EU Developments - Modernisation

A recurring feature
by Alec Burnside,
Linklaters & Alliance, Brussels

A review and commentary on recent decisions relating to licensing in the European Union.

Commission Green Paper on the Reform of the EC Merger Regulation

Mergers make good box-office material. They combine high finance, politics and strong personalities, sometimes with foreign affairs and potential trade wars thrown in for good measure. These elements also make merger control very difficult. It demands seeing clearly into a clouded crystal ball. The European Union's system for reviewing mergers, therefore, seems condemned to controversy. But that should not blind us to its many qualities—or prevent us from calling for change where it is needed.

The recent Green Paper from Mario Monti, the Commission's Competition Commissioner, signals the start of an important debate on future reforms to E.U. merger control. The topics it deals with range from the fundamental to the technical. The most fundamental issue raised is the test to be applied in giving or refusing consent to a merger. Today that test is based on the concept of "dominance" but it might, the paper suggests, be replaced with the U.S.-inspired "substantial lessening of competition," or SLC for short. Whether that is a good thing or not is tied in with another issue: the fairness of the E.U.'s procedures.

SLC seems from its description to suggest greater scope for deals to be blocked than the dominance test; but in the real world either notion has to be brought to life by defining the underlying economics and regulatory philosophy. Dominance started life as a tool to control the market power of single companies. It has since grown to cover collective dominance by two companies, then three, four or more, depending always on the character of the markets at stake.

Nowadays, the Commission intervenes routinely in cases that would have been comfortably outside its range only a few years ago, developing arguments of greater or lesser economic pedigree. These are based on concepts such as portfolio power, range effect, bundling and a host of other factors. The result is that, while the Commission still couches its conclusions in terms of dominance, in reality it seems to have moved the threshold for intervention down towards the SLC level. What matters, though, is not so much the name of the test but the rigour of the economics behind it, as to both the theory and its application to the facts.

That is where the E.U.'s system is falling down—and for reasons to do with the fairness of the procedures. The Green Paper devotes a section to defending the present system, listing its undoubted virtues and areas of superiority. These include transparency in the form of a written "statement of objections;" and the publication of fully reasoned decisions. However, it takes as a given the Commission's combined role as judge, jury and prosecutor—noting dismissively that this is inherent in an administrative procedure. It fails to recognise that systems of administration are many and varied and that not all of them suffer from this defect. The Green Paper thus fails to acknowledge the most commonly voiced criticism of the present system.

Companies often complain of insufficient checks and balances to enable them to influence the course of the Commission's investigation once it has begun. There are no easy fixes to this problem. A fundamental difficulty is to balance fixed timetables—a selling point of the E.U. system—with the realisation that looming deadlines in effect force companies to submit to the Commission's views. One option is to go over to a full judicial system, as in the U.S., where the regulator has to muster an economic theory and supporting evidence that would persuade a judge; and has to present that theory and evidence in order to appear credible in remedy negotiations with companies—even in cases that are settled without going to court.

Short of that, means must be found of reining in administrative discretion in ways that are considerably more effective than the present checks and balances allow. More efficient appeal procedures to the European courts would also help but are not a sufficient answer; the procedures should be fair from the outset.

And important as these matters are today, their importance will only grow if the Commission is to leave behind the constraints of showing dominance, in favour of the more discretionary SLC test. If the Commission aspires to the U.S.'s greater economic flexibility, it ought also to take on board the rigours of its judicial disciplines, or at least something equally rigorous within the E.U.'s system of administration.

Mergers will always remain controversial but there is no smoke without fire. The substantial chorus of disapproval there has been about the denial of a fair hearing in E.U. merger cases, notably in relation to questions of economics, suggests that this is a topic requiring bolder reform than the Green Paper currently contemplates.

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New De Minimis Notice

The Commission has published a new Notice on agreements of minor importance which do not appreciably restrict competition under Article 81 of the Treaty, more commonly known as the "De Minimis" Notice. This updates and revises the 1997 Notice and, as part of the Commission's review of the EC competition rules, it aims to reduce the compliance rules, in particular for smaller companies. The Notice specifies, by way of reference to market share thresholds, agreements which will be deemed not to have an appreciable restriction on competition. The notice is not exhaustive: agreements outside the thresholds will still be judged on a case-by-case basis.

The new Notice provided that agreements between small and medium-sized undertakings (SMEs) are generally considered "de minimis" and so fall outside Article 81. It raises the market share thresholds from those in the 1997 Notice from 5 percent to 10 percent for agreements between competitors and from 10 percent to 15 percent for agreements between non-competitors. The calculation of market share is still to be made on the basis of relevant product and geographical market as set out in the 1997 Commission Notice on the definition of relevant market. As in the old Notice, agreements which contain hardcore restrictions are excluded. These restrictions, which include price fixing and market sharing, are listed under the categories of "agreements between competitors" and "agreements between non-competitors" rather than horizontal and vertical agreements as in the current Notice. However, the new Notice in practice takes its list of hardcore restrictions from the Block Exemption Regulation on specialisation agreements and that on vertical agreements. As a new development, agreements in markets where competition is restricted by the cumulative effect of parallel networks of agreements are now covered by the Notice. The market share threshold for such agreements, common, for example, in the beer and petrol sectors, is 5 percent for both competitor and non-competitor agreements. The Notice is not binding on national courts but explicitly states that it is intended to give guidance on the application of Article 81.

Commission Consultation Exercise on Transfer of Technology Block Exemption

In December 2001, the Commission launched a consultation exercise on the future of the block exemption for technology transfer agreements (TTBE). The exercise, launched in December, was motivated partly by the existing block exemption requirement of regular assessments, and also with a view to bringing the TTBE into line with the recent horizontal and vertical block exemption regulations and guidelines. The Commission therefore suggests moving from a legalistic, form-based to an economic effects-based approach in particular to reduce the compliance burden on businesses that lack significant legal power. This can be achieved, for example, by setting "safe harbour" market share thresholds within which undertakings are automatically covered by the block exemption. Clear and coherent rules are needed in order for national authorities to apply Article 81(3) consistently after modernisation of Articles 81 and 82 EC. Further, the TTBE's opposition procedure for 'grey' clauses (a simplified notification procedure) will be obsolete after the notification system is abolished.

The Commission has invited comments on whether the TTBE should:

- focus on the economic effects of particular restrictions such as the parties' market shares and their competitive relationship;
- cover intellectual property rights other than patents and know-how. In particular, the software industry, which relies on chains of copyright agreements, would benefit if copyright were covered;
- cover multilateral agreements, which are increasingly important for industry; and
- focus on the competitive relationship of the parties by adopting a more lenient approach to licensing agreements between non-competitors, which are likely to be efficiency enhancing, and a more prudent approach to agreements between competitors, which risk resulting in market sharing.

Although the TTBE remains in force until March 31, 2006, the more imminent modernisation of Articles 81 and 82 EC require its revision before that date. The consultation procedure will last until April 26, 2002 and the Commission intends to make a firm proposal to amend the TTBE in the second half of 2002.

• Recent Anti-Trust Cases •

Vitamins Cartel

In November last year, the Commission pilloried eight vitamin producers with a record €855.22 million in fines for their involvement in cartels for a range of vitamins from September 1989 to February 1999. The vitamins in question are consumed alone, and as additives to many common foodstuffs, including cereals, biscuits and drinks, pharmaceutical products, cosmetics and animal feed.

The cartelistic behaviour entailed price-fixing and sales quotas. The mechanisms to implement this plan involved the exchange of sensitive information, agreement upon annual "budgets" and the estab-

lishment of a formal structure to oversee and implement the plan. The joint ring-leaders in the cartel were the number one and two global producers of vitamins: the Swiss pharmaceuticals giant Hoffmann-La Roche and the German company BASF. Hoffmann-La Roche was singled out as the "prime mover" and BASF was said to have assumed a "paramount role." They actively recruited many of the other culprits into their club.

Fines were calculated on the basis of the gravity of the infringement and its duration, as well as a number of other factors. The maximum fine under EU competition law is set at 10 percent of a company's annual turnover for all of its activities. The Commission considered this to be a single infringement that was "very serious" and of long-duration (i.e., over five years). Hoffman-La Roche was fined a staggering €462 million. BASF was clobbered with €296 million in fines. In addition, three Japanese companies, Takeda Chemical Industries, Eisai Co. Ltd. and Daiichi Pharmaceutical Co. were fined €37.05 million, €13.23 million and €23.4 million respectively. The German firm Merck received a fine of €9.24 million and Dutch company Solvay Pharmaceuticals a fine of €9.10 million. Five other companies involved were not fined because the cartels in which they had participated ended five years or more before the Commission opened its investigation.

The French company, Aventis, became the first cartel participant ever to be granted full immunity under the Leniency Notice by being the first to cooperate with the Commission with respect to the cartel in vitamins A and E and for providing decisive evidence. It was, however, fined €5.04 million for its passive role in the vitamin D3 infringement.

These fines are in addition to those meted out over two years ago under US law for the very same cartel. The US proceedings were launched when the French pharmaceutical interest, Rhone Poulenc, tipped the Department of Justice off about the legal activity, in order to secure immunity from prosecution. In the US, Hoffmann-La Roche was fined a then record $500 million and BASF was fined $225 million. Hoffmann-La Roche's former Director of Worldwide Marketing, Dr. Kuno Sommer, pleaded guilty to charges of participating in the cartel and lying to Department of Justice investigators in 1997 in an attempt to cover up the conspiracy. He was fined $100,000 and served a four-month prison term.

Under EC law, only companies involved in hard-core competition offences, such as participation in cartels, can be sanctioned. The advisability of imposing criminal penalties, including prison sentences, upon those officers within the companies responsible for the competition offences is currently being debated.

Hoffman and BASF have two months from the date they received the decision in which to appeal to the Court of First Instance, which has unlimited jurisdiction to interfere with fines.

Citric Acid Cartel

Hoffman-La Roche was also found to have been involved with four other companies in illegal agreements to fix the price and share the market for one of the most widely used additives in the food and beverage market. Citric acid is used in non-alcoholic beverages, jams, tinned vegetables and fruit, gelatine-based desserts and as a dissolving agent for drugs that come in tablet form. It is also used in detergents and in the cosmetic industry.

La Roche got together with the three other founder members, US companies Archer Daniels Midland (ADM) and Haarman & Reimer (H&R) and the Swiss firm Jungbunzlauer (JBL), to set up the cartel in 1991. They were joined in 1992 by Dutch company Cerestar Bioproducts BV. The cartel's objectives were, through frequent meetings, to allocate sales quotas, fix price targets, exchange customer information and eliminate price discounts. These provisions were all backed up by sophisticated systems for monitoring and compensation. In addition to these run-of-the-mill cartel activities, the parties mounted a full-scale price war against Chinese manufacturers who attempted to increase their share in the European market to cash in on the price rise that the cartel itself had caused.

The fines imposed by the Commission on La Roche and ADM were increased by 35 percent because they were joint ringleaders of the cartel. They were, in addition, both repeat offenders: La Roche had just been fined in the vitamin cartel and ADM had been penalised in October 2001 for its participation in price-fixing agreements for sodium gluconate and in June 2000 for doing the same in the market for the amino acid, lysine. La Roche ended up with a €63.5 million fine and ADM, a fine of €39.69 million.

Cerestar Bioproducts, the last company to join the cartel, was fined €1.7 million. It was the one to blow the whistle but since it did so only after becoming aware that the Commission had begun an investigation, it benefited from only a 90 percent reduction. ADM, who provided detailed information, including hand-written notes of secret meetings, sufficient to force admissions from the other participants, was granted a 50 percent reduction. JBL, fined €17.64 million, and H&R, €14.22 million, who both cooperated to a lesser extent, only providing information when formally requested to do so, were given reductions of 40 percent and 30 percent respectively.

This case, though it adds to the Commission's impressive list of successful cartel busts, is, however, another instance (as in the vitamin case above) where the Commission was following at the heels of the US authorities. In 1996, as part of a major Department of Justice investigation into the food and animal feed additives industry, ADM was fined $100 million for the same offences concerning citric acid and its part in

conspiring to eliminate or suppress competition in the market for lysine. The same investigation also led to fines in 1997 of $50 million for H&R, $14 million for Hoffman-La Roche and $11 million for JBL for the very same cartel activity. Also fined $150,000 each were Udo Haas, the Managing Director of SA Citrique Belge, an affiliate of Hoffman-La Roche, and the President of JBL, Rainer Bichlbauer.

• European Court of Justice •

Extra-Community Parallel Trade

In *Zino Davidoff v. A & G Imports* and *Tesco Stores v. Levi Strauss*, two joined Article 234 E.C. preliminary references from England, the European Court of Justice has taken a restrictive view of the requirement in the 1989 Trademarks Directive that a trademark owner who "consents" to the resale of trademarks goods within the Community has exhausted his rights in them. In the past, it was clear that putting the goods on the market within the E.C. exhausted the trademark rights. Now, after these references, there is clarity that where the goods are put on the market outside of the E.C. the trademark owner's consent to their resale within the Community cannot be established without clear, positive evidence of such consent. So this is a victory for trademark owners and a bitter defeat for low-priced retailers seeking to capitalise on price differentials between the Community and the world outside.

For three years, the supermarket chains Tesco and Costco had been acquiring Levi jeans from the United States and selling them for less than two thirds of their normal price within the United Kingdom. Levi Strauss, dismayed at what it saw as the commoditisation of its exclusive products, commenced proceedings in the United Kingdom High Court claiming an infringement of their trademark rights. They argued that their jeans had to be sold in specialised stores by trained staff. The luxury goods manufacturer, Zino Davidoff, also entered the battle when A&G Imports began acquiring their scents "Cool Water" and "Davidoff Cool Water" in Singapore and selling them to all and sundry at discount prices in the United Kingdom. The Trademarks Directive provides an exception to Community exhaustion where the trademark owner can show "legitimate reasons," such as a need to protect the value of the trademark or protect the public. It might be thought that this exception would apply, for the stronger reason, to goods placed on the market outside the Community. Levi's and Davidoff's obviously disapproved of the low-brow Tesco's and A&G as venues for their wares, but in resting their argument upon a restrictive construction of consent they sought protection from Community resale by any channel.

The grey market importers and resellers argued under the Trademark Directive that tacit consent of the trademark owner to Community resale was sufficient for Community exhaustion and that it was for the trademark owner to show that such consent had not been given. A&G had to argue that the express prohibition against Community resale, which Davidoff had taken pains to insert in its contracts with its Singaporean buyer, did not stand against a finding of such consent.

The ECJ ruled that this consent can be implied but only where the party so asserting unequivocally demonstrates that the trademark owner, by positive action, has renounced his right to oppose such marketing. The Court specified that consent cannot be implied by the absence of a warning on the goods, by the lack of stipulations in the sale contract or by the fact that the trademark owner has not told all subsequent purchasers of the goods that he opposes their resale within the EEA. Consent must be expressed positively and cannot be construed from mere silence. The burden is on the parallel trader to establish that the trademark owner has consented to the marketing of the goods within the Community. The case will now be referred back to the United Kingdom High Court for final judgment which must accord with the ECJ ruling.