




THE EUROPEAN ANTITRUST UPDATE

Key developments in competition law - Autumn 2009

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EC INVESTIGATES PHARMACEUTICAL INDUSTRY



The European Commission ("EC") published a 600 page report that criticises the lack of competition in the pharmaceutical sector. Competition Commissioner Neelie Kroes warned that pharmaceutical companies should "look out" for individual antitrust investigations.

EC CONCLUDES PHARMACEUTICAL SECTOR INQUIRY

The EC released its final report on the competition inquiry into the pharmaceutical sector. The report concludes that pharmaceutical companies systematically prevent the development of generic drugs. The report catalogues and analyses various delaying strategies used by patent-holders to block generic entry.

The EC's inquiry was launched in January 2008 with unannounced inspections at the premises of major pharmaceutical companies. The report is based on a sample of 219 medicines that faced loss of exclusivity between 2000 and 2007. The EC found that it took on average seven months for a generic product to enter the market following the expiration of the corresponding patent. This delay results in a significant loss for patients and taxpayers because generics are on average 40% cheaper than patented drugs. The EC estimates that delays to generic entry of the drugs analysed by the report cost EU Member States at least €3 billion.

The report also criticises shortcomings in regulatory framework. The EC advocates the establishment of a Community patent and of a unified specialised patent litigation system in Europe. It also urges Member States to accelerate approval procedures for new drugs and for generics. This approach is more balanced than the one the EC adopted in its preliminary report (issued in 2008), which argued that patent-holders alone were responsible for delays in generic entry.

EU DEVELOPMENTS

EC CLEARS PHARMACEUTICAL MERGERS

In October 2009, the EC cleared the proposed \$41 billion merger between US pharmaceutical companies Merck and Schering-Plough. In order to expedite the merger review, Merck had divested its stake in Merial to Sanofi-Aventis. Merial, an animal health operator, was a 50/50 joint venture between Merck and Sanofi-Aventis. The divestment of Merck's stake in Merial eliminated the overlap between Merck's and Schering-Plough's activities in animal health. The EC found that the transaction did not raise any competition concerns in the human health sector. The deal was also cleared by the US Federal Trade Commission and by several national regulators.

Earlier this year the EC approved the acquisition of US pharmaceutical group Wyeth by its rival Pfizer. The approval is conditional upon Pfizer's commitment to divest a number of animal health vaccines, pharmaceuticals and medicinal feed additives. Several other pharmaceutical mergers have been announced recently and the EC said that it would take into account the findings of its pharmaceutical sector inquiry when reviewing these mergers.

* Fried Frank provides on-going advice to Merck in relation to its merger with Schering-Plough.

EC REVIEWS RULES ON VERTICAL AGREEMENTS

The EC has published a draft of a revised regulation regarding vertical (i.e., supply and distribution) agreements. The current regulation exempts vertical agreements from EU competition law if the supplier's market share does not exceed 30% and the agreement does not contain certain prohibited provisions. Under the proposed new regulation, the exemption would be available only if (i) the supplier's share does not exceed 30% in the relevant upstream market, (ii) the distributor's share does not exceed 30% in the relevant downstream market, and (iii) the agreement does not contain prohibited provisions. The EC is also planning to introduce several other regulatory changes and to clarify the rules applicable to online sales. The new regulation is scheduled to come into force in May 2010.

The EC has also issued a communication regarding the future legal framework applicable to vertical agreements in the motor vehicle sector. These agreements are currently subject to special antitrust rules. The EC believes that the special treatment of motor vehicle distribution agreements is no longer justified and is planning to phase out sector-specific rules by May 2013. However, the EC may maintain a distinct regulatory regime for repair and maintenance services and for spare parts distribution.

EC FINES ELECTRABEL €20 MILLION FOR GUN-JUMPING

The EC fined Electrabel €20 million for acquiring Compagnie Nationale du Rhône ("CNR") without prior EC approval. Electrabel is a Belgian electricity producer and retailer controlled by the French energy group GDF Suez. CNR is a French electricity producer. In 2003, Electrabel acquired CNR's shares held by the French group EDF and became CNR's largest shareholder. The EC found that due to wide dispersion of the remaining CNR's shares, Electrabel enjoyed a stable majority at CNR's shareholders' meetings. Moreover, Electrabel was the sole industrial shareholder of CNR and has taken over the operational management of the company's power plants and the marketing of its electricity. Based on these facts, the EC concluded that Electrabel had acquired control over CNR in 2003. However, Electrabel notified the EC of this transaction only in 2008. Therefore, Electrabel was in violation of the rule which prohibits the parties from closing a reportable transaction before obtaining EC clearance.

GDF SUEZ AND E.ON FINED €1.1 BILLION FOR MARKET-SHARING

The EC fined GDF Suez and E.ON €553 million each for participating in a market-sharing cartel. This is the second largest cartel fine imposed by the EC (behind the €1.4 billion fine imposed on the car glass cartel in 2008). In 1975, Ruhrgas (now part of German energy group E.ON) and Gaz de France (now part of GDF Suez) decided jointly to build the MEGAL pipeline across Germany to import Russian natural gas into Germany and France. The parties agreed not to sell gas transported over this pipeline in each other's home market. At the time, both companies had legal monopolies in their domestic markets. However, the EC found that the parties maintained the agreement after 2000 when European gas markets were liberalised and opened to competition. The parties allegedly met on a regular basis to monitor each other's compliance with the agreement. Both companies announced that they would appeal the fine.

The investigation into the alleged market-sharing cartel was launched in 2006 as a follow-up to the EC's energy sector inquiry. This inquiry has also triggered several other investigations into alleged anti-competitive practices involving energy operators. In particular, the EC has also expressed concerns that GDF Suez was preventing competitors from gaining access to French gas import infrastructure (pipelines and LNG terminals). In order to address these concerns, GDF Suez has recently undertaken to release a large share of its long-term reservations of gas import capacity.



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ANTI-GENERICS PRACTICES IDENTIFIED IN THE REPORT:

- "Patent clusters": originators file multiple patent applications for the same medicine. This makes it difficult to develop a generic without infringing a patent.
- Vexatious litigation: during 2000-2007, there were 700 patent litigation cases between originators and generic companies. Generic companies won over 60% of these cases.
- Settlements: originators and generic companies concluded over 200 settlement agreements. Half of these agreements restrict generic entry.
- Follow-on products: originators launch second generation products prior to loss of exclusivity.
- Regulatory intervention: originators intervene in national procedures for the approval of generic medicines, which on average delays the entry of the generic medicine by four months.

AND LAUNCHES INDIVIDUAL INVESTIGATIONS

The EC said that it would use the report's findings in order to intensify antitrust scrutiny of the pharmaceutical sector. On the day it published its report, the EC initiated proceedings against Les Laboratoires Servier ("Servier") and several generic companies in relation to the market entry of generic perindopril, a cardio-vascular drug developed by Servier. In October 2009, the EC conducted announced inspections at the premises of several pharmaceutical companies. The EC's previous inquiries into other sectors have triggered legislative reform and individual antitrust cases.



EC EXTRACTS COMMITMENTS FROM IT OPERATORS

The EC is currently conducting several high-profile investigations into the activities of information technology operators. Two of these operators, Microsoft and Rambus, offered extensive commitments in order to avoid fines.

MICROSOFT UNTIES INTERNET EXPLORER FROM WINDOWS

The EC considers that Microsoft is dominant in the supply of PC operating systems, with a global market share of over 90%. In 2008, the EC started an investigation into the tying of Microsoft's web browser Internet Explorer to the Windows PC operating system. In the beginning of 2009, the EC issued a statement of objections in which it argued that by tying Internet Explorer to Windows, Microsoft provided its web browser with an unfair advantage over competitors. Rather than risking a hefty fine, Microsoft promised to enable PC manufacturers and end-users to choose between Internet Explorer and competing browsers. PC manufacturers will be free to pre-install any browser of their choice and set it as the default browser. Microsoft will also distribute a "ballot screen" software update to users of Windows PC systems in order to give users the opportunity to choose between twelve different browsers. The EC has launched a public consultation with regard to these proposals.

Microsoft is also expected to publish a public undertaking to disclose interoperability information that would make third party products compatible with Microsoft products. This undertaking will address the concerns raised by the EC in a separate investigation. The undertaking will include warranties offered by Microsoft to third parties that can be privately enforced.

RAMBUS CAPS ROYALTY RATES

Rambus is a US company that holds patents for a majority of DRAM (dynamic random access memory) chips that are used in PCs and other electronic equipment. DRAMs have been standardised by a US standard-setting organisation. According to the EC, Rambus engaged in deceptive conduct in the context of the standard-setting process. Rambus allegedly failed to disclose the existence of the patents and patent applications which it later claimed were relevant to the adopted standard. Once industry-wide standards had been set, Rambus asserted its patents and royalty rates at levels the EC viewed as excessive. The EC described

this conduct as a "patent ambush". In order to settle this case, Rambus offered to cap royalty rates for its DRAM patents for a period of five years.

COMMITMENTS INSTEAD OF FINES

The commitments offered by Microsoft and Rambus are expected to enable these companies to avoid adverse findings and fines. The EC can impose fines of up to 10% of the company's worldwide global revenues. Earlier this year, the EC fined US-based Intel €1.06 billion for abusing its dominant position in the global market for central processing units. The EC has also previously fined Microsoft a total of €1.68 billion for abusing its dominance and failing to comply with the EC's injunctions.

The EC is conducting several other investigations involving major IT companies. In particular, it is currently reviewing the proposed search advertising partnership between Microsoft and Yahoo. It has also opened an in-depth investigation into the takeover of software manufacturer Sun Microsystems by Oracle.

EC APPROVES LUFTHANSA'S ACQUISITION OF THREE AIRLINES

The EC cleared the acquisition by Lufthansa of three European airlines. In May 2009, the EC approved the acquisition by Lufthansa of British Midland (bmi). The EC did not impose any conditions because Lufthansa and bmi already closely cooperated with each other as members of the Star Alliance. In June the EC authorised Lufthansa's acquisition of SN Brussels Airlines and in August it approved the takeover of Austrian Airlines. Both deals were approved following in-depth investigations and subject to Lufthansa's commitment to offer slots to new entrants on several routes where the EC identified competition concerns. The EC also decided that the State subsidy received by Austrian Airlines prior to the transaction did not violate EU law.

EC DEMANDS THE RESTRUCTURING OF AILING BANKS

Under EU rules, Member States are required to receive EC clearance before granting subsidies (so-called "State aid") to private companies. Since the start of the economic crisis, the EC has approved over 70 national measures aimed at supporting financial institutions. This summer, the EC announced that it was now time to move into the "second stage" of the crisis management and "clean up" the banks which have received State aid. To that end, the EC issued guidelines concerning restructuring aid granted to the financial sector.

The guidelines provide that a Member State must submit a restructuring plan to the EC if it has recapitalised a distressed bank or if a bank has received State aid exceeding 2% of the bank's risk-weighted assets. The restructuring plan should comply with three key principles. First, the bank's long-term viability should be restored and the bank should be able to compete in normal and "stress" scenarios. The EC made it clear that restructuring may involve divestitures or absorption of the distressed bank by one of its rivals. Second, the bank and its shareholders must contribute to restructuring costs. Third, the bank should not use the aid to acquire its rivals or to distort competition. Restructuring should not last more than five years (this period is longer than the usual practice of two to three years). However, the EC promised to grant extensions if restructuring cannot be implemented due to market circumstances.



OFT CONDEMNS "COVER PRICING" IN THE CONSTRUCTION INDUSTRY

The UK's Office of Fair Trading ("OFT") imposed fines totalling £129.5 million on 103 construction companies in England for their involvement in bid-rigging. The OFT found that construction firms coordinated their bids and engaged in illegal "cover pricing". Cover pricing is the practice whereby several bidders agree that all but one would quote prices that would be too high to win the contract. This is the second highest combined fine ever imposed by the OFT (behind the £132 million fine imposed on tobacco companies in 2008). However, the OFT sought to attenuate the severity of these penalties:

First, most parties have cooperated with the investigation in exchange for reductions in fines. The OFT offered discounts of between 35% and 65% to 33 companies which applied for leniency and provided evidence of bid-rigging. A further 41 companies received reductions of 25% in exchange for "pleading guilty" before receiving the statement of objections. Twelve other parties received smaller discounts for admissions of guilt made after the OFT had issued statements of objections.

Second, while fines should normally be paid within two months, the OFT offered all parties the option of payment by instalments over three years. The OFT said that it has taken this exceptional step due to the current economic climate and to the fact that otherwise it would have faced a large number of requests for special payment terms.

Finally, both the OFT and the Office of Government Commerce (that supervises public procurement in the UK) cautioned public authorities and other contractors against excluding the infringing construction companies from future tenders. The OFT said that because the infringing companies had received significant penalties they could be expected to comply with competition law in the future.

The OFT stated that cover pricing was endemic in the construction industry. According to its press release, "the OFT uncovered evidence of cover pricing in over 4000 tenders involving over 1000 companies but had to focus its investigation on a limited number of companies and instances where the available evidence was strongest." The regulator believes that many other companies are likely to have been involved in bid-rigging, even though such activity remained undetected. It is unusual for the OFT to admit that it has not been able to fully investigate serious antitrust violations such as bid-rigging.

SEE YOU IN COURT

SCHNEIDER LOSES DAMAGES ACTION AGAINST EC

The European Court of Justice ("ECJ") rejected the damages action brought by the French group Schneider Electric against the EC. This litigation arose from Schneider's failed acquisition of its rival Legrand. In 2001, Schneider acquired Legrand subject to clearance of the deal by the EC (because Legrand's shares were publicly traded, EU laws allowed the takeover to proceed provided that Schneider did not exercise its voting rights prior to obtaining EC clearance). However, the EC blocked this transaction and ordered Schneider to divest Legrand. Schneider appealed to the Court of First Instance ("CFI") and the Court annulled the EC's decision. Following this annulment, the EC opened a new in-depth investigation into the transaction. Schneider refused to wait for the outcome of the new investigation and sold Legrand to a consortium formed by Wendel and KKR. Schneider then sued the EC before the CFI claiming damages of €1.7 billion. The CFI ruled in Schneider's favour but the ECJ overturned this ruling. The ECJ found that because Schneider sold Legrand while the EC was still reviewing the merger, the EC was not liable for the loss resulting from the divestiture of Legrand.

CFI DISMISSES CLEARSTREAM'S APPEAL

The CFI confirmed that Clearstream had abused its dominant position in the supply of clearing and settlement services in respect of German securities. Clearing is the process by which contractual obligations of the buyer and the seller of securities are established. Settlement is the transfer of securities from the seller to the buyer and of funds from the buyer to the seller. In 2004, the EC found that Clearstream had abused its dominant position in the clearing and settlement of German securities by refusing to supply certain services to its major rival Euroclear. The EC also found that Clearstream had charged discriminatory prices to Euroclear. Clearstream appealed the EC's decision but the CFI rejected this appeal. The CFI confirmed that Clearstream had a de facto monopoly in the clearing and settlement of German securities and that Clearstream had engaged in abusive practices aimed at harming Euroclear.

ECJ RULES ON DUAL PRICING OF MEDICINES

The ECJ confirmed that the dual pricing policy implemented by GlaxoSmithKline ("Glaxo") in Spain could potentially be exempted from competition rules. Glaxo sells medicines to Spanish wholesalers at different prices depending on the applicable national sickness insurance scheme. In practice, prices charged to wholesalers that export medicines are higher than those charged to wholesalers that resell medicines to Spanish pharmacies and hospitals. This dual pricing system is intended to prevent wholesalers from buying cheap medicines in Spain and reselling them at higher prices in other EU Member States. Several other pharmaceutical companies have adopted similar dual pricing systems.

In 2001, the EC decided that this policy violated competition law. On appeal the CFI annulled the EC's decision. According to the Court, Glaxo provided evidence showing that dual pricing generated additional revenues required to finance Glaxo's R&D efforts. The CFI ruled that the EC should have examined this evidence and determined whether Glaxo's dual pricing could be exempted as an agreement promoting technical progress. The ECJ confirmed this ruling and ordered the EC to reconsider Glaxo's pricing policy.

ADVOCATE GENERAL RECOMMENDS REVERSING THE ALROSA RULING

In 2002, South African group De Beers and Russian State-owned company Alrosa notified the EC of an agreement under which Alrosa was to supply half of its production of rough diamonds to De Beers. The EC found that De Beers dominated the global market for rough diamonds due to its vertical integration, highly sophisticated distribution system and unique knowledge of the diamond pipeline. Alrosa is the world's second largest producer of rough diamonds. The EC concluded that the agreement enabled De Beers to abuse its dominance by removing half of Alrosa's production from the open market. In order to avoid a fine, De Beers undertook to terminate the agreement in 2009 (with a phasing-out period starting in 2006). The EC issued a decision making these commitments binding.

Alrosa challenged the EC's decision arguing that these commitments breached the EU principle of proportionality and that the EC had violated Alrosa's right to be heard. The CFI agreed with these arguments and annulled the decision. The EC appealed to the ECJ. The Court's Advocate General Kokott has recently issued an advisory opinion in which she argues that the ECJ should reverse the CFI's ruling. The Advocate General considers that the CFI applied an excessively strict proportionality test and did not take into account the fact that the commitments had been offered by De Beers (rather than imposed by the EC). The Advocate General also considers that the EC had not infringed Alrosa's procedural rights.

A SINGLE MEETING MAY INFRINGE COMPETITION LAW

In 2004, the Dutch antitrust regulator fined five mobile telephone network operators ("MNOs") active in the Netherlands a total of €52 million for participating in a single meeting during which they exchanged information relating to the commissions paid to their dealers. The regulator considered that the exchange of information was anti-competitive even though the MNOs had not agreed on the level of commissions. The MNOs appealed this decision and the Dutch court asked the ECJ to issue a preliminary ruling regarding legal principles that should apply to this case. The ECJ confirmed that a single meeting between competitors may violate EU law if it involves an exchange of competitively sensitive information. In particular, an exchange of pricing information may be anti-competitive even if it does not concern retail prices and does not lead to a price-fixing agreement.

GERMAN COURT OF APPEALS HALVES CEMENT CARTEL FINES

In 2003, the German Federal Cartel Office ("FCO") fined five cement manufacturers a total of €650 million for operating a price-fixing cartel (a smaller fine of €12 million was levied against another cartel member, which informed the FCO of the cartel's existence). In June 2009, the Düsseldorf Court of Appeals significantly reduced the fines to a total of €328.5 million. The Court took into account the fact that some of the cartel members had cooperated with the investigation. It also considered that the FCO had overestimated the profits made by the cartel members. German cement company HeidelbergCement, which received the largest fine (€169.9 million following the Court's ruling), appealed to the German Supreme Court. Cement manufacturers also face a damages claim brought by Cartel Damage Claims, a company specialised in antitrust litigation, on behalf of 36 alleged victims of the cartel.

* For further information on recent developments in German competition law, see the September issue of *Corporate International*, with contributions by Fried Frank lawyers Sven Schulte-Hillen and Tobias Caspary, available at <http://www.corp-intl.com>.

NATIONAL UPDATE

UK: OFT FINES RECRUITMENT AGENCIES £39 MILLION

The OFT imposed fines totalling £39 million on six recruitment agencies for price-fixing and collective boycott of another company in the supply of candidates to the construction industry. The OFT granted two cartel members immunity from fines for informing the regulator about the cartel's existence. Five other parties applied for leniency and were granted reductions in fines. The OFT said that the total level of fines before reductions for leniency was £173 million.

UK: REVIEW OF ITV'S UNDERTAKINGS

In 2003, the UK's largest commercial television companies, Carlton and Granada, merged to create ITV. The Competition Commission ("CC") made its clearance of the merger conditional upon compliance with the Contract Rights Renewal ("CRR") undertaking. The CRR enabled advertisers and media buyers to freeze the terms of their contracts with ITV. In September 2009, the CC published its provisional findings on the review of the CRR. The CC found that while ITV's market share has decreased, ITV remained dominant in the market for TV advertising. Therefore, the CC provisionally decided to maintain the CRR and to extend it to high definition and time shifted channels.

GERMANY: NEW GOVERNMENT SET TO BOOST ANTITRUST POWERS AND FACILITATE FOREIGN INVESTMENT

The new German government announced its intention to introduce a number of significant changes in the area of competition law. It said it would enable the FCO to break up dominant companies and would bring German merger control legislation closer to EU rules. The new government also announced that it would review its power to veto foreign investments in German companies. This veto power has been recently extended to all transactions affecting Germany's security and public order (provided that the buyer is not based in the EU). The new government said that pending the outcome of the review, it would only use the veto power in exceptional circumstances.

GERMANY: FCO FIGHTS RESALE PRICE MAINTENANCE

This year the FCO has imposed significant fines on three companies guilty of resale price maintenance. The FCO fined Phonak, a manufacturer of hearing aids, €4.2 million for refusing to supply products to a retailer in order to induce it to increase resale prices. It fined CIBA Vision, a manufacturer of contact lenses, €11.5 million for unduly inducing retailers to comply with recommended resale prices and for restricting Internet sales. And earlier this year, the FCO fined Microsoft €9 million for agreeing with one of its German retailers on resale prices of the Office Home & Student 2007 software package. Phonak, CIBA Vision, and Microsoft said they would not appeal.

ITALY: INVESTIGATION OF MASTERCARD'S INTERCHANGE FEES

Italy's antitrust regulator launched an investigation into the interchange fees charged by MasterCard in Italy. The interchange fee is charged whenever a consumer pays a retailer using a credit or a debit card. The regulator is concerned that the level of interchange fees is too high and that the agreement on interchange fees between MasterCard and Italian banks may infringe competition law. In April 2009, MasterCard accepted to reduce its cross-border interchange fees after the EC found that these fees were anti-competitive.

PORTUGAL: PORTUGAL TELECOM FINED FOR MARGIN SQUEEZE

The Portuguese competition authority fined Portugal Telecom ("PT") and its spin-off company ZON Group a total of €53 million for abuse of dominance. The abuse was committed in 2002-2003 when PT was the sole provider of wholesale access to local loop in Portugal and a leading provider of retail broadband access. PT increased its wholesale prices and reduced its retail prices in order to squeeze its competitors' margins and drive them out of the market. The EC has previously fined Deutsche Telekom and Spanish Telefónica for similar practices.

Contacts

US



Bernard A. Nigro Jr.

Email: barry.nigro@friedfrank.com
Tel: +1.202.639.7373



Peter Guryan

Email: peter.guryan@friedfrank.com
Tel: +1.212.859.8477



Richard C. Park

Email: richard.park@friedfrank.com
Tel: +1.202.639.7064

Europe



Ianis Girgenson

Email: ianis.girgenson@friedfrank.com
Tel: +44.20.7971.6222



Tobias Caspary

Email: tobias.caspary@friedfrank.com
Tel: +44.20.7972.9618



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IF YOU HAVE QUERIES ABOUT ANY OF THE MATTERS MENTIONED IN THIS UPDATE, PLEASE CONTACT IANIS GIRGENSON AT +44.20.7972.9600

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