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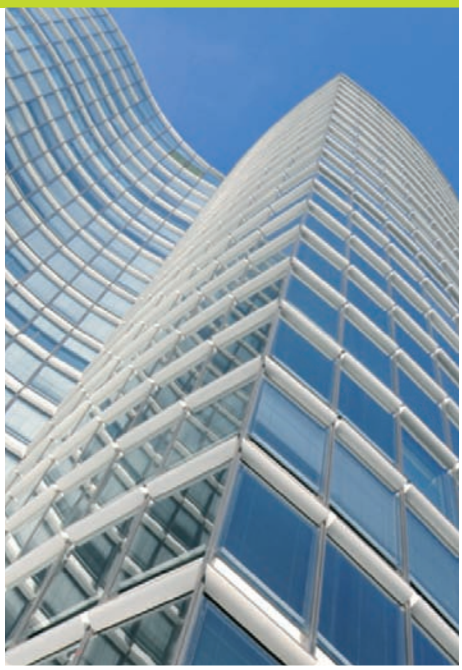

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Final closure of the door in landmark legal privilege case – No EU privilege for in-house lawyers

Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd v Commission (C-550/07 P)

In September, the Court of Justice of the European Union ("**CJEU**") gave its ruling in a landmark case on legal professional privilege under EU law, which has far-reaching implications for in-house lawyers across the European Union and more generally for the European Commission's (the "**Commission**") investigative powers.

The case concerns a long-running dispute involving Akzo Nobel about whether communications with in-house lawyers should be protected by legal professional privilege under EU law and, as such, can be withheld from disclosure in a competition investigation.

The CJEU has held that internal communications with in-house lawyers do not enjoy the protection of legal professional privilege under EU law, confirming the judgment of the then Court of Justice of the European Communities (now the CJEU) in the leading case AM&S Europe Ltd. v. Commission (C-155/79) ("**AM&S**"), and that of the then Court of First Instance (now the General Court of the European Union, "**GC**") in Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd v Commission (Joined Cases T-125/03, T-253/03). The CJEU considered that an in-house lawyer, despite his enrolment with a Bar or Law Society and the fact that he is subject to professional ethical obligations, does not enjoy the same degree of independence from his employer as an external lawyer. As a result of the in-house lawyer's economic dependence and the close ties with his employer, the CJEU held that, unlike communications with external lawyers, communications with in-house lawyers (who are EEA-qualified lawyers) are not privileged, and can therefore be examined and used by the Commission in an investigation.

The judgment firmly closes the door on the possibility for in-house lawyers to benefit from legal professional privilege in European Commission competition investigations for the foreseeable future.

WHAT IS LEGAL PROFESSIONAL PRIVILEGE?

Legal professional privilege is the rule under which communications between lawyers and their clients are treated as confidential and may not be examined or used by third parties, such as competition authorities, without the client's consent.

The European Union and the individual EU Member States have a variety of different privilege regimes. Some Member State regimes recognise privilege for in-house lawyers, others do not.

Under EU law, legal professional privilege for outside counsel was recognised by the Court of Justice in 1982 in AM&S. However, privilege for in-house counsel was not recognised in this judgment, since the Court held that to be privileged, advice must be sought from "an independent lawyer, that is to say one who is not bound to his client by a relationship of employment". Debate has raged for nearly 30 years about whether work product of in-house lawyers who are subject to professional ethical obligations should benefit from the protection of legal professional privilege, with many in-house lawyers, as well as Bar associations, lobbying hard for the AM&S judgment to be overturned.

BACKGROUND TO THE CASE

In February 2003, seeking evidence of possible anti-competitive practice, the Commission conducted a dawn raid at the office of Dutch-based pharmaceuticals manufacturer Akzo Nobel. A dispute arose concerning the Commission's right to review and seize a number of documents, including email exchanges involving Akzo's in-house lawyer, who was a member of the Dutch bar.

Akzo appealed the seizure of the documents to the GC. The GC ruled that legal professional privilege does not cover in-house counsel communications, even where in-house counsel is a member of a Member State bar association (in this case, the Dutch Orde van Advocaten).

On 29 April 2010, Advocate General Kokott gave an opinion recommending that the CJEU dismiss the appeal in its entirety.

THE CJEU JUDGMENT

The CJEU followed its judgment in the leading case of *AM&S v Commission* (Case 155/79), and held that the protection of legal professional privilege is subject to two conditions.

The first is that the exchange with the lawyer must be connected to "the client's rights of defence". The second is that the exchange must emanate from "independent lawyers", that is "lawyers who are not bound to the client by a relationship of employment". With respect to the second requirement the Court noted:

- the requirement of independence means the absence of any employment relationship between the lawyer and his client. The concept of the independence of lawyers is determined not only positively, that is by reference to professional ethical obligations, but also negatively, by the absence of an employment relationship. The CJEU added that "an in-house lawyer is less able to deal effectively with any conflicts between his professional obligations and the aims of his client."

- an in-house lawyer "occupies the position of an employee which, by its very nature, does not allow him to ignore the commercial strategies pursued by his employer, and thereby affects his ability to exercise professional independence". An in-house lawyer may be required to carry out other tasks, such as that of "competition law coordinator" which "cannot but reinforce the close ties between the lawyer and the employer"

- enrolment with a Bar or Law Society and the fact of being subject to professional ethical obligations do not mean that an in-house lawyer can enjoy the same degree of independence from his employer as a lawyer in an external law firm does in relation to his client.

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The CJEU rejected arguments that the AM&S judgment should be reinterpreted in the light of recent developments in the legal landscape since 1982, on the grounds that these had not been significant enough to justify a change in the case law. The CJEU noted:

- a large number of EU Member States still exclude correspondence with in-house lawyers from protection under legal professional privilege. In addition in a considerable number of EU Member States in-house lawyers are not allowed to be admitted to a Bar or Law Society, and they are accordingly not recognised "as having the same status as lawyers established in private practice"

- Regulation 1/2003 (i.e. the main procedural regulation governing EU competition investigations) "does not aim to require in-house and external lawyers to be treated in the same way as far as concerns legal professional privilege, but aims to reinforce the extent of the Commission's powers of inspection". Although it is silent on the issue, the CJEU appears not to have been swayed by the arguments that the introduction of self-assessment by Regulation 1/2003 justifies a change in the case law.

The CJEU rejected arguments that the GC's interpretation lowers the level of protection of the rights of defence. Any individual who seeks advice from a lawyer must accept the restrictions and conditions applicable to the exercise of that profession. The Court noted that "in-house lawyers are not always able to represent their employer before all the national courts, although such rules restrict the possibilities open to potential clients in their choice of the most appropriate legal counsel".

IMPLICATIONS FOR IN-HOUSE LAWYERS

This judgment is a considerable blow to those who have lobbied hard for in-house lawyer work product to be protected by legal professional privilege under EU law. However, the judgment is hardly surprising in light of the Advocate General's opinion which preceded it. By refusing privilege to in-house counsel, even where they are subject to professional rules and obligations and members of a bar, the Court has not taken the opportunity to improve the efficiency and effectiveness of the competition law compliance process for companies. However, the judgment is consistent with the strong position of the CJEU on the consequences of an employment relationship for the treatment of privilege.

The judgment leaves in-house lawyers with the continuing difficulty of needing to be able to provide clear guidance on EU competition law compliance issues whilst being reluctant to produce advice knowing that it will not be covered by privilege and so may have to be disclosed to the European Commission in a future investigation. In contrast in-house lawyers' advice is protected by legal privilege in national competition investigations in some Member States such as in the UK and the Netherlands.

Despite the heated debate that the subject raises, in practice, the question of whether a document is protected by legal professional privilege has not been a major issue in most investigations by the European Commission. In an on-site investigation, the Commission's objective is to obtain evidence of infringements of competition law. In cartel and most abuse of dominance cases, this is more likely to emerge from documents of senior management and their commercial teams than from in-house legal departments. Until the last couple of years, where the Commission has relied on advice from in-house lawyers, it has tended to be as evidence of an aggravating factor to justify an increase in the fine – on the basis that the company disregarded advice from their in-house lawyer – rather than as evidence of the infringement.

However, more recently and particularly in the pharmaceutical sector, communications with in-house legal advisers have become more central to Commission investigations as the Commission has turned its attention to rooting out conduct suspected of delaying generic entry such as patent litigation strategies, patent settlements and alleged abuses of the regulatory system. In these sorts of cases, communications with in-house lawyers are more likely to be a potential source of evidence of the sort of conduct alleged to infringe the competition rules. Consequently, as the Commission continues its investigations into the pharmaceutical sector, in-house legal departments are likely to be a direct target in Commission investigations – as was the case in the raids that took place at the start of the Commission's sectoral investigation in January 2008.

In this context, it is also worth noting that the European Commission appears to be unsympathetic to claims of privilege in respect of patent agent's advice – even external patent agents – maybe that will be the next issue for the European Courts.

It is worth noting that the judgment does not deal with the issue of whether communications from non-EU qualified counsel should be privileged, as the Court was not required to deal with this issue. Existing case law (which has not been disputed by the Akzo judgment) rules that the protection of legal privilege only applies to communications with a lawyer who is EEA-qualified.

DOES THE JUDGMENT HAVE ANY IMPLICATIONS OUTSIDE COMPETITION LAW?

To date the debate on the scope of legal professional privilege in EU law has centred on the powers of the European Commission in carrying out investigations at business premises into suspected breaches of the EU competition rules.

However, it is interesting to note the proposals to establish a European-wide system of financial supervisors, and in particular the establishment of the European Securities and Markets Authority (ESMA).

ESMA would primarily be responsible for supervising national supervisory bodies like the Financial Services Authority in the UK. However, it is also proposed that it would have a direct supervisory body for credit rating agencies. Within the draft regulation setting up ESMA, there is a proposal that ESMA will be able to carry out on-site investigations at credit rating agencies' premises. The powers look very similar to those in the competition legislation.

There is nothing on privilege in the draft regulation. However, the proposed powers for EMSA give rise to the possibility that questions on legal privilege under EU law will arise in the context of ESMA investigations.

In the original ECJ judgment in the AM&S case in 1982 it is clear that the Court there thought that privilege was a fundamental principle of EU law as part of the rights of the defence and that the actual content of the EU rules on privilege needed to be worked out in the context of the particular EU legislation. This raises the possibility (but probably not the likelihood) that the rules on privilege under EU law might be different in the context of the ESMA powers from those in competition cases.

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German restructuring tax privilege under EU State aid scrutiny

Earlier this year, the European Commission opened an in-depth state aid investigation against Germany regarding the so-called restructuring privilege granted under the Corporate Income Tax Act ("Sanierungsklausel"). The restructuring privilege allows companies to carry forward fiscal losses also in case of a take over of the company or a significant change in its shareholding structure. However, the privilege only applies to ailing companies that have potential for a turn-around whereas under the general rules such losses would have been forfeited. The European Commission investigates whether this differentiation unlawfully discriminates against certain market players and thus constitutes illegal State aid.

GERMAN RESTRUCTURING TAX PRIVILEGE

As a general rule of German corporate tax law, net operating losses (NOL) and existing loss carry-forwards of a corporation are forfeit if the company is taken over by another company or its shareholding changes significantly.

During the economic down-turn it became evident that this tax rule can preclude potential investors from engaging in or restructuring of loss-bearing companies due to potentially higher tax burdens in subsequent years. As a consequence, the German parliament adopted an amendment of the loss-forfeiture rule in the German Corporate Income Tax Act in July 2009 according to which the aforementioned loss-forfeiture rule does not apply if (i) the acquisition is made with the intention of restructuring and (ii) the main business organization of the loss-bearing corporation is preserved. The acquisition is deemed to be made with the intention of restructuring if the acquisition occurs while the respective corporation is overindebted and the measure suits to resolve the overindebtedness or illiquidity. If these requirements are met, any acquisition which would otherwise constitute a harmful acquisition is fully disregarded for the applicability of the loss-forfeiture rule. Consequently, the respective acquisition is also not taken into account in determining harmful acquisitions in subsequent years.

This rule ("Sanierungsklausel") is applicable retroactively as of 1 January 2008. Originally, the provision should have expired on 31 December 2009. However, at the end of 2009, the German parliament adopted a law making the measure permanent.

THE EUROPEAN COMMISSION'S ONGOING ASSESSMENT OF THE GERMAN RESTRUCTURING PRIVILEGE

The objective of European State aid law is to ensure that Member States' interventions do not distort competition in the EU. State aid may take the form of advantages in any form whatsoever granted by public authorities on a selective basis to companies. Article 107 TFEU (ex-Article 87 EC) sets out a general prohibition of State aid unless certain exceptions are met, e.g. for rescue and restructuring aid for firms in difficulties.

National tax legislation often is subject to European Commission State aid investigations. At first sight, a general tax provision does not seem to grant any aid to a specific company. If a tax benefit is only offered to specific businesses such as producers based in a certain region, it might constitute State aid.

The Commission preliminary assessed the tax privilege in 2009 and opened formal proceedings (file reference C 7/2010) on 24 February 2010. The Commission's key concern regarding the German restructuring privilege is that the measure might be selective as it differentiates between ailing and sound companies. Indeed, both types of companies could be loss making, but only those in severe financial difficulties are eligible for the carry forward of such losses under the Sanierungsklausel.

Germany argues that the aforementioned differentiation follows from the intention to prevent abusive shell company acquisitions only for the purpose of benefitting from the general loss carry forward rules in corporate taxation. According to the German government, such an intention was justified by the nature and general scheme of the tax system.

By contrast, the Commission has doubts whether the restriction of the restructuring privilege only on companies in terms of the aforementioned provision was necessary to prevent such abuse. In a precedent case regarding a German privilege for venture capital companies (VCC) the Commission held in 2008 that the right of target companies acquired by VCC to carry forward losses forms State aid.

Moreover, the Commission investigates the effects of the retroactivity of the restructuring privilege. Since Germany adopted the clause in July 2009 with a retroactive application since January 2008, companies would benefit even if they only met the conditions of the clause by chance without the intention to restructure the target.

The outcome and timing of the further investigation of the Commission is not clear. Depending on the cooperation of the German authorities, the State aid procedure might take 18 months or even longer.

IMPACT

The restructuring privilege is an important cornerstone of the German Corporate Income Tax Act. According to off-the-record estimates the clause led to a tax deficit of Euro 1.795 billion for the period 2008 through 2009.

If the Commission eventually holds the restructuring privilege to be illegal State aid, Germany will be obliged to amend the clause. In principle, the clause could either be broadened in scope or abandoned. If the privilege did not only apply to ailing but also to sound companies it would not be selective any more. However, since this would multiply the tax losses incurred by Germany this solution is unlikely in practice.

Thus, if Germany was obliged to withdraw the restructuring privilege, all tax benefits granted to companies under the scheme had to be recovered retroactively. Thus, German tax authorities could be required to re-issue respective tax assessment notices to any corporation which had benefit from the Sanierungsklausel in the past. Further, if any NOL or loss-carry forwards which were forfeit without the Sanierungsklausel were utilized in the past, and, therefore, a lower tax burden exists compared to the tax burden in case of a initial loss forfeiture, the respective taxes would have to be re-assessed.

Any investor or corporate shareholder who intends to purchase shares in a loss-bearing corporation should be aware that the validity of this provision is currently at risk. As a result, a worse-case scenario should be considered while reviewing the potential tax consequences of the planned acquisition and the further tax burden of the target company. The German fiscal administration already issued a so-called non-application decree according to which the Sanierungsklausel does no longer apply as long as the Commission's investigation has not been terminated.

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MOFCOM issues conditional clearance of Novartis/Alcon transaction

On 1 August 2010, China's Anti-Monopoly Law (**AML**) turned two. The Ministry of Commerce (**MOFCOM**) — the agency in charge of merger control in China — celebrated the anniversary with a bang: on August 13, it cleared the acquisition by life sciences company Novartis of a majority stake in rival Alcon, but only subject to conditions.

Almost ten months have passed since the last time MOFCOM imposed conditions on a merger clearance decision. The *Novartis/Alcon* case is only the sixth MOFCOM decision involving remedies, but already the second in the life sciences field (after *Pfizer/Wyeth*).

INTRODUCTION

Like the Hart-Scott-Rodino Act and similar provisions throughout the world, the AML merger control regime requires pre-closing filing to MOFCOM for certain types of business transactions if specified thresholds are exceeded. In China, the filing thresholds only focus on sales revenues. Pending examination by MOFCOM, the transaction cannot be closed.

In the first phase of the procedure, MOFCOM has 30 days after receipt of the complete set of notification documents to carry out an initial review. If it finds that an in-depth investigation is necessary, MOFCOM will open the second phase investigation for up to 90 days. Under certain circumstances, the deadline can be extended for a maximum of 60 additional days (which is sometimes referred to as 'phase 3').

THE *NOVARTIS/ALCON* TRANSACTION

The transaction concerned the acquisition by Novartis, one of the world's leading life sciences companies, of shares in Alcon, giving it a majority stake of 77% in the target. Alcon is a Texas-based life sciences company with a certain degree of specialization in eye care products.

The transaction was subject merger control in a variety of jurisdictions, including the United States and the European Union (**EU**). The EU and the US cleared the acquisition, also subject to conditions. Their clearance decisions were issued a few days before and after MOFCOM's decision, on August 9 and 16 respectively.

MOFCOM'S DECISION

Novartis notified the proposed transaction to MOFCOM on April 20, 2010. After identifying competition concerns in the first phase of the procedure, MOFCOM decided to open an in-depth investigation. MOFCOM found competition issues to exist in two relevant product markets: the markets for ophthalmological anti-inflammatory/anti-infective products and for contact-lens care products, respectively.

In the ophthalmological anti-inflammatory/anti-infective product market, Novartis and Alcon have an aggregate market share of 55% worldwide and over 60% in China. Yet, Novartis' share alone is less than 1% in China. With respect to contact lens care products, the merged entity holds a global market share of nearly 60% and a share of around 20% in China. With a share of more than 30%, the market leader in China is the Taiwanese company Ginko International, through its Hydron business. Novartis had entered into an agreement to appoint Hydron as exclusive distributor of its contact lens care products in China.

As a result, in order to address MOFCOM's concerns, the parties had to offer certain undertakings which were accepted by the regulator after two rounds of negotiations. While MOFCOM noted that Novartis had already taken the strategic decision to withdraw from the ophthalmological anti-inflammatory/anti-infective product market, it imposed an additional condition: during the next five years, Novartis will be barred from selling Infectoflam or similar ophthalmological anti-infective products in China. To overcome MOFCOM's concerns with respect to the contact lens care product market, Novartis had to commit to terminate the distribution agreement with Hydron within the next 12 months.

STREAMLINED TIMING?

In this case, MOFCOM closely followed the timeline set out in the AML. After the first phase investigation, MOFCOM went into the second phase for its in-depth review of the transaction. According to an interview which the head of MOFCOM's merger control unit gave just one day prior to the *Novartis/Alcon* decision, up to one third of the transactions filed with MOFCOM enter 'phase 2.' It is notable that MOFCOM issued the conditional clearance right at the end of phase 2, thereby averting the need to go into 'phase 3.' This may be pure coincidence or an attempt by MOFCOM to keep at bay those voices within the international investment community who have criticized the length of time needed for MOFCOM to complete its internal and external processes and reach a decision.

Perhaps the most striking aspect regarding timing in the *Novartis/Alcon* decision was the fact that MOFCOM accepted the submissions and opened the case file on the same day as it received the notification. The seemingly instantaneous acceptance and case opening is in stark contrast with earlier cases filed in 2008 and 2009, where MOFCOM only opened the case file after several weeks or months during which time the parties were required to provide further data, clarifications or even to make on-site presentations to the MOFCOM case team members.

Nonetheless, that filing and case registration should occur on the very same day was too much of a coincidence for many observers. While no information is available in the public domain on this point, it may well be the parties filed draft versions of the filing during the pre-notification phase.

MOFCOM'S CONTINUING EVOLUTION REGARDING SUBSTANTIVE ANALYSIS

The *Novartis/Alcon* decision is the first in which MOFCOM has imposed conditions to address 'coordinated effects' arising from a merger transaction.

'Coordinated effects' refer to the reduction of competition between the newly-merged entity and another rival in the market

— in this case, Hydron. Although the very short text of the published decision does not provide a full analysis of MOFCOM's reasoning, it seems that the regulator may have been concerned that the link between the new Novartis/Alcon entity and Hydron (through the distribution agreement) would align their behavior in the marketplace.

More generally, coordinated effects appear to be a topic to which MOFCOM has given considerable thought lately. Indeed, guidance on how MOFCOM will analyze coordinated effects was already contained in the draft guidelines on horizontal mergers prepared by MOFCOM for internal discussion towards the end 2009. In the summer months of 2010, MOFCOM held internal seminars with a few selected academics on topics including coordinated effects.

The coordinated effects theory complements the broad spectrum of theories of harm which MOFCOM has used so far. In most of the cases that ended with a published MOFCOM decision, the sole or main issue was 'unilateral effects' (ie, reduction of competition between the merging parties) — or sometimes MOFCOM simply did not explain its legal and economic thinking in detail at all. When examining unilateral effects, MOFCOM has taken into consideration a variety of factors, the most important of which is market share. Judging from past cases (such as the *Panasonic/Sanyo* transaction) it appears that combined market shares of 45% and above are potentially problematic.

In addition, in *Coca-Cola/Huiyuan*, MOFCOM blocked the transaction due to concerns that the parties' product portfolios would give rise to 'conglomerate effects.' But, of course, some observers have voiced the view that the real issue in that case was industrial rather than antitrust policy.

Finally, in the *Mitsubishi Rayon/Lucite International* and *General Motors/Delphi* transactions, MOFCOM examined the vertical effects of mergers. In *General Motors/ Delphi*, MOFCOM's concern was that the vertical integration between General Motors as a car maker and Delphi as a car parts supplier would have negative impacts on their competitors at both levels in the production chain. In *Mitsubishi Rayon/Lucite International*, the acquiror already operated at both levels within the supply chain. MOFCOM essentially found that the addition of the target's business on the upstream market would increase the merged entity's ability to foreclose downstream competitors.

FOCUS REMAINS ON REMEDIES

While the *Novartis/Alcon* decision illustrates the gradual expansion of MOFCOM's 'toolbox' for substantive assessment — to some extent in alignment with international practice — other aspects of the decision depart from the approach of antitrust agencies in other jurisdictions: with less than a 1% market share, Novartis' addition to the 60% share of Alcon in the Chinese ophthalmological anti-inflammatory/anti-infective product market seems negligible and would hardly justify the imposition of remedies, no matter what their nature or extent.

A few weeks before the *Novartis/Alcon* decision, on July 8, MOFCOM had issued a regulation on the implementation of divestiture remedies. Although the regulation came into force with immediate effect, MOFCOM did not rely on it in the *Novartis/Alcon* case. Instead, MOFCOM decided to impose behavioral remedies, also to address the miniscule overlap in the ophthalmological anti-inflammatory/anti-infective product market.

While it is difficult to interpret the link between the adoption of the new regulation on divestiture remedies and the *Novartis/Alcon* decision, the combination of these two developments may at least convey one message: MOFCOM continues to focus on remedies of all sorts, including the increasingly detailed practical issues of implementing them. Indeed, over the past few months, MOFCOM has held workshops on remedies and focused a good part of its legislative efforts on this issue. Some observers on the ground believe that, especially in cases where the US and EU antitrust agencies have imposed (or, in MOFCOM's view, are likely to impose) remedies, MOFCOM is keen to also subject the transactions to remedies in China —whether structural or behavioral— even though the remedies often display characteristics seemingly tailored for the Chinese market.

CONCLUSIONS

The *Novartis/Alcon* decision is only the sixth decision in which MOFCOM has imposed conditions, out of a total of around 140 notified transactions. While the high number of relatively routine transactions currently going into the phase 2 procedure is clearly unsatisfactory, the fact that the vast majority of cases are being cleared unconditionally shows a certain degree of restraint on the part of MOFCOM.

MOFCOM has recently been going on a charm offensive in the Chinese media, claiming that the AML is applied equally to foreign and domestic applicants alike and there is no 'discrimination:' MOFCOM asserts it is simply because foreign companies have relatively high market shares that all the conditional clearance and prohibition decisions have impacted on multinationals (as opposed to home-grown companies). However, the *Novartis/Alcon* case will continue to provide fuel for the fire of those observers who complain about discrimination. To date, there has not been any published decision in which a local Chinese company has been subject to an adverse ruling under the AML merger control regime.

The *Novartis/Alcon* decision evidences MOFCOM's continued willingness to intervene in foreign-to-foreign transactions which it believes raise competition issues in China. Hence, even foreign companies with small market shares are not immune from MOFCOM intervention when submitting for clearance, and all foreign investors should take note of the increasing sophistication of MOFCOM's scrutiny of business transactions caught by the AML. This article was previously published in Law360.

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California Supreme Court bars pass-on defense for State law antitrust claims

On 12 July 2010, the California Supreme Court in *Clayworth v. Pfizer, Inc.*, No. S166435, 2010 WL 2721021 (Cal. July 12, 2010), held that California law bars antitrust defendants from invoking a pass-on defense in most circumstances even though both direct and indirect purchasers may sue for treble damages. Defendants (or groups of defendants) in antitrust lawsuits are typically accused of illegally overcharging for their products. An overcharge would be initially borne by direct purchasers of the defendant's products such as dealers or distributors, and may be passed on, in whole or in part, to indirect purchasers such as consumers. If the direct purchasers do pass on the overcharge, a possibility of duplicative recoveries exists when multiple levels of purchasers are permitted to sue the defendant for damages. In such instances, the defendant will likely seek to argue that the plaintiff passed on the overcharge, which leaves the claimant with no measurable injury and therefore no cognizable claims for damages. This argument is referred to as a pass-on defense. The *Clayworth* decision raises significant questions about the scope of liability under California antitrust law and potentially opens the door for separate antitrust lawsuits to be filed by multiple levels of purchasers, and leaves defendants subject to duplicative recoveries.

LEGAL BACKGROUND

The United States Supreme Court has provided conclusive answers to the questions of whether a pass-on defense is available under federal law and how to avoid duplicative recoveries in federal antitrust lawsuits. In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), the Supreme Court held that federal antitrust defendants generally may not assert a pass-on defense. The Court reasoned that even a direct purchaser who passes on an overcharge will likely be damaged in other ways by the antitrust violation and that permitting a pass-on defense would potentially compromise antitrust enforcement by barring the parties most likely to sue – the direct purchasers – from recovery. Several years later, as a corollary to the Hanover Shoe principle, the Supreme Court held that indirect purchasers could not bring private treble damages actions under the federal antitrust laws. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). Thus, under the federal antitrust enforcement scheme, only direct purchaser plaintiffs are permitted to seek damages, and defendants may not assert as a defense that the direct purchaser passed on the alleged overcharge to an indirect purchaser.

After Illinois Brick, many states, including California, enacted laws specifically permitting indirect purchasers to sue for damages under state antitrust laws. Therefore, California law was clear that both direct and indirect purchasers could sue for damages (unlike federal law). However, it was not clear whether a defendant could invoke as a defense to a direct purchaser lawsuit that the direct purchaser passed on any alleged overcharge to the indirect purchasers. Many assumed that if indirect purchasers had standing, then defendants would be able to assert a pass-on defense in lawsuits by direct purchasers to avoid duplicative recoveries.

FACTS OF *CLAYWORTH*

In *Clayworth*, a group of retail pharmacies sued a group of pharmaceutical manufacturers alleging that the manufacturers violated California's antitrust law, known as the Cartwright Act, and state unfair competition laws by conspiring to fix the prices of brand-name pharmaceuticals. The defendant manufacturers argued that the pharmacy plaintiffs had passed on the alleged overcharge to consumers who purchased the drugs. After reviewing the parties' evidentiary submissions, the trial court agreed with the manufacturers, finding that the pharmacies had passed on all of the overcharges to consumers. The trial court granted summary judgment for the manufacturers because the pharmacies had sustained no apparent damages. The California Court of Appeal affirmed.

CALIFORNIA SUPREME COURT'S ANALYSIS

The California Supreme Court reversed the judgment for the manufacturers. The court analyzed the legislative history of the Cartwright Act and its amendments over time, particularly its amendment in response to the *Illinois Brick* decision, and concluded that, "under the Cartwright Act, as under federal law… a pass-on defense generally may not be asserted" even through the Cartwright Act differs from federal law in permitting indirect purchasers to sue.

The manufacturers had argued that permitting multiple levels of purchasers to recover while barring the pass-on defense could permit direct purchasers who passed on overcharges to receive a windfall recovery. The court acknowledged that this risk existed but appeared to find it acceptable. The court stated that the primary purpose of the Cartwright Act is to punish violators and promote free competition. If forced to choose between direct purchasers who had passed on overcharges but may still have suffered collateral effects of the antitrust violation receiving a windfall or antitrust violations going unpunished, the court indicated a preference for the first option, which would provide a greater deterrent effect.

The manufacturers also argued that permitting multiple levels of purchasers to recover while barring the pass-on defense could lead to duplicative recoveries. Again, the court acknowledged this risk but noted that trial courts and parties may employ procedural devices such as joinder, interpleader, and consolidation to bring all claimants before the trial court to prevent multiple lawsuits. The court further stated that in instances in which it became necessary to allocate damages among various levels of injured purchasers (for example, in a lawsuit involving both direct and indirect purchasers), it would then be permissible for a defendant to assert a pass-on defense to avoid duplicative recoveries. As a general rule, however, the court held that the pass-on defense could not be invoked where there was not at least some apparent risk of duplicative discovery in the case at bar.

IMPLICATIONS OF *CLAYWORTH*

The *Clayworth* decision raises significant questions about the scope of liability under the California antitrust laws. Permitting both direct and indirect purchasers to sue the same defendant for the same damages while barring the defendant from asserting a pass-on defense presents a risk of duplicative recovery. The California Supreme Court noted several methods by which trial courts could mitigate this risk, but it also acknowledged that the risk of duplicative recovery is a real one. Although the court suggested that an apparent risk of duplicative recovery in a single case would permit assertion of a pass-on defense, that situation was not present in *Clayworth*, and therefore the court declined to address it further. As a result, the decision may have far-reaching implications if multiple levels of purchasers, both direct and indirect, bring separate damages lawsuits relying on *Clayworth* to argue that the defendants are barred from invoking a pass-on defense in each suit. At a minimum, defendants may face the prospect of defending several such suits while attempting to consolidate them to enable assertion of a pass-on defense in a single proceeding.

The California Supreme Court's reliance on consolidation and coordination as the principal tool for eliminating the risk of duplicative liability is troubling for several reasons. **First**, the court assumed that separate suits by direct and indirect purchasers would be filed at times that permit use of such procedural devices. There is no guarantee that will occur, however, and the court offered no guidance on how duplicative liability will be avoided when the underlying assumption does not apply. **Second**, reliance on such procedural devices fails to account for those situations in which different levels of purchasers are litigating claims arising from the same facts in state and federal courts. Coordination of such proceedings may be difficult and will depend entirely on informal cooperation by the state and federal judges handling the litigation. Moreover, coordination may be constrained by differences in state and federal procedural rules. **Third**, the California court's analysis ignores other, related legal rules, such as the Full Faith and Credit Act and the Rooker-Feldman doctrine, that might have substantive effect on Cartwright Act litigation in federal court. Such issues are bound to arise in subsequent cases and the California courts will eventually have to address them.

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Round-up of key developments

EU

Access to Commission pleadings

On 21 September 2010, the CJEU dismissed three appeals (including by the international press association API) brought against a General Court judgment in relation to access to European Commission pleadings before the European Courts based on Regulation 1409/2001 (which sets out the principles and limits to the rights and access to documents issued by the European institutions). The General Court had held that, where the case had been decided, the Commission could not deny access to its pleadings on the grounds that there was a connected damages action against the Commission, or where the Commission was taking follow-up action in relation to non-compliance with the Court's judgment. The CJEU ruled that the General Court had erred in part of its judgment, but that was not enough to set aside the operative part of the judgment. The CJEU confirmed that a general presumption existed where the disclosure of pleadings lodged by one of the EU institutions in court proceedings would undermine the protection of those proceedings for the purposes of Article 4(2) of Regulation 1049/2001 while those proceedings remain pending. However, it ruled that the General Court erred holding that, in the absence of any evidence capable or rebutting that presumption, the Commission is under an obligation, after the hearing has taken place, to carry out a concrete assessment of each document requested in order to determine whether, given the specific content of that document, its disclosure would undermine the court proceedings to which it relates.

First "hybrid" settlement case

On 20 July 2010, the European Commission imposed fines totalling Euro 175,647,000 on five producers for price-fixing and market-sharing in animal feed phospates. Four of the producers used the Commission's cartel settlement procedure and were granted a 10% reduction. This is the first case in which the Commission has used both the settlement procedure and its usual administrative procedure (so-called "hybrid case").

New Hearing Officer

The European Commission has appointed Prof. Dr. Wouter Wils as hearing officer for competition cases. He will join Michael Albers, who was appointed as hearing officer in 2008. Dr Wils was formerly a member of the European Commission's Legal Service.

Tomra appeal

On 9 September 2010, the General Court dismissed an appeal by Tomra against a European Commission decision imposing a Euro 24 million fine for abuse of its dominant position in Germany, Austria, Sweden, the Netherlands and Norway on the market for reverse-vending machines (RVM) used to collect used beverage containers. The Court considered that, for the purposes of Article 102, it is sufficient for the Commission to show that the abusive conduct tends to restrict competition, or that the conduct is capable of having that effect. The Commission does not have to demonstrate the actual effects of the agreements on the market.

Lagardere/Natexis/VUP

On 13 September 2010, the General Court upheld the conditional approval of Lagardere's purchase of VUP's book publishing assets. In a parallel action brought by Odile Jacob, however, the General Court annulled the Commission's decision approving Wendel Investissement as purchaser of the assets which need to be divested on the basis that the decision was drawn up by a trustee who did not satisfy the required condition of independence in relation to the divested assets.

FRANCE

Waste collection

On 27 September 2010, the French Competition Authority considered that the 11 commitments proposed by Eco-Emballages and Valorplast, two companies active in the sector of waste collection and recovery of household plastic packaging, were sufficient to put an end to alleged discriminatory practices.

DKT, a firm trading in plastic waste, considered that it had been the victim of exclusionary practices at the time of the renewal of the contract between Eco-Emballages and the regional authorities in 2005 and 2006, and considered that Eco-Emballages had adopted discriminatory behaviour intending to promote Valorplast. Eco-Emballages granted or refused "non-objection" letters, without which a buyer had little chance of successfully obtaining subsidies from the authorities. This mechanism could serve as an entry barrier for new operators in the market for the recovery of plastic waste.

In particular, Eco-Emballages committed to apply objective criteria to validate the mechanisms used by recycling companies and to abandon its "non-objection" procedure.

GERMANY

Resale bans

On 7 July 2010, the Bundeskartellamt announced that it has concluded most of its poroceedings against gas and electricity suppliers for imposing illegal resale bans. 12 of the major energy suppliers in Germany have undertaken to abandon clauses in contracts with their industrial customers which prohibit the resale of minimum take volumes of gas and electricity. The Bundeskartellamt obtained first indications of the resale bans in a complaint received from the German Association of Industrial Energy Consumers and Generators as well as from its sector inquiry into the "Capacity situation in the German gas transmission networks".

Flights to Turkey

On 28 September 2010, the Bundeskartellamt announced that it has imposed a fine of Euro 1.2 million on Condor Flugdienst GmbH for its involvement in an illegal agreement on the prices of flights from Germany to Turkey. The Bundeskartellamt found that Condor and the airline SunExpress had agreed in the Summer of 2009 that SunExpress would not offer flights from Germany to Turkey for less than Euro 99. The price of an air ticket was to be set at no more than Euro 10 below the price offered by Condor. The agreement covered routes simultaneously offered by the two companies. SunExpress participated in the Bundeskartellamt's Leniency Programme and received no fine.

ITALY

Sky Italia Investigation

On 7 July 2010, the Italian Competition Authority ("ICA") decided to accept as binding the commitments submitted by satellite TV operator Sky to ensure third-party access to its technical platform. The investigation was launched following a complaint by television broadcaster Conto TV. Under the commitments, Sky's broadcasting divisions will operate under the same conditions as all other third-party operators without being able to rely on lower charges. Sky also undertakes to clarify and divulge its terms so as not to dissuade competitors from making an initial application for access to its platform, and that access contract negotiations with potential operators will be conducted promptly and within set deadlines so as to prevent Sky from adopting protracted, obstructionist negotiating methods.

Saint-Gobain fine

On 30 June 2010, the ICA fined Saint Gobain Ppc Italia S.p.A. a total of Euro 2,165,787 for engaging in abusive behavior to exclude or at least hinder and delay Fassa S.p.A.'s entry into the plasterboard market. The ICA's investigation determined that Saint-Gobain had sought to impede the opening of a new plasterboard production facility by Fassa in Calliano (Monferrato). In a market characterized by very few operators, Saint-Gobain applied a strategy that was designed to hinder Fassa's access to the gypsum reserves needed to produce and market plasterboard. More specifically, the ICA confirmed that Saint-Gobain had interfered with Fassa's contractual negotiations with gypsum deposit owners, both directly and by persuading farmers with land preemption rights to resist via legal channels.

POLAND

Electricity operator fined for abuse of its dominant position.

On 4 August 2010, the Office of Competition and Consumer Protection fined ENEA Operator sp. z o.o PLN 477,976.50 (approximately Euro 100,000) for its abuse of its dominant position on the regional market for the distribution of electricity. ENEA's distribution terms and conditions for connection to the power grid were found to be unfavourable for customers. In cases where the customer used less energy than the active power scheduled for downloading from the net (as set out in ENEA's energy sale contract for connection to the network) the customer was still obliged to pay for the active power scheduled. ENEA's standard contract was therefore qualified as an imposition by the undertaking of onerous agreement terms and conditions, yielding to this undertaking unjustified profits.

Street lighting

On 17 July 2010, the branch of the Office of Competition and Consumer Protection in Katowice fined EnergiaPro S.A., with its seat in Wrocław, for imposing on the District of Opole contract conditions which yielded unjustified profits. EnergiaPro S.A, the owner of the energy distribution facilities, negotiated a contract for lighting the streets in the city with Opole's district authorities. Under the terms of the contract, the district authorities were under the obligation to maintain and perform all the necessary repairs to the street light facilities which belonged to the energy distributor. The competition authorities qualified this contract as an abuse of a dominant position and imposed a fine amounting to PLN 84,591 (approximately Euro 20,000) on the distributor.

RUSSIA

Record fines imposed for abuse of dominance

Four major Russian oil companies (*TNK-BP Holding, Gazpromneft, Rosneft* and *Lukoil* with some subsidiaries) have been fined by the Federal Antimonopoly Service (the "FAS") a total of Euro 500 million for abuse of dominance in the wholesale market of fuel in 2007-2009.

The infringements included monopolistic high price setting and economically or technologically unjustified discriminatory pricing against non-group companies.

Price manipulation in the wholesale electricity market

Three Russian regional power generators (*TGK-11, Tatenergo* and *Biiskenergo*) have been found by the FAS to have been involved in price manipulation in the wholesale electricity market. The companies were found to have infringed the mandatory price setting rules by way of overrated price bidding at the "day-ahead market" which was not justified economically or technologically and resulted in a substantial increase of the price for electricity in 2007-2008.

The FAS has issued behavioural orders and fined *Tatenergo* and *Biiskenergo*.

Concerted actions in the hotel market

The Federal Arbitrazh Court of the North-West Region has overturned the FAS decision finding a number of Saint Petersburg hotels involved in illegal concerted actions resulting in higher rack rates during the XII International Economic Forum.

The court held that such a major international event was undoubtedly a market condition influencing equally all the market players. The single fact of a simultaneous price increase by a few players cannot qualify as concerted action in isolation of other factors such as the actual awareness of other players' behaviour. Limited to its facts, however, the decision may help in setting a clearer distinction between concerted and parallel actions in Russian law.

Alleged vodka cartel

The FAS has found the union of alcohol dealers of Kuzbass and its members to have infringed competition law by entering into an anti-competitive agreement setting out minimum prices and establishing different pricing models for vodka produced locally and in other regions.

However, the FAS lost the case in the Federal Arbitrazh Court of the North-West Region as the agreement, although intended, was not signed by all the members to become effective. Further, the union members went on selling vodka without regard to

Continued...

the agreement and the court was not satisfied that the FAS had proved that there had been a restrictive agreement.

SPAIN

Second annual report on State aid

On 5 August 2010, the Spanish Competition Authority (**SCA**) released its second Annual Report on State aid granted in Spain.

The report has two main objectives. The first is to provide a broad overview of the context of State aid in Spain, and the main developments which have occurred during the last year. Along these lines, the report reflects the effects of the economic crisis on the increase of government aid in various formats, and on the specific public measures adopted to soften such effects. The second is to raise awareness of the public benefits deriving from the full application of competition law in general and State aid control in particular, especially during the current difficult economic times.

Report on competition in the agrifood sector

On 16 June 2010, the SCA published its Report on *Competition and the Agrifood Sector*. The Report reviews the application of the EU competition rules to the agricultural sector, and concludes that regardless of the debate about whether this application should be relaxed or take into account the "special" characteristics of the rural world, Articles 101 and 102 TFEU and the corresponding national competition provisions are fully applicable to the practices engaged in by agricultural operators.

The Report also considers that potential exemptions from anti-competitive practices should be strictly limited to those practices that are strictly national in their effect. Moreover, it underlines that the participation of public authorities (as signatories or sponsors) in agreements between operators does not prevent the full application of competition law.

UK

UK commercial vehicle manufacturers

On 16 September 2010, the OFT announced that it is investigating suspected cartel activity among UK commercial vehicle manufacturers. The investigation is being carried out under both the Competition Act 1998 and the criminal cartel provisions of the Enterprise Act 2002.

Merger Guidelines

On 16 September 2010, the OFT and the Competition Commission published the final version of their new joint merger assessment guidelines.

Hotel online booking

On 16 September 2010, the OFT announced that it is conducting a formal investigation into suspected breaches of competition law in the hotel online booking sector.

OFT market studies guidance

The OFT has published the final version of its revised guidance on market studies (OFT 519). The guidance explains why the OFT conducts market studies, how it chooses markets to study, how it manages market studies, what the outcomes of a market study might be and how the OFT evaluates its market studies. The guidance has been updated to reflect the OFT's prioritisation principles and current practice.

Aggregates market study

On 7 September 2010, the OFT announced that it has launched a market study into the aggregates sector. The study will look at how high barriers to entry, increasing concentration at the local level, and Government involvement in the form of a national system of control over outputs influence competitive conditions.

US

On 10 October 2010, the FTC published statistics on pre-merger filings for the 2009 fiscal year.

The statistics show a dramatic decline in the number of filings, when compared with 2008, coupled with an increase both in the percentage of transactions subject to an extended inquiry and the percentage of transactions ultimately challenged by the agency.

Although this data may evidence a more aggressive agency posture under new leadership, the evidence may be inconclusive. First, the challenge rate is still so low (2.6 percent – nineteen transactions challenged out of 716 reported) that a few atypical transactions could tilt the result. In addition, it is not surprising that staff would exercise closer scrutiny in a period when they have far fewer deals to review.

COMPETE – competition law compliance e-learning

We have recently developed a customizable competition law compliance e-learning, testing and risk management programme, providing awareness level training for all company employees.

New in 2010, COMPETE is based on state-of-the-art, tried and tested online training solutions with high customer satisfaction. The 75 minute, learner paced, electronic multi-media programme allows a company to deliver awareness level training for all employees, including those whose roles may put them into a position that places the company at a heightened risk of a competition law infringement.

The programme can be customized to reflect the identity of the company, including branding, sector and company specific case studies and content. The programme is available in a variety of languages, including French, German, Spanish, Italian, Polish and Portuguese.

Key features of COMPETE
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- Focused case law summaries provide real life examples
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- Talking heads provide additional narrative excerpts adding to the multi-media experience and authenticity of content
- Q&A test at the end of the course with feedback on the answers
- Options for filtered business reports and tracking systems

We would be happy to discuss your needs in more detail and to arrange a demonstration.

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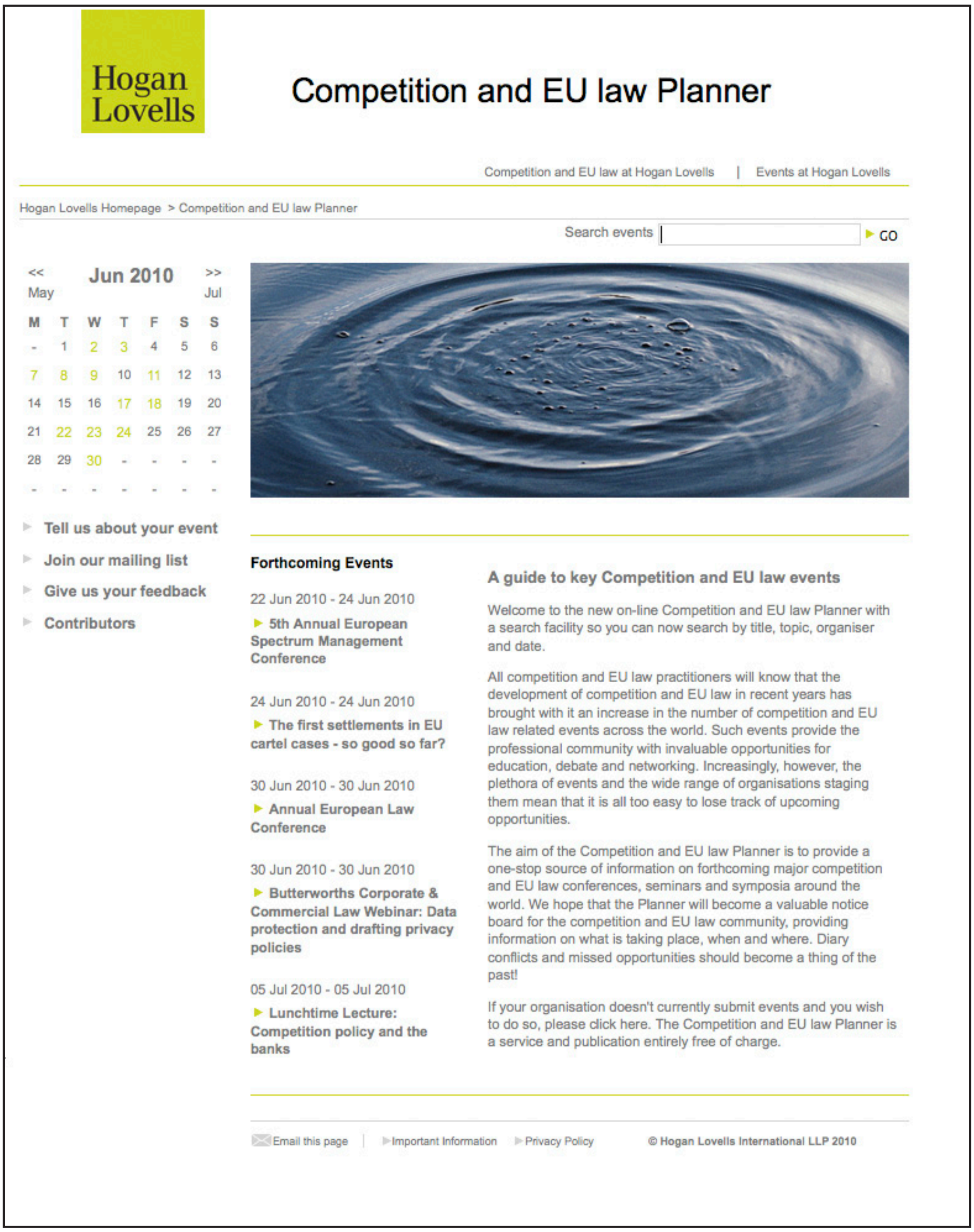

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