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Antitrust Update

Third Circuit *En Banc* Review Resuscitates DeBeers Settlement

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In This Issue

In *Sullivan v. DB Investments, Inc. et al.*,[1] the Third Circuit *en banc* vacated a panel decision that rejected the District Court's certification of two nationwide settlement classes of purchasers of diamonds from DeBeers S.A.[2] The settlement provided for a fund of $295 million to be distributed to both direct and indirect purchasers, with the direct purchasers to receive $22.5 million and the indirect purchasers to receive $272.5 million. The three-judge appellate panel held that the District Court's ruling was inconsistent with the "predominance" inquiry required under Fed. R. Civ. P. 23(b)(3) and remanded.

The Third Circuit *en banc* held that the predominance requirement was satisfied because DeBeers' conduct resulted in a common injury to all class members in the form of inflated diamond prices.[3] The Court *en banc* also rejected the notion, urged by objectors to the settlement, that a decision to certify a class must also include a determination that each class member possesses a viable claim or "some colorable legal claim."[4]

DeBeers II is the latest in a string of significant class action decisions from the Third Circuit and offers valuable guidance in class action settlement practice.

Background

According to the complaints, filed in 2001 and 2002, for much of the twentieth century, DeBeers has been the dominant participant in the wholesale market for gem-quality diamonds. Plaintiffs alleged that from 1890 through the initiation of the litigation, DeBeers coordinated the worldwide sales of diamonds by, *inter alia*, entering into output-purchase agreements with competitors, synchronizing and setting production limits, restricting the resale of diamonds to within certain geographic regions, and controlling the marketing and advertising of diamonds.[5] Allegedly, by coordinating a network of diamond producers, DeBeers was able to establish valuation criteria for diamonds and then control the quantity and prices of diamonds entering the marketplace by restricting sales to its preferred wholesalers, known as "sightholders."[6] Sightholders, in turn, resold these diamonds to jewelry manufacturers and retail jewelers.[7]

Plaintiffs alleged that these business practices allowed DeBeers to exploit its market dominance artificially to inflate the price of rough diamonds.[8] The plaintiffs fell within two classes. The first consisted of direct purchasers of gem diamonds from DeBeers or one of its competitors, asserting claims of price-fixing and monopolization under Sections 1 and 2 of the Sherman Act and seeking monetary and injunctive relief.[9] The second category consisted of indirect purchasers of rough or finished diamonds, including, for example, jewelry retailers and consumers.[10] This class sought injunctive relief under the Clayton Act and sought damages pursuant to state antitrust and consumer protection laws and under common law.[11]

DeBeers initially denied that United States courts had personal jurisdiction over it, arguing that it never transacted business in the United States.[12] DeBeers refused to appear in the lawsuits, resulting in default judgments in all but one of the pending cases.[13] While it contested the validity of the default judgments, DeBeers began settlement discussions regarding the indirect purchasers' claims.[14] These discussions resulted in a settlement of the indirect purchasers' claims with DeBeers agreeing to injunctive relief, as well as a $250 million settlement fund. DeBeers agreed to submit to US jurisdiction for the limited purpose of the settlement and enforcing the injunction.[15] DeBeers subsequently reached a parallel settlement with the direct purchaser class involving similar injunctive relief and a $22.5 million settlement fund; DeBeers also agreed to increase the indirect purchaser settlement fund by $22.5 million to accommodate indirect purchasers who also participated in the direct purchaser lawsuits, but who were not in the indirect purchaser settlement.[16]

The District Court conditionally certified the settlement classes and preliminarily approved a combined settlement of $295 million ($22.5 million allotted to the direct purchaser class and $272.5 million allotted to the indirect purchaser class (which was now comprised of two subclasses, an "indirect purchaser reseller subclass" and an "indirect purchaser consumer subclass")) and injunctive relief.[17] In response to preliminary approval, numerous objections to the settlement were filed. The key objections challenged the propriety of the certification of a nationwide indirect purchaser class and certification of the classes for injunctive relief.[18] Objectors challenging the nationwide class certification argued that the laws of many states prohibiting recovery by indirect purchasers of damages for antitrust injuries. This would require particularized legal remedies precluding a finding (as required by Rule 23) that common issues of law or fact predominated over individual issues.[19] The objectors to injunctive relief argued that the market for rough diamonds had become competitive during the course of the litigation, rendering injunctive relief designed to enforce compliance with the antitrust laws superfluous, divesting the indirect purchaser class of standing to seek relief.[20]

The district court held that differences in state law did not override class commonalities

The District Court overruled these objections (and others) and approved the settlement. With respect to the certification of the nationwide class, the Court explained that while antitrust and consumer protection laws varied from state to state, those differences did not override class commonalities.[21] The class shared common issues of fact regarding whether DeBeers actually fixed the price of rough-gem diamonds, whether DeBeers monopolized the supply of polished diamonds, and whether such conduct caused antitrust injury to plaintiffs.[22] The Court also noted that DeBeers sought a release of all damage claims in all 50 states as a condition of the settlement.[23] The Court concluded that certification was proper even though the law in many of the jurisdictions limited or denied the right of indirect purchasers to recover for antitrust injury.[24]

With respect to Rule 23(b)(2) certification for injunctive relief, the Court rejected the objectors' claim that both purchaser classes faced no risk of prospective harm.[25] The Court noted that DeBeers had stipulated to the injunction and "waived the right to demand proof of substantive elements of the claims," namely that DeBeers's ongoing conduct would continue to anticompetitively increase the price of all diamonds on the market, and concluded that injunctive relief would benefit all class members.[26]

Third Circuit: *DeBeers I*

In *DeBeers I*, a divided three-judge panel held that the District Court abused its discretion in certifying the nationwide purchaser class. The panel undertook a review of state antitrust statutes and found wide variations among the laws, depending on whether a state chose to follow the principles enunciated by the Supreme Court in *Illinois Brick*,[27] which limited standing to sue for damages under federal antitrust laws to direct purchasers. Based on this review, the panel concluded that "only some of th[e] jurisdictions recognize the claims for which recovery is sought". As a result many members of the indirect purchaser class lacked a substantive right under state antitrust laws to recover damages, thereby defeating a finding of predominance.[28]

The panel found similar variations in state consumer protection and unjust enrichment laws, many of which prohibited indirect purchasers from invoking state consumer protection laws to gain antitrust relief.[29] Moreover, the panel examined variations in state law covering the elements of proof necessary to establish unjust enrichment and consumer fraud claims and concluded that evidence of price-fixing or monopolization does not give rise to an unjust enrichment or consumer fraud claim, in every state, also defeating a finding of predominance.[30]

The panel also concluded that the District Court's class certification order violated the Rules Enabling Act[31] by extending antitrust remedies not available under state substantive law to class members. The panel rejected the argument that DeBeers's stipulation to liability in all 50 states supported the District Court's predominance finding, noting that such an approach would invite collusive settlements.[32] Similarly, the panel was concerned that the District Court sacrificed principles of federalism "in favor of obtaining an expedient settlement" by certifying a settlement class despite the fact that only some jurisdictions recognized the claims for which recovery was sought.[33]

Finally, the panel rejected the certification of the injunction claim under Rule 23(b)(2) finding that DeBeers's significant market share decline (65% in 2000 to 45% in 2006) supported the conclusion that because of the increasingly competitive market, plaintiffs faced no significant threat of prospective harm in the absence of an injunction.[34]

Third Circuit: *DeBeers II*

The *en banc* Court vacated *DeBeers I* and concluded that the District Court had properly certified the settlement classes and properly approved the settlement.

The *en banc* panel held that in a settlement, each class member does not need to have a "colorable claim."

Turning to the predominance inquiry, the Court identified three "guideposts" that direct this inquiry: (1) commonality is determined by the defendant's conduct and any resulting injuries common to all class members; (2) "variations in state law do not necessarily defeat predominance"; and (3) "concerns regarding state law largely dissipate when a court is considering the certification of a settlement class."[35]

The first guidepost was derived from *In re Warfarin Sodium Litig.*,[36] in which the Court emphasized that proof of liability "depends on the conduct of the [defendant], and whether it conducted a nationwide campaign of misrepresentation and deception, [and] does not depend on the conduct of individual class members."[37] The Court noted here that *DeBeers* involved claims remarkably similar to those in *Warfarin* – plaintiffs alleged that DeBeers anticompetitively exploited its 65% share of the diamond market to impose restraints on the sale and resale of those diamonds.[38] This conduct resulted in a common injury to all class members – inflated diamond prices – violating federal antitrust law and the antitrust and consumer protection laws of every state.[39] As a result, the Court held that each class member shared common legal and factual questions arising from whether DeBeers engaged in a broad conspiracy that affected diamond prices in the United States.[40]

The *en banc* majority rejected the dissent's argument that the Supreme Court's recent decision in *Wal-Mart Stores, Inc. v. Dukes*[41] required an inquiry into the existence or validity of each class member's claim at the class certification stage.[42] The majority explained that *Dukes* does not require that each settlement class member have a "colorable" claim, but instead instructed that the focus of the certification inquiry was whether the defendant's conduct was common to all class members, a requirement satisfied in *DeBeers*.[43]

The Court also explained that variations in state law do not preclude certification of a nationwide settlement class.[44] Looking again to *Warfarin*, the Court noted that certification of nationwide classes could be appropriate where the state law variations fell "into a limited number of predictable patterns" and deviations "could be overcome at trial by grouping similar state laws together and applying them as a unit."[45] Accordingly, the Court stressed that "[n]othing in our case law or the language of Rule 23 commands that everyone in a class must allege precisely identical or 'uniform' causes of action" to satisfy the predominance inquiry.[46] Here, although DeBeers's singular conduct might give rise to one cause of action in one state, and a different cause of action in another state, a court may properly group both claims in a single class action.[47]

In the context of a class settlement, the Court explained that the objectors improperly conflated the predominance inquiry for litigated classes with that required for certification of settlement classes, and noted that in a settlement class, manageability concerns are removed from consideration.[48] In the settlement context, the Court explained, "we are not as concerned with formulating some prediction as to how [variances in state law] would play out at trial, for the proposal is that there be no trial."[49]

The Court also rejected the argument that because variations in state law arguably resulted in a large proportion of the indirect purchaser class lacking any valid claim under state law there could be no finding of commonality between such class members and those having valid claims.[50] The Court stressed that the appropriate question is not what valid claims plaintiffs can assert; rather it is whether common issues of law or fact predominate. The predominance inquiry has no "merits" litmus test other than whether certain elements were capable of common proof or required individual analysis.[51] Indeed, the Court eschewed any analysis of the viability of asserted claims at the class stage because it would introduce a Rule 12(b) (6) inquiry as to every claim in the class before a class could be certified, noting that this proposition is rejected by Rule 23 itself.[52]

Similarly, the Court also rejected the argument that because some class members could not assert a valid claim to recovery, they lacked standing, thereby precluding class certification.[53] The court noted that unlike statutory standing, the lack of antitrust standing is not jurisdictional. It is simply an element of proof for an antitrust injury and not a prerequisite to assert a claim.[54]

Variations in state law do not present "manageability" issues in a settlement class.

The Court also approved class certification under Rule 23(b)(2) for injunctive relief. The Court noted that despite the need for plaintiffs to demonstrate the need for an injunction, "parties to a suit have the right to agree to anything they please in reference to the subject matter of their litigation."[55] Hence, the District Court did not exceed its discretion by approving an agreed upon stipulation that provided injunctive relief that was arguably broader than that which could have been won at trial.[56]

Conclusion

In his concurrence, Judge Scirica noted that ever since the Supreme Court's decisions in *Amchem*[57] and *Ortiz*,[58] "one of the most vexing questions in modern class action practice has been the proper treatment of settlement classes, especially classes national in scope that may also implicate state law."[59] *DeBeers II* provided important clarification of the standards and guidelines set down in *Amchem* and *Ortiz*.

Debeers II confirms that the same analytical rigor is required for litigation and settlement class certification, but clarifies that some inquiries essential to litigation class certification are no longer problematic to *settlement class* certification. This is particularly true with respect to manageability – a settlement class certification presents no manageability problems because the case will not be tried.

DeBeers II also emphasizes that, in the settlement context, variations in state law will not necessarily bar class certification. The proper focus in the settlement context should be on the conduct of the defendant and the injury suffered as a consequence by the class as a whole.

Whether the Third Circuit *en banc* panel has the last word on this remains to be seen. Given the Supreme Court's recent antipathy towards class actions there may be some chance the Court will grant certiorari to reverse and further circumscribe the scope of class action relief. However, the Court has also been concerned with the burgeoning caseload in the lower courts, and there is a strong policy in favor of settlements of private actions. Hence, the final decision on this case is quite difficult to predict.

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1 __ F.3d ____, 2011 WL 6367740 (3d Cir. Dec. 20, 2011) (*DeBeers II*).

2 *Sullivan v. DB Investments, Inc.*, 613 F.3d 134 (3d Cir. 2010), *reh'g en banc granted and vacated by Sullivan v. DB Investments, Inc.*, 619 F.3d 287 (3d Cir. 2010) (*DeBeers I*).

3 ___ F.3d ___, 2011 WL 6367740 at *1.

4 *Id.* (citation omitted).

5 *Id.*

6 *Id.*

7 *Id.*

8 *Id.* at *2.

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.* at *3.

17 *Id.*

18 *Id.* at *5.

19 *Id.*

20 *Id.* Objectors to the settlement included class members who were residents of states where a remedy allegedly was not available, who argued that certification of the indirect purchaser classes improperly allowed them and similarly situated class members to participate in the settlement.

21 *Id.* at *6.

22 *Id.*

23 *Id.*

24 *Id.*, *see also DeBeers I*, 613 F.3d at 142.

25 *DeBeers II*, 2011 WL 6367740 at *7.

26 *Id.*

27 *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061 (1977).

28 2011 WL 6367740 at *7.

29 *Id.*

30 *Id.* at *8.

31 28 U.S.C. §2072(b).

32 *DeBeers II*, 2011 WL 6367740 at *8.

33 *Id.*

34 *Id.*

35 *Id.* at *11.

36 391 F.3d 516 (3d Cir. 2004) (*Warfarin*).

37 *DeBeers II*, 2011 WL 6367740 at *12 (citing *Warfarin*, 391 F.3d at 528).

38 *DeBeers II*, 2011 WL 6367740 at *13.

39 *Id.*

40 *Id.* at *13, 14.

41 ___ U.S. ___, 131 S.Ct. 2541 (2011).

42 *DeBeers I*,. 2011 WL 6367740 at *13.

43 *Id.*

44 *Id.* at *14.

45 *Id.* at *14-15.

46 *Id.* at *15.

47 *Id.*

48 *Id.* at *16.

49 *Id.* at *17 (citing *In re Ins. Broker Antitrust Litig.*, 579 F.3d 241, 269 (3d Cir. 2009).

50 *Id.* at *17.

51 *Id.*

52 *Id* at *17-18.

53 *Id.* at *19.

54 *Id.*

55 *Id.* at *26.

56 *Id.* (The Court also noted the allegations of common impact to the class as a whole discussed in its predominance discussion satisfied plaintiffs' burden under Rule 23(b) (2) to show that injunctive relief was appropriate for the class as a whole. *Id.* at *27.)

57 *Amchem Products Inc. v. Windsor*, 521 U.S. 591, 117 S.Ct. 2231 (1997).

58 *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S.Ct. 2295 (1999).

59 *DeBeers II*, 2011 WL 6367740 at *41.

CEO Agrees to $500,000 Fine for HSR Act Violations Related to Acquisition of Stock as Executive Compensation

By John M. Sipple, Jr. and Laura A. Wilkinson

The Federal Trade Commission (FTC) recently obtained $500,000 in civil penalties for violation of pre-merger notification requirements with respect to a corporate officer's acquisition of stock in the context of executive compensation. On December 16, 2011, Brian L. Roberts, the Chief Executive Officer of Comcast Corporation, reached a settlement with the FTC regarding alleged failure to comply with the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act), for his acquisition of voting securities of Comcast between 2007 and 2009.[1]

The FTC charged that Roberts failed to file the required notifications under the HSR Act when restricted stock units (RSUs) that he had been awarded as compensation vested, which resulted in his ownership of the associated Comcast voting securities.[2] The alleged violations of the HSR Act occurred on March 9, 2008 and April 28, 2009, when separate groups of RSUs vested and Roberts' holdings of Comcast stock exceeded the applicable reporting threshold. In total, Roberts acquired 334,560 shares of Comcast voting securities through the vesting of RSUs during this time period.

In addition, the FTC charged that Roberts failed to file required notifications in violation of the HSR Act when he acquired shares of Comcast through his 401(k) account via the reinvestment of dividends and his holdings of Comcast stock exceeded the reporting threshold. Specifically, the FTC alleged that from October 22, 2007 through April 28, 2009, Roberts acquired approximately 3,700 shares of Comcast stock via his 401(k) account in violation of the HSR Act.[3]

Roberts voluntarily filed a corrective HSR Act filing on August 25, 2009. Upon investigation, the FTC concluded that Roberts was in continuous violation of the HSR Act beginning on October 22, 2007, when he acquired Comcast voting securities resulting in his ownership of shares valued in excess of $59.8 million, the applicable threshold in 2007, and ending on September 24, 2009, when the HSR Act waiting period for his corrective filing expired.[4] Roberts agreed to pay a civil penalty of $500,000 to settle the FTC's charges. The fine could have been substantially higher. For the alleged HSR Act violations, the maximum civil penalty was $11,000 per day for part of the time period and $16,000 per day for the rest of the time period. However, the FTC explained that the settlement sought an "appropriate civil penalty" and that the amount of the fine imposed was "limited by several factors, including that the violation was inadvertent and technical; that it was apparently due to faulty advice from outside counsel; that Roberts did not gain financially from the violation; and that he reported the violation promptly once it was discovered."[5]

Commentary:

This is the first time that the FTC has sought civil penalties from a corporate officer for the failure to report an acquisition of voting securities in connection with executive compensation. Although the case serves as a reminder regarding the FTC's interpretation of the applicability of the HSR Act to aspects of executive compensation, the unique situation surrounding Roberts' repeat violations of the HSR Act likely does not signal a change in the agency's exercise of prosecutorial discretion.

The case highlights the FTC's position that the receipt by an officer of voting securities[6] as compensation is an acquisition subject to the HSR Act and notification is required if the reporting thresholds are met. Similarly, the case illustrates the FTC's position that even the reinvestment of dividends in the form of voting securities are subject to the HSR Act and can require notification if the reporting thresholds are met.

Typically, the FTC has not sought civil penalties for a person's first inadvertent violation of the HSR

Act. However, the FTC generally will seek civil penalties for any subsequent violations. This was not the first time that Roberts had violated the HSR Act. The FTC's complaint explains that Roberts had twice before submitted corrective filings related to situations where he had failed to file in violation of the HSR Act.[7] Those situations related to acquisitions made by Comcast when Roberts controlled the company and was Comcast's ultimate parent entity. On both prior occasions, the FTC did not recommend civil penalties.[8] However, Roberts specifically was reminded in writing that he "is accountable for instituting an effective program for all entities he controls to ensure full compliance with the [HSR] Act's requirements."[9] Therefore, because Roberts already had benefited from the FTC's prosecutorial discretion on two prior occasions, the agency sought civil penalties in connection with Roberts' latest violations.

1 FTC Press Release, "FTC Obtains $500,000 Penalty for Pre-Merger Reporting Act Violations," Dec. 16, 2011, as well as the complaint and settlement are *available at* http://www.ftc.gov/opa/2011/12/brianroberts.shtm. Procedurally, the Department of Justice, Antitrust Division (DOJ), filed the lawsuit and settlement with the district court at the request of the FTC. DOJ Press Release, "CEO of Comcast Brian Roberts to Pay $500,000 Civil Penalties for Violating Antitrust Premerger Notification Requirements," Dec. 16, 2011, *available at* http://www.justice.gov/atr/public/press_releases/2011/278338.pdf.

2 The Comcast RSUs did not entitle Roberts to voting rights or rights to dividends. However, upon vesting of the RSUs, Roberts received Comcast Class A Common Stock, voting securities that entitled him to voting rights and dividend rights.

3 Complaint at 8.

4 Complaint at 7-8.

5 FTC Press Release at 1.

6 It is important to note that RSUs vary in their attributes and when they are considered voting securities for HSR Act purposes. Some RSUs entitle the holder to vote the underlying shares when the RSU is awarded although it has not yet vested, while other RSUs only entitle the holder to vote the shares upon vesting. In the former scenario, an HSR Act filing is required prior to the receipt of the RSU, if the HSR notification thresholds are met. In the latter scenario, as was the situation in the Roberts case, an HSR Act filing is required prior to the vesting of the RSUs, the point at which the holder receives voting securities. Similarly, if an officer receives warrants to acquire voting shares, an HSR Act filing is required prior to the exercise of the warrant, if the notification thresholds are met. However, an HSR Act filing is not required if the officer makes arrangements to have the shares subject to the warrant immediately sold to third parties on the exercise date.

7 Complaint at 5-6.

8 Complaint at 5-6. It was unusual that the FTC did not seek civil penalties when Roberts submitted a corrective filing for his second HSR violation. However, that violation resulted from a secondary acquisition (*i.e.*, an indirect acquisition of voting securities that occurs when an acquiring person acquires control of person that holds a minority interest in another corporation). This may explain why civil penalties were not sought for Roberts' second violation.

9 Complaint at 6.

H&R Block's Acquisition of TaxACT Enjoined

by Vadim M. Brusser and Laura Wilkinson

On October 31, 2011, the U.S. District Court for the District of Columbia granted the Department of Justice Antitrust Division's (DOJ) motion for a preliminary injunction to stop H&R Block's acquisition of a controlling stake in 2SS Holdings, Inc., the maker of TaxACT tax preparation products.[1] The DOJ alleged that the $287.5 million transaction would combine the second and third largest providers of "digital do-it-yourself tax preparation products" (DDIY).[2] According to the DOJ, post-merger the combined H&R Block/TaxACT plus the market leader, Intuit's TurboTax, would account for 90 percent of the DDIY market.[3] Based on a detailed analysis of the evidence, the Court held that the proposed acquisition was likely to result in anticompetitive effects and should be enjoined.

Relevant Product Market

The Court's relevant product market analysis considered three types of income tax preparation methods: (1) "manual" or "pen and paper" preparation, (where a taxpayer prepares tax forms by hand and mails them to the Internal Revenue Service (IRS)); (2) "assisted" preparation, which typically involves hiring a certified public accountant or a tax specialist at a retail tax store; and (3) DDIY preparation, which allows a taxpayer to prepare and submit tax forms online or with software downloaded to the filer's computer.[4]

The Court analyzed in detail the parties' relevant product market definition arguments. The defendants alleged that a narrow market for DDIY products was inappropriate because taxpayers could use any of the three preparation methods to complete a tax return.[5] The DOJ conceded that all three tax preparation methods accomplished the task of preparing a tax return, but that the methods differed significantly as to time and effort, convenience and, most importantly, price.[6] In contrast to the DDIY's industry average price of $44.13, the typical price of an assisted tax return ranged from $150 to $200.[7] Because of these differences, the Court concluded that taxpayers did not consider manual or assisted preparation as reasonably interchangeable substitutes for DDIY preparation.

The Court was swayed by the defendants' internal business documents cited by DOJ and the testimony of DOJ's economic expert. TaxACT's documents consistently viewed DDIY products from H&R Block and TurboTax as TaxACT's primary competitors.[8] TaxACT heavily tracked those companies' products and determined pricing and strategic decisions based on their DDIY offerings.[9] Similarly, H&R Block's documents focused on analyzing a DDIY market and the "Big Three" competitors in that market.[10] The Court also noted that documents from TaxACT's investment bankers identified DDIY products from H&R Block and TurboTax as TaxACT's primary competitors.[11] The Court thus concluded that defendants' documents provided strong evidence that DDIY is the relevant product market.[12]

Defendants' documents provided strong evidence that DDIY is the proper relevant market.

The DOJ's economic expert presented multiple analyses in support of a DDIY market. Using defendants' internal documents and IRS data showing taxpayer switching among tax preparation methods, the expert estimated diversion ratios between the various tax preparation products.[13] The switching data from the IRS was particularly robust, and had information from over 100 million taxpayers.[14] DOJ's expert used both critical loss analysis and merger simulation to show that taxpayers were unlikely to switch away from DDIY products to other methods in sufficient quantities to defeat a DDIY price increase.[15] The defendants' economic expert relied on a pricing simulator, which the Court found contained critical design flaws, and an email survey commissioned by defendants, which the Court concluded contained methodological deficiencies.[16] The Court found "severe shortcomings" in defendants' consumer survey data.[17]

The Court ultimately agreed with the DOJ that DDIY was a properly defined relevant product market. Applying the Horizontal Merger Guidelines, the Court concluded that a hypothetical DDIY monopolist could successfully impose a five or ten percent price increase because not enough DDIY users would switch to other methods.[18] Citing prior cases in which district courts have excluded "self supply" from a relevant product market, the Court concluded that the number of DDIY consumers who would switch to manual tax preparation would not be sufficient to restrain the prices of DDIY tax preparation products.[19] The Court also rejected the defendants' contention that a broader tax preparation market was appropriate because tax preparation products were moving to a "hybrid" product that combined both digital and assisted tax. The limited presence of hybrid products was not sufficient to compel including tax preparer-assisted services in the DDIY product market.[20]

Competitive Effects

After finding that DDIY preparation was the proper relevant product market, the Court turned to the DOJ allegations that the transaction could result in both unilateral and coordinated anticompetitive effects. The Court found that the DDIY market was already highly concentrated and that the transaction would further increase concentration: TurboTax would retain a 62.2 percent share and the combined H&R Block/TaxACT would hold a 28.4 percent share.[21] The defendants maintained that there were 18 companies that offered DDIY products, including TaxSlayer and TaxHawk. However, the Court concluded that these "very small-time operators" were unlikely to expand their presence and new competitors were unlikely successfully to enter the DDIY segment.[22] The Court found that reputation was an especially high barrier to entry because of the highly sensitive nature of preparing and submitting a tax return.[23]

The Court also gave weight to evidence that supported the likelihood of post-merger coordinated interaction. First, the DOJ alleged that there was historical evidence of cooperation between H&R Block and Intuit. For example, when TaxACT launched a free DDIY software offering (in addition to its paid offerings) for all taxpayers, Intuit proposed that DDIY product makers pull back on free DDIY software promotions.[24] H&R Block and Intuit also had joined together to successfully lobby the IRS to limit free DDIY offers.[25] The Court discussed other industry factors that made coordination more likely, including the presence of small but numerous transactions spread among many individual consumers. Finally, the Court noted that TaxACT's aggressive effort to roll out free DDIY offers made TaxACT an industry maverick, and that elimination of this aggressive competitor would make coordination between the remaining firms more likely.[26]

The Court also concluded that the merger of H&R Block and TaxACT would likely result in unilateral effects because it would eliminate direct competition between the companies. The Court rejected the defendants' arguments that unilateral effects were unlikely because H&R Block and TaxACT were not close competitors. The defendants argued that while H&R Block competed against TurboTax in the "premium" DDIY segment, TaxACT competed in the "value" segment.[27] The Court called this argument "misleading" – although H&R Block's list prices for certain DDIY products were higher than TaxACT's list prices, H&R Block had been increasingly marketing free products in response to competition with TaxACT.[28] The Court found more convincing the fact that H&R Block had lowered its pricing in response to TaxACT's free DDIY offers, that H&R Block based its prices partly on TaxACT's pricing, and that H&R Block began offering its own free DDIY offers in response to aggressive competition from TaxACT.

The combined H&R Block/TaxACT would have only a 28.4% market share but the Court found anticompetitive effects likely.

The Court also found that unilateral anticompetitive effects were likely after considering the companies' documents and testimony regarding competition as well as the simulation model prepared by DOJ's economic expert.[30] Finding unilateral effects likely although the combined firms' post-merger share was below 35 percent, the Court specifically declined to impose a market share threshold for proving unilateral effects.[31]

Finally, the Court rejected defendants' efficiencies claims on the grounds that they were not merger-specific nor independently verifiable.[32]

Conclusion

The Court decided that H&R Block's proposed acquisition was reasonably likely to result in anticompetitive effects and that it should be enjoined. Shortly after the decision the parties abandoned the transaction.[33] TaxACT subsequently agreed to be acquired by InfoSpace.[34]

Although the Court's opinion is a relatively straightforward application of horizontal merger law, it offers several interesting observations:

- The central focus of the Court's opinion was the analysis of product market definition. This demonstrates that, although the agencies' Horizontal Merger Guidelines have deemphasized the role of market definition in merger analysis, courts still view market definition as an important element in a Section 7 case.
- The Court relied not only on the merging companies' documents, but also documents prepared by TaxACT's investment bankers. This highlights the importance of making sure that a company's ordinary course and deal-related documents accurately reflect the competitive dynamics in the industry and the rationale for the transaction. Also, since the revised Hart-Scott-Rodino Act (HSR) notification form may call for additional investment banker-prepared documents to be included with a company's initial HSR filing, it is important to make sure that investment bankers and consultants are aware that the documents they generate will be reviewed by the antitrust agencies.

- The Court relied heavily on documents and economic analysis to conclude that a market for DDIY was appropriate. The DOJ and the defendants used diversion ratios, critical loss analyses, simulations and other econometric modeling to support their legal arguments and economic analyses. The Court recognized that both parties' economic analyses had shortcomings, but it harshly critiqued defendants' economic data and analyses as flowing from models that were based on flawed methodologies.

1 *U.S. v. H&R Block, Inc.*, No. 11-00948 BAH, at *1-2 (D.D.C. Oct. 31, 2011). The Court issued the decision to the parties on October 31, 2011, but it delayed public release of the opinion until November 10, 2011, so that the Court could redact any confidential business information.

2 *Id.* at 5.

3 *Id.*

4 *Id.* at 4.

5 *Id.* at 16.

6 *Id.* at 5.

7 *Id.* at 24.

8 *Id.* at 19.

9 *Id.*

10 *Id.* at 21.

11 *Id.* at 20.

12 *Id.* at 19–22.

13 *Id.* at 35.

14 *Id.* at 36.

15 *Id.* at 38-39.

16 *Id.* at 42–49

17 *Id.* at 32.

18 *Id.* at 18–19.

19 *Id.* at 27–31.

20 *Id.* at 26.

21 *Id.* at 52.

22 *Id.* at 54.

23 *Id.* at 57.

24 *Id.* at 62.

25 *Id.*

26 *Id.* at 63.

27 *Id.* at 70.

28 *Id.*

29 *Id.* at 68.

30 *Id.* at 79.

31 *Id.* at 73.

32 *Id.* at 85.

33 H&R Block, Form 8-K, filed on November 15, 2011 at 1.

34 On January 9, 2012, InfoSpace, Inc., an online service company announced that it was acquiring TaxACT for $287.5 million. InfoSpace Press Release, "InfoSpace to Acquire TaxACT," dated January 9, 2012, *available at* http://investor.infospaceinc.com/phoenix.zhtml?c=119056&p=irol-newsArticle&ID=1645740&highlight=.

FTC Judge Requires Health System to Unwind 2010 Hospital Acquisition to Remedy §7 Violation

By Brianne Kucerik

In late 2011, an administrative law judge (ALJ) issued a decision supporting the Federal Trade Commission (FTC) staff's challenge to ProMedica Health System Inc.'s (ProMedica) September 2010 acquisition of St. Luke's Hospital (St. Luke's) in Lucas County, Ohio.

Initial FTC Investigation; 60-Day Hold Separate Agreement

In May 2010, ProMedica, a nonprofit health-care system serving portions of Ohio and Michigan, entered into an agreement to acquire St. Luke's, an independent, nonprofit general acute-care community hospital in Ohio. Three of ProMedica's eleven hospitals are in Lucas County, Ohio, where St. Luke's is located.[1]

Although the transaction did not meet the threshold for filing a notification with the US antitrust agencies under the Hart-Scott-Rodino Antitrust Act, the FTC and the Ohio Attorney General opened investigations to evaluate the potential anticompetitive effects of the acquisition. In September 2010, ProMedica closed the transaction. Since the FTC and state of Ohio investigations were still pending at that time, ProMedica agreed to a 60-day Hold Separate Agreement. Under the terms of the agreement, ProMedica was prohibited from: (i) terminating St. Luke's health-plan contracts (and allowing health plans the option to extend their existing contracts with St. Luke's past the termination date); (ii) eliminating, transferring, or consolidating any clinic service at St. Luke's; and

(iii) terminating employees at St. Luke's without cause.[2]

FTC Challenge

The FTC investigation proceeded throughout the fall of 2010, and in January 2011, the FTC filed an administrative complaint alleging that ProMedica's acquisition of St. Luke's may substantially lessen competition in violation of Section 7 of the Clayton Act. The FTC alleged that the transaction (i) reduced the number of competitors from four to three in the market for general acute-care inpatient hospital services sold to commercial health plans in Lucas County, Ohio; (ii) reduced the number of competitors from three to two in the market for inpatient obstetrical services in Lucas County, Ohio; (iii) resulted in high post-acquisition market shares and concentration; and (iv) created a "must have" system for commercial health insurance networks "with an increased ability and incentive to demand supra-competitive reimbursement rates."[3]

Federal District Court Relief

At the same time the administrative complaint was filed, the FTC and state of Ohio brought suit in the Northern District of Ohio seeking preliminary injunctive relief to prevent any further integration of St. Luke's into ProMedica operations while the FTC's administrative proceeding was pending.[4] The district court granted the request for a preliminary injunction and ordered that the Hold Separate Agreement remain in effect until the completion of the FTC's proceedings.[5]

ALJ Decision Ordering Divestiture

On December 12, 2011, the ALJ overseeing the FTC administrative proceeding held that ProMedica's acquisition of St. Luke's was likely to substantially lessen competition in violation of Section 7 of the Clayton Act and ordered that ProMedica divest St. Luke's in order to remedy the violation.

The acquisition would enable the merged hospitals to obtain increased reimbursement rates.

The Relevant Market

The ALJ decision first addressed the relevant market. The ALJ noted that "[p]roper definition of a product market 'is a necessary precondition to assessment' of the effect of a merger or acquisition on competition,'" and as a result, "Complaint Counsel bears the burden of identifying a relevant market."[6]

The ALJ found that general acute-care inpatient services are a "cluster of services" that constitute a relevant product market. The parties agreed with this market definition and also agreed that managed care organizations are the consumers of these services. The parties disagreed as to whether general acute-care inpatient services include complex tertiary services and whether there is a separate relevant product market for inpatient obstetrical services.

The ALJ held that general acute-care inpatient services includes complex tertiary services – even though St. Luke's does not provide these services – because managed care organizations demand and contract to purchase primary, secondary, and tertiary services together. The ALJ also held that there is no separate market for inpatient obstetrics services. The FTC staff had alleged a separate market for obstetrics services because "no other hospital services are reasonably interchangeable with inpatient obstetrical services."[7] The ALJ found that "carv[ing] out individual hospital services would be contrary to the logic upon which the inpatient services 'cluster market' rests" and that there was no evidence establishing a separate relevant product market for inpatient obstetrical services.[8]

All parties agreed that the proper geographic market for general acute-care inpatient hospital services (including primary, secondary, and tertiary services) is Lucas County, Ohio.

Anticompetitive Effects

The ALJ then analyzed the evidence presented by FTC staff regarding anticompetitive effects in the market for general acute-care inpatient hospital services in Lucas County, Ohio. The ALJ found that the evidence presented demonstrated that the transaction would significantly increase ProMedica's market share and market concentration in the already highly concentrated market. However, the ALJ noted that, "More powerful than the market share and concentration statistics is the simple fact that after the [transaction], there are only two remaining competitors to ProMedica that provide [general acute-care] inpatient hospital services in Lucas County."[9] The ALJ found that the transaction would significantly increase ProMedica's bargaining leverage in negotiations with managed care organizations and grant ProMedica sufficient market power to enable it to increase the reimbursement rates it charges to managed care organizations for general acute-care inpatient hospital services. Since this rate increase would likely be passed on to customers, the ALJ found a reasonable probability that the transaction would result in anticompetitive effects in the relevant market.[10]

Procompetitive Effects, Efficiencies, and Weakened Competitor Defenses

ProMedica argued that the transaction did not violate Section 7 – even with a finding of anticompetitive effects – because the transaction's procompetitive benefits outweighed any anticompetitive effects. While the ALJ found some support in the record for ProMedica's claims regarding the procompetitive benefits and efficiencies that would result from the transaction, the ALJ held that they were insufficient to outweigh the likely anticompetitive effects of the transaction.[11] In that connection, the ALJ found that there was insufficient evidence to support ProMedica's claims that competitors and customers would constrain its ability to impose supracompetitive prices.[12] The ALJ also held that applicable case law did not support allowing the transaction to proceed based on St. Luke's weakened financial condition, principally because St. Luke's increased its patient volume and market share prior to the transaction, had "prospects for improvement," and had merger options other than ProMedica.[13] As a result, the ALJ held that the transaction violated Section 7 of the Clayton Act.

Remedy

Once the ALJ established that the transaction violated Section 7 of the Clayton Act, the analysis turned to the appropriate remedy. FTC staff sought an order requiring ProMedica to completely divest its ownership of St. Luke's. ProMedica argued that it would be sufficient to create a "firewalled" negotiation team that would negotiate and administer managed care organization contracts exclusively for St. Luke's, independent of ProMedica's other Lucas County hospitals. According to ProMedica, this would negate any increased bargaining power and restore St. Luke's as an independent competitive restraint because managed care organizations would be free to contract with St. Luke's alone.[14]

The ALJ rejected these arguments and ordered ProMedica to divest itself of St. Luke's. In doing so, the ALJ distinguished the facts of this case from the facts of a prior case, *Evanston*, where the Commission approved a remedy similar to the one proposed by ProMedica. The ALJ found that, because the Hold Separate Agreement had prevented extensive integration between ProMedica and St. Luke's, divestiture in this case would not be "complex, lengthy, and expensive" as it would have been in *Evanston*.[15] "Where, as here, 'it is relatively clear that the unwinding of a hospital merger would be unlikely to involve substantial costs, all else being equal, the Commission likely would select divestiture as the remedy.'"[16]

Lessons Learned

The ALJ decision is still subject to review by the full commission. However, this case serves as a reminder of several important factors to consider when evaluating the antitrust risks associated with a potential acquisition.

- The fact that a transaction is not reportable under the Hart-Scott-Rodino Act is not determinative of whether the transaction will be investigated or even challenged. The US antitrust agencies are more likely to pursue an investigation if the transaction is in a high-profile industry (such as hospitals) or if customers or other entities contact the agencies to complain about the transaction.
- Consummated transactions may be challenged by the US antitrust agencies. In fact, the FTC and Department of Justice Antitrust Division (DOJ) have sought to unwind previously consummated transactions several times in recent years.
- Although the revised Horizontal Merger Guidelines issued by the FTC and DOJ in 2010 suggest that an analysis need not start with market definition, market definition continues to play a significant role.
- A showing of some efficiencies is not sufficient to overcome anticompetitive concerns regarding a transaction. Rather, the parties must show "significant economies" benefiting consumers, or

that the benefits/efficiencies clearly outweigh the likely anticompetitive effects of the transaction.

- Parties face a difficult burden in trying to establish a merger should be permitted to proceed based on the fact that the acquired firm is a weakened competitor – in particular where there is evidence the acquired firm still competes effectively in the market.

1 Initial Decision, *In re ProMedica Health System, Inc.*, File No. 101-0167 (FTC Dec. 12, 2011), *available at* http://www.ftc.gov/os/adjpro/d9346/index.shtm, at 7-8.

2 *Id.* at 8-9.

3 FTC Complaint, *In re ProMedica Health System, Inc.*, File No. 101-0167 (FTC Jan. 6, 2011), *available at* http://www.ftc.gov/os/adjpro/d9346/index.shtm, ¶¶ 20-23.

4 Plaintiff's Motion for Preliminary Injunction, *FTC v. ProMedica Health Sys., Inc.*, No. 3:11-cv-00047-DAK (N.D. Ohio Jan. 7, 2011).

5 *FTC v. ProMedica Health Sys., Inc.*, 2011 U.S. Dist. LEXIS 33434 (N.D. Ohio Mar. 29, 2011). The court asked for an update from the parties on Nov. 30, 2011.

6 Initial Decision at 137 (quoting *United States v. General Dynamics Corp.*, 415 U.S. 486, 510 (1974)).

7 FTC Complaint ¶ 14.

8 Initial Decision at 144.

9 *Id.* at 152-53.

10 *Id.* at 176.

11 *Id.* at 204.

12 *Id.* at 181.

13 *Id.* at 189.

14 *Id.* at 205.

15 *Id.* at 209 (quoting *In re Evanston NW Healthcare Corp.*, No. 9315, 2007 FTC LEXIS 201, at *249 (Aug. 6, 2007)).

16 *Id.* at 209 (quoting *Evanston*, 2007 FTC LEXIS 201, at *250).

17 Both ProMedica and FTC staff have appealed portions of the decision, with oral argument scheduled for February 2012. *See* Complaint Counsel's Appeal Brief, *In re ProMedica Health System, Inc.*, File No. 101-0167 (FTC Dec. 27, 2011), *available at* http://www.ftc.gov/os/adjpro/d9346/index.shtm; Respondents Appeal Brief, *In re ProMedica Health System, Inc.*, File No. 101-0167 (FTC Dec. 27, 2011), *available at* http://www.ftc.gov/os/adjpro/d9346/index.shtm.

18 *See, e.g.*, Final Order, *In re Polypore Int'l, Inc.*, File No. 081-0131 (FTC Dec. 13, 2010), *available at* http://www.ftc.gov/os/adjpro/d9327/index.shtm.

19 U.S. Dep't of Justice & Fed. Trade Commission, Horizontal Merger Guidelines (2010), §4, *available at* http://ftc.gov/os/2010/08/100819hmg.pdf.

20 Initial Decision at 204.

Seventh Circuit Vacates *Minn-Chem Incorporated v. Agrium Incorporated* Opinion and Grants Petition for Rehearing *En Banc*

By Alan Kusinitz

In the Fall 2011 *Antitrust Update*, we reported that the Seventh Circuit in *Minn-Chem Incorporated v. Agrium Incorporated*[1] held that a class action alleging an offshore conspiracy to raise the price of potash should have been dismissed by the district court because the conduct complained of was either exempt under the Foreign Trade Antitrust Improvements Act (FTAIA)[2] or was insufficient to state a "plausible" claim for relief under the pleading standards of *Twombly/Iqbal*.[3]

Plaintiffs filed a petition for rehearing *en banc* on October 7, 2011, arguing that *en banc* review was appropriate because the panel's decision conflicted with another decision of the Seventh Circuit[4] and several Supreme Court cases[5] and, therefore, consideration by the full court was necessary to secure and maintain uniformity of the court's decisions.[6] On December 2, 2011, the Seventh Circuit granted plaintiffs' petition and vacated the panel's decision.[7]

Regarding the *Twombly/Iqbal* pleading standard, Plaintiffs' *en banc* petition argued that the panel's decision conflicted with the Seventh Circuit's decision in *In re Text Messaging Antitrust Litig.*[8] As noted in our Fall *Update*, *Minn-Chem* and *Text Messaging* appeared to be at odds with each other: *Minn-Chem* reversed a denial of a motion to dismiss an antitrust conspiracy, whereas *Text Messaging* affirmed a denial of dismissal of an antitrust conspiracy even though the factual content of the two cases were similar.[9] Controversy and commentary ensued,[10] even though such conflicts are inevitable given that the Supreme Court's instruction to interpret whether a complaint states a plausible claim for relief based on "judicial experience and common sense."[11]

The petition also argued that the panel misconstrued the two exceptions to the FTAIA: the import exception[12] and the substantial and foreseeable effects exception.[13] Regarding the import exception, Plaintiffs argued that the panel added a requirement not found in the statute or case law that foreign cartels that import products into the US must specifically target the US for imports in order to be subject to the Sherman Act. The petition also argued that under the "direct, substantial, and reasonably foreseeable effect" exception, the panel narrowly defined the term "direct" to mean "follows as an immediate consequence of the defendant's activity." Plaintiffs argued that this definition effectively imposed an intent requirement into the exception, a requirement that the Third Circuit in *Animal Sci. Prods., Inc. v. China Minmetals Corp.*,[14] had previously rejected.[15] Finally, the petition argued that the panel erred by not deciding whether the FTAIA is "jurisdiction-stripping" or simply prescribes an element of an antitrust claim against a global cartel.[16] As we noted in our Fall *Update*, the panel sidestepped that issue by stating that it was unnecessary for it to reach the result.

1 *Minn-Chem, Inc. v. Agrium, Inc.*, ___ F.3d ___, 2011 WL 4424789, 2011-2 (CCH) Trade Cases ¶77,611 (7th Cir. 2011) (vacated).

2 15. U.S.C. §6a.

3 *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). *Twombly* and *Iqbal* require that the court on a motion to dismiss (i) identify and then set aside conclusory allegations and (ii) identify well-pleaded factual allegations and determine whether these plausibly give rise to entitle to relief measured against "judicial experience and common sense." *Iqbal*, at 1950.

4 *In re Text Messaging Antitrust Litig.*, 630 F.3d 622 (7th Cir. 2010).

5 *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004); *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006); and *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010). *See* n.14 infra.

6 *See* Fed. R. App. P. 35(b)(1)(A) and 35(b)(1)(B).

7 *En Banc* Argument is set for Wednesday, February 8, 2012.

8 *Id.* n.8.

9 The complaint in *Text Messaging* alleged a highly concentrated market particularly susceptible to collusion; alleged that defendants belonged to a trade association and exchanged price information at association meetings; alleged that defendants simultaneously changed their heterogeneous pricing structures to a uniform pricing structure; and that defendants made across-the-board increases in price. The complaint in *Minn-Chem* alleged a concentrated market dominated by defendants; a commodity product; a lack of cost-effective substitutes; inelastic demand; excess capacity; numerous opportunities for defendants to collude as to potash prices and global supply; and lockstep price increases in the face of falling demand and excess supply.

10 *See, e.g.*, Chris Sagers, "A Tale of Two Panels: The Size of the Chancellor's Foot in Text Messaging and Potash," *CPI Antitrust Chronicle* (November 2011(1)).

11 *Iqbal* at 1950. As Judge Posner remarked, perhaps in an ironic understatement, the "plausibility" standard "is a little unclear." *Text Messaging*, 630 F.3d at 629.

12 15 U.S.C. §6a.

13 15 U.S.C. §6a(1)(A)-(B). If plaintiffs allege international anticompetitive conduct by defendants that falls within either exception, then the FTAIA's general bar against Sherman Act liability does not apply.

14 No. 10-2288, 2011 WL 3606995 (3d Cir. Aug. 17, 2011).

15 *Id.* at 2011 WL 3606995 at *6 ("effects exception does not contain a subjective intent requirement.").

16 Previously, the Seventh Circuit in *United Phosphorus, Ltd. v. Angus Chemical Co.*, 322 F.3d 942, 952 (7th Cir. 2003) (*en banc*), held that the FTAIA imposed a subject matter jurisdictional limitation, not an additional element of a Sherman Act claim. In *Minn-Chem*, however, the Court acknowledged that two recent Supreme Court decisions and a decision from the Third Circuit called into question the soundness of its opinion in United Phosphorus. *See Morrison v. Nat'l Austl. Bank*, 130 S. Ct. 2869, 2876-77 (2010) (extraterritorial reach of §10(b) of the Securities and Exchange Act of 1934 is not jurisdictional); *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 515-16 (2006) (numerical qualification contained in Title VII's definition of employer is not jurisdictional, as jurisdictional stripping requires a clear legislative statement); *Animal Sci. Prods., Inc. v. China Minmetals Corp.*, No. 10-2288, 2011 WL 3606995 (3d Cir., Aug. 17, 2011) (FTAIA does not impose a jurisdictional limit but establishes an element of a Sherman Act claim).

European Commission Issues Guide on Competition Compliance

by Evelyn Niitvaeli and Stephan Wachs

On November 23, 2011, the European Commission (the Commission) published a brochure on competition compliance with the promising title "*Compliance matters – What companies can do better to respect EU competition rules.*"[1] It introduces the guide as "*a road safety brochure*" aiming at helping companies "*to stay out of trouble.*" In times of skyrocketing fines imposed by the Commission and national competition authorities for violations of competition law, such compliance is of ever-increasing importance.

The Commission's brochure explains the importance and benefits of compliance with competition law, provides an overview of the applicable EU competition rules, and suggests practical measures companies should take to develop an effective compliance strategy.

Responsibility to Comply with Competition Rules in the EU

In the first chapter of the guide, the Commission stresses that EU competition rules concern everyone who does business in the EU and that ignorance of the law will not shield undertakings from the consequences of violations. The Commission reminds companies that awareness of the rules is a precondition for effective adherence to them and that not only managers but also employees require guidance on how to implement law-abiding behavior.

The guide states that the sole benchmark as regards the success of a compliance program is its effectiveness in avoiding infringements. Companies need to do more than merely pay lip service to an abstract or formalistic commitment to compliance. Rather, any credible compliance program must be built on a firm foundation of management commitment and supported by a "top-down" compliance culture.

The Costs of Non-Compliance

The second part of the brochure deals with the consequences of competition law infringements and focuses on four aspects:

- ***Fines.*** The Commission emphasizes that under EU competition law fines on companies can be very substantial-as high as 10 percent of an undertaking's annual turnover-and that such fines can be imposed even where the illegal purpose of an infringement was not actually achieved, *i.e.* in the event of a price-fixing cartel a breach of EU competition law exists per se even if the prices did not rise at all due to the cartel. The Commission illustrates the considerable risk of high fines by referring to its strong enforcement record in recent years.
- ***Sanctions on individuals.*** In addition to fines on companies, a number of Member States also provide for sanctions on individuals, such as fines, director disqualification and even imprisonment.
- ***Civil law consequences.*** Agreements that are incompatible with EU competition law are void and cannot be enforced. In addition, the infringer may be subject to damages claims before national courts.
- ***Reputational damage.*** Companies infringing competition law usually receive negative media coverage, which has a detrimental impact on their reputation.

The sole benchmark of the success of a compliance program is its effectiveness in preventing violations.

Applicable Competition Rules - Examples of Prohibited Behavior

In the third part of the guide, the fundamental rules and prohibitions of EU competition law are summarized. The Commission explains the two basic types of illegal behavior that are prohibited by Article 101 and Article 102 of the Treaty on the Functioning of the European Union (TFEU), *i.e.* illegal contacts (in particular the unilateral disclosure of strategic information to competitors) and agreements between companies and the abuse of a dominant position.

As regards illegal contracts and agreements between companies, the Commission illustrates prohibited conduct by referring to four basic "Don'ts":

- Don't fix purchase or selling prices or other trading conditions;
- Don't limit production, markets, technical development or investments;
- Don't agree to share markets or sources of supply;
- Don't exchange individualized information on intended future prices or quantities or other strategic information.

Companies that account for a large proportion of the business in a particular market are reminded that they may likely hold a dominant position and therefore have a special responsibility not to engage in behavior that is considered "abusive." The Commission provides the following examples of abusive conduct: charging unreasonably high prices that may exploit customers, charging unrealistically low prices which may be used to drive competitors out of the market, unjustified discrimination between customers, and forcing unjustified trading conditions (*e.g.*, exclusive dealing) on trading partners.

The Commission emphasizes that companies must assess for themselves whether their behavior complies with competition rules and points out that "*being small is no excuse for not complying.*"

How Can Companies Ensure Compliance?

The fourth chapter of the brochure provides guidance on steps companies should follow in order to establish an effective compliance culture. In particular, the Commission identifies the following "ingredients" for a successful compliance program: (i) a clear compliance strategy and commitment thereto, (ii) "backup measures," (iii) regular updates and training, and (iv) monitoring and auditing.

Formulating a strategy and putting it in writing alone is not sufficient.

The Commission begins with highlighting that companies need to develop ***a clear compliance strategy***. Such strategy must be based on a comprehensive analysis of the areas in which a company is most likely to run a risk of infringing competition rules. These areas depend on factors such as the company's sector of activity, the frequency and level of interaction with competitors and the characteristics of the market. The Commission points out that such strategy has to be made explicit. It suggests providing guidance in the form of a manual using a practical set of "Don'ts" and "Red Flags." Such a manual should be plainly worded and available in all working languages of the company. Importantly, however, the Commission reminds companies that formulating a strategy and putting it in writing alone is not sufficient. Rather, companies need clearly to endorse the message that compliance is a fundamental company policy. To that effect, the Commission considers the unequivocal support of senior management as vital.

In order to ensure adherence to the adopted compliance, the Commission recommends companies to take certain "***backup measures***". Such measures could include (i) asking staff for a written acknowledgement of receipt of relevant information on compliance, (ii) putting in place positive incentives for employees, and (iii) introducing penalties for a breach of internal compliance rules. According to the Commission, a further essential feature of a successful compliance program is the presence of a clear internal reporting mechanism. Staff should know whom to contact and in what form in case a problem situation arises.

The Commission warns companies that the compliance strategy and in particular manuals should be reviewed and ***updated regularly***. Furthermore, companies should consider offering ***training*** on competition rules, in particular to staff members who are likely to be confronted with situations that could lead to the company becoming involved in infringements, *e.g.* sales personnel or employees attending trade association meetings or industry events.

Finally, the Commission highlights that it considers ***monitoring and auditing measures*** as effective tools to prevent and detect anti-competitive behavior.

Benefits of Compliance Efforts

The brochure concludes with a summary of the benefits of a compliance strategy even in case it fails to ensure full compliance. The Commission points out that a compliance program may enable a company to stop an infringement at the earliest possible stage, thereby limiting the damage to competition and minimizing the company's exposure. It also reminds companies that the detection mechanisms provided by a compliance strategy can help a company to benefit from the Commission's leniency program as early detection allows companies willing to cooperate with the Commission to be the first or among the first companies to file a leniency application and thus receive full immunity from or a substantial reduction of the fine.

It has to be noted, however, that while the Commission emphasizes that it welcomes and supports all compliance efforts, it warns companies that the mere existence of a compliance program would not be considered as a mitigating factor when setting a fine for an infringement. Hence, the monetary benefit of a compliance plan lies solely in the avoidance of violations.

Conclusion

The publication of the Commission's brochure on competition compliance follows the current trend of national competition authorities to support and foster an effective compliance culture in companies.[3] However, by failing to acknowledge genuine compliance efforts as a mitigating factor, the Commission stayed behind the approach recently adopted by some national competition authorities and missed the opportunity to provide companies with an effective positive incentive for instilling a strong compliance culture.[4] Nonetheless, it should be kept in mind that a tailor-made and effective compliance program has a number of benefits as it can save companies a lot of money on potential fines and enable them to maintain a good business reputation – or as the European Commissioner for Competition Joaquín Almunia pointed out in one of his recent speeches: "*prevention is always better than the cure.*"[5]

1 The brochure can be downloaded from the Commission's webpage at http://ec.europa.eu/competition/antitrust/compliance/compliance_matters_en.pdf.

2 It has to be noted that such undertaking comprises the group of undertakings controlled by the company being the addressee of the fine. For further details see "Parental Liability in the European Union" by Neil Rigby in *Antitrust Update* Summer 2011 which can be downloaded at http://www.weil.com/files/upload/Weil_Alert_Antitrust_Update_Summer_2011.pdf.

3 For example, in June 2011 the Office of Fair Trading (*OFT*) released guidance for businesses on competition law compliance. The materials published by the OFT include advice for directors, general guidance for all businesses, a quick guide to competition law compliance and a short film. The OFT's resources can be found on its webpage at http://www.oft.gov.uk/OFTwork/competition-act-and-cartels/competition-law-compliance/.

The French Competition Authority, Autorité de la Concurrence, published draft guidelines regarding competition law programs on October 14, 2011. The public consultation on the draft ended on December 14, 2011. The release of the guidelines in final form is expected in February 2012. Further details as well as the draft guidelines can be found at http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=389&id_article=1713.

4 Both the OFT and the French Autorité de la Concurrence have announced that they would take into account the existence of a compliance program when setting the amount of a fine.

5 Speech by Joaquín Almunia in Poznan, *Competition – what's in it for consumers?* (Speech/11/803 of November 24, 2011). The full text of this speech can be found at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/803&format=HTML&aged=0&language=EN&guiLanguage=en.

Canada: 2011 Competition Law Year In Review

*By Anthony Baldanza, Leslie Milton and Antonio DiDomenico**

Mergers

Enforcement Policy

Updated Merger Enforcement Guidelines

In the wake of the issuance in 2010 of updated US Merger Enforcement Guidelines, and after conducting an extensive consultation process, in October 2011 the Canadian Competition Bureau (the Bureau) published updated Canadian *Merger Enforcement Guidelines*[1] (the 2011 MEGs) that replace the pre-existing Canadian *Merger Enforcement Guidelines*[2] that were published in 2004 (the 2004 MEGs). The Bureau's stated objective in updating the 2004 MEGs was not to do a full rewrite, but to "address certain discrete areas where the [2004] MEGs do not fully reflect current Bureau practice and current economic and legal thinking."[3]

The following are among the most noteworthy changes:

- The 2011 MEGs provide additional guidance as to how the Bureau assesses transactions in which minority interests or interlocking directorates are at issue and when they result in a "merger" for purposes of the substantive merger review jurisdiction under the *Competition Act*[4] (the Act).
- While the 2011 MEGs state that examination of the competitive effects of a merger generally involves defining the relevant markets and assessing the competitive effects of the merger in those markets, the guidelines also state that "Market definition is not necessarily the initial step, or a required step,..." and that the Bureau may instead rely on other methods of assessing the likely competitive effects of a merger including "various economic tools."[5]
- The 2011 MEGs have replaced the two-year time frame for effective entry (to constrain the exercise of market power arising from a merger) with a requirement that entry occur "quickly enough to deter or counteract any material price increase owing to the merger."[6]
- The 2011 MEGs provide additional and useful guidance on how the Bureau assesses the unilateral and coordinated effects of a merger, on countervailing market power and monopsony issues, and on how the Bureau assesses vertical and conglomerate mergers.
- The 2011 MEGs now incorporate the Bureau's guidance in relation to the efficiencies defense, superseding the 2009 Bureau bulletin on "Efficiencies in Merger Review."[7]

Competition Bureau Releases Merger Remedies Study Summary

In August 2011, the Bureau issued a bulletin respecting the results of its study of the effectiveness of remedies obtained under the merger provisions of the Act during the period 1995 to 2005.[8] The results of the study will be used to update the Bureau's *Information Bulletin on Merger Remedies in Canada*, Competition Bureau (22 September, 2006)[9], including the consent agreement outline template.

Competition Bureau Updates Guidance on Merger Review "No Action" Letters

Effective September 1, 2011, the Bureau changed its practice with respect to no- action letters (NALs).[10] Whereas prior to that date, NALs referred to the insufficiency of grounds to challenge a merger, NALs now state only that the Commissioner of Competition (the Commissioner) does not at that time intend to make an application under the merger provisions in respect of the transaction.

New Filing Thresholds

Pre-merger notification under the Act is required where both size-of-parties and size-of-transaction thresholds are exceeded. The size-of-parties threshold is exceeded where the parties, including their respective affiliates, together have assets in Canada or gross revenues from sales in, from or

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into Canada that exceed C$400 million. The size-of-transaction threshold varies with the type of transaction involved (*e.g.*, acquisition of assets, acquisition of shares, amalgamation, etc.), but generally includes a monetary threshold in terms of the gross book value of assets in Canada or the value of annual gross revenues from sales in or from Canada generated from those assets. The size-of-transaction threshold effective February 1, 2012 is C$XX million (up from C$73 million during most of 2011).[11] *[NTD: The announcement is expected to be made by month's end.]*

Proposed Merger Register

On October 6, 2011, the Bureau announced that it would establish a merger register, being a list of all closed merger reviews, updated on a monthly basis.[12]

Updated Merger Review Process Guidelines

In January 2012, the Bureau issued updated *Merger Review Process Guidelines*[13] that replace its 2009 guidelines and that reflect the considerable experience the Bureau has gained with respect to the two-stage merger review process since its introduction in September 2009. The updated guidelines provide increased guidance on the supplementary information request process, including pre and post-issuance dialogue and custodians, sample instructions and the use of timing agreements.

Cases

CCS Corporation and Complete Environmental Inc.

In January 2011, the Commissioner brought an application challenging the acquisition by CCS Corporation of Complete Environmental Inc. CCS Corporation operates a landfill that accepts hazardous waste produced at oil and gas fields. Complete Environmental Inc. has a permit to operate such a landfill. A noteworthy aspect of the challenge is that the transaction was not notifiable and is being challenged post-closing. Also, unusually, the Commissioner is seeking dissolution amongst possible remedies.[14]

Mergers can be challenged even if not notifiable, and even if already closed.

Competition Bureau Seeks to Block Joint Venture Between Air Canada and United Continental

In June 2011, the Commissioner filed an application with the Competition Tribunal (the Tribunal) to prohibit a proposed joint venture between Air Canada and United Continental. The Commissioner asserted that the joint venture would monopolize ten Canada/US routes and substantially reduce competition on nine additional routes, leading to increased prices and reduced consumer choice. The Commissioner asserted that the proposed joint venture would allow the parties to jointly set prices, capacity and schedules, and would result in significantly higher prices. The Commissioner also challenged three existing coordination agreements between Air Canada and United Continental. These agreements allow the two airlines to coordinate key aspects of competition including joint pricing and scheduling as well as revenue-sharing.[15]

Competition Bureau Clears Canadian Tire's Acquisition of the Forzani Group

This transaction involved the purchase of a national sporting goods retailer by a mass merchandiser with significant sales in sporting equipment. In analyzing the transaction, the Bureau considered various possible product markets (the retail sale of sporting equipment; the retail sale of certain sporting equipment categories such as hockey equipment; and the retail sale of specific sporting equipment products such as hockey skates) and analyzed the potential competitive effects of the transaction from quantitative and qualitative perspectives on the basis of each of the potential markets. Because the Bureau's review did not find significant competitive effects in any of the candidate markets, consistent with the approach articulated in the 2011 MEGs, it determined that it was not necessary to define the relevant product markets.

As a large proportion of the parties' respective retail outlets were located in close proximity to one another, one approach taken by the Bureau to assess the competitive effects of the transaction was to assess whether the nature of competition between the parties was such that, following the transaction, market power could be exercised in local geographic markets. In particular, the Bureau considered the extent to which the parties, prior to the transaction, determined prices or product offerings in response to local competition with one another and with other retailers, and whether Canadian Tire, post-merger, would have the ability to increase prices or reduce product offerings in local markets or across one or more broader geographic areas.

With respect to the possible product markets, the Bureau engaged in a competitive effects analysis to determine whether prices or product offerings varied in local markets rather than on a broader geographic scale. Econometric results indicated that neither party adjusted its prices or product offerings in local markets in response to the presence of the other party. (This finding is to be contrasted with the finding in *Staples-Office Depot* where the presence of three office superstores in a variety of markets showed lower prices than where there were only two.)

The Bureau also concluded that the presence of competing retailers was likely to constrain the merged entity's ability to exercise market power in each of the candidate product markets across all relevant geographic areas.[16]

Competition Bureau Approves Divestitures in Novartis Acquisition of Alcon

In March 2011, the Bureau announced its approval of the divestiture of certain assets and associated licenses related to the sale in Canada of ophthalmic products belonging to Novartis.[17] The transaction is part of a remedy required to address competition concerns resulting from Novartis's acquisition of control of Alcon in August 2010.

Competition Bureau Clears Merger of XM Canada and Sirius Canada

In February 2011, the Bureau announced that it would not challenge the proposed acquisition of Sirius Canada by Canadian Satellite Radio Holdings (CSRH.)[18] CSRH is the parent of Canadian Satellite Radio Inc., which provides satellite digital audio radio services in Canada under the trade name XM Canada. Like CSRH, Sirius Canada provides satellite digital audio radio services. The parties' respective US counterparts merged in July 2008; however, the Canadian entities remained independent and continued to operate separately under their respective broadcasting licenses.

In the absence of competitive effects, a rigorous relevant market analysis may not be necessary.

Competition Bureau Clears Acquisition of CTV Globemedia Inc. by BCE Inc.

In February 2011, the Bureau announced[19] that it did not then intend to challenge the proposed acquisition of CTV Globemedia by BCE Inc., but that it would continue to monitor the parties and regulatory developments to assess whether it should apply to the Tribunal within the one-year statute of limitations period following closing. BCE Inc. provides telecommunications services, Internet access and television distribution services. CTV Globemedia is active in broadcasting and publishing. The Bureau observed the growing trend toward vertical integration in the broadcasting industry. Its focus in that regard has been on the ability of vertically integrated firms to foreclose competing broadcasting distribution undertakings from accessing programming and the exchange of competitively sensitive information of broadcasters and broadcast distribution undertakings. However, the Bureau noted that the issues are being considered in the context of an industry that is innovating and within a regulatory framework that is evolving. Importantly, the Bureau observed that the Canadian radio-television and telecommunications commission was separately examining the transaction and had initiated hearings into vertical integration in the broadcasting industry.

Abuse of Dominance and Other Reviewable Practices

Toronto Real Estate Board

In May, 2011, the Commissioner filed an application for an order from the Tribunal under Section 79 of the Act (abuse of dominance) prohibiting the Toronto Real Estate Board (TREB) from enacting or enforcing rules that prevent or discriminate against TREB members that wish to use TREB's multiple listing service (MLS) system to offer services over the Internet.[20] The Commissioner alleges that the TREB substantially or completely controls the supply of residential real estate brokerage services in the Greater Toronto Area by reason of its ability to control access to and use of the TREB's MLS system, that TREB rules restricting the ability of brokers to provide customer access to certain MLS data online through, for example, virtual online websites, are discriminatory, preclude innovative brokerage business models and constitute a practice of anticompetitive acts, and that the practice has limited or prevented competition substantially. TREB has responded that, among other things, it is exercising its copyright in the MLS system. The case is currently scheduled to be heard by the Tribunal in September – October 2012.

Air Canada and United/ Continental

In *Commissioner of Competition v. Air Canada and United/ Continental* (discussed above) the Commissioner is seeking a remedy for the first time under the civil competitor collaboration provision of the Act in respect of existing alliance and marketing agreements between the respondents in conjunction with her request for an order under the merger provision prohibiting a proposed joint venture between the respondents.[21]

Visa/MasterCard

The Visa/MasterCard price maintenance application filed by the Commissioner in December 2010 relating to the terms of supply of credit card network services and reported in our update last year is scheduled to be heard by the Tribunal in April – June of this year.[22]

Used Car Dealers of Canada (UCDC)

On the private action front, UCDC was granted leave to file and has filed an application under Section 75 of the Act (refusal to deal) seeking an order requiring the Insurance Bureau of Canada (IBC) to supply certain vehicle accident and claims data to UCDC.[23] An interim supply order was issued pursuant to Section 104 of the Act (interim orders) on consent of the parties on October 20, 2011, pending a determination on the application. In December, IBC filed an application seeking recission of the interim supply order pursuant to Section 106 of the Act (variation of consent agreement or order). The Tribunal has since directed IBC to refile its request for recission under Section 104.

Canadian Internet Registration Authority (CIRA)

Conversely, a request for leave to commence a refusal to deal proceeding against CIRA was denied by the Tribunal as the applicant had failed to submit any evidence that CIRA's refusal to renew its authorization to act as a .ca domain name registrar would have an adverse effect on competition in a market.[24]

Nadeau Poultry

Finally, the Federal Court of Appeal dismissed Nadeau Poultry's appeal of the Tribunal's 2009 decision denying Nadeau's private application for relief under Section 75.[25] The Court upheld the Tribunal's assessment of "ample supply" as requiring that producers have capacity to increase production and would not be obliged to redirect product from one customer to another. The Court also endorsed the Tribunal's determination that anticompetitive effects should be assessed in downstream markets, and emphasized that the Tribunal's findings of fact are not subject to appeal absent prior leave of the Court. Leave to appeal to the Supreme Court of Canada has been denied.[26]

The stage is set for the Supreme Court of Cananda to clarify the scope of indirect purchaser claims.

Cartels and Other Criminal Prohibitions

Cartel, bid-rigging and deceptive marketing matters were an enforcement priority for the Bureau. 2011 saw a number of charges laid and convictions through guilty pleas, including in retail gasoline, infrastructure and telemarketing.

Class Actions

There were significant developments for claims made by indirect purchasers of allegedly price-fixed products.

The Supreme Court of Canada granted leave to appeal the British Columbia Court of Appeal's decisions in *Pro-Sys Consultants Ltd. v. Microsoft*

Corporation (Microsoft)[27] and *Sun-Rype Products Ltd. v. Archer Daniels Midland Company (Sun-Rype)*.[28] *Microsoft* and *Sun-Rype* were two to one majority decisions concluding that indirect purchasers of allegedly price-fixed products have no cause of action recognized in law. These findings suggest a departure from the trend of previous decisions that signalled greater opportunities for indirect plaintiffs to achieve certification.

Conversely, the Québec Court of Appeal in *Option Consommateurs v. Infineon Technologies AG*[29] allowed indirect plaintiffs to proceed with their price-fixing claim. The Court expressly disagreed with the British Columbia Court of Appeal's decision in *Microsoft* and *Sun-Rype* that indirect plaintiffs have no cause of action recognized in law.

The stage now appears to be set for the Supreme Court of Canada to clarify the scope of indirect purchaser claims in Canada.

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2 *Enforcement Guidelines: Merger Enforcement Guidelines*, Competition Bureau (1 September, 2004), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01245.html.

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4 *Competition Act*, RSC 1985, c C-34, as amended.

5 *The 2011 MEGs, supra* note 1 at 9-10.

6 *Ibid* at 28.

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11 <NTD: the announcement is not available to cite yet.>

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14 *Commissioner of Competition v. CCS Corporation, Complete Environmental Inc., Babkirk Land Services Inc., Karen Louise Baker, Ronald John Baker, Kenneth Scott Watson, Randy John Wolsey, and Thomas Craig Wolsey*, CT-2011-002.

15 *The Commissioner of Competition v. Air Canada, United Continental Holdings Inc., United Airlines Inc., and Continental Airlines Inc.*, CT-2011-004.

16 *Canadian Tire/Forzani Position Statement*, Competition Bureau (August 2011), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03421.html.

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20 *The Commissioner of Competition v. The Toronto Real Estate Board*, CT-2011-003.

21 *Supra* n.14.

22 *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated et al.*, CT-2010-010.

23 *Used Car Dealers Association of Ontario v. Insurance Bureau of Canada*, CT-2011-008.

24 *Brandon Gray Internet Services Inc. v. Canadian Internet Registration Authority*, 2011 Comp. Trib. 1.

25 *Nadeau Poultry Farm Limited v. Groupe Westco Inc.*, 2011 FCA 188.

26 *Nadeau Ferme Avicole Limitée / Nadeau Poultry Farm Limited v. Groupe Westco Inc., Groupe Dynaco, Coopérative Agroalimentaire and Volailles S.E.C. and Volailles Acadia Inc./Acadia Poultry Inc.*, 2011 CanLII 82376 (SCC).

27 *Pro-Sys Consultants Ltd. and Neil Godfrey v. Microsoft Corporation and Microsoft Canada Co./Microsoft Canada CIE*, 2011 CanLII 77282 (SCC).

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