Briefing

BURGES SALMON

Competition

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Recent developments in cartels, dominance, follow-on litigation and merger control

As one year ends and another begins, and the Competition and Markets Authority gets ready to start work on 1 April 2014, in this Briefing we look back at a number of important recent developments in UK and EU competition law, which will influence how competition law is applied in the future, whether in cartel enforcement, merger control, antitrust investigations or competition litigation.

In the field of cartel enforcement, we examine a number of recent decisions of the Office of Fair Trading and the European Commission, as well as two important judgments of the Court of Appeal concerning follow-on damages actions brought against the participants of international cartels. We also consider the impact of the OFT's closure of an investigation into a suspected abuse of dominance without making a finding of infringement, which emphasises the central importance of market definition in dominance cases.

We also consider a number of recent decisions and judgments concerning merger control. These provide further guidance on how the OFT and Competition Commission should review mergers, including as regards their jurisdiction to review mergers, their duty to provide merging parties with access to evidence, their substantive assessment of a merger's effects on competition and their powers to impose remedies. We also assess the application of the 'failing firm' defence in mergers involving firms in financial difficulty.

Cartels: OFT and European Commission punish companies large and small for involvement in illegal cartels

In our **March 2013 Briefing** we explained how the OFT and European Commission ("EC") investigate and punish illegal cartels and how companies can avoid or reduce fines by cooperating with an authority under their respective leniency programmes and/or by admitting their involvement in settlement proceedings. In addition, in our **November 2013 Briefing**, we set out how the Competition and Markets ("CMA") (which will assume the OFT's cartel investigation powers) intends to investigate and punish illegal cartels, including by prosecuting individuals under the revised cartel offence.

Both the OFT and the EC have recently punished companies large and small for participating in illegal cartels. However, in each case a number of companies either avoided fines altogether or saw their fines reduced for cooperating with the authorities, admitting their involvement and providing information that assisted in proving the existence of the cartels. These cases are another strong reminder of the need for companies, large and small, to ensure that their staff do not become involved in illegal cartels and, should they nevertheless become aware of such involvement, to consider informing the relevant authority in order to benefit from either immunity from fines or a reduction in any fine. In particular, small companies should not be under the misplaced illusion that competition authorities will not take action against them on account of their small size; the OFT and EC clearly will.

UK: OFT fines pharmacies for cartel in supply of medicines to care homes

In December 2013, the OFT found that two pharmacies, Quantum and Lloyds, had illegally partitioned the market for the supply of prescription medicines to residential care homes throughout England. The cartel lasted for six months in 2011.

Quantum was fined over £380,000, but Lloyds avoided a fine as it had informed the OFT of the cartel, so gaining immunity from fines under the OFT's leniency programme. It is notable that Quantum's fine was reduced by almost half, as it had also admitted its involvement in the cartel and cooperated with the OFT.

UK: OFT also fines retirement home security suppliers for collusive tendering

Also in December 2013, the OFT found that four suppliers of access control and alarm systems had colluded in tenders organised by operators of retirement homes. This enabled the winning company to submit higher bids than would otherwise have been possible. The total value of the affected tenders was £1.4 million. Although this may seem small, the OFT nevertheless considered these to be serious infringements. Three companies were fined a total of £53,000. A fourth company, the winning bidder in each case and which presumably organised the rigged bids, escaped a fine because it was first to inform the OFT: to avoid fines, companies should therefore inform the OFT before their co-conspirators do.

EU: EC fines international banks and brokers over € 1.7 billion for illegally fixing interest rate benchmarks, but whistleblowers escape fines of over € 3.3 billion

In December 2013, the EC announced the conclusions of its investigation into the fixing of LIBOR and other interest rate benchmarks.

A number of major global banks participated in various cartels to distort these benchmarks, by making false submissions of the rates at which they borrowed on the interbank money markets and by discussing their trading and pricing strategies. In doing so, the interest rates applied to derivatives products were distorted.

Fines of over € 1.7 billion were imposed on these banks and also upon a small broker which facilitated some of the collusive contacts. This is the record aggregate fine imposed by the EC in one investigation. However, Barclays escaped a fine of around € 690 million for revealing collusion concerning the EURIBOR benchmark and UBS a fine of over € 2.5 billion for revealing collusion in setting the LIBOR and TIBOR benchmarks; Citigroup also avoided a smaller fine for disclosing one of the Yen-based cartels. In addition, all the other fines were reduced by between 25% and 40% for cooperation under the EC's leniency programme and by a further 10% for admitting the infringements and entering into settlement agreements with the Commission, so shortening the investigation procedure.

Investigations continue against some banks and a broker that chose not to admit their involvement and settle with the Commission. The Commission also has on-going cartel investigations into Swiss franc denominated derivatives, credit default swaps and the foreign exchange market.

The unprecedented fines imposed (both before and after reductions for leniency and cooperation) are a stark reminder of the need to avoid any conduct that may directly or, as here, indirectly, affect market prices, whether through fixing prices or other trading conditions or participating in other contacts with competitors with a view to influencing their conduct. The level of fines avoided by Barclays and UBS are also a reminder of the financial benefits that can be obtained by disclosing a cartel to and thereafter cooperating with the relevant authority.

Court of Appeal clarifies UK jurisdiction to hear follow-on damages actions concerning international cartels

Once a competition authority has found that companies have infringed competition law, for example by participating in a cartel or by abusing a dominant position, those affected can bring a private action for damages. Such 'follow-on' claims are increasing in number. Claimants will often seek to bring a single action against all defendants and for all losses allegedly suffered by them throughout the European Economic Area ("EEA"). The English High Court and the Competition Appeal Tribunal ("CAT") are seen as attractive fora for such claims, given judicial expertise, broad obligations to disclose evidence and cross-examination of witnesses.

In November 2013, the Court of Appeal handed down two judgments concerning the jurisdiction of the English courts to hear follow-on damages claims. The judgment in *Deutsche Bahn* confirms that the English courts can hear actions by indirect purchasers to recover losses caused by international cartels, but that in *Ryanair* confirms that they have no jurisdiction to hear claims to recover losses for a cartel not involving the United Kingdom. Both claimants and defendants must consider carefully issues of jurisdiction at an early stage.

Deutsche Bahn: UK-based indirect purchasers can sue foreign cartel members in the UK courts

Deutsche Bahn concerns a claim by European railway operators (most not British) to recover losses allegedly suffered by them as a result of an international cartel between manufacturers of carbon and graphite products (only one of which was British, Morgan Crucible). The cartel had been investigated and punished by the EC. *Deutsche Bahn* has led to significant litigation on whether the CAT has jurisdiction to hear the claims, including as to whether the claim was brought "out of time" against the whistleblower, Morgan Crucible: that matter is presently before the Supreme Court.

In August 2013, the CAT held that, irrespective of whether the claim against Morgan Crucible had been brought out of time, it had jurisdiction to hear claims made by claimants incorporated in the UK against the foreign defendants on the basis that those customers had suffered harm in the UK, even if they had in fact purchased the products covered by the cartel only from a subsidiary of a cartel member or through a third party, and not directly from a cartel member.

On 20 November 2013, the Court of Appeal refused permission to appeal the CAT's judgment. It held that the CAT's judgment was clearly correct and it has jurisdiction to hear claims made by UK purchasers, whether direct or indirect victims.

Ryanair v Esso Italiana: contractual jurisdiction clause does not permit damages claim to be brought in UK following a foreign cartel

In *Ryanair v Esso Italiana*, the airline sought to recover losses suffered by it as a result of a cartel between fuel suppliers in Italy, which had been investigated and punished by the Italian competition authority.

Ryanair had purchased fuel from several of the cartel members. It asserted that the English High Court could hear the claim on the basis of a clause in its contract with Esso that conferred on the English courts non-exclusive jurisdiction to hear disputes on the operation of a price adjustment clause.

The Court of Appeal held that the English courts did not have jurisdiction to hear Ryanair's claim, whether under contract or for damages under competition law. First, the price adjustment clause was not intended to and did not operate to revise prices allegedly increased as a result of the illegal cartel, so could not be used to vest jurisdiction in the English courts. Second, as a result, it could not be presumed that the parties intended the jurisdiction clause to cover a dispute based purely on a breach of competition law. Therefore, as the cartel did not affecting fuel supply in the UK, it did not cause any harm in the UK and the High Court did not have jurisdiction to hear the follow-on claim.

The consequence of the *Ryanair* judgment is that contractual jurisdiction clauses included in numerous commercial contracts will not, in the absence of a clear intention to the contrary, cover competition damages claims and the English courts will have jurisdiction only if harm has been suffered in the UK.

Dominance: OFT closes investigation without finding of infringement due to uncertainties over the relevant market

In a dominance case, it is essential to define precisely the relevant market, as only then can it be determined whether the defendant is dominant; absent dominance, there can be no abuse. This was recently clearly demonstrated by the OFT closing, without taking action, a lengthy investigation into the conduct of bunker fuel firm CH Jones.

CH Jones's principal competitor, UK Fuels, had complained that CH Jones had abusively excluded UK Fuels from competing in the supply of bunker cards by entering into exclusive agreements with service station operators. Bunker cards allow operators of heavy goods vehicles ("HGVs") to obtain fuel at wholesale prices from the card operator's network of bunker sites.

The OFT closed its investigation despite having issued a Statement of Objections ("SO"). In its SO, the OFT had provisionally concluded that CH Jones abused a dominant position by entering into exclusive contracts that excluded UK Fuels from those sites. It had identified markets for direct bunkering card services (where customers purchase their own fuel, have it delivered to a bunker site and then draw it down as required, for which CH Jones had a 94% share) and, separately, for the provision of pay as you go ("PAYG") bunker card services (where customers purchase fuel when required, for which CH Jones had a share of 31%).

CH Jones and UK Fuels both contested these definitions. UK Fuels argued that there was a single market comprising both direct bunker and PAYG bunker services, in which CH Jones was dominant; it considered that this market did not include bunker cards provided by other fuel suppliers, such as the "oil majors" (e.g. BP, Esso and Shell). By contrast, CH Jones argued that there was a much wider market, in which it was not dominant, for services enabling customers to access diesel "on the road" at wholesale prices, comprising direct bunker and PAYG bunker services and also bunker cards provided by the oil majors.

In considering these opposing views, the OFT reviewed its approach to market definition. As well as obtaining the views of hauliers and competitors, it also undertook an econometric assessment (critical loss analysis) of what would happen were prices for a particular bunkering service to rise, to determine whether customers would switch to other bunkering services: this is the standard so-called "SSNIP" test.

Having done so, it concluded that there was insufficient evidence to support the existence of distinct markets for either the supply of direct bunker cards (as found in the SO) or for both direct and PAYG bunker cards (as asserted by UK Fuels), although this was "finely balanced". Therefore, the OFT was unable to identify any relevant market on which CH Jones was dominant. As a result, there was no prospect of establishing that CH Jones had infringed the Chapter II prohibition of the Competition Act 1998. It therefore closed its investigation.

It is not clear why the OFT was unable to develop at an earlier stage a robust market definition that could have been successfully defended following the SO, but its change appears to be the result of additional factual evidence and data obtained by the OFT following the SO.

CH Jones is a clear reminder to complainants that they must define correctly the relevant market in order to sustain a complaint that a firm has abused a dominant position. It is not sufficient to simply assert that unilateral conduct has had anti-competitive exclusionary and/or exploitative effects. Only if dominance is established can such conduct be unlawful. It also demonstrates the need for an evidence-based approach to market definition, using factual, documentary and expert economic evidence.

Mergers: CAT clarifies the concept of a "substantial" lessening of competition

The Competition Commission ("CC") can find that a merger is anti-competitive only if it has or is expected to substantially lessen competition ("SLC"). The CAT gave guidance on the concept of a "substantial" lessening of competition in a recent judgment dismissing an appeal by Global Radio Holdings against a CC decision that its acquisition of GMG Radio led to an SLC in the supply of non-contracted radio advertising in various cities and that the merger could proceed only subject to Global divesting radio stations in those cities.

Global argued that any lessening of competition arising from the merger was not "substantial" and thus did not lead to an SLC. The CAT disagreed with Global's assertion that a "substantial" lessening of competition must be "large", "considerable" or "weighty" in absolute terms. It held that the CC was correct to find an SLC where a merger has a "significant effect on rivalry over time" on a particular market (however small in size or geographic scope) and that it did not need to demonstrate that that lessening was large in absolute terms. The CAT also rejected Global's challenge to the divestment remedies imposed by the CC: the CC has a broad discretion in imposing remedies and had not acted unreasonably or disproportionately in requiring the divestment of overlapping businesses.

Mergers: EC and CC apply "failing firm" defence to approve several mergers that would lead to high market shares or even monopolies

In certain circumstances, a merger that would otherwise be anti-competitive can be approved because the target company is in such a weak financial position that it would in any event fail and exit the market.

Under both UK and EU merger rules, strict conditions must be satisfied for the "failing firm" defence to be applicable. Clearances relying on it are highly fact-specific and require credible evidence demonstrating that the target will fail financially and exit the market. Merging parties wishing to avail of the defence must consider at an early stage how they will demonstrate to the relevant authority that these conditions are satisfied: in particular, they must adduce pre-merger contemporaneous documents that the target company (or the division subject to the merger) is in such a weak financial position that insolvency and market exit are both inevitable.

UK: CC approves merger of laser eye surgery providers

In *Optimax/Ultralase*, the CC approved a merger of two of the UK's three largest providers of refractive eye surgery, even though they had been close (and in some cases the only) competitors in a number of areas. The CC found that Ultralase's consistently deteriorating financial position would have caused it to exit the market and that there was no other credible buyer that could have acquired it as a going concern. As the merger had been completed, it observed how Ultralase's market share had been redistributed and compared this with the expected (counterfactual) outcome had Ultralase simply exited the market. In both cases, most of its sales would have gone to either Optimax or Optical Express, the other remaining large supplier. The CC thus concluded that the merger was not a more anti-competitive outcome than exit and therefore approved it unconditionally.

It may be asked why the OFT was unable to reach the same conclusion, which would have obviated the need for the merger to be referred to the CC. Although it accepted that Ultralase's failure was inevitable absent a merger, it could not exclude the possibility that there was a less anti-competitive alternative purchaser for Ultralase. The CC was able to undertake a more detailed assessment of the applicability of the "failing firm" defence, to eliminate the possibility of any other possible acquirer and to determine that the merger did not lessen competition compared to the counterfactual of Ultralease's exit.

EU: EC applies failing firm defence to approve two mergers

Although application of the failing firm defence remains very rare, two recent merger clearances under the EU Merger Regulation have also relied on the defence. In September, the EC unconditionally approved Nynas' acquisition of part of Shell's Harburg refinery, which was structurally unprofitable. Nynas and Shell were the only EU producers of napthenic base and process oils. The EC found that there were no alternative purchasers and, absent the merger, Shell would have closed the part of its refinery producing these and other distillate products. Closure would have reduced EU capacity to below EU demand, and thus have led to price increases as customers would have been forced to switch to more costly imports. The EC therefore approved the merger as it was the only way to maintain EU capacity and avoid price rises.

The defence was also applied to approve Aegean Airlines' acquisition of Olympic Air: Olympic's chronic financial difficulties and the unwillingness of its parent company to provide continued financial support would have seen it closed down, as there was no means by which Olympic could have been restructured to restore it to profitability. In reaching this conclusion, we understand that the EC reviewed many internal documents, pre-dating the announcement of the merger, which demonstrated Olympic's inevitable insolvency and closure. In the absence of any other credible buyer and because Aegean would have captured Olympic's market position on all overlap routes, the merger did not reduce competition (even though it would have created a monopoly on many routes) and was approved unconditionally.

UK: OFT refuses to apply failing firm defence as no evidence of failure and exit

In *Diamond Bus/First Redditch and Kidderminster* the OFT refused to apply the defence. It found that there was no evidence that either the purchaser or the target would have inevitably exited the market, despite being loss-making. Neither company had made a decision to exit and neither could produce documentation showing an intended exit. The merger was, however, approved on other grounds, given its de minimis effect on competition, even though the parties overlapped on several bus routes in the town of Redditch.

Mergers: CAT overturns prohibition of Eurotunnel/SeaFrance merger but clarifies CC's duties of disclosure and powers to impose remedies

In June 2013, the CC found that Eurotunnel's acquisition of the assets of the failed ferry operator, SeaFrance, had substantially lessened competition on the short-sea routes between the UK and France and Belgium. It accordingly prohibited Eurotunnel from operating ferry services from Dover, unless it sold two of the three vessels it had acquired.

In December, the CAT overturned this decision. It considered that the CC had not correctly determined that it had jurisdiction to review the merger by failing to determine that, SeaFrance having ceased trading and entered liquidation, the SeaFrance assets (including ferries, brands, customer lists, a website and goodwill) acquired by Eurotunnel constituted a business. The CC is presently reconsidering whether it has jurisdiction and will adopt a new decision by the end of April. It is notable that the French competition authority, the Autorité de la concurrence, to which Eurotunnel had notified the merger and which had approved it, had considered that (under French law) the assets represented a business and that the transaction was thus a merger. It is also notable that the successful challenge to the CC's jurisdiction was made not by Eurotunnel, but the workers' cooperative which operates the ferries on Eurotunnel's behalf.

However, the CAT rejected all other challenges made by both Eurotunnel and the cooperative to the CC's decision. In doing so, it provided valuable guidance on a number of aspects of UK merger control.

First, it confirmed that the CC did not breach the rules of natural justice in withholding certain, confidential, evidence and not using a "confidentiality ring": the CC must balance its duties to consult (and disclose evidence) and to protect confidential information. The CAT found that the CC had acted fairly by redacting or withholding confidential (and in some cases highly confidential) evidence and disclosing the "gist" of it, so that the parties understood the case against them and could make appropriate submissions to the CC: fairness does not require the disclosure of all evidence, even within the confines of a confidentiality ring.

Second, it confirmed that the CC was required to consult not only Eurotunnel, but also any other party (such as the workers' cooperative) that might be affected by its intended remedies, including by disclosing its working paper on remedies. The CC had not done so, by failing to disclose it to the cooperative, which was "troubling" for the CAT. However, the cooperative had received copies of the remedies working paper from Eurotunnel and had thereby been able to make submissions on the CC's intended remedies; with "considerable misgivings", the CAT held that this inadvertently cured the CC's procedural failure.

Third, the CAT confirmed that the CC has a broad discretion in imposing merger remedies, provided that they are proportionate and as comprehensive as possible in addressing the SLC identified by it. The prohibition on Eurotunnel operating ferry services at Dover was proportionate, to prevent Eurotunnel raising fares on its tunnel services, which could have happened were it to operate any ferries on the short sea (to which part of any loss of business arising from a fare increase would be transferred, so 'internalising' the effects of the price rise), whether to Calais and/or Dunkerque. Further, in determining that the remedy was proportionate, the CC was not obliged to take account of job losses were Eurotunnel to cease operating ferries at Dover, since no remedy short of that prohibition would have been effective.

This judgment is important for several reasons. The CC must consider whether a transaction is a merger, which can only be the case if the target constitutes an "enterprise" and not merely a collection of assets. The CC must act fairly in its procedures, but this does not require it to disclose in full (or at all, provided its gist is given) confidential information. It must consult not only with the merging parties, but also with any third party whose interests may be directly affected by its decision and any remedies it imposes. The CAT also confirmed that, provided it considers all relevant matters, the CC is not obliged to reach the same conclusion as any other competition authority which reviews the same transaction: the French authority had conditionally approved the merger. It is, above all, yet another reminder of the potential risks that an acquiring party takes in completing a merger before receiving approval from the OFT or, if relevant, the CC.

continued overleaf

Burges Salmon Competition Group

Burges Salmon's Competition Group is one of the United Kingdom's leading competition and State aid practices.

We undertake the full range of high quality and challenging work. We advise clients on all aspects of UK and EU competition law, including merger control proceedings before the Office of Fair Trading, Competition Commission, European Commission and other competition authorities, as well as cartel and other antitrust investigations. Our lawyers have extensive experience of competition and State aid litigation in the UK and EU courts, including both appeals and follow-on damages actions.

In 2012, we were awarded *The Lawyer*'s 'Competition and Regulatory Team of the Year' award for our representation of the Co-operative Group in its successful appeal to the Competition Appeal Tribunal against the Office of Fair Trading's Competition Act decision in *Tobacco.* In 2103, we were runner-up for this award for our successful defence of a substantial follow-on damages action brought against Cardiff Bus.

Should you require any further information on the issues described in this Briefing or on any UK or EU competition law matter, please contact your usual contact or one of the members of our Competition Group.

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"hugely knowledgeable, with an impressive range of contacts at the UK competition authorities and a good grasp of Brussels cases"

The Legal 500, United Kingdom 2013

"a wide breadth of experience and a pragmatic commercial approach"

Chambers, United Kingdom 2014

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