THE EUROPEAN ANTITRUST UPDATE

Key developments in competition law - Spring 2007

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PAY TV IN HIGH DEFINITION

Investigations put TV industry in spotlight

The UK's Competition Commission will launch a full-scale inquiry into BSkyB's acquisition of a 17.9% stake in terrestrial broadcaster ITV. The Secretary of State for Trade and Industry ordered the review after receiving a report from the Office of Fair Trading (OFT) that a substantial lessening of competition could be expected as a result. The Office of Communications (Ofcom) also advised a probe was necessary because of the possible impact on plurality of media enterprises serving news audiences. Ofcom advised that the Sky stake may operate against the public interest.

The ITV inquiry follows Ofcom's decision to launch its own investigation into the pay TV industry, a power it has when it believes there may be structural defects in a UK communications market. Ofcom is also examining BSkyB's proposal to launch a new pay TV service on digital terrestrial television (DTT) replacing its Freeview channels on that platform. Ofcom's investigation into the pay TV industry may result in another market reference to the Competition Commission. Ofcom has only once before initiated such a sweeping review when it examined the telecommunications sector which led to significant undertakings from BT.

One specific issue Ofcom has mentioned, is the loss of BSkyB basic channels on Virgin Media's pay TV platform. This is separately the subject of a High Court claim Virgin Media has made against BSkyB alleging the withdrawal of the channels is an abuse of dominance under UK and EU competition law. In the UK, BSkyB supplies most premium sports and all premium movie channels and is the leading retailer of pay TV over its own satellite platform. Virgin Media's lawsuit also seeks fair payment for carriage of Virgin Media's channels, such as Bravo and Living on the BSkyB platform.

Separately, Ofcom has been conducting a review of wholesale digital broadcasting platforms which will examine access to the satellite platform and the degree of competition between rival platforms. It has also begun a Market Impact Assessment of the BBC's proposal for a new High Definition Television Channel which would be available free-to-view on digital satellite, digital cable and DTT.

Some commentators have suggested that UK pay TV may be approaching a "tipping point" meriting regulatory intervention. The OFT's 70-page report into BSkyB's stake in ITV notes that the advent of digital switchover in 2008 could result in an "equilibrium shift" between the free TV and pay TV platforms. It states that as the ITV stake "has no plausible efficiency enhancing effects,…the cost of inadvertently leaving competitive harm unchecked could…directly harm the welfare of much of the UK TV audiences".



The OFT concluded that the 17.9% stake posed a risk of a material reduction in competition between BSkyB, which is dominant in certain pay TV markets, and ITV, the leading commercial free-to-air TV provider. Therefore, the OFT said, they could no longer be considered independent of each other. An investigation of shareholder voting patterns indicated that BSkyB's 17.9% holding could translate into more than a 25% voting block. This would be sufficient in the OFT's view to block special resolutions, block strategic initiatives, demand a board seat, affect co-operative arrangements and allow BSkyB, with the largest single stake, to cease to be a "supporting shareholder" if it so chose. These powers could be expected to affect ITV's formal and informal decision making and give BSkyB access to strategic information. The remedies BSkyB offered, which have not been published, were considered insufficient because they did not address the risk of BSkyB's "corporate leverage" over ITV's competitive strategy.

The OFT specifically examined the ability of "activist minority" shareholders to exercise material influence. This will have important ramifications in the UK and the rest of Europe beyond just the pay TV sector.

The ITV Competition Commission inquiry will last until November, Ofcom's market review will last at least through 2008 and the effects on UK pay TV may be felt for an even longer time.

Disclaimer: Fried Frank is a competition law adviser to Virgin Media.

NATIONAL ROUND UP

Controversy around German merger rule
The Federal Cartel Office ("FCO") is stubbornly maintaining a broad approach to the scope of German merger control despite a Court ruling against it. Under the German law there is an exemption for mergers in "de minimis markets" defined as those with total sales less than €15 million. A Düsseldorf Court in DuPont/Pedex recently decided that the reference to market means a German market. The FCO has appealed arguing that if there is a European-wide market, that market must also have a value less than €15 million for the exemption to apply. After the Court ruling against it, the FCO refused to change its interpretation and blocked a merger of Swiss companies and ordered them to be unwound, even though the German market was less than €15 million. The FCO says it will maintain this approach until the final DuPont/Pedex appeal is heard.

France: a new criminal case
Prosecution of a bid-rigging cartel for building schools has ended in criminal penalties for the individuals involved and fines of €47 million on the companies. The penalty was the maximum allowed.

New UK approach to cartel prosecution
The OFT has made a "fast track" offer of reduced penalties in its largest cartel investigation into bid-rigging by construction companies which has been running for more than two years. The offer was made to companies suspected of cartel law infringement which have not applied for leniency. During the investigation, 57 companies were raided, and 37 companies applied for leniency. The OFT announced that it would not accept any further leniency applications in this case (with the exception of applications relating to possible criminal violations. However, its new approach offers a reduced penalty to companies still prepared to admit to participation in bid-rigging.

Guidance on Irish merger control rules
New guidelines have introduced a de minimis rule that may limit the number of Irish merger filings. Currently any sales in Ireland (i.e. including Northern Ireland) by one party to a merger can trigger a filing obligation if only one other party has sales over €40 million in the Irish Republic. The new rule requires two parties either to have a physical presence on the island of Ireland (e.g. a registered office or subsidiary) or have annual sales into the island of Ireland of at least €2 million.

Poland increases its merger control thresholds
Polish turnover thresholds for merger filings have been increased. With effect from April, concentrations have to be notified in Poland if the parties' combined worldwide turnover exceeds €1 billion or the parties have a combined turnover in Poland in excess of €50 million. However, no notification is required if the target's Polish turnover did not exceed €10 million in any of two financial years preceding the notification. Previously the exemption only applied if the sales of the whole seller group in Poland did not exceed the €10 million threshold.

Russia: new penalties proposed for breach of competition law
Under new rules, fines between 1% to 15% of revenues from the sale of goods in the relevant market may be imposed for abuse of a dominant position or a cartel agreement. However, fines cannot exceed 2% to 4% of total revenues for the company being fined. The new penalties are not yet in force and it is expected that after the adoption of the proposed amendments a transitional period of one year will be granted.

Estonia: new penalties
New penalties have been introduced for implementing a merger before clearance. Pre-clearance implementation now is a ground for a misdemeanour and, in the case of a repeated offence, also a ground for criminal liability.

Swisscom mobile and ADSL decisions
The Swiss Competition Commission (SCC) imposed a CHF 333 million (£138 million) fine on Swisscom Mobile for imposing excessive call termination charges. Termination charges are fees charged by a mobile network operator for connecting calls to its network. The SCC has also closed its investigation into Swisscom's network access charge discounts for ADSL service providers. Originally, Swisscom had offered higher discounts to its subsidiary Bluewin than to other, independent ADSL service providers but it has now agreed to grant all providers the same discounts.

Turkish ruling on minority stakes
In a recent case, the Turkish Competition Board decided that the acquisition of a minority stake can result in a change of control even if the buyer is not granted veto rights over strategic decisions. This is a departure from EU law under which a minority stake normally confers control only if it is accompanied by veto rights over strategic decisions such as the budget and business plan. EU competition law is not applicable in Turkey but the Turkish authorities have generally followed its principles, until now.





SEE YOU IN COURT

BA's loyalty rebates abusive

British Airways (BA) has lost its final appeal regarding rebate incentives schemes for travel agents. The schemes have been found to be an abuse of dominance. Virgin Atlantic Airways first objected to BA's rebates in 1993, and they have now been confirmed as exclusionary and discriminatory. BA has been fined €6.8 million.

The main issue was the strongly loyalty-enhancing structure of BA's rebates. According to EU courts, exclusionary effects may particularly arise from rebates which are triggered if a target is met, but pay out over a customer's total volume of sales and not just the incremental increase in sales. BA's rebates to travel agents paid out by comparing total revenues in any given month to that in the previous year. A bonus was paid for hitting targets, but the amount of the bonus was paid out on the value of all tickets sold. The Court said that therefore a small increase in sales could exponentially increase the bonus providing a very strong incentive not to switch to rival airlines. Perhaps a key fact was that BA was an "unavoidable business partner" and therefore its scheme would likely always take precedence over rivals.

The Court also considered that the bonus scheme discriminated between travel agents because two agents having sold an identical number of tickets could be remunerated at different levels depending on whether or not they each had attained their sales growth target.

Predatory pricing case affirmed

In its first predatory pricing case in many years, the Court of First Instance (CFI) upheld the EC decision that imposed a €10.35 million fine on Wanadoo, a French Internet services provider, for predatory pricing. Unsurprisingly, the EC has welcomed the decision stating that broadband is a strategic sector and it is determined to prevent exclusionary behaviour by incumbents. Perhaps more surprising, given the EC's paper advocating an "economic-effects" approach to abuse of dominance, is that the decision restates a legalistic approach to assessing when pricing below cost may be predatory. In 1999-2002, at a time when high speed internet access was nascent, Wanadoo marketed its ADSL services at prices below its average costs. Wanadoo suffered substantial losses but its market share increased from 46% to 72%. The EC found that Wanadoo deliberately sacrificed short-term profitability in order to drive its competitors out of the ADSL market.

Key to the decision was affirmation of the established EU tests for predatory pricing. First, prices below Average Variable Cost (AVC) are presumptively abusive because the only reason for them can be the elimination of competition. Second, prices above AVC but below Average Total Cost (ATC) will be deemed abusive if shown to be part of a plan to eliminate competitors. The EC found that Wanadoo's prices were below AVC in 1999-2001 and below ATC in 2001-2002. In respect of the latter period, internal Wanadoo documents were said to show that predation ("profitability coming later") was a deliberate strategy.

The Court rejected each defence Wanadoo pleaded. First, the tests applied equally to a nascent market as well as a static market. Second, there was no absolute right for a dominant firm to align its prices with price-cutting competitors. Wanadoo had argued that it charged low prices in response to aggressive pricing by other ADSL service providers and that this price war benefited customers. Third, the Court also considered that predatory pricing was abusive even if the dominant company was not likely to recoup the losses resulting from pricing below costs.

UK Court of Appeal raises bar for excessive prices

In Attheraces (ATR) v. British Horseracing Board Limited (BHB), the Court of Appeal has overturned the High Court and indicated it may be difficult to show excessive prices are an "abuse of dominance". Following a lengthy commercial dispute, BHB, the governing body of British races, refused to continue the supply of pre-race data to the broadcaster ATR unless it accepted to pay a price corresponding to 50% of ATR's profits for its racehorse services. Pre-race data was an essential facility for ATR and the BHB had a monopoly on it. ATR brought proceedings before the High Court, which ruled in favour of ATR. The High Court said that BHB prices were excessive because they were well in excess of the cost of compiling the pre-race data plus a reasonable return ("cost plus" test). BHB appealed.

The Court of Appeal held that the High Court was incorrect to use the cost plus test. It said that an excessive price is one that significantly exceeds the economic value of the product supplied to the customer. Accordingly, the economic value of a product is different from its cost, as it reflects its revenue-earning potential to the person who acquires it. BHB also prevailed on the related discrimination claim against it that BHB charged other broadcasters less than ATR. The Court said that for price discrimination to be an abuse there must be an element of arbitrariness.

BANKING SECTOR



Payment Cards – the State of Competition

In January, the EC released its Final Report on the Retail Banking Sector Inquiry. Its focus was on competition in current accounts and the use of plastic cards for payment transactions at the point of sale (POS). In this summary, we focus on POS payment card systems.

POS transactions in Europe were worth €1350 billion in 2005. The Report presented the EC conclusions after an 18 month inquiry into the state of competition between existing payment systems. The EC said it studied data from 203 banks and 26 domestic and international payment card systems. Perhaps most keenly awaited were the EC's recommendations regarding interchange fees used in payment card systems. The Report also identified a number of competition concerns it said are evidenced by high profitability of the sector, discrepancies across the EU in the level of fees and high barriers to entry.

Interchange fees: Interchange fees charged by banks in payment systems have been the subject of antitrust scrutiny around the world. Price fixing suits have been launched in New Zealand and the US and there is an ongoing investigation into Mastercard in the UK. Industry sources have largely argued that interchange fees are indispensable to the efficient operation of the payment network because:

1. in the absence of interchange fees, issuers would have to recoup all of their costs from cardholders which would increase significantly cardholders fees; and
2. the fees represent a transfer of revenues from the card acquirer to the card issuer which is necessary because there is an imbalance between the acquirer and the issuer revenues.

The EC's Report said that interchange fees were "not intrinsic" to the operation of the systems and challenged the claim that without the fees the banks would derive insufficient revenue. However, the industry won a victory of sorts because the Report makes it clear that its aim is "not to argue in favour of a zero interchange fee for all networks" but calls into question the "optimality" of the current level of interchange fees in several countries.

This is consistent with the EC's decision allowing Visa's interchange fees in 2002 on condition that the fee be based on objective costs incurred. Another condition was that Visa introduced greater transparency in the way fees were set.

Other concerns: Some of the rules in the Mastercard and Visa networks were said by the Report to raise entry barriers to foreign operators and non-banks. One particular issue was the ban on surcharging. This prohibits retailers from granting a discount to customers paying in cash or applying a surcharge to those paying with a payment card. The Report says this may restrict intra-network competition by concealing the true cost of payment cards for consumers and may constitute a barrier to entry for alternative non-cash payment instruments such as mobile phones or e-money. Most retailers said they favoured surcharges.

Next steps: The Report does indicate it would like to encourage self-regulation. However, it also stresses that past action taken by the EC and national authorities regarding interchange fees has had a positive effect. Remedial action was said by the Report to be the most likely reason for the decrease of Visa cross-border fees. Further antitrust actions by the EC or by the national authorities are likely to tackle at least some of the issues raised by the Report.

UK bank overdraft charges under scrutiny

In the UK, the OFT has adopted a careful approach on bank overdraft charges, which contrasts with its action last year against credit card default charges. The watchdog set a cap of £12 above which card default charges were presumed to be unfair. As a result of this ruling, card issuers significantly lowered default charges. Consumers groups urged the OFT to take similar measures to cap bank charges. However, the industry warned the regulator that clamping down on bank charges could precipitate the end of free banking. The OFT took note of the argument and announced that it will carry out more work before taking any action. A "quick-fix solution" might have "unintended and far-reaching consequences across the whole sector" the OFT said.





EC IN BRIEF

Complaint filed against Canal Plus France

France Telecom has filed a complaint with the EC against pay TV broadcaster Canal Plus France, a Vivendi subsidiary. France Telecom claims that Canal Plus France, which was formed by the merger between TPS and Canal Plus, has failed to honour various commitments it made in 2006 in order to address concerns arising from the TPS/Canal Plus merger.

Record fine imposed

The EC fined Otis, Kone, Schindler and ThyssenKrupp a total of €992 million for operating a cartel in the Benelux and German markets for lifts and escalators. According to the EC decision, cartel participants rigged bids for procurement contracts, fixed prices, allocated projects to each other, shared markets and exchanged confidential information. This is the largest fine imposed by the EC for a cartel violation. In the first four months of 2007, the EC has already imposed cartel fines totalling €2 billion, more than in the entire previous year which stands at €1.8 billion.

iTunes probe launched

The EC has announced a surprise inquiry against Apple in relation to its online iTunes store. The EC is concerned that consumers can only buy music from the iTunes online stores in their country of residence. The move follows a complaint by UK consumer body Which? that British users have to pay more to download songs than other residents in the EU. Apple has published a statement that it wanted to operate a Europe-wide store, but music labels and publishers expressed legal concerns. This inquiry is not connected with the probe launched by Norway and France against iTune's "closed" system. Apple has described those actions as "state sponsored privacy."

Microsoft v. EC…continues

Microsoft, seeking to avoid another multimillion-dollar fine in its antitrust battle with the EC, has filed documents with the Commission defending its claim for royalties for releasing some software code to competitors. Microsoft was answering the recent charge by the EC that it infringed the EC's 2004 order requesting that Microsoft share source code on "reasonable terms." The EC said that Microsoft charged excessive prices for the supply of the software data. In addition to fines, the Competition Commissioner Neelie Kroes has now threatened Microsoft with structural remedies saying: "It could be reasonable to draw the conclusion that behavioural remedies are ineffective and that a structural remedy is warranted".

CLAMP DOWN

ON PREDATORY STRATEGIES

OFT argues Cardiff Bus engaged in predatory behaviour

The OFT has provisionally found that the council-owned Cardiff Bus Company engaged in predatory behaviour designed to eliminate a competitor. The OFT has issued a statement of objections to the company deliberately making a loss after another bus company, 2Travel plc, entered the market. Cardiff Bus is accused of providing a new no-frills bus service which operated below cost and was withdrawn once 2Travel left the market. The OFT found that the Cardiff Bus Company, which carries an estimated 80,000 people each weekday in Cardiff, used its dominant position to run its no-frills services with revenues so far below cost that it was impossible for its competitor to remain in the market.

Predatory behaviour is defined by the OFT as a dominant company sustaining losses in the short run with the knowledge it will be able to recoup them once the competition is forced to exit, and is in breach of the Competition Act 1998.

The OFT has now given Cardiff Bus the opportunity to make written and oral representations, which the OFT will take into account before making a final decision on whether the law has been infringed. However, no assumption should be made at this stage that there has been an infringement of competition law. Robin Finder, OFT assistant director, said: "Dominant companies have every right to compete vigorously but they have a special responsibility not to distort competition. Though consumers might see a short term fall in prices, ultimately they will lose out if a dominant company can exercise its market power without constraint or regard to normal competitive pressures."



Complaint against oil company

The Austrian competition authority (BWB) has referred to the Cartel Court allegations of an abuse of a dominant position by oil company OMW in the Austrian market for jet fuel. The investigation followed a complaint from Austrian Airlines (AUA). AUA alleged that OMV undersupplied the airline with jet fuel despite having the capacity to meet its yearly demands, thus forcing AUA to buy fuel from other suppliers, which often buy it from OMV as well, thus raising AUA's costs.

BA EXECUTIVES WARNED EXTRADITION POSSIBLE

BA and several other airlines are under investigation by the US Department of Justice (DOJ), the EC and the OFT for alleged illegal price-fixing of fuel surcharges on air cargo and passenger fares. BA says in its published results that it has put aside £350 million to settle possible claims against it. Last year Lufthansa also agreed to pay $85 million to settle pending class actions suits against it in the US. Lufthansa had reportedly applied for leniency from the antitrust authorities in return for co-operation and immunity from prosecution. It has now been reported that the US DOJ has written to BA executives allegedly involved warning they may face extradition to the US for criminal price-fixing. The executives may be at risk because the UK is one of the few jurisdictions outside the US where price-fixing may also be criminal.

REPRESENTATIVE ACTION THREATENS FOLLOW-ON DAMAGES

Which? the magazine run by UK group the Consumer's Association, has sued sports retailer JJB Sports before the Competition Appeal Tribunal. The action was taken on behalf of 130 consumers who have been allegedly "unlawfully overcharged" for football shirts. JJB Sport was one of ten companies fined by the OFT in 2003 for fixing the price of England and Manchester United shirts in 2000 and 2001. JJB has already paid a £6.7 million fine and is now facing the risk of an award against it in private litigation. Although class actions do not currently exist as such in the UK, designated consumer bodies may bring representative actions on behalf of consumers – not businesses – provided that each consumer has given his or her consent.

MORE COMPETITION IN AIR TRANSPORT?

While "open skies" reforms between Europe and the US have been in the headlines, competition in air transport is getting close attention in the UK too. Following a one-year investigation, the OFT has made a "market reference" to the Competition Commission (CC) of the supply of airport services by BAA. BAA, which was recently acquired by the Spanish building group Ferrovial, owns airports through which 60% of all UK air passengers travelled in 2005.

The OFT announced that it was concerned that a lack of competition might lead to higher costs, poor quality of services and less innovation than would be the case if the airports were owned by separate firms and carried out a public consultation. Most serious concerns were said to arise in the London area, where BAA owns Heathrow, Gatwick and Stanstead and this concentration is combined with airport planning constraints and regulatory price regime. In the event the CC confirms the OFT findings, BAA could be forced to sell off one of its airports or to concede long term leases on terminal facilities. The CC has called for evidence and will initially carry out the review in tandem with a reference from the Civil Aviation Authority into price controls on how much BAA can charge airlines at Heathrow and Gatwick. The CC's market reference investigation can last up to two years.



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