular situation. A regulator's duty to take licence enforcement action does not apply when he is satisfied that, in a particular case, it is more appropriate to take action in relation to the Chapter I prohibition, the Chapter II prohibition, Article 81 or Article 82. When applying the provisions of Article 81, Article 82, the Chapter I or the Chapter II prohibition, regulators should not have regard to their sectoral duties except where the OFT may do so in exercising its powers under the CA in relation to UK or EU competition law.

In practice, the line between enforcement under sector-specific legislation and under the CA in relation to UK or EU competition law will be an uncertain one. For example, discriminatory pricing issues could be dealt with under sector-specific legislation or competition law yet the regulator's investigative and enforcement powers are much more powerful under the CA than its sector specific powers.

Why do sector regulators have concurrent jurisdiction?

Following restructuring and privatisation of many utilities in the UK, sector regulation has been a key feature in ensuring that the new competitive regime resulted in benefits for the consumer. Through the use of licensing regimes, the regulators are able to influence and review the behaviour of companies within their ambit.

It has been argued that the aims of sector regulation are similar to those of competition policy as both are intended to provide a competitive regime which ultimately benefits consumers. Accordingly, the powers of the regulators in the competition arena were said to add credibility and effectiveness to the role of regulation. Without competition law powers, the sector regulatory regime would lack teeth. Also, given the diversity of sectors covered, it was thought that the sector regulators had valuable expertise to contribute to particular cases. The Communications Act 2003 extended sectoral powers in relation to competition to radiocommunications and broadcasting.

Potential problems with concurrent jurisdiction

It was argued when the CA came into force that the concurrent powers of regulators under the CA would lead to inconsistent application of competition law in the UK between sectors of industry. Rather than having just one investigatory body, there are nominally eight. Each one has the power to investigate and enforce the provisions within its sector. Similar concerns were voiced about duplication or dissipation of resources.

Second, it was feared that there would be difficulties in determining which regulator should have jurisdiction. If a particular case concerns more than one sector it may be difficult, in the absence of set procedures, to decide which regulator should have authority to act, especially where utility companies are increasingly operating in more than one sector.

In practice, the few publicised investigations by regulators do not appear to have given rise to difficult jurisdictional queries. There is constant formal and informal discussion between the OFT and the offices of the regulators to review practice and policy.

The efficacy of the arrangements for dealing with cases involving EU competition law and notably the allocation of cases where more than one NCA may be interested in pursuing an investigation will continue to be tested over the coming months. It is clear that practice will evolve as the regulators cut their teeth on Articles 81 and 82.

Which of the OFT, the sector regulators or other NCAs will act?

The UK has made regulations dealing with the issue of who should act in particular cases, the Competition Act 1998 (Concurrency) Regulations 2004 (the Concurrency Regulations). They provide some guidance but do not deal with all aspects of the relationship between the OFT and the sector regulators.

The Concurrency Regulations are mainly procedural and provide rules for the determination of jurisdiction disputes and the transfer of jurisdiction between the OFT and the sector regulators. They do not set down guidelines on the principles to be applied when resolving difficulties.

The overriding principle of the Concurrency Regulations is that the OFT and sector regulators must decide between themselves which of them shall have jurisdiction in a case. If the OFT and the sector regulator cannot agree which of them shall have jurisdiction, the matter will be put to the Secretary of State for resolution. There are also procedural safeguards to avoid the risk of double jeopardy, and mechanisms for transferring cases, as well as steps for informing interested parties and for pooling staff resources.

Where a case may involve Article 81 or 82, it is possible that another NCA in another EU Member State may deal with it. The European Commission's "Notice on Cooperation within the network of Competition Authorities" sets out case allocation principles for determining whether a UK authority or an NCA of another EU Member State should act. The main principle of this notice is that cases should be dealt with by the authority which is "best placed to act"

A UK NCA is generally well placed to act in relation to a complaint where:

- the agreement or conduct has substantial, direct, actual or foreseeable effects on competition and is implemented within or originates from within the UK; and

- the UK NCA is capable of bringing effectively to an end the entire infringement; and
- the UK NCA can gather, possibly with the assistance of other authorities, the evidence required to prove the infringement.

A joint working group where the OFT and regulators with concurrent powers are represented (the Concurrency Working Party) meets to consider the practical application of concurrency, to advise on jurisdiction disputes and to discuss general policy. This is intended to enhance consistency in decision making. Information about complaints received and investigations in progress or envisaged is also shared within the Concurrency Working Party where necessary to determine if there is concurrent jurisdiction. This includes information capable of being investigated under sector specific powers.

The OFT has published a guideline on this area "Concurrent application to regulated industries" which gives more details on the Concurrency Working Party and concurrency issues in general.

Concurrency in practice – notifications and complaints

The UK's notification system under the CA was abolished from 1 May 2004 and replaced by a legal exception regime, in order to bring it into line with the EU system. Under the new regime, any agreement which meets certain criteria set out in the CA is automatically valid and enforcable for as long as those criteria remain satisfied. Individual notifications are no longer possible, nor can the OFT or regulators make decisions or give formal guidance on the applicability of the Chapter I or Chapter II prohibition. However informal advice may be given and written opinions published in certain circumstances.

Complaints and applications for urgent interim measures to remedy competition problems should be made to either the OFT or the relevant sector regulator, but not to both. Complainants will be told who is to deal with the case and if this changes, they will be informed of the change. The OFT will send a copy of applications to sector regulators which it considers may have concurrent jurisdiction. It will then inform the applicant which sector regulator will deal with the matter and will also inform the applicant if this changes.

Complaints solely about licence conditions should be sent directly to the applicable sector regulator.

The Enterprise Act 2000 introduced a system of super-complaints whereby certain bodies can bring competition complaints on behalf of consumers. Sector regulators with concurrent powers are under a duty to respond to super-complaints which concern the sector for which they are responsible.

Where a complaint may involve Article 81 or Article 82, it can be made to any relevant NCA. It will be dealt with by the authority which is "best placed to act". This may be an NCA of a different EU Member State. The NCAs have a system in place to enable them to decide once a complaint is received by any of them which authority is best placed.

Concurrency in practice – powers of investigation

Sector regulators with concurrent jurisdiction may carry out investigations, including dawn raids, on their own initiative or following complaints. They have the same powers as the OFT to require documents and information to be produced and to search premises in relation to possible breaches of Article 81, Article 82, the Chapter I prohibition or the Chapter II prohibition. However, sector regulators have no powers in relation to investigations by the European Commission, nor do they have powers in connection with investigations on behalf of NCAs. Sector regulators may be permitted to assist the OFT in such investigations.

What should business do?

It is important for companies operating in regulated industries to be aware of the concurrency issues, not least because information secured by a sector regulator under the CA or EA may in certain circumstances be used by the same regulator in relation to its sector specific powers and vice versa. Sector regulators now have considerable enforcement powers. Businesses should be aware that there will be situations where sector regulators will opt to use the powers under the CA or EA where powers under sectoral legislation are less effective.

Companies need to be aware of the prevailing guidance on concurrency. They should also be aware that the OFT and sector regulators may now deal with cases involving Article 81 or 82, and that cases which involve effects on EU trade may be dealt with by authorities from other EU Member States if they are "best placed to act". For complaints and applications for urgent interim measures, companies may consider informing the relevant sector regulator rather than the OFT in the first instance.

The sector regulators have concurrent jurisdiction in the following areas:

Agreements or conduct relating to	Statute	Regulator's office
Commercial activities connected with electronic communications (telecommunications and broadcasting)	The Communications Act 2003	OFCOM
The shipping, conveyance or supply of gas and activities ancillary thereto	The Gas Act 1986	OFGEM
Commercial activities connected with generation, transmission or supply of electricity	The Electricity Act 1989	OFGEM
Commercial activities connected with the supply (or securing a supply) of water or of sewerage services	The Water Industry Act 1991	OFWAT
The supply of railway services	The Railways Act 1993 as amended by the Transport Act 2000 and 2005	ORR
Commercial activities connected with the generation, transmission or supply of electricity in Northern Ireland	The Electricity (Northern Ireland) Order 1992	OFREG
The conveyance, storage or supply of gas in Northern Ireland	The Gas (Northern Ireland) Order 1996	OFREG
The supply of air traffic services	The Transport Act 2000	CAA

Modernisation

Accession of Bulgaria and Romania

Bulgaria and Romania acceded to the EU on 1 January 2007. The EU now has 27 Member States.

Overview of Council Regulation (EC) 1/2003 (the Regulation)

When the previous accession round took place in May 2004 (accession of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia), the Regulation entered into force modernising the European framework for competition law enforcement.

Abolition of notification scheme

The Regulation set out (*inter alia*) a new system for dealing with potentially anti-competitive agreements. Since 1 May 2004, firms have been unable to notify their agreements to the European Commission for exemption from the prohibition on restrictive agreements (Article 81(1) EC Treaty).

The system now in place instead relies on firms making their own assessment of whether their agreements comply with the exemption criteria set out in Article 81(3). Where an agreement meets the exemption criteria, the agreement benefits from a direct exception without the need for prior notification or approval.

The UK has abolished its notification regime in respect of UK competition law and replaced it with a "self-assessment" system modelled on the EU system.

Aside from self-assessment, some legal certainty may be derived from written opinions which the European Commission may publish in cases involving novel or unresolved points of law. The Office of Fair Trading (OFT) offers informal advice on the compatibility of agreements with EU or UK competition law in certain limited circumstances. The OFT may also publish written opinions where cases present novel or unresolved questions. In addition, where notification systems continue to operate in other EU Member States some guidance can be obtained from their decisions.

Minimum standards of competition enforcement

The aim of the Regulation was to level the playing field for scrutiny of agreements across Europe requiring National Competition Authorities (NCAs) and National Courts (NCTs):

- to apply Article 81(1) and (3) directly;
- to apply Articles 81 and 82 in parallel with domestic law (where agreements/conduct have an effect on inter state trade); and
- to take decisions/judgments consistent with European Commission decisions.

A requirement that national laws on restrictive agreements (such as the Chapter I prohibition) may not be more stringent than EU competition law further reinforces the Regulation's efforts towards harmonisation. National laws may be more stringent than Article 82 in relation to unilateral conduct e.g. abuse of dominant position.

Close cooperation between the European Commission, NCAs and NCTs to facilitate enforcement

The Regulation seeks to promote cooperation between the NCAs, NCTs and the European Commission by providing for the mutual exchange of information (including sensitive business information) and the creation of a network of NCAs to determine jointly the most appropriate forum for dealing with complaints. Where an agreement or conduct affects more than three EU Member States, the European Commission is generally the appropriate forum and where it is limited to two or three EU Member States, one Member States should generally take the lead (depending on which is best placed to impose a remedy).

The European Commission's powers of investigation

The Regulation:

- codified the European Commission's existing powers;
- created new powers of investigation e.g. powers to enter any premises, land or means of transport of a firm (such as directors' homes);
- widened the range of remedies available; and
- enabled the European Commission to impose financial sanctions to ensure compliance which are tougher than those previously available (see the section of this Survival Pack entitled "Competition authorities' powers of investigation").

At the same time, the rights of parties to an investigation were strengthened with the codification of rights of defence and limited access to the European Commission's file.

OFT able to investigate possible breaches of EU competition law

The Regulation has given the OFT the power to investigate and enforce breaches of Article 81 (EU prohibition on restrictive agreements) and of Article 82 (EU prohibition on abuse of dominance) on its own initiative. In addition the OFT may carry out investigations regarding EU competition law on behalf of the European Commission and on behalf of other NCAs.

The applicable powers of investigation and rules on privilege vary according to whether the OFT investigates on its own initiative, on that of the European Commission or on that of another NCA (see the section of this Survival Pack entitled "Competition authorities' powers of investigation").

UK Government's response to the Regulation

Following public consultation, the government made various changes to UK legislation in order to bring it into line with the EU system set out in the Regulation. As mentioned above, the UK notification system has been abolished. Other significant changes prompted by the Regulation include:

- aligning the penalties available under UK competition law with those under EU competition law i.e. to 10% of worldwide turnover for the preceding year;
- giving the OFT the power to seal premises when conducting investigations;
- giving the OFT the power to accept commitments remedying competition issues when dealing with EU or UK competition law infringements; and
- repealing the UK's exclusion in relation to vertical agreements and instead relying on the parallel application of the EU vertical agreements block exemption (the UK exclusion in relation to land agreements remains albeit in a new statutory instrument).

1 January 2007

EU enlargement

The new Member States

On 1 January 2007 the EU welcomed Bulgaria and Romania into the EU. This follows the accession on 1 May 2004 of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

Accession negotiations have been opened with a number of other countries, including Croatia and Turkey (candidate countries). Others who wish to open negotiations in the future (potential candidate countries) include Albania, Serbia and Bosnia.

The entry criteria

Before candidate countries may become full members of the EU they must fulfil the entry criteria set by the Copenhagen European Council in 1993. The entry criteria are threefold:

- Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.
- Existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the European Union.
- Ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

Association or "Europe" agreements

The first step towards becoming an EU member is for the relevant country to conclude an Association Agreement or "Europe" Agreement with the EU and its existing Member States. The individual Association Agreements are later replaced by a Treaty of Accession, once negotiations have concluded.

The Europe Agreements form the legal framework for association between the candidate countries and the EU and provide the framework for the candidate countries' gradual integration into the EU. Candidate countries must incorporate the *acquis communautaire* into their domestic law prior to accession.

The *acquis communautaire* comprises the entire body of EU legislation. This includes the founding Treaty of Rome as revised by the Single European Act and the Maastricht and Amsterdam Treaties, all Regulations and Directives passed by the Council of Ministers and all judgments of the ECJ.

The incorporation and implementation of all EU legislation requires considerable strengthening of the candidate countries' administrations and legal systems. To facilitate these adjustments, pre-accession aid is provided to the candidate countries.

Competition policy

In order that the candidate countries are able to satisfy the Copenhagen economic criterion of surviving the competitive pressures of the internal market, they must adopt a competition discipline in line with that of the EU well in advance of accession.

As well as adopting appropriate legislation, the European Commission has persistently stressed the importance of the need for sound enforcement procedures in the new EU Member States.

Overview of key competition law provisions

Article 81 (horizontal agreements)

Experience to date of the competition laws in the recent accession countries has shown that cartel regulations have been difficult to enforce. There is generally a limited number of suppliers in the Central and Eastern European markets and cartels do therefore exist. However, there has been little enforcement of the rules relating to cartels pre-accession.

Article 81 (vertical agreements)

The recent accession countries have introduced prohibitions on vertical restrictions and several have adopted block exemptions in line with the EU's block exemptions on vertical restraints. The investigation of vertical relations in the recent accession countries to date has been predominantly concerned with the fixing of prices.

Article 82

There have been a significant number of proceedings initiated by the competition authorities in the recent accession countries relating to the abuse of a dominant position.

State aid

Much progress has been made in this area through a combination of an improved legal framework, enhanced state aid transparency tools, and a better enforcement record. There are still, however, incompatible fiscal aid schemes operating in some recent accession countries, which those countries have been invited to convert into compatible, usually regional, aid.

1 January 2007

Litigating competition

History of the competition claim

To the present day, litigation based on breaches of competition law (of either or both of Articles 81 and 82 EC Treaty and/or Chapters I and II Competition Act 1998) has been scarce and in about 95% of cases enforcement of the rules has been confined to the regulator, rather than the courts. There are historical reasons for the reticence of claimants:

- national courts have been unable to apply Article 81 in its entirety since they could not consider the question of whether an exemption to the prohibition (Article 81(3)) could apply. The prospect of having to stay national proceedings pending a European Commission decision on Article 81(3) has been a real deterrent to bringing competition claims;
- the lack of specialist competition knowledge within the judiciary; and
- the lack of successful actions awarding damages. The right to claim damages for breach of EU competition law has long been recognised by the UK courts, but until recently none had been awarded.

The changing climate

The position has been gradually changing in favour of more competition-based litigation. The early turning point was perhaps in 2001, when on a reference from the High Court, the ECJ in *Courage v Crehan*[1] was asked to determine the legality of a UK rule barring claimants with "dirty hands" from claiming damages.

The High Court case, *Crehan v Inntrepreneur*[2], involved Mr Crehan, who had taken a lease of premises from the Courage brewery, a condition of which also required him to buy Courage's beers (the beer tie). Mr Crehan defaulted on his payments for Courage's beers, Courage sued and Mr Crehan counterclaimed for damages on the basis that the beer tie was contrary to competition law and he had suffered loss as a result of it.

The ECJ determined that the rule of English law barring claims by parties to illegal agreements was incompatible with EU law where it failed to take account of the economic context and relative bargaining positions of those involved (namely of Crehan, the individual publican, versus Courage the international brewer). In reaching its judgment, the ECJ made unequivocal the requirement of national courts, as a matter of EU law, to provide for damages for breach of the competition rules.

1 **Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others (European Court Reports 2001 page I-06297, case C-453/99)**

2 **Crehan v Inntrepreneur Pub Company and another ([2003] EWHC 1510). This case considered the position of Crehan and Inntrepreneur in the context of 3 European Commission decisions (Scottish and Newcastle -1999/474/EC; Bass - 1999/473/EC; and Whitbread 1999/230/EC), which determined that the beer ties of several brewers foreclosed the UK beer market to non-tied estates, contrary to competition law.**

The ECJ's judgment did not at first herald the expected breakthrough. On the reference back from the ECJ to determine the question of whether Crehan could claim damages and following the principle laid before it by the ECJ[3], the High Court concluded that Inntrepreneur's beer tie did not breach European competition law. It did not, therefore, award damages. In May 2004, however, the Court of Appeal ruled that the beer ties in question had indeed infringed European competition law and, therefore, that Mr Crehan should be awarded £131,336 damages[4]. However, in July 2006 the House of Lords overturned the Court of Appeal's findings, although it did not call into question the availability of damages for proven breaches of competition law.

More recent legislative changes have also contributed to the prospect of increased competition litigation:

- the entry into force on 1 May 2004 of the European Commission's "Modernisation" Regulation (EC) 1/2003, which emphasises the central role of national courts in fostering private enforcement of competition law through the courts. Under this Regulation, the European Commission also relinquished its monopoly over Article 81(3) allowing national courts for the first time to determine the question of exemption (without prior European Commission decision of infringement and unavailability of Article 81(3)); and
- the introduction by the Enterprise Act 2002 of a new specialised route for claiming damages based on breach of the competition rules to the Competition Appeal Tribunal (CAT).

The European Commission has also become involved, publishing a green paper discussing how best to encourage private enforcement of competition law infringements.

The European Commission's green paper on private enforcement

The European Commission has recognised that while the introduction of Regulation 1/2003 facilitated to some extent private competition litigation, it did not go far enough to make private enforcement more effective. One of the overriding problems facing the potential competition litigant is the difference in approach taken to particular issues over the now 27 EU Member States. In December 2005 the European Commission published a green paper on this area and requested public comments. The aim is to create a pan-EU enforcement system, while recognising the diversity of EU Member States' different litigation systems. The green paper focuses on:

- Access to evidence – should obligations to disclose documents evidencing competition law breaches be introduced and if so, what form should disclosure take?;
- Fault requirement – should it be necessary in competition damages claims to also prove fault (as well as infringement)?;
- Damages – how should damages be calculated e.g. to compensate for losses?/by reference to the illegal gain made?/double damages for horizontal cartels? Should complex economic models be used in damages calculations?;

3 Namely that a party to a contract which breaches competition law can bring a claim for damages provided he is in a very weak bargaining position relative to his co-contractor.

4 See Case No. A3/2003/1725 [2004] EWCA Civ 637, dated 21 May 2004 at paragraph 183.

- Passing-on defence/indirect purchasers – should the infringer be able to argue that it is not liable where the claimant passed on higher cartel prices to its customers by increasing the sale price of its own goods (passing-on defence)? Should indirect purchasers be barred from making competition damages claims?;
- Consumer actions – should special procedures be available for bringing collective actions on behalf of consumers? If so, how should this be achieved?;
- Legal costs – should special rules be introduced to reduce the risk for claimants of having to pay high litigation costs if their claims fail?;
- The relationship between (i) encouraging cartel members to blow the whistle on their cartel and apply for leniency and (ii) encouraging private litigants to bring competition damages claims - how to reconcile the inherent tensions between these two methods of enforcement;
- Applicable law – how to determine which national law should govern competition damages claims.

Depending on the responses received by the European Commission to this consultation on the Green Paper, we may see a proposal for legislation, although it seems unlikely that any eventual rules would enter into force much before 2008.

Basis for competition claims

With these developments, increased litigation based on infringement of the competition rules is now a much likelier prospect. The following considers the basis for bringing such claims.

A firm that suffers loss as a result of an infringement may make a civil claim in tort for breach of statutory duty and seek interim relief (e.g. an injunction restraining the breach) or damages (where damages are capable of remedying the situation, the court is unlikely to grant injunctive relief).

Claims may be brought before the Chancery Division of the High Court[5], the Outer House of the Court of Session[6] or the Competition Appeal Tribunal (CAT). The Chancery Division has responsibility for hearing competition law cases (and has had some special training to help it to do so) alongside its commercial caseload, whereas the CAT is a specialist competition court. The first President of the CAT was an experienced competition judge of the European Court, Sir Christopher Bellamy. Claims before the CAT must be based on an infringement decision by the European Commission or the OFT, whereas at the High Court such a decision is not necessary (although it may be desirable – see below).

There are 4 key prerequisites to making a competition claim for damages:

- first, there must be an infringement of the competition rules. If the European Commission/OFT has already reached an infringement decision, this should be binding on the court, in which case the claimant has a significant tactical advantage in not having to re-prove the infringement. If not, the claimant has two options: (i) either he informs the European Commission or OFT of the alleged infringement and encourages it to investigate, in which case he should probably postpone his court

5 English or Welsh claims.

6 Scottish claims only.

claim, pending the outcome of the investigation[7]; or (ii) he goes it alone, in which case the claimant must devote his resources to proving the infringement. This can be an onerous task bearing in mind the expert economic and legal issues which are usually involved and the related evidentiary difficulties, particularly in secret cartel cases. It may be strategically advantageous therefore, to have a European Commission/OFT infringement decision, or at least to try to get one, before commencing litigation;

- second, the claimant must have suffered loss. This might be relatively straightforward in the case of a direct purchaser from a cartel who suffers loss in having to buy at the cartel price. However, there may be practical difficulties in assessing the supra-competitive cartel price and the competitive price against which to compare it and a customer who passes on his loss to the consumer may not be able to show that he made any loss at all. The US bars the defence of passing on, the corollary of which is to prevent indirect customers from claiming for loss (which, according to the rule, has not been passed on). Where loss can be successfully shown, a claimant in the UK may be awarded restitutionary damages (i.e. such damages as are necessary to place him in the position as if the tort had not been committed) or there is the possibility that the court may award exemplary damages (for instance, where the defendant calculated that his gain from the infringement would exceed his losses from any competition claim) which to this date it has not done. Contrast however the US, where a claimant may seek treble damages;
- third, the claimant must have suffered the loss as a direct result of the infringement (causation). This is easier to show for direct customers than those lower down the chain. Significant difficulties in practice may arise for the claimant to show that his loss was not caused by factors other than the breach. For example, a defendant may be able to show that prices were not artificially high, but were the result of particular market factors, e.g. an increase in the cost of raw materials, inflation, fluctuations in exchange rates, production problems leading to reduced capacity etc; and
- fourth, the claim must be in time. In the High Court, the claimant has 6 years from the date on which damage is caused by the commission of the tortious act (here the competition law breach). If an infringement was deliberately concealed (for example by a secret cartel) the limitation period does not run until the claimant discovered the breach or could with reasonable diligence have discovered it. The rules are more complicated in the case of the CAT, where claims must be brought within 2 years of the requisite waiting periods (see below) or within two years of the date on which the cause of action accrued. The requisite waiting periods during which claimants are required to postpone making a claim (unless special leave is granted) are during the time in which an appeal against an OFT decision may be lodged at the CAT (within 2 months), or if a further appeal against the decision of the CAT has been lodged, whilst that further appeal is heard by the Court of Appeal or House of Lords; or during the period in which proceedings against the decision may be instituted with the European Court, or if instituted, prior to determination by such court.

7 It would be highly damaging to the claim were the European Commission/OFT's investigation to reach a non-infringement decision and in any event, in Synstar/ICL, the High Court stayed proceedings pending the OFT's investigation. National courts are further invited to stay proceedings in respect of European Commission investigations by Regulation 1/2003 (see Article 16 (1)).

Forum shopping

Claimants should also consider which is the most advantageous forum for bringing their claim. In the EU, there are international rules governing jurisdiction that basically allow a claimant to claim either in the jurisdiction where the tort/breach was committed, or in the country where the defendant is domiciled. Usually, the desire for familiarity will encourage claimants to concentrate on their domestic courts, but there may be domestic laws in other jurisdictions (for example on quantum of damages) that make it preferable to claim elsewhere. This prospect is enhanced by the modernisation programme (encouraging private litigation as a means of local enforcement of competition law), which applies equally to the 27 Member States of the EU. A judgment by the Swedish Court of Appeal (also upheld by the Swedish Supreme Court) awarded damages and restitution in the region of €100m for an infringement of Article 82 by the Swedish Board of Civil Aviation[8].

Claimants should also consider the prospect of claiming in the US where treble damages are available. A recent US case considered whether it is possible to claim damages through US courts for anti-trust law breach and resulting damage suffered outside the US based on conduct occurring outside the US. Initial rulings suggested that this could be possible in certain circumstances[9]. However, the US Supreme Court then decided that such damages claims are not possible where the adverse effect on customers outside the US is independent of any adverse US domestic effects, even though the price-fixing significantly and adversely affects both customers outside the US and within the US[10]. The US Court of Appeal then went on to confirm that if the adverse foreign effect was not independent of domestic US effects, such damages claims are only possible where there is a direct causal relationship between the results of the illegal practices in the US and the high prices charged outside the US[11]. Thus the remit of US courts has not been significantly expanded as regards anti-trust damages actions as some had hoped.

8 See Scandinavian Airlines System v Swedish Board of Civil Aviation (Supreme Court decision dated November 12, 2002, Case No. T 2137-01) where the Board of Civil Aviation was found to have applied a discriminatory tariff to SAS, imposing a special obligation on it to bear a significant proportion of construction costs, in addition to the landing charges generally applied to the other airlines.

9 See Empagran SA et al v F Hoffman-La Roche Limited et al, 354 US App. D.C. 257 2003-1 Trade Cas. The defendants were vitamin companies who had conspired to fix vitamin prices around the world. The foreign purchasers however, bought vitamins exclusively outside the US. The relevant legislation requires i) that the conduct has a direct, substantial and reasonably foreseeable effect on domestic commerce and ii) that such effect gives rise to a claim under the Sherman Act. The court found that there was no real dispute in relation to limb i): the defendants had operated a worldwide cartel which, inter alia, aligned global prices with those in the US in order to prevent arbitrage. In relation to limb ii), the court took a wide interpretative view of legislative intent, allowing the appeals on the basis that the US effects of the cartel had given rise to (other) claims by parties injured in the US from transactions occurring in the US. Individually, these satisfied the need for "a claim under the Sherman Act" as required by limb ii), notwithstanding that they were not the claims of the foreign plaintiffs in question. Hoffmann la Roche opposed the Court of Appeal's finding and petitioned the Supreme Court. The US government and the FTC supported the petition on the basis, inter alia, that the Court of Appeal's finding would undermine the detection and deterrence objectives of the US leniency programme. Seven other nations, including the UK, supported the US government.

10 F Hoffman-La Roche Limited et al Petitioners v Empagran SA et al, 542 US155 2004, dated 14 June, 2004. The Supreme Court delivered an opinion stating that such claims fail, as congress (when passing the relevant legislation) did not intend to bring within the reach of the Sherman Act "independently caused foreign injury" [i.e. adverse effect on customers outside the US which is independent of any adverse US domestic effect]. The Supreme Court opinion also emphasised that in these circumstances, such claims should fail as the application of US laws should avoid interference with a non-US nation's "ability independently to regulate its own commercial affairs". It also noted that upholding the Court of Appeal's broad interpretation would undermine the anti-trust detection policies of non-US countries by discouraging whistle blowing under leniency regimes.

11 Empagram SA et al v F Hoffman-La Roche Limited et al, No 00cv01686 DC Circuit, June 28, 2005. The Court noted that had it found otherwise this would have opened the door to interference with other nations' prerogative to safeguard their own citizens from anti-competitive activity within their own borders.

Progress of competition damages claims brought in the CAT

Since 1 May 2004, a number of claims for damages for breach of competition law have been brought before the CAT. The first two such claims were brought by certain customers of the vitamins manufacturers found by the European Commission to have participated in a cartel infringing Article 81. The customers claimed damages arising from the cartel-inflated prices they paid for vitamins purchased. These cases were both settled out of court for an undisclosed sum.

The third damages claim before the CAT was brought by a customer of a drug producer found by the OFT to have abused its dominant position in pricing the drug and the drug delivery system. At the time of writing this case is on-going although the claimant was awarded interim damages in November 2006 as the CAT was satisfied that the claimant would obtain judgment for a substantial amount of damages from the defendant at subsequent trial. This is the first time the CAT has awarded interim damages.

Conclusion

Whilst private enforcement of the competition rules in the UK is unlikely to take place on quite the same scale as in the US, it is clearly encouraged by the European Commission's modernisation programme and green paper on private enforcement. The ability of national courts to apply Article 81 in its entirety removes a real obstacle to doing so. Now, the UK has a tailored procedure for claiming damages before the CAT and a successful damages award to provide further encouragement in the courts.

Finally, the possibility of consumer class actions before the CAT should not be ruled out. To date, none has been brought although the Consumers Association (*Which?*) has been specified as a body qualified to bring such actions.

1 January 2007

EU merger control and merger checklist

Council Regulation (EC) No 139/2004 (the Merger Regulation) catches large scale mergers and full function joint ventures. It is obligatory to notify the European Commission in advance about any transaction covered by the Merger Regulation and to delay implementation until clearance is received.

Does the Merger Regulation apply? What your lawyer will ask you

A brief explanation of the Merger Regulation threshold tests follows this checklist.

- Give a brief description of the proposed transaction including any transactions which are linked to it.
- What rights are to be acquired?

  For example: shares and associated voting rights; rights in relation to the appointment/removal of directors of the target; contractual terms which may give the acquirer(s) the ability to restrict/ control/veto decisions of the board of the target, its business operations or particular decisions such as those relating to capital expenditure, business plans, sales of assets, borrowings etc.
- Does the acquirer already have an interest in the target?
- Describe any other shareholders in the target.
- Does the transaction involve any form of consortium, syndicate or grouping (including of family members)?
- What is the worldwide turnover of the acquiring group(s)?
- What is the worldwide turnover of the target group?
- What is the EU wide turnover
  - of the acquiring groups
  - of the target group?
- Is the EU turnover of the acquiring group (or each acquiring group in the case of joint control) and that of the target group concentrated in one and the same EU Member State? If so, please give an indication of the percentage involved.
- In which EU countries (if any) does each group have turnover in excess of €25m?
- If the transaction is a joint venture, give turnover figures for each JV parent, and for the joint venture, give its turnover and assets.
- What is the proposed timetable for the transaction?
- What are the main businesses of the acquiring group(s) and the target group and what sort of overlap is there? Are the businesses the same / upstream / downstream of each other / in related areas?
- Does the transaction involve any party accepting restrictions of any kind (e.g. non-compete, use of information, restriction on business activity, exclusivity, supply or purchasing obligations etc.)?

The Merger Regulation

Council Regulation (EC) 139/2004 is the EU's comprehensive merger control system which covers "concentrations" between businesses which have "a Community dimension".

There is therefore a two-fold test of structure and size to determine whether a transaction is caught by the Merger Regulation and thus needs to be notified to the European Commission.

There is a parallel control in the EEA Agreement for large scale concentrations which have an "EFTA dimension".

The Merger Regulation currently in force replaces Regulations 4064/89 and 1310/97 and has undergone some major changes. The general structure of the current Merger Regulation is based on that of its predecessor. Some areas remain exactly as they were before, others have been subject to only minor changes, while some areas have been significantly altered.

A "concentration"

The Merger Regulation covers acquisitions on a lasting basis of direct or indirect control over another business. This may be acquisition by a single purchaser or by companies which will exercise joint control over the target. The question of whether an acquirer will have control of the target requires consideration of all the rights that person will be able to exercise directly or indirectly. This may include voting rights arising from the acquisition of shares and/or contractual rights under a management contract or joint venture.

The Merger Regulation also covers "full function joint ventures". These are all joint ventures which "perform on a lasting basis all the functions of an autonomous economic entity" and exceed the Community dimension thresholds.

Control – the concept of decisive influence

Does a company acquire control of a business or its assets? There are two questions:

- what rights are acquired

  and

- do they give the acquirer decisive influence over the target?

In order to determine whether a potential acquirer will have control of the target, it is necessary to consider all the rights that person will be able to exercise directly or indirectly (even if there is no intention to exercise such rights to secure control).

This may include:

- rights arising from the acquisition of securities (for example, voting rights on shares in the target), or
- contractual rights (for example, under a management contract or joint venture agreement), or
- other rights, or
- a combination of different rights (for example, a minority equity investment together with contractual rights in a shareholders' agreement).

"Control" as used in the Merger Regulation does not mean outright control in the sense of a 51% shareholding in the target. It is defined by reference to the "possibility of exercising decisive influence" on the target.

Control need not be exercised by only one party. There may be joint controllers who together have decisive influence over the target.

A Community dimension

The Merger Regulation generally only catches concentrations which are big enough to have a "Community dimension".

There are two separate ways in which a deal may have a Community dimension:

- the basic test

  (a) the combined aggregate worldwide turnover of all the undertakings concerned exceeds €5,000 million

  and

  (b) the aggregate Community (EU) wide turnover of each of at least two of the undertakings concerned exceeds €250 million

  unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same EU Member State.

- multiple jurisdiction cases

  (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than €2,500 million

  (b) in each of at least three EU Member States, the combined aggregate turnover of all the undertakings concerned is more than €100 million

  (c) in each of at least three of the EU Member States included for the purpose of (b), the aggregate turnover of each of at least two of the undertakings concerned is more than €25 million

  and

  (d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than €100 million

  unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same EU Member State.

The turnover of the "undertaking concerned" is not the turnover of the individual company but that of the whole parent group. Where an undertaking is acquiring outright just part of another undertaking (say one particular subsidiary of a large group), then the turnover thresholds are applied to the whole of the acquiring group, but only to that part of the vendor which is actually being acquired.

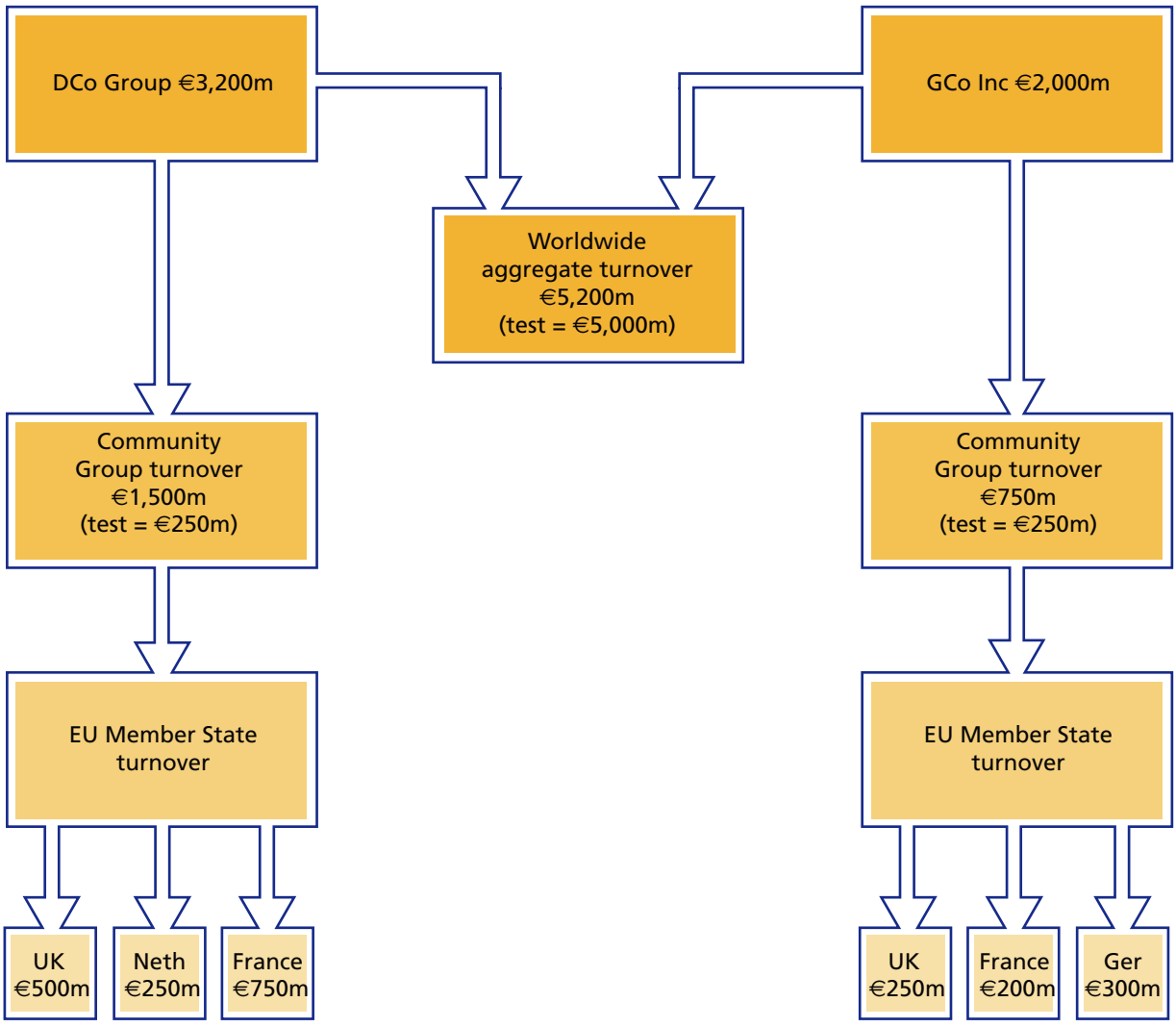
Community turnover refers to the turnover derived from sales to persons in the EU. EU Member State turnover refers to the turnover derived from sales to persons in that EU Member State.

It is possible in certain circumstances for transactions which are not large enough to have a "Community dimension" nevertheless to be examined by the European Commission under the Merger Regulation. See "the referrals system" for further details.

Calculating turnover

The classic test

DCo Group (based in the EU) acquires the whole of GCo Inc. (head office in the USA). The turnover calculations must be applied to the whole of both groups.

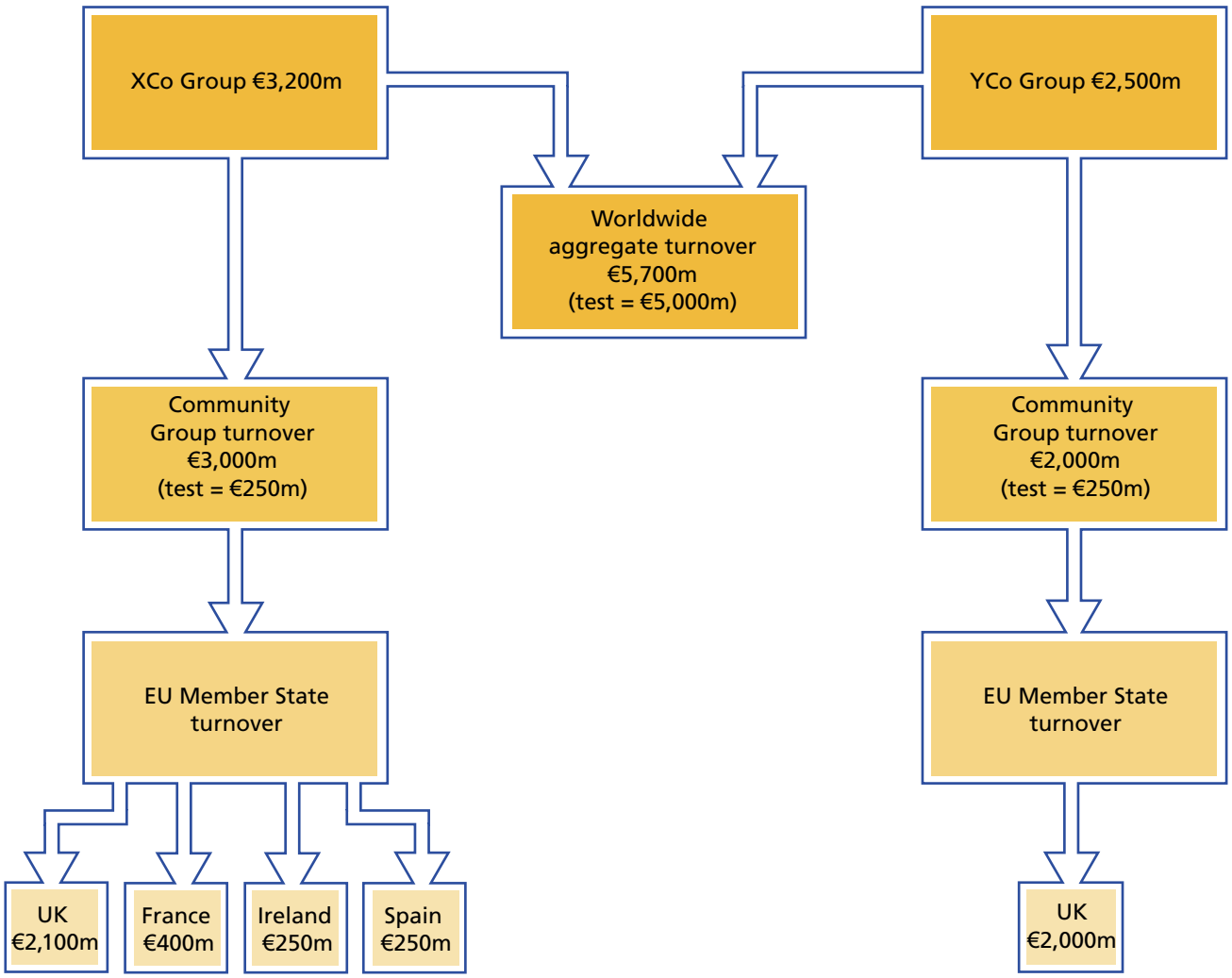


The worldwide and Community aggregate threshold tests are satisfied. Community business of each group is spread across various countries. The transaction has a Community dimension. The Merger Regulation applies.

The "two-thirds" rule

XCo Group merges with YCo Group.

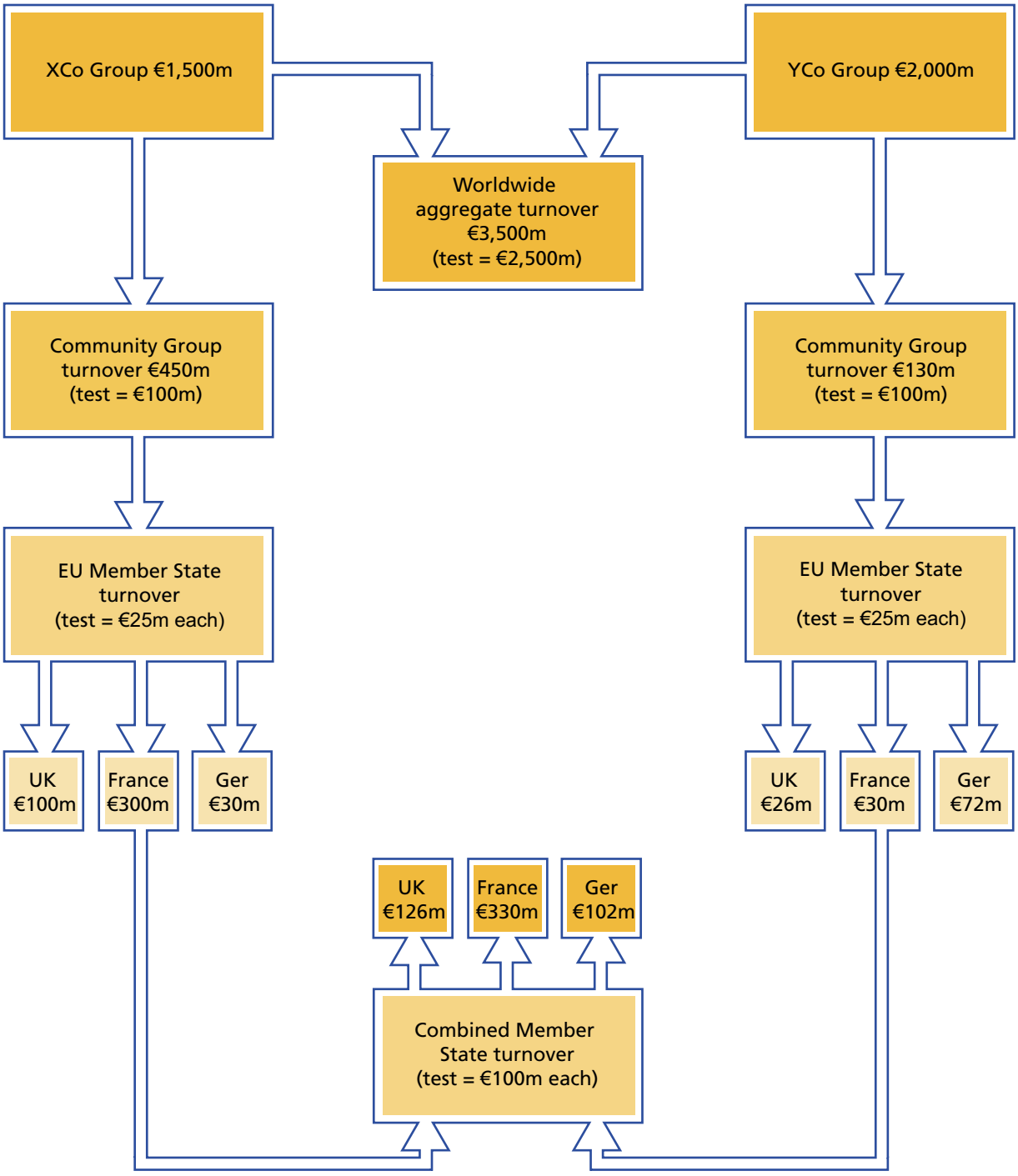
Turnover calculations must be applied to the whole of both groups.



XCo Group and YCo Group each have more than two-thirds of their Community turnover arising from operations in the UK, so the Merger Regulation does not apply. The parties should look at the application of the UK Enterprise Act and the possible application of other domestic legislation.

Multiple jurisdiction cases

XCo and YCo are not big enough to satisfy the classic worldwide €5,000m test, but they have considerable business in several EU Member States.



In each of the UK, France and Germany the groups have combined turnover of more than €100m. The Merger Regulation applies. There is some turnover (not shown above - XCo €20m, YCo €2m) in other EU countries. Instead of making separate notifications (where required) in each country, the parties notify the European Commission.

Companies outside the EU

It is not only companies based in the EU which are subject to the Merger Regulation.

Several transactions involving only US or Japanese or other non-EU companies, as well as many cases involving both EU and third country undertakings, have had to be notified under the Merger Regulation because the groups concerned were sufficiently large worldwide and the companies, or their subsidiaries, had sufficient sales to the EU to exceed the Community-wide turnover threshold.

Notification

It is compulsory to notify to the European Commission all concentrations caught by the Merger Regulation. The European Commission must clear transactions before they can be completed. Failure to notify may affect the validity of the transaction.

Merger Regulation notifications are handled by the European Commission's Competition Directorate.

Notifications are made on Form CO annexed to the Implementing Regulation which also sets out the relevant procedural rules. The preparation of a Form CO is lengthy and complex. It requires turnover data on the companies concerned, ownership and control, personal and financial links, information on the product/geographical markets affected by the merger and general conditions prevalent in those markets and how the transaction is likely to affect the interests of intermediate and ultimate consumers and the development of technical progress. There is a Short Form notification for certain concentrations which are unlikely to raise competition concerns. The European Commission has provided guidance on the types of transaction likely to use only the Short Form.

Ancillary restrictions

Where a notified transaction includes contractual restrictions on the parties, one has to determine whether they are ancillary to the concentration, that is, whether they are directly related and necessary to the implementation of a concentration. They must be included in its assessment.

Ancillary restrictions include non-compete clauses, provided these are limited to what is strictly necessary to achieve the merger in terms of duration, geographical field of application, subject matter and persons subject to them. Normally a 3 year limit applies. Licences of industrial and commercial property rights and of know-how, and purchase and supply agreements necessary to maintain continuity of business, are all commonly within the definition of ancillary restraints. The European Commission has published a Notice explaining its approach.

If restrictions are not ancillary, then Article 81 and/or the UK Competition Act 1998 or other domestic legislation in the relevant countries may apply to those restrictions.

Two phase investigation system

Investigations under the Merger Regulation are characterised by a two phase system. In phase I, assuming that it has asserted jurisdiction, the European Commission decides whether to clear the concentration (possibly with conditions attached) or to open a full formal phase II investigation. The majority of cases are closed by a phase I decision.

Calculation of turnover

The European Commission has published guidance on the particular method of calculating turnover for the purpose of the Merger Regulation.

Notification deadline

Notification is possible *before* or *after* signature of binding agreements, the announcement of a public bid or the acquisition of controlling interest. For notifications before signature of binding agreements etc, the European Commission will accept a notification if the parties can show a "good faith intention to conclude an agreement" and demonstrate that their plans are sufficiently concrete (for example an agreement in principle, a memorandum of understanding, or a letter of intent signed by all the parties) or make an announcement of a public bid. For notifications after signature of binding agreements etc, there is no time limit, although notification must take place before completion and the transaction must still be suspended until clearance.

Substantive test

The European Commission reviews transactions in order to determine whether or not they will "significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position".

Time periods

The Merger Regulation first phase is 25 working days and is automatically extended by 10 days where the parties submit remedies. The second phase is generally 90 working days but can be extended in various situations. 125 working days is the long-stop for a phase two investigation and applies where the case involves remedies and time extensions have been requested.

The referrals system

Referrals "up" involve notifications to a national competition authority of an EU Member State (or a number of such authorities) being referred "up" to the European Commission for review. Referrals "down" involve notifications to the European Commission being referred "down" to a national competition authority for review. Under the Merger Regulation, where certain conditions are met, the parties may request referrals "up" or "down" before notification. EU Member States continue to be able to request referrals "up" or "down". The Merger Regulation also allows the European Commission to invite EU Member States to request referrals "up" or "down". A formalised procedure with time limits is set out for these referrals.

European Commission's powers

Under the Merger Regulation, the European Commission has wide powers to take any "appropriate measure" to restore the pre-merger situation (e.g. by dissolving the transaction or forcing disposal of shares) where a transaction is implemented despite a prohibition decision and where a concentration is implemented in breach of a condition to a clearance decision.

1 January 2007

National merger control in the UK and other countries and UK merger checklist

In cases where mergers and acquisitions fall outside the thresholds under the EC Merger Regulation and the EEA Agreement, then they fall under the jurisdiction of national law.

This section examines the national merger legislation of the UK.

For an analysis of the national merger laws of other European countries, please see the CMS Guide to Merger Control in Europe.

Do the merger provisions of the Enterprise Act 2002 apply? What your lawyer will ask you

The Enterprise Act 2002 (EA) contains a system for voluntary notification to the Office of Fair Trading of mergers which involve either the acquisition of a business whose UK turnover exceeds £70 million or the merger of businesses which together will have more than 25% share of supply or acquisition of any product or service in the UK.

A brief explanation of the relevant tests follows this checklist.

- What sort of a transaction is this and are there any linked transactions?
  - Explain what rights are being acquired - shares, voting rights, contractual rights in relation to business operations and so forth.
  - Who are the other shareholders in the target (if any) and what are their shareholdings?
  - Does the acquirer already have any interest in the target?
- Is the acquirer "associated" with any other person who has, or will have, an interest in the target (e.g. family relations or partners)? Does the transaction involve any form of consortium, syndicate or grouping?
- What is the UK turnover of the target group as stated in the most recent Report and Accounts? If the current value is thought to be very different, explain why.
- Describe the business of the acquiring and target groups and their market position in the UK.
- Are they in the same or similar businesses? What are their shares of supply or acquisition of any products or services in the UK and what are those of their main competitors?
- Explain the reasons for the acquisition.
- Does the City Code apply to the transaction?
- Does the target group have any newspaper interests?
- What is the proposed timetable for the transaction?
- Does the transaction involve any party accepting restrictions of any kind (e.g. non-compete, use of information, restrictions on business activity, exclusivity, supply or purchasing obligations, etc.)? If so, please provide details.

Mergers under the Enterprise Act 2002

The EA contains the main domestic legislation on the control of mergers involving one or more UK businesses.

Transactions where the parties have connections with newspapers are dealt with under the EA in conjunction with certain public interest considerations set out in the Communications Act 2003.

There are also particular provisions dealing with certain mergers in the utilities sectors, governed by relevant industry Acts.

These notes do not deal with the specific rules on newspaper or utility company mergers.

An important reform to the UK merger control system introduced by the EA was the removal of ministers from the merger control regime. Decisions are now taken by the OFT and Competition Commission, rather than the Secretary of State for Trade and Industry acting on advice from them. It is still possible under the EA for the Secretary of State to intervene in mergers on certain public interest grounds. It is understood that national security issues could qualify as relevant public interest grounds. It remains to be seen which other issues will qualify.

Which merger situations does the EA cover?

The EA applies to "relevant merger situations" involving two or more enterprises. A merger which is not a "relevant merger situation" is unaffected by the EA.

Two questions arise:

- What is a "merger situation"?
- Where a merger situation exists, what makes it "relevant"?

Investigation is first by the OFT and then, if necessary, by reference to the Competition Commission (CC). References can be made to the CC, either where a merger is proposed or, subject to certain time limits, after it has taken place.

What is a merger situation?

A merger for these purposes is widely defined as arising when "enterprises cease to be distinct". This happens when enterprises are brought under common ownership or control, or where there are arrangements whereby one or more enterprises ceases to be carried on in order to prevent competition. An "enterprise" means the activities, or part of the activities, of a business. A sale of assets which does not also include the sale of any business activity or contracts or goodwill will therefore not be covered by the EA.

A merger can therefore arise either where there is a change of control in a company (for example, upon a sale or issue of shares), or where there is a change of control or ownership of a business.

There are three levels of influence over an enterprise which constitute a change of control:

- the acquisition of the ability to exercise material influence.
  - A shareholding of 25%, enabling the shareholder to block special resolutions, will usually amount to material influence, even if all the other shares are held by one person. A shareholding of between 15% and 25% may give material influence, depending on the size of the other shareholders. A shareholding below 15% might involve material influence where other factors exist which point to the shareholders having such power.
- the acquisition of the ability to control policy.
  - This amounts to "de facto" control. It arises when the acquirer has a sufficiently large shareholding and/or other rights in the target to enable it, in practice, to control the policy of the target, even though it has less than 50% of the voting rights.
- the acquisition of a controlling interest.
  - This is outright or "legal" control, which normally means a shareholding with more than 50% of the voting rights in the target.

The first threshold of material influence is lower than the decisive influence test under the EC Merger Regulation and can arise on the acquisition of a shareholding as small as 10-15%.

A merger arises either when control, at whatever level, is first acquired by the party concerned or when someone who already has control (at the material influence or de facto control level) acquires a higher level of control.

What makes a merger situation "relevant"?

There are two separate criteria, either of which may cause a merger to be a "relevant merger situation" which may therefore be investigated:

- the share of supply test
- the turnover test.

The share of supply test

This test is satisfied where, as a result of the merger, at least 25% of all the goods or services of a particular description are supplied or consumed in the UK (or a substantial part of it) by the acquiring and target group.

If the merger does not result in any increase in the share of supply or acquisition of any product or service in the UK at all, this test is not satisfied. If, however, one of the parties already has a share of supply or acquisition exceeding 25%, any enhancement, no matter how small, will have the result that the merger qualifies for investigation.

The turnover test

This test is satisfied where the annual UK turnover of the target group exceeds £70 million. Normally, UK turnover according to the target group's latest audited accounts is considered when reviewing whether the turnover test is met. UK turnover relates to turnover generated by sales to customers located within the UK.

The substantive test

The OFT reviews mergers in order to determine whether they may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services. The OFT has a duty to refer to the Competition Commission for further review any merger which may be expected to result in SLC. The Competition Commission has to prepare and publish its report on referred transactions within 24 weeks of the date of reference, subject to one eight week extension.

Notification

There is no UK duty to pre-notify a merger. Prenotification does, however, carry the benefit of legal certainty.

Where the merger is thought by the parties and their advisers to have no possible anti-competitive effect – for example, because the turnover of the target group is over £70m, but the acquirer and target group are in unrelated businesses – then they may decide that no notification is necessary.

If the parties do not pre-notify, however, the purchaser/controller runs various risks arising from the possibility of a reference being made to the CC after contractual commitments have been made and even after completion. Reference to the CC is possible for up to 4 months after completion of a non-notified transaction. If there were an adverse report from the CC, the purchaser might be required to divest itself of all, or part, of the acquired enterprise which may necessitate a "forced sale". The OFT monitors the press, trade journals and industry contacts to identify mergers which have not been notified to it by the parties concerned.

Confidential guidance and informal advice

In the past, the OFT has offered parties considering a merger the opportunity to gauge whether the OFT would be likely to refer the contemplated transaction to the CC. This was done via a process culminating in a formal written (but confidential) decision ("confidential guidance") or in an informal oral opinion ("informal advice").

In December 2005, both confidential guidance and informal advice were withdrawn, due to concerns that their provision was becoming unduly burdensome to the OFT and also due to a growing view that both confidential guidance and informal advice were becoming less reliable as the processes did not allow for the taking into account of the views of third parties.

In April 2006, the OFT reinstated informal advice for "good faith confidential transactions … where the OFT's duty to refer is a genuine issue", but confidential guidance was not reinstated. However, the limited reintroduction of informal advice was stated to be an interim arrangement, pending a formal OFT clarification of the long-term position. The OFT intends to consult publicly on the long-term situation in relation to both informal advice and confidential guidance and then publish new guidance by early 2007.

Fast track notification

There is a statutory notification route available where there has been a public announcement and where the merger will not take place until clearance is obtained.

The parties complete a Merger Notice which gives the OFT 20 working days to consider the proposed merger. The consideration period is subject to one single possible extension of 10 working days.

Informal applications

The parties may make an informal application to the OFT in writing with a view to obtaining clearance. This is the usual route chosen. In this case, the statutory fast track time limits for a decision do not apply, but the OFT has indicated that the parties can generally expect a decision within 40 working days.

Relevant mergers: should we notify?

- Target group's UK turnover exceeds £70m, but companies are in substantially different areas of business: no combined share of supply or acquisition above 10% can be identified in any UK business sector. The companies are certain there could be no effect on competition in their respective markets as a result of the acquisition.

Decision: no pre-notification made.

- Target group's UK turnover is £42m. Merger plans are still secret and no announcement has been made. The companies are in related business areas, making different ranges of kitchen cabinets, tables and other fittings. They are unsure of the correct definition of the particular goods or services for the purposes of the share of supply test. If the goods are "kitchen furniture", then this includes many suppliers, from the bespoke hand-made to the self-assembly chain store, and the companies' combined shares of supply are about 5%. On the other hand, a narrowing down of the description of goods to the "upper" or "luxury" end might produce a share of supply of 30% (Company A's 20% plus Company B's 10%).

Decision: confidential guidance not available. The acquirer may consider applying for informal advice. If the OFT declines to give informal advice, the acquirer must decide whether or not to pre-notify the transaction. If the acquirer wants certainty, he may decide to pre-notify.

- XCo, which has 62% of the share of supply for domestic heating units suitable for use in bathrooms, announces that it intends to acquire a 40% interest in the shares of YCo. The transaction will also give XCo contractual rights which enable it to control YCo's business plan. YCo has 4% share of supply of these goods; it is the specialist bathroom business unit of WCo, which also makes complete domestic central heating systems. If the deal goes well, XCo will probably acquire the other 60% of YCo next year.

Decision: confidential guidance not available, so XCo pre-notifies the transaction to the OFT.

The technology transfer block exemption

Commission Regulation (EC) No 772/2004 (TTBER)

Regulation 772/2004 block exempting technology transfer agreements from the prohibition in Article 81(1) EC Treaty (the prohibition on restrictive agreements) entered into force on 1 May 2004 replacing Regulation 240/1996. The TTBER departs radically from its predecessor.

This section of the Survival Pack focuses on the new approach to assessing technology agreements adopted in the TTBER and how it affects businesses, but begins by looking at the TTBER in context, first at the old regime, and second at the European Commission's modernisation programme.

Block exemptions

Article 81(1) prohibits agreements which have as their object or effect the prevention, restriction or distortion of competition which may affect trade between EU Member States. An agreement which falls within Article 81(1) is void unless it fulfils the exemption criteria set out in Article 81(3). These criteria are that agreements must improve production/distribution or promote technical/economic progress and give consumers a fair share of these benefits while containing only indispensable restrictions of competition and without leading to a substantial elimination of competition.

Regulation 240/1996 applied a formalistic approach to assessing whether technology transfer agreements (licences of patents, know-how or a mix of the two) were exempt from the prohibition in Article 81(1). Without analysis of the economic context or effect of such agreements, an exemption could be available provided prescribed conditions were met and blacklisted restrictions were not included.

Introduction of the TTBER

Its resources having long been overstretched, the European Commission introduced in 2004 a programme to modernise the enforcement of competition law. Its objective was to concentrate resources on the most anti-competitive or technically complex arrangements, whilst devolving the enforcement of competition law more generally to national regulators and courts. In order to achieve this, the European Commission shifted the onus of determining the compatibility of agreements with competition law on to the companies themselves, who instead of notifying their agreements, must now make their own assessment. As with the European Commission's overhaul of the block exemptions for vertical and horizontal agreements, the European Commission adopted the TTBER together with detailed guidelines to assist companies in making their assessment. These depart significantly from the formalistic approach of Regulation 240/1996, instead assessing the impact of certain technology transfer agreements on competition according to market power.

Adoption of the TTBER was not without controversy, not least given the difficulties of determining relevant markets in which to assess market power, in the fast moving and complex technology sector. Many suggested that the current TTBER regime leads to less legal certainty and that the protections afforded are not sufficiently far reaching, the result of which is to discourage the development and licence of technological improvements.

TTBER general framework of analysis

The TTBER follows the general structure of a number of the European Commission's recent block exemptions. Thus an agreement is block exempted if:

- it is the right type of agreement;
- the parties to it fall within the relevant market share thresholds;
- there are no hardcore restrictions; and
- withdrawal or disapplication is unlikely.

TTBER specific framework for assessment

Is it the right type of agreement?

Agreements covered:
The TTBER applies to licences (and assignments where the risk remains with the assignor) of patents, know-how and software copyright, and those involving a mixture of such rights, between two undertakings permitting the manufacture or provision of goods or services incorporating the licensed technology.

Agreements not covered:
Generally, agreements involving other forms of IP are not covered, unless such IP is ancillary to the licence. The following is a non-exhaustive list of agreements which are not covered by the TTBER:

- Licensing agreements for sub-contracting research and development;
- Licences leading to specialisation;
- Vertical supply and distribution agreements;
- Trade Mark licences;
- Licence agreements setting up technology pools;
- Master licence agreements.

Are the parties within the relevant market share safe harbour?

Undertakings can benefit from the TTBER if:

- in the case of competitors, their combined share of the relevant technology and product market does not exceed 20%; or
- in the case of non-competitors, the market share of each party on the relevant technology and product market does not exceed 30%.

There are limited principles on how to apply these thresholds in the TTBER, supplemented also by the guidelines (themselves supplementing the general guidelines on market definition in the technology field), but there has been criticism that this is not sufficient in this complex area.

If the parties' market shares are outside the thresholds and no hardcore restrictions are entered into, there is no presumption that the agreement is prohibited. Instead an individual assessment is required of the agreement's compatibility with Article 81(3), taking into account its impact on competition in the market context in which it operates. The second part of the guidelines is devoted to this sort of analysis.

Where market shares are initially within the relevant safe harbour, but subsequently drift outside it, the exemption afforded by the TTBER will continue to apply for two more consecutive years following the year in which the relevant threshold was first exceeded.

It is imperative to establish whether the agreement is between competitors or non-competitors, in the first instance to establish whether the parties are within the relevant safe harbour and in the second because a stricter regime applies to agreements between competitors. In short, competing undertakings are those which compete on the relevant technology and/or product market without infringing each others' IP rights. The relevant technology market includes technologies which are regarded by the licensees as interchangeable with or substitutable for the licensed technology. The TTBER provides that where non-competitors become competitors during the life of an agreement, such parties will continue to be treated as non-competitors for the life of the agreement unless the agreement is subsequently amended materially.

Does the agreement contain any hardcore restrictions?

The TTBER prescribes that if any of the restrictions classified as "hardcore" are present, the block exemption will be prevented from applying. Inclusion of hardcore restrictions also makes it unlikely that an individual exemption will be possible and thereby raises the presumption of illegality. The TTBER lists different hardcore restrictions depending on whether the agreement is entered into by competitors or non-competitors. Generally, for competitors, the following are considered hardcore: price fixing; quotas; non-exploitation/no R&D; and market partitioning and for non-competitors: price fixing; customer/territory limitations; and restrictions of sales to end users by a licensee who is a member of a selective distribution system. The restrictions categorised as hardcore for competitors, and non-competitors in the TTBER are set out in full at Annex 1 to this section.

Provided the parties to a licence were non-competitors at the time of entering into it, the hardcore list for non-competitors will apply for the life of the agreement, even where the parties subsequently become competitors.

Excluded restrictions

The exemption offered by the TTBER will not apply to exclusive grant backs by the licensee of its own severable improvements, to no-challenge clauses, to restrictions on the exploitation by a licensee of its own technology or to restrictions on either party from carrying out R&D, notwithstanding that the exemption may still be available for the remainder of the agreement. The "excluded restrictions" are set out in full at Annex 2 to this section.

Is there the possibility of individual withdrawal?

The possibility of withdrawal arises where parallel networks of similar restrictive agreements have the cumulative effect of either prohibiting licensees (actual or potential) from using third parties' technologies or prohibiting licensors from licensing to other licensees. In addition, withdrawal is possible where the parties do not exploit the licensed technology and have no objectively valid reason for having not done so.

The European Commission may withdraw the benefit of the TTBER where there is an effect on trade between EU Member States and a national competition authority of an EU Member State may do so where the effects are incompatible with Article 81(3) in the territory of that EU Member State or a part of it and where that territory or that part of it has all the characteristics of a distinct geographic market.

Could the TTBER be disapplied?

The European Commission may declare that the TTBER shall not apply to licences/agreements which contain certain specified restrictions where it finds that parallel networks of similar licences/agreements cover more than 50% of a relevant market. The European Commission must enact a Regulation in order to disapply the TTBER. This power cannot be exercised in relation to licences/agreements of individual companies, rather it relates to specific restrictions on specific product and geographic markets which the European Commission will define in any eventual disapplication Regulation.

Disapplication does not mean that the agreements are automatically prohibited, it instead means that the TTBER cannot apply to that agreement. However, it is still possible that the agreement could meet the exemption criteria of Article 81(3), such that it would not infringe EU competition law. However, the burden of proof rests on the party arguing that the criteria of Article 81(3) are met and this burden may be difficult to discharge.

Duration of the exemption offered by the TTBER

The exemption offered by the TTBER will apply for as long as the IP right in the licensed technology has not expired, lapsed or become invalid or in the case of know-how, as long as it remains secret, unless it becomes publicly known due to an action taken by the licensee. In this case the exemption will continue to apply for the duration of the agreement.

Overview of the TTBER

The TTBER has broadened the scope of the block exemption protection for technology transfer agreements in certain respects as compared to its predecessor:

- software copyright licences are now included;
- territorial exclusivity is no longer limited to 10 years in the case of pure know-how licences, but for as long as the know-how remains secret;
- non-compete and tying clauses are now exempt;
- licensors need not licence their own improvements when in a non-reciprocal agreement the licensee is required to grant-back his severable improvements on a non-exclusive basis;
- output limitation is now permitted in licences between non-competitors, and between competitors where the licensee's output is limited and the licence is non-reciprocal and does not extend beyond the licensed products (if the licence is reciprocal, output limitation is considered a hardcore restriction);
- customer allocation between non-competitors is now permitted;
- a licence between competitors which is non-reciprocal where the licensor and licensee agree not to sell actively or passively into exclusive territories or groups reserved for the other party is now exempt.

However, in certain respects the TTBER takes a stricter approach:

- by introducing market shares above which the TTBER does not apply (individual assessment under Article 81(3) required);
- by introducing the possibility of withdrawal for cumulative network effects;
- by taking a hard line in relation to cross-licences between competitors where each is limited to a certain field of use or product market (now considered to be hardcore);
- Customer or territory allocation between non-competitors is now only exempt for a start-up period of 2 years instead of previously 5 years.

How does the TTBER affect you and your business?

Companies must make their own assessment of whether a restrictive agreement is capable of exemption from the prohibition in Article 81(1). A sophisticated analysis of the relevant product and technology markets and the parties' share of such markets is now necessary in order to determine whether a technology licence is capable of block exemption. This applies as much to newly created agreements as those currently in place.

If the block exemption is not available, perhaps because the parties' market shares are above the relevant thresholds, a sophisticated economic analysis is then required of the agreement's impact on competition taking into account the parties' market position.

1 January 2007

Annex 1
Hardcore restrictions

Hardcore restrictions between competitors

- resale price fixing;
- limitation of output (except limitations on the licensee's output on contract products in a non-reciprocal agreement or limitations on only one of the licensees in a reciprocal agreement);
- restrictions on the licensee's ability to exploit its own technology;
- restrictions on any of the parties' ability to carry out R&D unless the restrictions are indispensable to prevent the disclosure of the licensed know-how to third parties;
- most instances of market or customer allocation except

  in the case of reciprocal or non-reciprocal agreements where:

  - the licensee is obliged to produce with the licensed technology only within one or more technical fields of use or one or more product markets;
  - the licensor is prevented from licensing the technology to another licensee in a particular territory; and
  - the licensee is obliged to produce the contract products only for its own use (however the licensee may not be restricted in selling the contract goods/services actively or passively as spare parts for its own products).

  and in the case of non-reciprocal licences only, where:

  - either or both of the licensor/licensee are required not to produce (through use of the licensed technology) within one or more technical fields of use, product markets or territories reserved exclusively for the other;
  - active and/or passive sales by the licensor and/or licensee into an exclusive territory or customer group reserved for the other party are restricted;
  - active sales by the licensee into an exclusive territory or to an exclusive group allocated by the licensor to another non-competing licensee are restricted; and
  - the licensee is required to produce the contract goods or services only for a particular customer where the licence was granted in order to create an alternative source of supply for that customer.

Hardcore restrictions between non-competitors

- Resale price restrictions except the stipulation of maximum sale prices and recommended resale prices, provided the latter do not in practice amount to a fixed or minimum sale price;
- Restriction of active or passive sales to end users by a licensee which is a member of a selective distribution system operating at retail level. It is permitted to prohibit a member from operating out of an unauthorised establishment;

- Restrictions on the territory or customer group to whom licensees may passively sell except:
  - the restriction on passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor;
  - the restriction on passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two years that this other licensee is selling the contract products in that territory or to that customer group;
  - the restriction on production of the contract goods/services only for its own use (provided the licensee is not restricted from selling the contract products actively and passively as spare parts for its own products);
  - the restriction on production of the contract goods/services only for a particular customer where the licence was granted in order to create an alternative source of supply for that customer;
  - the restriction on sales to end users by a licensee operating at the wholesale level of trade; and
  - the restriction on sales to unauthorised distributors by the members of a selective distribution system.

Annex 2

Excluded restrictions

- any direct or indirect obligation on the licensee to grant an exclusive licence/to assign, in whole or in part to the licensor or to a third party designated by the licensor rights to its own severable improvements to or to its own new applications of the licensed technology;
- any direct or indirect obligation on the licensee not to challenge the validity of intellectual property rights which the licensor holds in the EU, although it is still possible to provide for termination in the event the licensee challenges the validity of the IP rights;

in the case of a licence/agreement between non-competitors only, any direct or indirect obligation limiting the licensee's ability to exploit its own technology or limiting the licensee's ability to exploit its own technology or limiting the ability of any of the parties to the agreement to carry out R&D unless the restriction is indispensable to prevent the disclosure of the licensed know-how to third parties.

Lifesciences and competition law

Introduction

The purpose of this section is to address particular competition law issues which arise in the Lifesciences sector.

In this context, lifesciences covers pharmaceuticals, biotechnology and medical devices. For discussion purposes, pharmaceuticals and biotechnology can be seen as one. Medical devices can be considered separately, although there will be an element of cross over for pre-filled devices and associated drug delivery systems.

The competition rules applicable are the same for the lifesciences sector as for any other and companies in this area face very similar issues. However, three main aspects are worth considering in more detail:

- distinguishing characteristics of pharmaceuticals and medical devices
- market definition issues
- particular agreement types.

Distinguishing characteristics of pharmaceuticals and medical devices

Pharmaceuticals and medical devices have very different regulatory environments. These differences affect the nature of barriers to market entry and thereby condition the structure of competition for these types of product.

Pharmaceuticals are heavily regulated and have a very thorough pre-market approval system, whether for prescription-only medicines or for over-the-counter medicines. Prescription-only medicines are also subject to intense reimbursement and price control mechanisms from competent national authorities.

These factors make the pharmaceutical sector a particularly unusual or almost a dysfunctional market. Particularly unusual is that the ultimate consumer, the patient, is not the main paymaster. This is the role of the competent national authority even though it is not directly involved in the individual clinical decision. That role is reserved to the medical professional whose choices are driven by therapeutic rather than commercial considerations. The medical professional is the proxy for both the government paymaster and for the patient.

Medical devices might be implanted in the body, used with the body or in the case of in vitro devices, used without contact with the body at all. In the European context, medical devices are subject to a much lighter regulatory regime than pharmaceuticals and are not subject to a pre-marketing approval process. Also, typically, medical devices will be procurement markets. Where the purchaser is a public sector entity it will often be under a legal obligation to conduct a regulated procurement process for the purchase of products. This creates a structural form of competition. This can also be the case for some pharmaceutical purchases by hospitals.

Market definition issues

As for any other sector, relevant markets will be defined by reference to geography and product.

Particularly in the case of pharmaceuticals, geographic markets tend to be looked at as national ones because the regulatory and reimbursement systems are still very heavily marked by national policy, despite progress towards greater regulatory harmonisation and centralisation. Markets may be wider than the national level for the bulk supply of pharmaceuticals.

In the case of product market definition, the same principles apply as for any other product, ie. markets are defined by reference to potential substitutability based on characteristics, price or intended use, viewed from the demand side. Again, the view of the medical professional is a proxy for the market.

This issue has given rise to considerable discussion particularly in the pharmaceutical sector where market definition has been driven by therapeutic category. The accepted starting point for pharmaceutical product market definition is to look at ATC (anatomical/therapeutic category) level 3. ATC is an internationally recognised classification and is a common basis for the compilation of market data within the industry. Even so there may be few true substitutes within a given third level ATC class and some might be found in a separate third level class. Equally, to find true substitutes it may be necessary to look at the fourth or fifth levels within the classification, or to compile a bespoke classification.

When looking at market substitution issues, a range of factors need to be considered, such as indications, dosage, posology, side effects, tolerance levels, methods of administration and price. For example, sustained released products may even not be regarded as effective substitutes for the shorter acting version of the same compound. A wide range of therapeutic categories have received consideration from the competition authorities, principally in European Commission decisions in merger control cases.

An associated market analysis issue is the type of health service customer. A very clear distinction arises between supplies to hospitals (the hospital segment) and supplies to wholesalers who resell to pharmacies (the community segment). The conditions of competition will be very different in each of these. They are sufficiently distinct to justify being treated differently even by dominant companies.

Particular agreement types

In many respects the types of agreement used in the Lifesciences sector are similar to those in other sectors. There will be merger arrangements, horizontal and vertical deals and technology transfer arrangements common to research-based industries. Nonetheless, the pharmaceutical sector in particular uses agreement types which deserve particular consideration:

- distributive deals: co-promotion and co-marketing
- strategic alliances: research and development and/or commercialisation.

Distributive deals

Collaborative commercialisation of an innovator's pharmaceutical product is frequently achieved in one of two ways, i.e. co-promotion or co-marketing.

Co-promotion is where one company (usually the innovator) sells into the market place under a single trade mark, but enlists another company's sales force to promote the product alongside its own sales force. The arrangement involves buying in promotional capacity and usually raises few competition issues. The position can be different where the co-promoters are competitors or where the one seeks to influence the pricing strategy of the other.

Co-marketing is generally more sensitive. This is where the innovator licenses one or more companies to distribute the product under a different trade mark from the innovator's. The rationale is to secure rapid market penetration by the molecule, even under a variety of trade marks. The relationship inherently creates competition between the co-marketers. This can cause legal difficulties, particularly if there is coordination between them on marketing practices or price. If the licensed territory is a low-priced one, it is likely to become a source for parallel traded products. By appointing co-marketers, innovators have less control over the distribution chain and may be exposed to greater parallel trading activity.

Strategic alliances

No two strategic alliances are the same. In the pharmaceutical sector, they often involve collaborative research and development and/or a commercialisation stage. The commercialisation stage can often involve a combination, according to territory, of exclusive licenses, co-promotion or co-marketing arrangements. Generally, such competition issues as do arise are greater, the closer the product is to the market place.

Strategic alliances raise particular difficulties under the regime on horizontal agreements. One feature of research markets is that the horizontals regime recognises the existence of competitive markets, even at the R&D and pre-market stage. It calls an innovative centre an R&D "pole". If the only two R&D "poles" investigating a particular therapy were to combine, this would be regarded as having an exclusionary effect by dissuading others from conducting R&D in that therapeutic area.

At the commercialisation stage, the period for which joint commercialisation can be permitted is usually capped at 7 years from EU launch. This may be too short for parties who may have invested heavily in commercialisation, particularly when the residual patent protection can be 10-12 years from product launch.

1 January 2007

The oil and gas industry – do's and don'ts in competition law

UK and EU competition law are both based on the same two prohibitions. The UK prohibitions are found in Chapters I and II of the Competition Act 1998 and the EU prohibitions are found in Articles 81 and 82 EC Treaty. The prohibitions are against:

- anti-competitive agreements and practices (Chapter I / Article 81)
- abuse of dominance (Chapter II / Article 82).

The prohibitions are explained briefly below. Fuller explanations of each of these prohibitions can be found in the sections of this Survival Pack entitled "Competition Law in the EU and UK - basic principles", "Restrictive agreements", and "Abuse of a dominant market position".

Chapter I/Article 81 prohibits arrangements which:

- affect trade in the UK/EU (as appropriate), and
- prevent, restrict or distort competition in the UK/EU (as appropriate).

Anti-competitive agreements include price-fixing and market sharing agreements, but also a lot of agreements you might not necessarily think might cause difficulties, such as customer boycotts, some trade association rules, and certain types of exclusive purchasing agreement.

Agreements which fall within this prohibition are void and unenforceable, although there are some exclusions and exemptions (e.g. for vertical agreements – see further below). However, individual agreements which on the face of it fall within the prohibition are automatically permissible if they meet certain criteria, set out in Article 81(3) and section 9 of the Competition Act 1998, including that any restrictions go no further than is necessary and that there are countervailing efficiencies and benefits. It is up to the parties to assess their own agreements for compliance with these criteria. Ultimately the issue will be tested if the agreement is challenged in the courts. Although there is an exclusion in both systems for agreements of minor importance, it is unlikely that many agreements in the oil and gas sector will fall within these de minimis exclusions.

Chapter II/Article 82 prohibits conduct which

- amounts to the abuse of a dominant position, and
- affects trade in the UK/EU (as appropriate).

You will only be caught by this prohibition if you have a dominant position. The key to a dominant position is having market power, which in essence means that you can act in the marketplace without fearing that your competitors will take custom from you or that your customers will go elsewhere. It usually involves a significant market share. It is not the holding of a dominant position which is the problem: it is any abuse of that position. This may be for instance by imposing unfair prices/conditions, by refusing to supply a particular customer, or imposing tie-in obligations or operating loyalty schemes. You may also have a dominant position in relation to the purchase of particular types of goods or services. There are fewer exclusions, and no exemptions, available in relation to this prohibition.

UK or EU – what's the difference?

The interpretation of the two prohibitions is broadly similar in UK and EU law and both carry significant sanctions for breach including substantial fines. But there are differences between the two systems, for instance:

- procedures for dealing with complaints
- investigative powers
- the EU concern about agreements which put up barriers to a single market
- whether information is regarded as benefiting from legal privilege.

UK or EU – which applies?

In order to decide which of the two systems applies to your agreement you need to decide whether there is any potential effect on trade with other EU/EEA countries (EU rules apply also in the EEA).

EU	Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and UK
EEA	EU countries plus Norway, Iceland and Liechtenstein

Because of the existence of interconnectors for gas and the global trade in oil, any agreement concerning the distribution of product is likely to have such an effect, unless it is an isolated one such as an agreement by one field to supply fuel gas to a neighbouring field. Equally, given the close proximity of other EU countries to the UKCS, it is likely that any offshore contract could be performed by a supplier from another EU/EEA country and so it too will have a potential effect on EU/EEA trade. Onshore contracts may or may not affect trade depending on the nature of the goods or services concerned and the likelihood of their being supplied from outside the UK.

Type of contract	UK or EU competition law?
Contract dealing with production	EU law
Contract for offshore services	Likely to be EU law
Contract for onshore services	May be EU or UK law

If in doubt, it is probably safer to assume that EU law applies since if a European exemption applies you will have a parallel exemption under UK law.

Why worry about competition law?

There are serious consequences for breaching the prohibitions.

The Office of Fair Trading has extensive, some would say draconian, powers to enforce competition law and the European Commission has similar powers. Further details of these powers can be found in the section of this Survival Pack entitled "Competition authorities' powers of investigation", but briefly they can:

- obtain interim injunctions to stop harmful conduct while investigations are carried out
- on completion of investigations, order the conduct to cease permanently
- arrive unannounced at your premises, demand to see the managing director's diary and ask his secretary to explain the meaning of coded entries in it
- download the contents of your computer system and take copies of interesting files you keep in your study at home
- fine you or, in the UK, even imprison you, if you interfere with their investigation
- fine your group 10% of its worldwide turnover for the last financial year
- send you to prison for up to 5 years if you were responsible for cartel activity by your company (UK law only, not EU law)
- if you are a director of a company which breached competition law, disqualify you as a director in the UK for up to 15 years.

When the authorities have finished with you, your competitors can sue you in court for the damage your conduct has had on their business and, of course, your anti-competitive agreement may be unenforceable.

What your in-house lawyer will ask you if you are entering into a new agreement

Does your agreement breach the prohibition? If so, are any exclusions or block exemptions applicable? If not, would the agreement meet the criteria of Article 81(3) EC Treaty or section 9 of the Competition Act 1998? In answering these questions, your in-house lawyer will be conducting four types of overlapping analysis and will need information from you in order to give you a firm answer:

Legal analysis:

- Who are the parties?
- Are they part of corporate groups and what is the turnover of those groups?
- Can you provide copies of their latest report and accounts or any relevant product catalogues or other marketing material?
- What is the object of the agreement?

- What is its significance to the parties?
- Have all of its terms been disclosed?

Market analysis:

- What is the precise product or service being provided under the agreement and are there any substitutes? (See next section on market definition)
- What is the geographic market in which it is provided?
- What are the parties' market shares on that market, and in the EU and worldwide?
- Who are the principal competitors and what is their turnover and market share in the UKCS, EU and worldwide?
- How easy would it be for a new competitor to enter the market - what are the barriers to entry (e.g. start up costs, R&D, distribution network, IP rights, reputation).
- Who are the customers for this product/service (e.g. operators, major contractors, small service companies)?

Competition analysis:

- What are the likely effects of the agreement on competition in that market?
- Will a customer, supplier or competitor be restricted in who he can do business with (or on what terms) in future?
- Is there a network of agreements similar to this one?
- Does the agreement have "spillover" effects on any other markets?

Risk/visibility analysis:

- Are competitors or customers likely to complain?
- Is this a particularly high value or high profile contract?

Defining the relevant market

In order to apply competition law it is crucial to know what market is affected. A market has two aspects - the product market and the geographic market.

In determining the product market the authorities will ask what products or services the customer considers substitutable for the product or service concerned. In other words, if the price of the particular product went up by, say, 5%, to what alternative would he turn? If there is such an alternative, it is likely to form part of the market.

In determining the geographic market the authorities will look at the area from which customers usually purchase the relevant goods and services. The growth of e-commerce and the global procurement marketplace may expand the market for some goods and services but the authorities will be interested in concrete examples of such purchases, not just theoretical options.

Example of market definition

For example, if an operator were to enter into an exclusive contract with a contractor for the supply of ROVs for rig positioning, what would be the relevant market? The first step would be to consider all suppliers of ROVs for rig positioning but are there any other ways of checking rig position accurately? If these are comparable in cost and quality, such that the operator would turn to them if the cost of using ROVs increased by, say, 5% then they too will be part of the market.

As ROVs are regularly bought in from Norway or Denmark, the market may be Europe-wide, not just UK. What if another contractor has ROVs but has traditionally used them only for seabed surveys – if the prices were attractive could that contractor adapt his business? If he could enter the market within, say, a year, then he too may be a potential competitor and even if he is not considered part of the market, he may limit the foreclosure effect of the exclusive agreement.

What's the bottom line? How does competition law apply to upstream industry agreements?

The rules impact horizontal and vertical agreements in a different way.

Horizontal agreements

Horizontal agreements are agreements with competitors and are viewed with suspicion by the competition authorities. Some of the principal types of horizontal agreement are discussed below.

Joint Operating Agreements and Unit Operating Agreements

Because of the enormous risks and capital involved in oil and gas development, oil companies need to spread their risk by taking different levels of interest in different fields and developments. This does require co-operation between companies which are competitors in other markets but if it were not possible to share risks in this way, development would be significantly restricted. A joint operating agreement or JOA is therefore generally considered necessary in order to regulate the sharing of risk and reward.

JOAs rarely restrict the parties in relation to matters outside the joint development itself. Joint development does not necessarily entail joint sale of the products of development and so is unlikely that JOAs will be treated as restrictive of competition to an appreciable extent.

The same arguments can be made in relation to UOAs.

The situation may be different however in the case of bidding agreements or AMIs as these may contain clauses preventing parties from bidding for assets in a particular area except through the consortium and these will need careful consideration if they extend beyond the of the area of the current bid.

Problems may also arise with regard to decisions to re-inject or shut-in which have an appreciable effect on production, as these may amount to a joint decision to limit production. Some aspects of information exchange can be problematic - the keys are the level of confidentiality involved and the potential uses of the information. This is explained further below in relation to benchmarking exercises.

Joint procurement

Joint procurement by neighbouring fields is encouraged in UK industry initiatives. Such joint purchasing is likely to produce economies of scale and may even enable the development of previously uneconomic fields. It is unlikely to be a problem under competition law unless the purchasing consortium reaches a size where it would be dominant in the relevant purchase market, or the consortium imposed exclusive selling obligations on its chosen suppliers. Exchange of cost information between suppliers can be problematic but costs in relation to a particular service may represent only a small part of an operator's overall costs, which removes some of the transparency that might otherwise result. In any event, knowledge of another operator's costs is of little advantage in the case of sale onto a commodity market.

Oil/gas sales agreements

Oil is sold onto a commodity market and is movable around the world. Co-venturers in a particular development therefore generally sell on an individual basis. Joint sales rarely occur except in the case of small accumulations unlikely to represent an appreciable restriction on competition and individual sales rarely include any clauses restrictive of competition.

Gas sales agreements are a different matter. Gas is not a commodity. In order to reach the ultimate consumer it must be transported through a pipeline system which has limited capacity. In the absence of a fully integrated global distribution system, gas field owners have almost always looked for a long term contract for sale of their gas to a gas distributor - in the absence of such a contract any single co-venturer may veto a development. Although gas is owned separately and therefore in theory each seller could contract separately there are a number of practical difficulties with this:

- the difficulty of negotiating lifting and gas balancing agreements;
- the need for consistency as regards technical considerations such as landfall, pipeline size, production profile and processing arrangements;
- the impact of swing factors, liquidated damages or other shortfall arrangements on the management of production;
- the need to offer economic volumes and ease of administration to buyers.

These factors have meant that joint selling has been, until recently, the norm. Indeed, certain joint gas sales agreements benefited from a specific exemption from the old UK competition regime under the Restrictive Trade Practices Act. No such exemption exists under the Competition Act and therefore joint selling of gas by co-venturers is likely to fall within the prohibition on anti-competitive agreements if UK law applies.

If, as is more likely, EU law now applies, since amongst other things the Interconnector has very visibly rendered the UK market part of a wider EU market, then joint selling will already give rise to competition law problems.

There are no published decisions of the UK or EU authorities on the application of competition law to gas sales agreements other than the Britannia decision of the European Commission which related to an agreement before the time of the Interconnector. However, we do have some press releases (for instance relating to the Corrib Field in the Irish Sea, the Norwegian GFU arrangements and DONG's agreements with producers in the Danish sector) which give us a clear signal as to the European Commission's approach. Looking at these and applying basic principles it may well be difficult in future to convince the courts or competition authorities that joint selling is essential. One of the keys to showing that the benefits of a joint arrangement outweigh any technical breach of Article 81 is to demonstrate the indispensability of the restrictions (e.g. the requirement to act jointly). Some technical and production related issues may need to be determined jointly but it is difficult to see why, in many instances, pricing negotiations could not take place separately.

Gas transportation agreements

Gas transportation agreements raise two issues under competition law.

First, joint decisions of the infrastructure owners and/or shippers with regard to tariffs and other matters raise issues of joint selling similar to those raised by joint sales of oil or gas.

Second, depending on the definition of the relevant market, infrastructure owners may be found to be in a dominant position and the infrastructure to amount to an "essential facility" which, under EU case law, imposes obligations on the owners to provide access on fair, transparent and non-discriminatory terms.

Compliance with the Infrastructure Code of Practice is likely to assist an argument that there has been no abuse.

Don't do this – horizontal agreements

- Exchange sensitive information
- Discuss with competitors your or their price structures or terms of business for the sale of products - beware trade associations, friendly get-togethers, market researchers
- Price fix in any shape or form
- Share or control markets - by product/by service/geographically/by limiting or controlling investment
- Agree customer or supplier boycotts

Mind your language

Don't write/email anything suggestive of anti-competitive practices. The following types of statement are likely to arouse suspicion in the mind of a competition authority investigator:

- "We must restore order in the market"
- "We have eliminated the competition"
- "It's time XCo learned a lesson"
- "Confidential - addressee only"
- "Please destroy/delete after reading"

Can we take part in benchmarking or industry data gathering exercises?

The exchange of information between competitors can be anti-competitive because it can result in concerted practices or reveal a competitor's commercial strategies. As such, care needs to be taken over the exchange of industry data. The following table sets out some of the factors which determine whether an exchange is likely to be permitted. If in any doubt, consult your legal adviser.

Benchmarking/industry data exercises

Safe	Dangerous
◤ The relevant data is available publicly in any event	◤ The relevant data is confidential
◤ The relevant data is entirely technical	◤ The relevant data is commercial
◤ The data will be published in an aggregated form or it will be published anonymously and in such a way that no individual company's data will be identifiable	◤ The data will not be aggregated and the source of the data will be identified/identifiable
◤ The data will be available only to regulatory authorities or to an industry task force set up to deal with a specific public interest issue	◤ The data will be circulated freely around the industry
◤ The data will be available only to potential customers	◤ The data will be available to competitors
◤ The data is historic	◤ The data is current or relates to future plans

Vertical agreements

A vertical agreement is one between two or more parties each of which acts at a different level in the supply chain for the purposes of the agreement – even though they may be at the same level of the chain in other contexts – and which relate to the conditions under which goods or services may be purchased, sold or resold.

A vertical agreement would include an agreement between an operator and a contractor, or a contractor and a sub-contractor. It may also involve the related assignment or licence of intellectual property rights as long as these are not its primary object. Procurement contracts entered into by individual operators are vertical agreements and generally raise fewer competition issues than the horizontal agreements between competitors discussed above.

Are vertical agreements ever a problem?

The exclusion from UK competition law for vertical arrangements was abolished with effect from 1 May 2004. However, companies entering into vertical agreements may take advantage of the EU exemption, whether their agreement falls under UK or EU law.

The EU exemption applies only where the relevant party has a market share not exceeding 30% (see section below on whose market share to measure). It has a number of other restrictions, the principal examples being set out in the table below. It does not apply to price fixing agreements (although maximum resale prices are allowed, as are recommended minimum prices where these are not binding).

Because some of the limits to the exemption are technical and their interpretation has not yet been fully explored, it is always best to have any vertical agreement reviewed by a lawyer if it restricts competition i.e. it places any restrictions on the ability of the parties to do business with third parties. Examples of such restrictions are clauses which require one party to the contract to sell only to (or buy only from) the other party all of its production (or requirements) of a particular good or service. (For these purposes, EU law treats any contract for 80% or more of your requirements as exclusive).

Verticals block exemption – whose market share do you measure?

Generally the relevant market share is the share of the supplier but in the case of exclusive supply agreements (i.e. agreements in which the supplier agrees to supply the relevant goods and services to only one buyer for a particular use or for resale) it is the market share of the buyer that counts.

Which vertical agreements may cause problems?

- Price fixing always out - beware of "English clauses" which require the supplier to match terms offered to the customer by other suppliers
- Vertical agreements entered into by dominant companies may be exempted from Chapter I or Article 81 but still infringe the Chapter II or Article 82 prohibition
- Market shares over 30% - agreements cannot benefit from block exemption and will require specific analysis
- Agreements where non-competes are for indefinite period or for more than 5 years
- Any restriction on the territory or customers to which the buyer can sell
- Any restriction on the sale of spare parts by the supplier to end users/repairers who are not the buyer's own repairers
- Agreements between competitors unless the agreement is non-reciprocal and the buyer either has a total annual turnover not exceeding €100 million or is a pure distributor of goods

Downstream issues: the European Commission's sector investigation into gas

On 13 June 2005 the European Commission announced its decision to launch an investigation into the gas and electricity sectors. The aim of a sector investigation is to review whether competition is working effectively in a given sector, and if not, why not. The Commission regards sector investigations as particularly well suited to investigating cross border market concerns. If the Commission finds that particular features of a market/types of agreement impede competition, it can take specific action, for example, it could propose new legislation or launch actions against individual companies for infringements of competition law.

On 16 February 2006, in its preliminary report on the findings of its energy sector investigation, the Commission announced that it had found serious malfunctions in competition in gas and electricity markets. In particular, the Commission stated that it intends as an "immediate priority" to pursue anti-trust investigations regarding alleged:

- foreclosing of gas markets by means of long-term downstream contracts; and
- restrictions on access to capacity on gas pipelines, gas storage and on gas and electricity interconnectors between EU Member States.

Competition Commissioner Neelie Kroes stated that this is a "gentle word of warning" at the beginning of a period of more intensive antitrust enforcement and encouraged companies to review their competition law compliance.

Other serious malfunctions identified by the Commission as possibly meriting further action include:

- Market concentration – future mergers in the sector may face increased scrutiny;
- The powers of certain national regulators, which need to be increased in a number of EU Member States, to strengthen surveillance of third party access for competitors and pricing for such access;
- Grandfathered rights (capacity rights stemming from pre-liberalisation monopoly contracts), which are considered as "seriously impeding effective entry of competitors".

The Commission intends to reach its final conclusions on the gas sector inquiry early in 2007.

Operate a compliance system

An effective and up-to-date compliance system can not only prevent problems arising but can lead to reduced fines if you do breach the rules inadvertently. Here are some of the things you can do to ensure that your compliance system works:

- Review your current agreements and arrangements for compliance with competition law
- Ensure your standard documents and practices comply
- Update the compliance programme - and use it
- Issue simple team guidelines and monitor activities
- Have clear reporting lines for spotting/dealing with problems
- Have a single focal point for queries or at most one per business unit
- Take disciplinary action for non-compliance
- Have a dawn raid procedure in place and ensure the relevant people know about it
- Implement a document retention/destruction programme
- Keep legal advice separate - to ensure you can easily claim privilege if investigators arrive.

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